## Navigation

use the keyboard arrow keys or the navigation menu to move through the document

zoom in / zoom out

fit to screen

print

hand tool (H key, hold SPACEBAR)

select tool

use the ESCAPE key to exit fullscreen mode

Bank Pekao

# Trust builds success.


# 2016 Annual Report

Business success is dependent upon trust. Not only in finance. As an institution of public trust with an almost 90-year tradition, we are perfectly aware of the value of long-term relations with all our stakeholders in strengthening the Bank's reputation.

The Report provided here shows our approach to banking and the philosophy of business based on key competences.

The well-being of our customers is not simply an empty phrase. Each day through the commitment of all our staff, we prove that our bank is trustworthy, listening to the changing needs of our customers and offering innovative financial solutions.

With full determination and courage, we wish to continue our strategy of growth by building well-being among the Bank's customers and ensuring a better future for our employees, partners and local communities.

We intend to demonstrate that we are worthy of your trust, since we believe that trust is the foundation of success.

Bank Pekao

# Table of Contents

# Highlights of Bank Pekao S.A. Group

| | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|---|
| **INCOME STATEMENT CONTINUED OPERATIONS – SELECTED ITEMS (*)** | | | | | | (in PLN million) |
| Operating income | 7,347 | 7,059 | 7,346 | 7,494 | 7,790 | 7,567 |
| Operating costs | (3,212) | (3,220) | (3,286) | (3,331) | (3,445) | (3,497) |
| Operating profit | 4,135 | 3,839 | 4,060 | 4,162 | 4,345 | 4,070 |
| Profit before income tax | 2,897 | 2,831 | 3,360 | 3,433 | 3,619 | 3,519 |
| Net profit for the period attributable to equity holders of the Bank | 2,279 | 2,293 | 2,715 | 2,767 | 2,906 | 2,842 |
| **INCOME STATEMENT – SELECTED ITEMS** | | | | | | (in PLN million) |
| Operating income | 7,347 | 7,059 | 7,346 | 7,565 | 7,953 | 7,808 |
| Operating costs | (3,212) | (3,220) | (3,286) | (3,376) | (3,529) | (3,583) |
| Operating profit | 4,135 | 3,839 | 4,060 | 4,189 | 4,424 | 4,225 |
| Profit before income tax | 2,897 | 2,831 | 3,360 | 3,454 | 3,664 | 3,593 |
| Net profit for the period attributable to equity holders of the Bank | 2,279 | 2,293 | 2,715 | 2,785 | 2,943 | 2,899 |
| **PROFITABILITY RATIOS** | | | | | | |
| Return on average equity (ROE) | 9.8% | 9.7% | 11.5% | 12.0% | 13.3% | 14.2% |
| Return on assets (ROA) | 1.4% | 1.4% | 1.8% | 1.9% | 2.0% | 2.2% |
| Net interest margin | 2.8% | 2.8% | 3.1% | 3.4% | 3.7% | 3.7% |
| Non-interest income / operating income | 39.6% | 40.0% | 38.3% | 39.6% | 37.3% | 40.6% |
| Cost / income | 43.7% | 45.6% | 44.7% | 44.6% | 44.4% | 45.9% |
| **STATEMENT OF FINANCIAL POSITION – SELECTED ITEMS** | | | | | | (in PLN million) |
| Total assets | 174,215 | 168,786 | 167,625 | 158,522 | 150,755 | 146,590 |
| Net loans and advances to customers (**) | 122,663 | 117,299 | 109,189 | 101,356 | 94,864 | 93,895 |
| Amounts due to customers (***) | 136,380 | 124,399 | 120,630 | 116,129 | 102,898 | 103,822 |
| Debt securities issued | 1,523 | 2,903 | 3,857 | 3,064 | 4,759 | 3,044 |
| Equity | 22,912 | 23,424 | 24,046 | 23,514 | 23,264 | 21,357 |
| **STATEMENT OF FINANCIAL POSITION STRUCTURE RATIOS** | | | | | | |
| Net loans (**) / total assets | 70.4% | 69.5% | 65.1% | 63.9% | 62.9% | 64.1% |
| Securities / total assets | 20.6% | 13.2% | 15.0% | 22.2% | 19.5% | 20.4% |
| Deposits (****) / total assets | 79.2% | 75.4% | 74.3% | 75.2% | 71.4% | 72.9% |
| Net loans (**) / deposits (****) | 88.9% | 92.1% | 87.7% | 85.0% | 88.1% | 87.9% |
| Equity / total assets | 13.2% | 13.9% | 14.3% | 14.8% | 15.4% | 14.6% |
| Total capital ratio (Basel III) (*****) | 17.6% | 17.7% | 17.3% | 18.3% | 18.1% | 17.0% |
| **EMPLOYEES AND NETWORK** | | | | | | |
| Total number of employees | 17,757 | 18,327 | 18,765 | 18,916 | 19,816 | 20,357 |
| Number of outlets (Bank Pekao S.A. and PJSC UniCredit Bank) | 928 | 975 | 1,034 | 1,001 | 1,040 | 1,051 |
| Number of ATMs (Bank Pekao S.A. and PJSC UniCredit Bank) | 1,761 | 1,759 | 1,825 | 1,847 | 1,919 | 1,910 |

(*) As financial data for the period 2014 – 2016 don't include results of PJSC UniCredit Bank – sold on July 16, 2013, in order to ensure comparability, the section "Income statement continued operations – selected items" was added where for the previous periods only results of continued operations are reported.

(**) Including debt securities eligible for rediscounting at Central Bank and net investments in financial leases to customers and excluding reverse repo transactions.

(***) Excluding repo transactions.

(****) Deposits include amounts due to customers and debt securities issued.

(*****) The total capital ratio for the period 2012 – 2016 is calculated in accordance with the 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 force since January 1, 2014. The total capital ratio (previously capital adequacy ratios) for 2011 was calculated in accordance with the methodology which was in force before January 1, 2014.

Note: Since 2013 in the income statement in a presentation form, to align the presentation to the standards implemented by the major Polish and European banks, gains on disposal of available for sale financial assets and held to maturity investments are reported under trading result (and thus in operating income, operating profit and respective ratios). In order to ensure comparability, data for the period 2011 – 2012 have been restated in comparison to those previously published.

In relation to changes in accounting policy in 2013 (for description refer to the Note 5 to the Consolidated Financial Statement of Bank Pekao S.A. Group for the period ended on December 31, 2014) data for the period 2012-2016 have been presented in accordance with the new rules. Data for earlier period remain unchanged.

Since 2014, the financial data include data of Spółdzielcza Kasa Oszczędnościowo Kredytowa named Mikołaj Kopernik in Ornontowice, took over by Bank Pekao S.A. following decision of The Polish Financial Supervision Authority on December 5, 2014.

Income statement data included in the table above and other notes to the Report on activities were presented according to income statement in a presentation form, which differs from the long form of the income statement presented in the Financial statements of the Group. Reconciliation of income statement in the presentation form and the long form is in the point 7.4.4 of the Report on activities of the Group.

# Supervisory Board and Management Board of Bank Pekao S.A.

## Supervisory Board

Jerzy Woźnicki **Chairman**

Gianni Papa **Deputy Chairman**

Leszek Pawłowicz **Deputy Chairman**

Massimiliano Fossati **Secretary**

**Members**

Dariusz Filar

Katarzyna Majchrzak

Laura Penna

Wioletta Rosołowska

Doris Tomanek

## Management Board

Luigi Lovaglio **President of the Management Board, CEO**

**Vice Presidents**

Diego Biondo

Andrzej Kopyrski

Adam Niewiński

Grzegorz Piwowar

Stefano Santini

Marian Ważyński

# Chairman's Message to the Shareholders

"Bank once again achieved excellent results and confirmed its strong market position in strategic business areas, while maintaining the highest standards of risk management and high cost effectiveness. Traditionally we kept a very strong capital and liquidity position. Taking care of strengthening the foundations of security and improvement of the systemic risk management is a strategic priority, which among other brings the growing confidence of the Stakeholders to the Bank."

**Jerzy Woźnicki**
Chairman of the Supervisory Board

## Dear Shareholders,

The Supervisory Board has made an assessment of the Bank's situation in year 2016 in compliance with legal requirements and corporate governance rules defined i.a. in "Best Practice for the WSE Listed Companies in 2016", and admitted that economic and financial situation of the Bank as very good, despite growing uncertainty and intensifying regulatory pressure on financial results of banks.

Bank once again achieved excellent results and confirmed its strong market position in strategic business areas, while maintaining the highest standards of risk management and high cost effectiveness. Development of the Bank in accordance with the adopted strategy was conducted in a sustainable manner with big attention to a high quality of the presented offer, accompanied by looking after standards of social responsibility in business. Traditionally we kept a very strong capital and liquidity position. Taking care of strengthening the foundations of security and improvement of the systemic risk management is a strategic priority, which among other brings the growing confidence of the Stakeholders to the Bank.

The Supervisory Board positively assessed the results achieved by the Bank and the Bank Pekao S.A. Group in year 2016, which had allowed achieving a return on equity at 9.8%, while maintaining a safe level of Core Tier 1 capital adequacy ratio amounting to 17.6%. Consolidated net profit again exceeded PLN 2.2 billion, despite maintaining interest rates at a record low levels and the negative impact of regulatory pressure on the Bank's results.

The Bank continued expanding its scale of activity, increasing lending activity and strengthening its market position in key areas. We increased volume of key retail loans by 10%, with an increase in retail deposits by 10.7%. The Bank systematically strives to increase base of clients served, increasing their number by another 140,000 persons.

This was possible thanks to the intensification of commercial activity and consistent implementation of innovative solutions, such as banking on a tablet or mobile payment system PeoPay.

As one of the largest financial institutions in the region of Central Europe, we do not limit ourselves exclusively to the effective development of the business, but we also care about the durable ties with the society, inter alia, thanks to the promotion of culture and art and pro-social projects, such as many-year participation in the charitable activities of "The Great Orchestra of Christmas Charity".

Intensification of the Bank's business activity is accompanied by strict cost control and robust quality of the loan portfolio. Permanent cost optimization determines the high operational efficiency, which constitutes competitive advantage gained by the Bank. Improving risk management techniques makes that we maintain the cost of risk consistently below average in the sector.

The Supervisory Board conducted analysis and assessment of internal control systems and risk management functioning in the Bank and Pekao Group.

In the opinion of the Supervisory Board, the internal control system properly ensures reliably maintained and effective control of executed processes. Internal control is of continuous nature and it is executed at all levels of the organizational structure by statutory bodies, particular organizational units of the Bank, and also by supervisors and all Employees. The most important risk areas are effectively monitored. Control functions in regard to the subsidiaries are performed through the Bank's representatives to the supervisory boards of these companies.

The Supervisory Board positively assessed the system of management of particular types of risks in banking activity. This system is of comprehensive and consolidated nature, covering all units of the Bank and its subsidiaries. It is adapted to the specifics of the Bank's activities, organizational structure and particular risks.

Capital and financial strength of the Bank, high quality of management, its high immunity to external shocks and high liquidity is confirmed by high financial credibility ratings of the Bank assigned by leading rating agencies: Fitch Ratings, S & P Global Ratings and Moody's Investors Service.

On 8th December, 2016 Powszechny Zakład Ubezpieczeń S.A. and Polski Fundusz Rozwoju signed purchase agreement with UniCredit S.p.A. on a substantial package of 32.8% of Bank Pekao S.A.'s shares. It is expected that the transaction will be finalized in the course of year 2017. This agreement closes an important chapter in the history of the Bank, during which the Bank has developed within the UniCredit Group frameworks, making use of support in the range of know-how and benefits given by the stability of the shareholding and managerial staff of the Bank.

The Supervisory Board is convinced that Bank Pekao S.A. will remain the outstanding financial institution in the Polish banking sector, setting standards and playing a key role in strengthening the financial safety of households, as well as in financing investments and development of Polish enterprises and the public sector. Strengthened year by year relationships with Customers, achieved competitive advantages and business experience enable the Bank to compete effectively and achieve sustainable growth of value creation for all Stakeholders of the Bank.

On behalf of the Supervisory Board, I would like to thank the Management Board and Employees of the Bank and entities from our Capital Group for their commitment, efficient work and contribution to the achievement of very good results.

I thank also all Shareholders of the Bank for their trust, which we proudly hold.

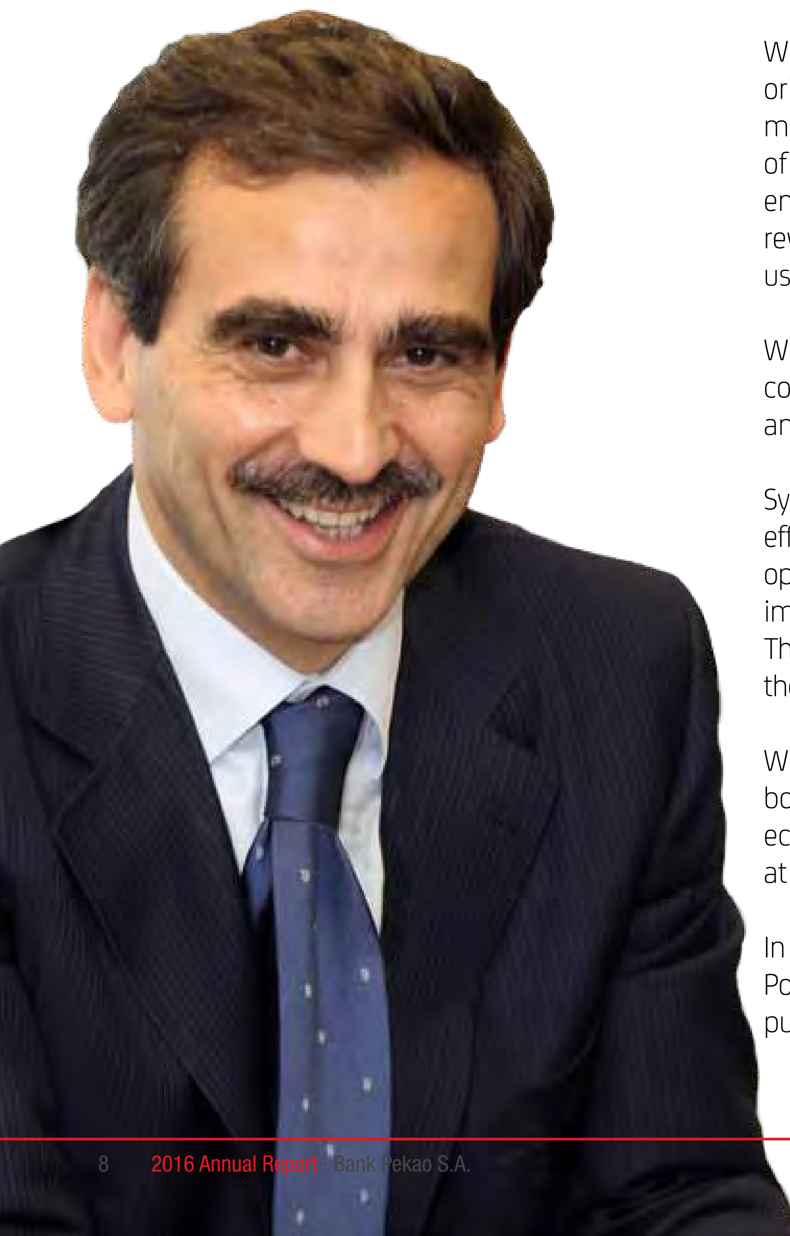
Warsaw, April 2017

**Jerzy Woźnicki**
Chairman of
the Supervisory Board

# CEO's Letter to the Shareholders

"We have in the Bank people who know how to deliver, and with them we are ready to face new challenges and assure sustainable profitability."

**Luigi Lovaglio**
President
of the Management Board and CEO



## Dear Shareholders,

Bank Pekao Group achieved last year 2 279 mln PLN net profit, successfully almost fully offsetting impact of introduced banking tax. I believe that this was another confirmation of our ability to mobilize ourselves and deliver sustainable profits despite adverse external factors.

We continued supporting the economy and Polish families, growing volumes in key retail on double digit pace, reaching PLN 128 billion of total loans and PLN 138 billion of total deposits. The number of customers, who showed us their trust and use our services, exceeded 5.2 million.

We achieved record level of consumer loans origination, maintained high level of activity in mortgages, allowing together for almost 15 bn of new retail loans. We continue investing in enhancing our digital solutions and we are rewarded by strong growth of customers actively using them.

We are number one bank of choice for Polish corporates, offering them highest quality product and services tailored to their needs.

Systematic rationalization of the processes and effective cost management enabled us to keep operating costs flat y/y, allowing for further improvement in cost to income ratio to 43.7%. The quality of our portfolio remains the benchmark in the sector and the cost of risk is among the lowest.

We achieved all this during very eventful year, both if one looks at the developments in global economy and politics and if one looks specifically at the developments directly involving our Bank.

In December 2016 a consortium of PZU and Polish Development Fund signed an agreement of purchasing from UniCredit 32.8% of outstanding

Pekao shares. The finalization of this agreement is expected by the buyers in the second quarter 2017.

This transaction is closing the seventeen years chapter of Bank Pekao participation in UniCredit group. Bank benefited from this since an early stage of cooperation, thanks to transfer of know-how and expertise. Participation in UniCredit group has offered us also stability in management and shareholders structure, supporting healthy principle of long term value creation, which allowed for full concentration on executing our sustainable growth strategy.

I trust that new controlling shareholders will bring equal benefits to the Bank, as UniCredit did, especially thanks to their capital strengths, positively impacting on continuation of our growth strategy.

Coming back to present days, year 2016 was generally positive for Polish economy, which enjoyed sound GDP growth of 2.8%. We faced slow down compared with previous year 3.9% growth, however in the European context this is still very respectful number.

Economy was driven mainly by consumption, benefitting from very strong labor market and also increased social transfers in the form of "500 +" program of subsidies for families with more than one child.

Investments decreased as a result of growing uncertainty, which had an impact on demand for corporate loans.

From the perspective of banking sector the most important development was introduction of the banking tax, as high as 44 bp of adjusted assets. Bank Pekao paid 450 mn PLN of this tax, which is almost 20% of previous year net profit. Despite this, thanks to growth of our business, continued cost and risk control and also gains we achieved on disposal of VISA shares, we managed to achieve level of net profit almost the same as last year.

We made strong progress last year, both for core business generation and for innovation agenda.

As the leading institution in Poland we feel responsible for the country development, not only economic but also social one. We want to actively participate in our clients, employees and business partners' lives. We do this by sponsoring and promoting art, culture, social and environmental projects. We are the long term partner of "The Great Orchestra of Christmas Charity" and continued supporting created by us Kanton Foundation.

We have in the Bank people who know how to deliver, and with them we are ready to face new challenges and keep delivering sustainable profitability.

On behalf of Management Board, I would like to thank our Clients and Shareholders for their trust and loyalty, the Supervisory Board members for their strong support.

As each year, my special thanks I address to our employees. Their dedication to our customers, hard work and respect for the values define what it really means Pekao.

I am proud to work at this company and with these outstanding people.

**Luigi Lovaglio**
President
of the Management Board and CEO

# Summary of Performance

# Summary of Performance

Net profit of Bank Pekao S.A. Group attributable to equity holders for 2016 amounted to PLN 2,279.3 million after tax on certain financial institutions in the amount of PLN 449.5 million and the extraordinary one-off charge of PLN 16.6 million to the Bank Guarantee Fund in relation to bankruptcy of Bank Spółdzielczy in Nadarzyn. Strong contribution to the results was brought by a substantial growth of loan and deposit volumes in key strategic areas, further progress in cost optimization and lower cost of risk, also thanks to successful recoveries from vindication activity.

Underlying net profit of Bank Pekao S.A. Group, i.e. excluding net impact of significant extraordinary charges and one-off non-recurring items in 2016 would amount to PLN 2,367.8 million and would be higher by PLN 185.9 million, i.e. 8.5% than comparable net profit achieved in 2015.

Thanks to the effective commercial activity of the Group in 2016 a significant growth in loan volumes was reported in the area of retail loans (an increase of 7.7% year on year) and a 1.3% year on year growth in the area of corporate loans and non-quoted securities. Such increase in lending was financed by higher volumes of retail deposits growing 11.0% year on year.

The solid liquidity structure of Bank Pekao S.A. Group is reflected by net loans to deposits ratio at 88.9% as at the end of December 2016. This, together with high equity level reflected by total capital ratio (Basel III) amounting to 17.6%, enables for further sound and stable development of the Group's activities.

## Main P&L items

In 2016, the Group's operating income amounted to PLN 7,347.2 million, an increase of PLN 288.6 million, i.e. 4.1% in comparison to 2015 with the following trends:
- Total net interest income, dividend income and income from equity investments in 2016 amounted to PLN 4,437.4 million and was higher by PLN 205.1 million, i.e. 4.8% compared to 2015 driven by higher volumes,
- Net non-interest income in 2016 amounted to PLN 2,909.8 million, higher by PLN 83.5 million, i.e. 3.0% in comparison with 2015 thanks to higher trading result supported also by gains on settlement of the transaction of the acquisition of Visa Europe Limited by Visa Inc. and by higher net other operating income supported by disposal of loans, with net fee and commission income lower by 2.3% compared to 2015 mainly due to some pressure observed on capital market related fees.

The operating costs amounted to PLN 3,211.9 million in 2016. They were lower by PLN 7.8 million, i.e. 0.2% as compared with 2015.

Guarantee funds charges in 2016, amounted to PLN 262.9 million, a decrease of PLN 11.5 million, i.e. 4.2% in comparison with 2015.

On February 1, 2016 tax on certain financial institutions under the Act on tax on certain financial institutions was introduced. In 2016, it amounted to PLN 449.5 million.

In 2016, the Group additionally incurred one-off charges in the amount of PLN 16.6 million related to the contribution to the BGF for the purpose of payments of the funds guaranteed to the depositors of the bankrupt Bank Spółdzielczy in Nadarzyn.

The Group's net impairment losses on loans and off-balance sheet commitments amounted to PLN 500.6 million in 2016, a decrease of PLN 16.9 million, i.e. 3.3% as compared with 2015.

## Volumes

As at the end of December 2016, loans and advances at nominal value and securities issued by non-monetary entities amounted to PLN 128,304.3 million, an increase of PLN 5,048.9 million, i.e. 4.1% in comparison to the end of December 2015 with significant growth in key strategic areas.
- As at the end of December 2016, the volume of retail loans amounted to PLN 58,109.9 million, an increase of PLN 4,165.3 million, i.e. 7.7% in comparison to the end of December 2015,
- The volume of corporate loans, non-quoted securities and securities issued by non-monetary entities amounted to PLN 70,194.4 million as at the end of December 2016, an increase of PLN 883.6 million, i.e. 1.3% as compared to the end of December 2015.

As at the end of December 2016, there were no reverse repo transactions. As of December 31, 2015, reverse repo transactions amounted to PLN 4,753.2 million.

As of December 31, 2016, the ratio of impaired receivables to total receivables excluding reverse repo transactions amounted to 6.0% as compared to 6.5% as at the end of December 2015.

As at the end of December 2016, the total amounts due to the Group's customers and debt securities issued amounted to PLN 137,902.7 million, an increase of PLN 10,600.7 million, i.e. 8.3% in comparison to the end of December 2015.
- The total volume of retail customers deposits, Structured Certificates of Deposit and other amounted to PLN 70,724.8 million as at the end of December 2016, an increase of PLN 6,859.5 million, i.e. 10.7% in comparison to the end of December 2015,
- The total volume of corporate deposits, Certificates of Deposit, Pekao Bank Hipoteczny S.A. covered bonds, interest and other

# Summary of Performance

amounted to PLN 67,177.9 million as at the end of December 2016, an increase of PLN 3,741.2 million, i.e. 5.9% as compared to the end of December 2015 while continuing selective pricing approach and focus on securing liquidity needs of the Group.

Repo transactions amounted to PLN 1,436.2 million as at the end of December 2016, a decrease by PLN 3,032.7 million, i.e. 67.9% in comparison to the end of December 2015.

The value of net assets of investment funds managed by Pioneer Pekao TFI S.A. amounted to PLN 16,793.9 million as at the end of December 2016, an increase of PLN 91.4 million, i.e. 0.5% in comparison to the end of December 2015.

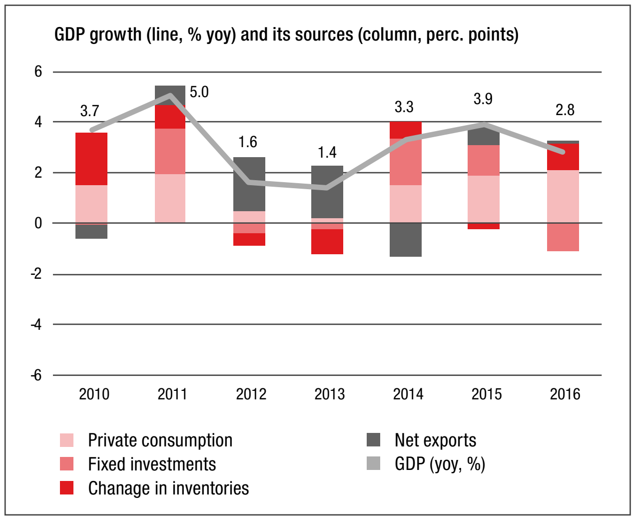
# External Activity Conditions

# External Activity Conditions

## Economic growth

Poland's economic growth in 2016 estimated by Główny Urząd Statystyczny (Central Statistical Office) accounted for 2.8% as compared with the GDP growth of 3.9% in 2015. Economic growth slowed markedly, moderating towards about 2.5% year on year in the second half of 2016 due to deepening declines in investments. In 2016 as a whole, fixed investments decreased by 5.5% after an increase of 6.1% in 2015. The main engine of economic growth in 2016 was households consumption growth by 3.6% on the back of continued improvement on the labour market, what positively influenced disposable income of households. Consumer incomes were also supported by payments of Family 500 plus government program (in total just over PLN 17 billion in 2016). Foreign trade had neutral impact on the GDP growth in 2016. Net exports contributed positively to the GDP in 2016 and accounted for ca. 0.1 p.p. vs. 0.7 p.p. in 2015.

In 2017, the GDP growth is expected to accelerate slightly to ca. 3.0%. Domestic demand will still be supported by a robust growth of households consumption fueled by further improvement in the labour market conditions and higher social transfers (households will receive ca. PLN 23 billion within Family 500 plus program). At the same time, delays in implementing projects co-financed with the European Union funds from 2014-2020 financial perspective along with subdued propensity to invest in the private sector are likely to translate into further slight decline in fixed investments. Key external risks are linked to developments in the troubled Italian banking sector and changes in the U.S. economic policy under the new U.S. administration.

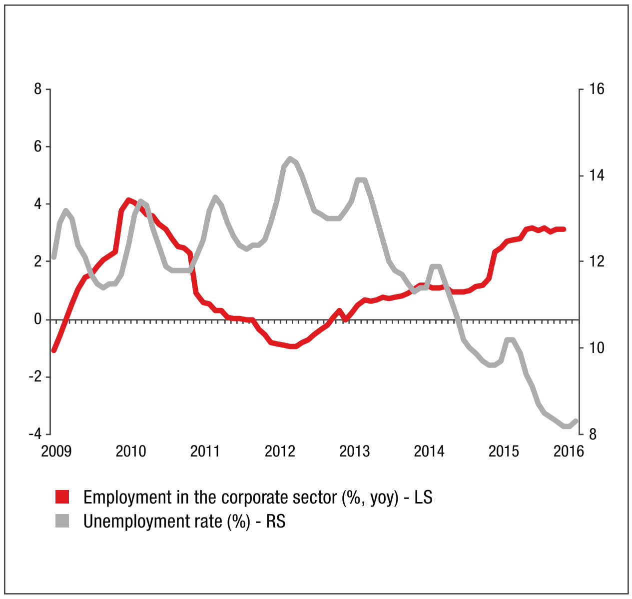



## Labor market

Average employment in the Polish corporate sector amounted to 5,799 thousand people in December 2016, by ca. 173 thousand more than in December 2015. The increase in employment in 2016, was a continuation of the upward trend in the number of jobs, which began in mid-2013 and in 2016 noted considerable acceleration. The centers of job creation in 2016 were still, as in the previous year, the manufacturing sector, trade and services (especially transportation), while job cuts still dominated in the construction sector (the fifth consecutive year) and the mining industry (long-term trend).

In 2016, it was a continuation of the downward trend in unemployment rate, which in December 2016 was at 8.3% compared to 9.7% in December 2015. It is expected that in 2017, the downward trend in unemployment rate will be continued, though at a much slower pace than in the recent years due to the emerging constraints of labour supply.

Wage growth rate in the Polish corporate sector in 2016 registered slight acceleration, which was supported by rising tensions on the domestic labour market resulting from shortage of labour supply. The average wage in the corporate sector increased in 2016 by 3.8% compared with an increase of 3.5% in the previous year. As a result, wage bill in the corporate sector increased in 2016 in nominal terms by 6.7% against 4.8% in 2015, which after adjusting for deflation resulted in an increase in real terms by 7.4% in 2016 compared to 5.8% in 2015.



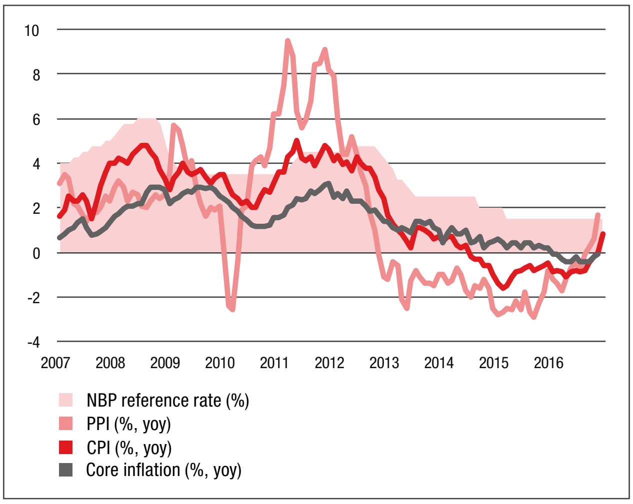
## Inflation and monetary policy

Data from the Central Statistical Office showed that average level of inflation amounted to -0.6% in 2016 vs. -0.9% in 2015. The CPI has been below the lower limit of the range of permissible deviations from the inflation target of the National Bank of Poland (NBP) since February 2013, the center of which is defined at 2.5%, and the scope ranges from 1.5-3.5%. In December 2016, the CPI reached 0.8% year on year.

The biggest impact on low inflation level came from declines in prices of transport, clothing and footwear, and goods and services from the category of „recreation and culture". In 2016, there was a decline in core inflation (excluding food and energy prices) to 0.0% from 0.3% in 2015. Besides a decrease in consumer price inflation, it was recorded a drop in producer prices in 2016.

The Monetary Policy Council (MPC) kept interest rates unchanged throughout 2016. The reference rate remained at 1.50%, the Lombard rate at 2.50% and the deposit rate at 0.50%.

In 2017, it is expected a strong increase in CPI inflation. It will be largely due to higher food and transport prices. Inflation may return to the NBP target (2.5%) in the third quarter of 2017.

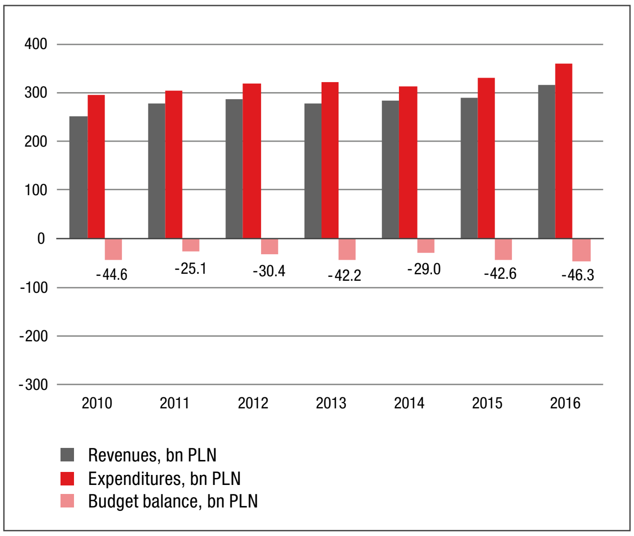



## Fiscal policy

According to the preliminary estimated data of the Ministry of Finance, the state budget deficit in 2016, amounted to PLN 46.3 billion i.e. 84.6% of the annual limit envisaged by the 2016 budget act at PLN 54.7 billion and was higher than deficit at the level of PLN 42.6 billion in 2015. In 2016, state budget revenues amounted to PLN 314.6 billion, i.e. 100.3% of the plan, and the expenditure amounted to PLN 360.9 billion, i.e. 97.9% of the plan. Revenues from VAT collections amounted to PLN 126.6 billion and were merely 2.8% higher as compared to 2015. The Ministry of Finance announced that Eurostat probably considers that proceeds from LTE, which in February 2016 credited the state budget with the amount of PLN 9.2 billion, according to the European definition methodology (ESA2010), will not be treated as the assets sale but as revenues from lease. Due to the fact that the digital frequencies were reserved for 15 years, then in subsequent years income of the general government will be increased by 1/15 of the amount of proceeds received in cash. In case of such interpretation, the general government deficit in the first quarter of 2016, will be enlarged by ca. 0.5% of the GDP. Combined with the lower than planned revenues from VAT, it pushes the government estimates of the general government deficit in 2016 to the level of 2.8-2.9% of the GDP (ESA2010 methodology).

The 2017 draft budget assumes the state budget deficit at record-high level of PLN 59.3 billion. In the budget bill it was stated that legal and enforcement actions will translate into significant improvement in tax collections. The Ministry of Finance projects that VAT collections will improve by PLN 16.9 billion (+13.3%). At the same time the budget expenditures will need to cover full annual cost of Family 500 plus program and the cost of lowering of the retirement age, effective from the fourth quarter of 2017. In cash terms, the support for income may come from higher-than-assumed payment from the NBP profit. Officials declare that the deficit according to the ESA2010 will be kept below the level required by the Stability and Growth Pact of 3% of the GDP.

The State Public Debt at the end of 2016 is estimated at 52.2% of the GDP vs. 48.8% of the GDP at the end of 2015.



# External Activity Conditions

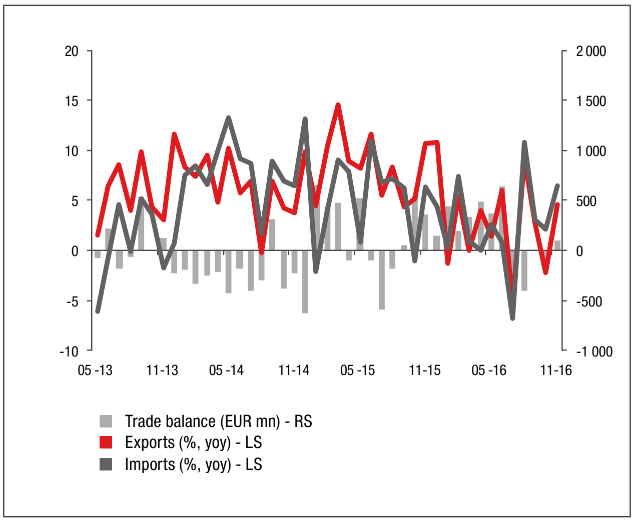
## Foreign Sector

The NBP data indicate that in the period January-November 2016 the current account deficit amounted to EUR 2.0 billion vs. EUR 1.7 billion in the corresponding period of 2015, which translates into stabilization of 12-month relation to the GDP at the level of 0.7%.

A slightly deeper deficit of the current account resulted mainly from a deeper deficit of primary income due to a shift of inflow of part of the funds within the Common Agricultural Policy for 2017 (a deficit of EUR 14.9 billion in January-November 2016 against a deficit of EUR 13.5 billion in the corresponding period of 2015). A negative factor for the current account balance was also a slight decrease in the trade surplus (EUR 1.7 billion vs. EUR 2.1 billion in 2015) amid a larger scale of slowdown in exports growth (2.1% year on year vs. 8.3% year on year in 2015) than in imports growth (2.4% year on year vs. 5.0% year on year), as well as a deeper deficit of secondary income (EUR 0.9 billion vs. EUR 0.4 billion in 2015). A positive contribution to the current account balance was, in turn, a higher surplus of the services account (EUR 12.1 billion against EUR 10.1 billion a year earlier).

As for the financing side, there was a decline in foreign direct investment (FDI). In the period January-November 2016 there was an inflow of EUR 10.3 billion compared with EUR 14.3 billion in the corresponding period of 2015. In the case of portfolio investment, there was an outflow of funds (EUR 1.2 billion vs. an inflow of EUR 4.7 billion in 2015), both from the domestic debt market (an outflow of EUR 1.0 billion vs. an inflow of EUR 3.0 billion in 2015) and the stock market (an outflow of EUR 0.3 billion vs. an inflow of EUR 1.6 billion in 2015). Due to delays of the implementation of the EU new financial perspective there was a strong decrease of the EU capital transfers inflow – to EUR 3.4 billion from EUR 10.4 billion in 2015.

In 2016, a considerable increase in the Treasury's foreign debt was recorded. According to the Ministry of Finance data, at the end of October 2015, the Treasury's foreign debt amounted to PLN 307.4 billion, which means an increase by ca. PLN 16.1 billion in comparison to December 2015 (by 5.5%). The growth of the Treasury's foreign debt was partly caused by the weakening of the złoty against foreign currencies, in which it is denominated.




## Capital market

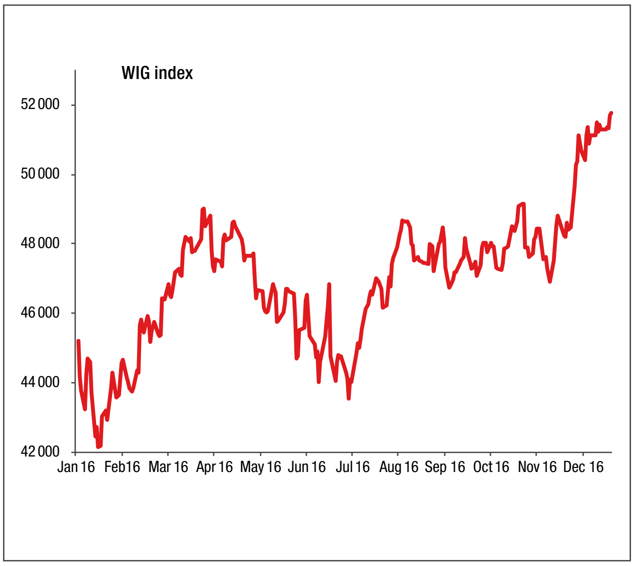
In spite of the risk of continuation of the cycle of tightening monetary policy by the U.S. Fed, key global stock indices remained in upward trend throughout 2016. Meanwhile an unexpected outcome of the UK referendum on Brexit (June 2016) and victory in the U.S. presidential elections (November 2016) triggered corrections, though short-lived only. They did not disrupt the long-term trend, however. Moreover the Republican candidate's success was a key supportive factor for equities later in the year. As a result the main indices increased by 14.4% (FTSE), 13.4% (Dow Jones), 9.5% (S&P 500) and 6.9% (DAX) during a whole year. The outlook for the financial markets remains mixed in the coming months. The economic policy of a new U.S. administration, the U.S interest rate path and a risk of "hard Brexit" will be key market points of interest in the near future.

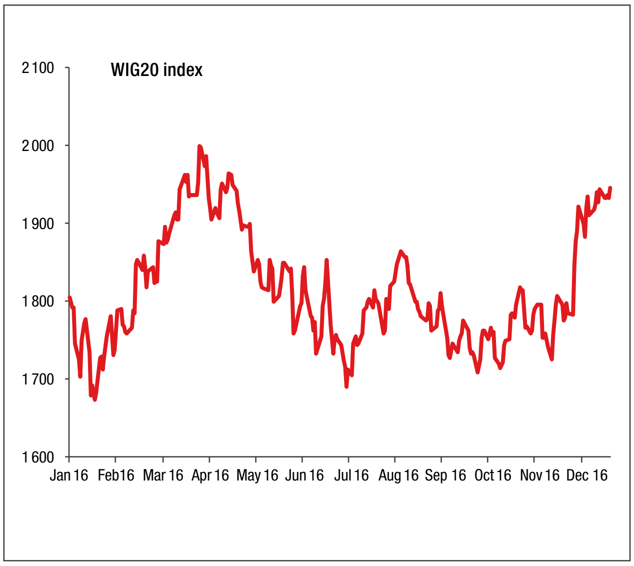
Despite a promising beginning of 2016 on the Warsaw Stock Exchange (WSE) – as equities gained in the first quarter – following months brought a decline in the WIG and WIG20 indices and then a long-term consolidation, despite better situation in core markets. Concerns about Poland rating after the S&P downgraded it in January 2016 affected investment sentiment. Equities remained under pressure of uncertainty regarding Open Pension Funds and plans on the CHF mortgages. Banking tax, introduced in February 2016, was another adverse factors for banking sector. Solid demand for equities in the world in November and December 2016, helped to improve annual performance on the WSE and sent rates of return above zero in case of the biggest companies. The WIG index gained 11.4%, while the WIG20 index rose by 4.8%. Smaller companies outperformed the basket another year in a row. The mWIG40 rew by 18.2%, reaching the highest levels since 2007 (4,215.54 at the end of the period). As for the sub-indices, WIG-mining (79.7%), WIG-IT (33.7%) and WIG-oil & gas (26.9%) were top-performers. Chemical, energy, telecommunications and construction companies affected performance of the WIG index.

The capitalization of domestic companies rose to PLN 557.1 billion from PLN 516.8 billion in 2015. On the other hand, foreign companies capitalization fell to PLN 558.6 billion from PLN 566.1 billion in the previous year. The value of total turnover on the stock market fell to PLN 202.3 billion vs. PLN 225.3 billion in 2015.

The value of investment funds' assets increased slightly to PLN 258.9 billion in 2016. If not for the outflows by ca. PLN 9 billion from non-retail funds in December, the balance would be much better. Assets reached a record high level in November (PLN 265.2 billion).

If the Fed's interest rates path is neutral for investors and the European Central Bank leaves rates at a record lows, capital outflows from emerging markets should be an alternative scenario only. Domestic factors will be key market drivers as well, including economy performance after the GDP slowdown in the second half of 2016.




## Banking sector

In 2016, financial results of banks improved, which was however a result of a one-off event and base effect. According to Financial Supervision Authority (KNF), data in the period of January-November 2016 banking sector achieved a total net profit of PLN 13.1 billion (+20.5% year on year). Positive influence had transaction of the selling of banks' shares in Visa Europe to Visa Inc. (it is estimated, that it contributed over PLN 2 billion to gross profit). The event was reflected in growth of 30.6% year on year on so-called other positions from banking activity. Strong pace of growth was also influenced by base effect connected to the bankruptcy of SK Bank in November 2015. It lowered the banking sector's results in fourth quarter of 2015 due to payments within the deposits guarantee system and higher risk costs. In consequence costs related to assets' impairments and provisions in January-November 2016 fell by 12.4% year on year. Although banks' operating costs still rose by 5.4%, the mentioned base effect eased to some extent the negative impact of the implementation of the so-called banking levy. In the first eleven months of 2016 positive contribution to profits was also visible in case of net interest income (growth of 7.4% year on year). In turn a negative impact on results had a decline in net income from fees and commissions (-5.7% year on year).

According to KNF data the pace of growth of banking sector's assets was moderate – at the end of November of 2016 amounted to 6.1% year on year (in comparison to 6.7% in November 2015). At the same time deposits of the non-financial sector grew by 10.0% year on year (10.8% y/y in November 2015), while receivables by 5.3% year on year (8.0% year on year in November 2015).

In terms of main deposit categories, in 2016 the following developments were noted1

– a growth of households' deposits at a similar rate as year before – as at the end of the year they increased by 9.1% year on year (9.2% in 2015). A high pace of growth was maintained mainly as a result of: improving financial situation of households, inflow of funds from government's new social programs (mainly Family 500 plus program) and limited propensity to invest in more risky assets (e.g. investment funds units, shares),
– weaker than in previous year, but still robust growth of corporate deposits portfolio – as at the end of the year they increased by 7.8% year on year, while in 2015 the growth pace amounted to 10.4% year on year. Continuing positive situation in corporate deposits stems mainly from their good financial performance and limited propensity to invest,

[1] Segment data for deposits and receivables are based on NBP monetary statistics.

- relatively strong growth of other deposits – as at the end of the year the growth pace reached 7.5% year on year (in comparison to 3.2% year on year in 2015).

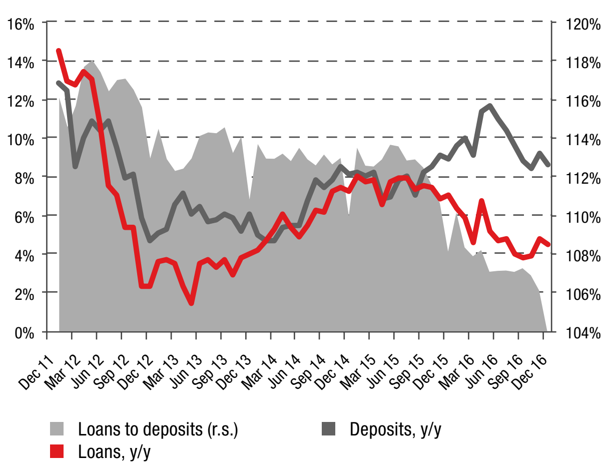
As at the end of December 2016, household deposits accounted for 65.2% (64.9% as at the end of 2015), corporate deposits for 24.9% (25.0% as at the end of 2015), and other deposits for 9.9% (10.1% as at the end of 2015) of all deposits.

In terms of main receivables categories, in 2016 the following developments were noted:

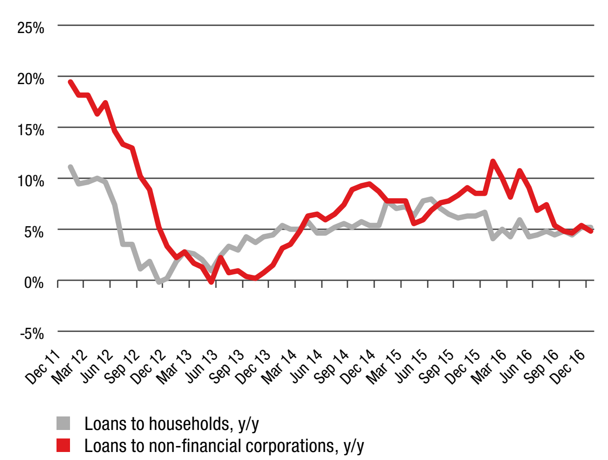
- an increase in households' receivables – as at the end of the year they increased by 5.1% year on year (6.6% at the end of 2015). This pace can be perceived as relatively weak, which is mainly connected with persistently low growth rate of housing loans, caused by growing requirements in terms of own contribution. At the same time, consumer loans' value is increasing relatively fast, which in turn can be associated with improving situation of households and thus higher propensity to take out loans on current needs,
- an increase in corporate receivables, though the pace was much slower than in previous year – as at the end of the year they increased by 4.9% year on year (8.6% year on year at the end of 2015). Deteriorating pace was mainly influenced by limited demand for current funds and falling investment activity,
- a minor decline in other receivables – as at the end of the year they decreased by 0.4% year on year (compared to a growth by 5.1% year on year at the end of 2015).

As at the end of December 2016, loans to households accounted for 59.2% (58.8% as at the end of 2015), corporate loans for 30.2%

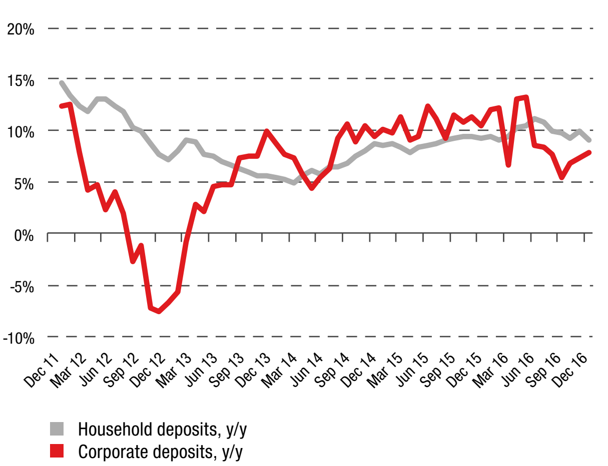
Loans and deposits



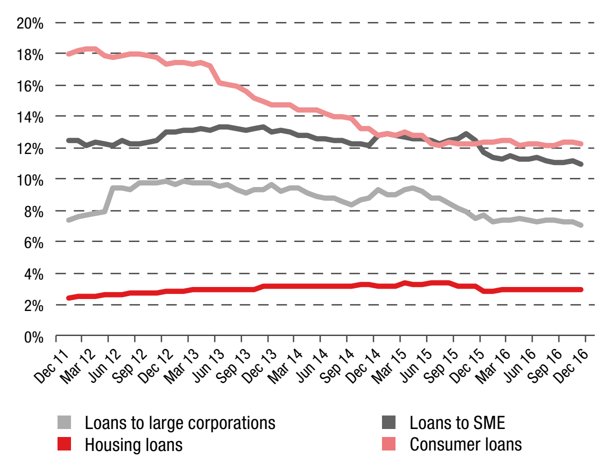

Loans to enterprises and households




Household and corporate deposits




Non-performing loans, % of portfolio



(30.1% as at the end of 2015) and other loans for 10.6% (11.1% as at the end of 2015) of all loans.

In terms of loan portfolio quality, in 2016 the following developments were noted:

– further decline in terms of the share of non-performing loans (NPLs) in the corporate loans portfolio. In November 2016, NPLs made up 9.2% of the portfolio, while as at the end of 2015 it was 10.0%. A similar fall of NPLs' share concerned both loans to large corporates (7.0% in November 2016 in comparison to 7.7% as at the end of 2015) and loans to SMEs (10.9% in November 2016 in comparison to 11.7% as at the end of 2015),
– stabilization of non-performing loans share in case of households' loan portfolio – the ratio was 6.2% in November 2016, similarly to the end of 2015. The NPL ratio remained the same for housing loans (2.9% both as at the end of November 2016 and 2015), while it decreased slightly for consumer loans (from 12.3% as at the end of 2015 to 12.2% as at the end of November 2016).

As far as the regulatory environment is concerned, an important event in 2016 was the introduction, from February, of tax on certain financial institutions. In case of banks, the tax base is assets value (net of selected items). The banks' activity was also affected by growing equity requirements and the need to support the Bank Guarantee Fund (BFG) caused by the bankruptcy of one of the cooperative banks.

## Reputation

**Transparent relations with customers and appropriate risk management guarantee their safety. We keep this in mind at all times.**

# “Now I am confident about her future.”

# Important Events and Achievements

# Important Events and Achievements

## Changes in the Group' structure

The composition of Bank Pekao S.A. Group is presented in the Note 2 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December, 2016.

The most significant changes concerning the Group occurred in 2016 are presented below.

### The deletion of Polish Banking System S.A. (in liquidation) and PPU Budpress Sp. z o.o. (in liquidation) from the Registry

On January 1, 2016 the following associates entities of the Bank: Polish Banking System S.A. (in liquidation) and PPU Budpress Sp. z o.o. (in liquidation) were deleted from the Registry.

### Opening of liquidation of the company

On July 21, 2016 the Extraordinary Shareholders Meeting of Pekao Fundusz Kapitałowy Sp. z o. o. (a subsidiary of the Bank) took the resolution on starting liquidation procedure of the Company.

### Termination of liquidation procedure

In connection with termination of liquidation procedure of Pekao Leasing Holding S.A. (in liquidation), on September 20, 2016 the Company was removed from the National Court Register.

Termination of liquidation procedure of Pekao Leasing Holding S.A. was preceded by the transfer of shares of Pekao Leasing Sp. z o.o. held by the Company to Bank Pekao S.A. Currently, the Bank holds directly 100% share in the capital and votes in the General Meeting of Pekao Leasing Sp. z o.o.

### Transfer of asset management directly to Pioneer Pekao TFI S.A.

On September 30, 2016, Pioneer Pekao Investment Management S.A. (PPIM) made an agreement with Pioneer Pekao Towarzystwo Funduszy Inwestycyjnych S.A. (TFI) on transfer of organized part of the enterprise being, in the internal organizational structure of PPIM, separate organizationally, financially and functionally set of tangibles, intangibles and liabilities designed to perform business activities within the scope of portfolios management which include one or more numbers of financial instruments. Transfer of the organized part of the enterprise was conducted on October 1, 2016 as a contribution in kind to cover shares acquired by PPIM in the increased share capital of TFI.

### Restructuring Agreement

In accordance with the Restructuring Agreement between PBG S.A. and the creditors, on November 14, 2016 Bank Pekao S.A. became the owner of 62,848,380 H series stocks of PBG S.A., with a nominal value of PLN 0.02 representing 8.15% in the votes and the share capital of the Company.

## Changes in the Statutory Bodies of the Bank

### Supervisory Board

On June 16, 2016, the Management Board of Bank Pekao S.A. informed in the current report No. 10/2016 that, taking into account the fulfillment of suitability assessment, the Ordinary General Meeting of the Bank on June 16, 2016 appointed Mr. Dariusz Filar, Mr. Massimiliano Fossati, Ms. Katarzyna Majchrzak, Mr. Gianni Papa, Mr. Leszek Pawłowicz, Ms. Laura Penna, Ms. Wioletta Rosołowska, Ms. Doris Tomanek and Mr. Jerzy Woźnicki as Members of the Supervisory Board of the Bank for the three-year joint term of office, starting on June 17, 2016.

On December 12, 2016, the Management Board of Bank Pekao S.A. informed in the current report No. 33/2016 about resignation from the position of Member of the Supervisory Board of the Bank as of December 31, 2016 by Mrs. Wioletta Rosołowska.

On January 13, 2017, the Management Board of Bank Pekao S.A. informed, in the current report No. 2/2017, on resignations of Mr. Gianni Papa, Mr. Massimiliano Fossati, Ms. Laura Stefania Penna and Ms. Doris Tomanek from the positions of Members of the Supervisory Board of the Bank subject to the condition and with effect as of the date of: (i) the indirect sale by UniCredit S.p.A. of 52,494,007 shares in the Bank to Powszechny Zakład Ubezpieczeń S.A. and (ii) the direct sale by UniCredit S.p.A. of 26,247,003 shares in the Bank to Polski Fundusz Rozwoju S.A.

Composition of the Supervisory Board:

| 31.12.2016 | 31.12.2015 |
|---|---|
| Jerzy Woźnicki<br>Chairman of the Supervisory Board (*) | Jerzy Woźnicki<br>Chairman of the Supervisory Board |
| Gianni Papa<br>Deputy Chairman of the Supervisory Board (*) | Roberto Nicastro<br>Deputy Chairman of the Supervisory Board |
| Leszek Pawłowicz<br>Deputy Chairman of the Supervisory Board (*) | Leszek Pawłowicz<br>Deputy Chairman of the Supervisory Board |
| Massimiliano Fossati<br>Secretary of the Supervisory Board (*) | Alessandro Decio<br>Secretary of the Supervisory Board |
| Dariusz Filar<br>Member of the Supervisory Board | Dariusz Filar<br>Member of the Supervisory Board |
| Katarzyna Majchrzak<br>Member of the Supervisory Board | Katarzyna Majchrzak<br>Member of the Supervisory Board |
| Laura Penna<br>Member of the Supervisory Board | Laura Penna<br>Member of the Supervisory Board |
| Wioletta Rosołowska<br>Member of the Supervisory Board | Wioletta Rosołowska<br>Member of the Supervisory Board |
| Doris Tomanek<br>Member of the Supervisory Board | Doris Tomanek<br>Member of the Supervisory Board |

(*) The Supervisory Board of the Bank elected at the meeting held on July 22, 2016, Mr. Jerzy Woźnicki as Chairman of the Supervisory Board, Mr. Gianni Papa as Deputy Chairman of the Supervisory Board, Mr. Leszek Pawłowicz as Deputy Chairman of the Supervisory Board and Mr. Massimiliano Fossati as Secretary of the Supervisory Board.

### Management Board of the Bank

As of December 31, 2016 the composition of the Management Board had not changed compared to December 31, 2015 and was as follows:

| 31.12.2016 | 31.12.2015 |
|---|---|
| Luigi Lovaglio<br>President of the Management Board, CEO | Luigi Lovaglio<br>President of the Management Board, CEO |
| Diego Biondo<br>Vice President of the Management Board | Diego Biondo<br>Vice President of the Management Board |
| Andrzej Kopyrski<br>Vice President of the Management Board | Andrzej Kopyrski<br>Vice President of the Management Board |
| Adam Niewiński<br>Vice President of the Management Board | Adam Niewiński<br>Vice President of the Management Board |
| Grzegorz Piwowar<br>Vice President of the Management Board | Grzegorz Piwowar<br>Vice President of the Management Board |
| Stefano Santini<br>Vice President of the Management Board | Stefano Santini<br>Vice President of the Management Board |
| Marian Ważyński<br>Vice President of the Management Board | Marian Ważyński<br>Vice President of the Management Board |

Members of the Management Board of the Bank are appointed for a joint three-year term of office.

Members of the Management Board are appointed and removed from office by the Supervisory Board, taking into account assessment of fulfillment of suitability requirements. Vice Presidents and Members of the Management Board of the Bank are appointed and removed from office upon the request of the President of the Management Board of the Bank, taking into account assessment of fulfillment of suitability requirements. Appointment of two Members of the Management Board, including the President of the Management Board and the Member of the Management Board supervising the management of significant risk in the Bank operations and to entrust this function to the appointed Member of the Management Board, is subject to approval by the Polish Financial Supervision Authority, taking into account assessment of fulfillment of suitability requirements. The body which applies for the approval is the Supervisory Board.

The Management Board of the Bank runs the Bank's affairs and represents the Bank. The scope of activities of the Management Board of the Bank includes all matters which, pursuant to the provisions of law or the Bank's Statute do not fall within the scope of competence of other bodies. The rules and procedures governing the activities of the Bank's Management Board are stipulated in the Rules of Procedure for the Management Board of the Bank.

Members of the Management Board of the Bank coordinate and supervise the activity of the Bank in accordance with the division of powers enacted by the Management Board of the Bank and approved by the Supervisory Board.

Mr. Luigi Lovaglio, President of the Management Board of the Bank, coordinates the activities of the Members of the Management Board of the Bank, supervising also, in particular the following areas of the Bank's activity: internal audit, compliance, and corporate communication, including investor relations.

Mr. Luigi Lovaglio heads the Management Board, convenes and presides over the Board meetings, presents its stance to other governing bodies of the Bank and in relations with third parties, in particular with the State authorities, and issues internal regulations.

Mr. Diego Biondo, Vice President of the Management Board of the Bank supervises the activity of the Risk Management Division.

Mr. Andrzej Kopyrski, Vice President of the Management Board of the Bank supervises the activity of the Corporate Banking and MIB Division.

Mr. Adam Niewiński, Vice President of the Management Board of the Bank supervises the activity of the Private Banking Division.

Mr. Grzegorz Piwowar, Vice President of the Management Board of the Bank supervises the activity of the Retail Banking Division.

Mr. Stefano Santini, Vice President of the Management Board of the Bank supervises the activity of the Finance Division.

Mr. Marian Ważyński, Vice President of the Management Board of the Bank supervises the activity of the Logistics and Procurement Division.

# Important Events and Achievements

## Organizational changes

In 2016, there were organizational changes in the Bank's Head Office impacting Financial Division and Global Banking Services Area.

The aim of the changes in the Global Banking Services Area was to centralize the process for data management and data quality in the Bank, their collection, processing and sharing.

In the Global Banking Services Area was created function of Chief Data Officer responsible for the overall management of data in the Bank, development and implementation of strategies and methods of management and use of data.

From the Financial Division to the Global Banking Services Area has been moved MIS Department responsible for the maintenance and development of the Management Information System, preparation and implementation of data management strategy and their quality. It was also separated unit (Data Architecture Team) dedicated to supporting processes of architecture and data quality management as well as the development and maintenance of Data Architecture Repository.

In addition in 2016, it was continued the process of centralization of operational activities which resulted in transferring tasks related to Money Transfer service (Western Union) from the Retail Banking Division to the Central Back Office.

## Awards and distinctions

**Global Finance: Bank Pekao S.A. Innovator of the Year 2016 in transactional banking**
Bank Pekao S.A. was awarded the title of „Innovators 2016 – Transactions Services" in the international ranking organized by Global Finance magazine. Independent experts appreciated new solution for corporate clients – the Digital Gate which allows the use of multiple financial services and products through the Internet banking system PekaoBiznes24 based on one agreement. The Digital Gate offers the widest range of products and services on the market, including treasury products, integrated in one package.

**Global Finance: Bank Pekao S.A. Best Sub-Custodian Bank in Poland**
Bank Pekao S.A. for the fifth consecutive year won the title of the "Best Sub-Custodian Bank in Poland 2016" in the ranking organized by the Global Finance magazine what confirms professional and comprehensive approach of the Bank to custodian services.

Bank Pekao S.A. received the highest award due to such criteria as individual service by dedicated advisor, opportunity to conduct transaction through any brokerage house, opportunity to collect on escrow account any types of securities and full service of corporate rights arising from the securities.

**EMEA Finance: EFRA project financed by Bank Pekao S.A. the best transaction of 2015 in Oil & Gas sector**
In June 2016, EFRA project was recognized as the best transaction of 2015 in Oil & Gas sector by EMEA Finance magazine. EFRA transaction is a financing for the amount of USD 432 million and PLN 300 million for LOTOS Asfalt belonging to LOTOS Group. Bank Pekao S.A. in consortium with 7 financial institutions signed credit facility agreements with LOTOS Asfalt to finance the construction of an advanced Delayed Coking Unit (DCU) with auxiliary installations on the premises of the refinery in Gdańsk.

Bank Pekao S.A. was entrusted with the role of the coordinator, arranger and agent for this strategic project. EFRA project is one of the largest Project Finance transactions in the history of the Polish market in terms of both structure and scale.

**Najwyższa Jakość Quality International: Digital Gate offered by Bank Pekao S.A. awarded with the Gold Emblem of Quality International**
Digital Gate offered by Bank Pekao S.A. and dedicated to corporate clients, won a prestigious title of the Highest Quality Service in the Quality International 2016 competition in QI Services category.

The Chapter of the Program, for the consecutive time, appreciated quality of services offered by Bank Pekao S.A. The Gold Emblem for the Digital Gate is an acknowledgement of the Bank's involvement in the improvement of quality of services provided to its clients.

Najwyższa Jakość Quality International competition is held under the auspices of the Polish Agency for Enterprise Development, Polski Komitet Normalizacyjny (Polish Standard) and Katedra Zarządzania Jakością Uniwersytetu Ekonomicznego in Kraków (Department of Quality Management in Cracow University of Economics).

**Euromoney: Bank Pekao S.A. for the consecutive time Best Trade Finance Provider in Poland**
Bank Pekao S.A. was awarded with the title of the "Best Trade Finance Provider in Poland 2016" according to the survey organized by prestigious Euromoney magazine.

Over 2 thousand international companies selected three banks in which they use trade finance products. Bank Pekao S.A. received the most votes among banks operating in Poland.

**Panattoni Europe: award for Bank Pekao S.A. in the category of the Best Financial Institution 2016**
Panattoni Europe, the recognised developer and the undisputed leader in industrial real estate in Europe, honoured Bank Pekao S.A. with the title of the Best Financial Institution 2016 for its professional approach and confidence over many years.

**BANK Financial Magazine: three awards for Bank Pekao S.A.**
Bank Pekao S.A. received three awards in the rankings organized by BANK Financial Magazine. In the main ranking, which takes into account assets, liabilities, volume of loans, number of outlets as well as traditional and online bank accounts, the Bank took the second position. The Bank took also the second position in the ranking of consumer banks, where absolute value of consumer loans portfolio and growth of these loans were factored and in the ranking of banks financing real estate, where current development achievements such as growth of loans portfolio, increase in sales of loans and the position of a given bank on the market were particularly factored.

**Global Finance: Private Banking of Bank Pekao S.A. recognized as the best in Poland**
Private Banking offered by Bank Pekao S.A. was recognized as the best in Poland by prestigious magazine Global Finance in the second edition of World's Best Private Banks Awards competition.

World's Best Private Banks Awards are granted to institutions, which offer the private banking customers the best customer service and the highest value and level of services. Experts from Global Finance magazine selected winners based on applications provided by these institutions, market analysis, opinions of analysts, top managers and private banking customers.

**Forbes: the best 5-star score for Private Banking of Bank Pekao S.A.**
Private Banking of Bank Pekao S.A. received, for the first time, the highest score in the sixth edition of private banking services competition organized by Forbes magazine. This distinction confirms high quality of private banking services and solutions that meet the needs of extremely demanding group of customers.

Evaluation of quality of private banking offer is conducted by a representative group using private banking services with a particular focus on solutions corresponding to market trends. The reason underlying the high position of Private Banking of Bank Pekao S.A. included the fact that the Bank has the right to distribute in Poland Goldman Sachs funds, which is a unique asset and a competitive advantage in the segment.

**Forum Biznesu: title Highest Quality Services QI SERVICES for Private Banking investment advisory of Bank Pekao S.A.**
Investment advisory, offered to the Private Banking clients was honored the title of the Highest Quality Services in QI Services category by the Quality International Program 2016 organized by Forum Biznesu and held under the patronage of the Polish Agency for Entrepreneurship Development and the Polish Committee for Standardization.

**Bankier.pl: MasterCard Debit of Bank Pekao S.A. recognized as Financial Innovation in the competition Złoty Bankier**
Multicurrency debit card MasterCard Debit of Bank Pekao S.A. was recognized as Financial Innovation in the competition Złoty Bankier organized by the Internet portal Bankier.pl with the cooperation of "Puls Biznesu" daily. The Bank was awarded with the statuette of Złoty Bankier in this category for the third time. Bankier.pl experts and the journalists of Puls Biznesu appreciated multicurrency card of Bank Pekao S.A. which meets requirements of the product defining trends in the banking sector in the coming years.

Multicurrency debit card is one of the most advanced products on the market that enables execution of transactions in PLN as well as in selected foreign currencies without FX conversion thanks to card's connection with corresponding currency accounts.

**„Produkt Roku IT@BANK 2016" for the PeoPay mobile application**
At an annual conference dedicated modern technologies in banking IT, the PeoPay mobile application of Bank Pekao S.A. was awarded with the title of „Produkt Roku IT@BANK 2016".

System of mobile payments PeoPay allows payments execution in terminals accepting contactless payments in Poland and abroad as well as payments, not only in majority of shops and online but also in public administration offices.

**XI Edycja Kongresu Gospodarki Elektronicznej: Bank Pekao S.A. awarded for PeoPay system**
PeopPay, the first in the world system of contactless mobile payments on Windows 10 Mobile won the top prize in the category Project of the Year 2015 in the XI Edycja Kongresu Gospodarki Elektronicznej (the XI Edition of the Congress of Electronic Economy). The Chapter of the competition appreciated innovation of the solution, among others, the ability to pay even if the phone is in offline mode, as well as to make payments up to PLN 50 without necessity to switch the application on.

The PeoPay application allows the Bank's customers to make fast payments between users (using the phone number), contactless

# Important Events and Achievements

payments execution in shops and service points cooperating with the Bank and online payments. Currently, thanks to PeoPay application it is possible to make payments in 425 thousand of POS terminals in Poland (ca. 85% of total number of POS) as well as in terminals accepting contactless payments abroad (nearly 4 million of terminals).

**Contactless Intelligence: KULkarta of Bank Pekao S.A. won in the competition Contactless Intelligence 2016**

KULkarta of Bank Pekao S.A. won in the prestigious, international competition Contactless Intelligence 2016 in the category ID&Authorisation. Student card with the functionality of debit card and additionally library card is one of the first products of this type in Poland, which is in the Bank's offer is since October 2015. The card is addressed to the students of Katolicki Uniwersytet Lubelski (The Catholic University of Lublin).

During this year's 10th edition of the competition Contactless Intelligence that promotes most advanced technological solutions in the area of contactless payments, the prizes were awarded in 9 categories, which include, among others, the most innovative payment product, security of transaction, "mobile wallet", the best loyalty product, ID and authorization. The winners were selected by the jury of experts and the results of voting conducted among the Internet users.

**Izba Gospodarki Elektronicznej: Bank Pekao S.A. received distinction in the 4th edition of e-Commerce Polska awards 2016**

Tablet application „Pekao24 na tablety" of Bank Pekao S.A. received distinction in the category "The most digital bank" in competition E-commerce Polska awards 2016 organized by Izba Gospodarki Elektronicznej (Chamber of digital economy).

Bank Pekao S.A. presented the application „Pekao24 na tablety" which is dedicated to individual customers using tablets daily for banking operations. The applications combines functions of Pekao24 Internet service with a tool for analysis of personal finance and provides information on expenditures that are aggregated in categories such as: home, kids, travel.

Competition e-Commerce Polska awards 2016 is organized for four years and addressed to entities operating in e-commerce, banking and insurance market. In 2016, the competition received a record number of nearly 150 notifications.

**Polskie Stowarzyszenie Marketingu SMB: employees of Call Center of Bank Pekao S.A. won three main awards in the competition „Telemarketer Roku"**

Call Center employees of Bank Pekao S.A. won in the category of Customer Service, Help Desk and Other Projects in the competition „Telemarketer Roku" organized for the eighth time by Polskie Stowarzyszenie Marketingu SMB. In the competition attended nearly 180 consultants representing 30 companies, including over one third of companies from financial sector. 25 telemarketers participated in the final stage of the competition for three days presenting their skills in the field of sales and telephone service in the headquarter of Polskie Stowarzyszenie Marketingu SMB. The jury selected five winners.

The competition, apart from selection of the best telemarketers and call center employees in Poland, aims to promote the profession and to underline its influence on sales and marketing efficiency of the company.

The competition jury evaluated substantive preparation for the interview, the skill to make contact with the customer to collect the information and application of tools to control the conversation as well as correct language and voice handling. There was sought telemarketer who is able to combine sales efficiency with sensitivity towards customer and its needs.

# Information for the Investors

# Information for the Investors

## The Bank's share capital and share ownership structure

As at December 31, 2016, the share capital of Bank Pekao S.A. amounted to PLN 262,470,034 and remained unchanged until the date of submitting the report. The share capital of the Bank consisted of 262,470,034 shares of the following series:

| | | | |
|---|---|---|---|
| 137 650 000 | Series | A | bearer shares with a par value of PLN 1 per share |
| 7 690 000 | Series | B | bearer shares with a par value of PLN 1 per share |
| 10 630 632 | Series | C | bearer shares with a par value of PLN 1 per share |
| 9 777 571 | Series | D | bearer shares with a par value of PLN 1 per share |
| 373 644 | Series | E | bearer shares with a par value of PLN 1 per share |
| 621 411 | Series | F | bearer shares with a par value of PLN 1 per share |
| 603 377 | Series | G | bearer shares with a par value of PLN 1 per share |
| 359 840 | Series | H | bearer shares with a par value of PLN 1 per share |
| 94 763 559 | Series | I | bearer shares with a par value of PLN 1 per share |

All the existing shares are ordinary bearer shares. There are no special preferences or limitations connected with the shares, or differences in the rights attached to them. The rights and obligations related to the shares are defined by the provisions of the Polish Commercial Companies Code and other applicable law.

Shareholders of Bank Pekao S.A., holding directly or indirectly, through subsidiaries, at least 5% of the total number of votes at the General Meeting of the Bank, are as follows:

| | NUMBER OF SHARES AND VOTES AT THE GENERAL MEETING | SHARE IN SHARE CAPITAL AND TOTAL NUMBER OF VOTES AT THE GENERAL MEETING | NUMBER OF SHARES AND VOTES AT THE GENERAL MEETING | SHARE IN SHARE CAPITAL AND TOTAL NUMBER OF VOTES AT THE GENERAL MEETING | NUMBER OF SHARES AND VOTES AT THE GENERAL MEETING | SHARE IN SHARE CAPITAL AND TOTAL NUMBER OF VOTES AT THE GENERAL MEETING |
|---|---|---|---|---|---|---|
| SHAREHOLDER'S NAME | AS AT THE DATE OF SUBMITTING THE REPORT | | AS AT DECEMBER 31, 2016 | | AS AT DECEMBER 31, 2015 | |
| UniCredit S.p.A. | 105 250 485 | 40,10% | 105 250 485 | 40,10% | 131 497 488 | 50,10% |
| Other shareholders (below 5%) | 157 219 549 | 59,90% | 157 219 549 | 59,90% | 130 972 546 | 49,90% |
| **Total** | **262 470 034** | **100,00%** | **262 470 034** | **100,00%** | **262 470 034** | **100,00%** |

In the current report No. 17/2016, the Management Board of Bank Pekao S.A. informed that on July 18, 2016 it received the notification from UniCredit S.p.A. according to which, UniCredit S.p.A. sold 26,247,003 shares of the Bank as a result of the execution on July 13, 2016 of the block trades concluded as a result of the accelerated book-building process. The transactions were settled on July 15, 2016.

Prior to the disposal, the UniCredit S.p.A. owned 131,497,488 shares in the Bank, constituting 50.10% of capital share of the Bank and corresponding to the same number and percentage share of votes at the General Meeting of the Bank.

After the transaction, the UniCredit S.p.A. holds 105,250,485 shares in the Bank, constituting 40.10% of capital share of the Bank and corresponding to the same number and percentage share of votes at the General Meeting of the Bank.

In the current report No. 30/2016, the Management Board of Bank Pekao S.A. informed that on December 8, 2016 UniCredit S.p.A. announced it has entered into an agreement for the disposal of a 32.8% stake in Bank Pekao S.A. to Powszechny Zakład Ubezpieczeń S.A. (PZU) and Polish Development Fund S.A. (PFR).

The Transaction is subject to the customary regulatory and antitrust approvals and is expected to be completed around mid-2017.

Moreover in the current report No. 31/2016 on December 8, 2016 the Bank informed that it had received communication from UniCredit S.p.A. concerning announcement on sale offer of 1,916 of certificates exchangeable for the Bank shares (equity linked certificates) of total reference value of approx. EUR 500 million, compulsorily settled in the Bank common shares no later than on December 15, 2019. Those certificates shall be used to sell the remaining 7.3% of the Bank shares belonging to UniCredit S.p.A. (after the conclusion of sale agreement mentioned above).

The Bank has not received any other notifications regarding changes in the ownership structure in accordance with par. 69 of the Act of July 29, 2005 on Public Offerings and Conditions Governing the Introduction of Financial Instruments to an Organized System of Trading, and on Public Companies.

Polish open-end pension funds (OFE) constitute to the group of financial investors holding significant equity interests in the Bank. Based on their publicly available financial reports, as at December 31, 2016 OFE held in aggregate 14.78% of the Bank's shares.

The Polish open-end pension funds' holdings in Bank Pekao S.A.:

| SHAREHOLDER | NUMBER OF SHARES AND VOTES AT GM | % OF SHARE CAPITAL AND TOTAL VOTE AT GM | NUMBER OF SHARES AND VOTES AT GM | % OF SHARE CAPITAL AND TOTAL VOTE AT GM |
|---|---|---|---|---|
| | DECEMBER 31, 2016 | | DECEMBER 31, 2015 | |
| Aviva OFE Aviva BZ WBK | 10 749 990 | 4,10% | 10 709 906 | 4,08% |
| Nationale-Nederlanden OFE | 6 254 975 | 2,38% | 4 715 432 | 1,80% |
| OFE PZU „Złota Jesień” | 5 291 194 | 2,02% | 5 836 563 | 2,22% |
| OFE MetLife | 3 644 584 | 1,39% | 2 801 190 | 1,07% |
| AXA OFE | 3 132 742 | 1,19% | 3 020 824 | 1,15% |
| Aegon OFE | 2 312 363 | 0,88% | 2 103 268 | 0,80% |
| Generali OFE | 2 165 755 | 0,83% | 1 852 089 | 0,71% |
| Allianz Polska OFE | 1 770 132 | 0,67% | 1 863 768 | 0,71% |
| Nordea OFE | 1 715 436 | 0,65% | 1 653 909 | 0,63% |
| PKO BP Bankowy OFE | 1 045 153 | 0,40% | 1 039 288 | 0,40% |
| OFE Pocztylion | 705 234 | 0,27% | 732 676 | 0,28% |
| **Total** | **38 787 558** | **14,78%** | **36 328 914** | **13,84%** |

Source: OFE Reports – annual structure of open-end pension funds assets; closing share price of Bank Pekao S.A. as at end of the period.

## Performance of market valuation of Bank Pekao S.A.'s stock

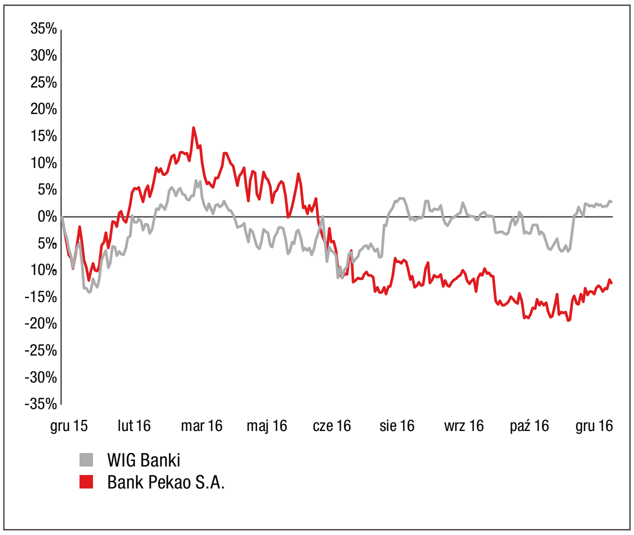
The shares of Bank Pekao S.A. have been listed on the WSE since June 1998 and they are one of the most liquid equities in Poland and Central and Eastern Europe. Since 2000, the Bank maintains Global Depositary Receipts (GDR) program. The Bank's GDRs are traded on London Stock Exchange and on the over the counter market in the USA.

The Bank's market capitalization as of December 31, 2016 amounted to PLN 33.0 billion and making the Bank one of the largest traded companies from Central Europe. Given the high capitalization and liquidity the Bank's shares are a part of many important stock indices maintained by domestic and foreign institutions including Polish blue chips index – WIG20 and sector index – WIGBanks. Since December 19, 2011, the shares of Bank Pekao S.A. are included in the CEERIUS Sustainability Index at Vienna Stock Exchange.

With the average daily turnover volume at the level of 640 thousand and the worth of trading at PLN 21.1 billion in 2016, the share of the Bank's stock in trading on the WSE amounted to 11.13%.

The share price of Bank Pekao S.A. reached to PLN 125.8 as at the end of December 2016 comparing to PLN 143.5 a year earlier. Share price drop in 2016 was driven by both introduction of regulatory changes, adversely affecting the profitability of the banking sector and uncertainty coming from the change of controlling entity.

Performance of Bank Pekao S.A.'s shares and WIGBanks in year 2016.



# Information for the Investors

## Dividend payment history

In 2016, the Bank paid dividend for 2015 in the amount of PLN 8.70 per share. Dividend yield amounted to 6.1%.

The dividend payments for the years from 2003 to 2015 are presented below:

| DATE | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Dividend for the year (in PLN million) | 748 | 1,065 | 1,234 | 1,504 | 2,517 | – | 761 | 1,785 | 1,412 | 2,202 | 2,614 | 2,625 | 2,283 |
| Dividend per 1 share (in PLN) | 4.50 | 6.40 | 7.40 | 9.00 | 9.60 | – | 2.90 | 6.80 | 5.38 | 8.39 | 9.96 | 10.00 | 8.70 |

## Investor Relations

The Bank's activity in investor relations area is focused on providing transparent and active communication with the market through active co-operation with investors, analysts and rating agencies, as well as fulfilling disclosure requirements within the frameworks of applicable law regulations.

The Bank's representatives regularly hold a lot of meetings with investors in Poland and abroad, and take part in most of the regional and sector dedicated investors conferences. Financial results of Bank Pekao S.A. Group are presented quarterly at conferences that are simultaneously transmitted via the Internet.

The Bank's financial results and its activity are regularly monitored by analysts representing Polish and foreign brokerage entities. In 2016, 21 analysts published reports and recommendations on the Bank.

The main activity of the Bank's investor relations is to enable to make a reliable evaluation of the Bank's financial situation, its market position and business model effectiveness in the context of banking sector conditions and macroeconomic situation in the domestic economy as well as on international markets.

Relevant information for the investors about the Bank is available on the Bank's website http://www.pekao.com.pl/information_for_investors/. The Bank publishes also on-line annual report available on the Bank's website, where is also posted "Information Policy of Bank Polska Kasa Opieki Spółka Akcyjna regarding communication with investors, media and customers".

## Bank Pekao S.A. financial credibility ratings

### Bank Pekao S.A. financial credibility ratings

Bank Pekao S.A. co-operates with three leading credit rating agencies: Fitch Ratings, S&P Global Ratings, and Moody's Investors Service. In the case of the first two agencies, the ratings are provided on a solicited basis under relevant agreements, and with respect to Moody's Investors Service, the ratings are unsolicited and they are based on publicly available information and review meetings.

As of December 31, 2016, Bank Pekao S.A. had assigned following financial credibility ratings:

| FITCH RATINGS | BANK PEKAO S.A. | POLAND |
|---|---|---|
| Long-term rating (IDR) | A- | A- |
| Short-term rating | F2 | F2 |
| Viability rating | a- | – |
| Support rating | 2; credit watch negative | – |
| Outlook | Stable | Stable |
| **S&P GLOBAL RATINGS** | **BANK PEKAO S.A.** | **POLAND** |
| Long-term rating in foreign currencies | BBB+ | BBB+ |
| Long-term rating in domestic currency | – | A- |
| Short-term rating in foreign currencies | A-2 | A-2 |
| Short-term rating in domestic currency | – | A-2 |
| Stand-alone credit profile | bbb+ | – |
| Outlook | Stable | Stable |
| **MOODY'S INVESTORS SERVICE (UNSOLICITED RATING)** | **BANK PEKAO S.A.** | **POLAND** |
| Long-term foreign-currency deposit rating | A2 | A2 |
| Short-term deposit rating | Prime-1 | Prime-1 |
| Baseline Credit Assessment | baa1 | – |
| Long-term counterparty risk assessment | A1(cr) | – |
| Short-term counterparty risk assessment | Prime-1(cr) | |
| Outlook | Stable / Negative (*) | Negative / Stable (**) |

(*) Stable for liabilities in domestic currency, Negative for liabilities in foreign currencies
(**) Negative for Polish economy, Stable for Polish banking sector

Among banks rated in Poland, Bank Pekao S.A. has the highest viability rating assigned by Fitch Ratings, the highest Stand-Alone Credit Profile rating assigned by S&P Global Ratings, the highest Baseline Credit Assessment as well as long- and short-term counterparty risk ratings assigned by Moody's Investors Service.

### Pekao Bank Hipoteczny S.A. financial credibility ratings

Fitch Ratings agency assigned the "A" rating to the covered bonds issued by Pekao Bank Hipoteczny S.A., a 100% subsidiary of Bank Pekao S.A. The reasons underlying the Agency's decision included the high rating assigned to Pekao Bank Hipoteczny S.A. (A-), legal regulations pertaining to the covered bonds collateral register and the excess of collateral over the volume of bonds in issue, as declared by the bank.

The high rating assigned to the covered bonds confirms Pekao Bank Hipoteczny's ability to issue securities offering a high level of security and raise long-term capital to fund its lending activity. During the latest revision on December 20, 2016, outlook was change from Negative to Evolving. The national long-term rating of Pekao Bank Hipoteczny S.A. is AA+(pol) with a Stable outlook.

## The Energy to Act

**The force that drives Bank Pekao S.A. both strengthens and optimises our operations.**

“We’ve got the force!”

# Activity of Bank Pekao S.A. Group

# Activity of Bank Pekao S.A. Group

## Important factors influencing the Group's activities and results

In 2016, the Group's activity was to a large extent determined by the macroeconomic situation in Poland and abroad as well as by the trends observed in the banking sector.

Polish economy achieved growth rate at the level of 2.8%, comparing to 3.9% in 2015. The slowdown was caused by decreased investments, which were lowered by 5.5% year on year. Private consumption remained as the main driver of growth supported by significant labour market improvement and growth of social transfers.

The Monetary Policy Council kept interest rates unchanged for the whole year 2016, what neutrally impacted loan demand and net interest margin in banking sector.

Household lending growth rate amounted to 5.1% year on year, compared to 6.6% year on year a year ago. The slowdown was mostly caused by lower mortgage loans growth, where customer's own contribution requirements had been increased.

Corporate loans increased by 4.9% year on year, compared to 8.6% year on year a year ago, what resulted from investments decrease and was connected with lower demand for loans.

Household deposits growth amounted to 9.1% year on year vs. 9.2% year on year in the previous year, mainly due to steady improvement of labour market. Interest in alternative forms of investing, including investment funds, still remained low. The large uncertainty on the stock exchange market due to growing geopolitical risks, volatile commodity prices and intervention of politicians in some sectors of the economy were neither supportive for stock market indices nor for demand for investment products. Corporate deposits growth was at the level of 7.8% year on year vs. 10.4% year on year in 2015, what confirms the good financial standing of enterprises.

The banking sector results were improved. However, it was largely a result of realization of one-off profits from sales of Visa Europe shares to Visa Inc., what increased banking sector gross profit by ca. PLN 2 billion.

Since February 2016, the banking sector was burdened with so called banking tax amounting to 44 b.p. (annualized) of assets decreased by deducting selected items, what significantly influenced profitability of banking sector in negative way.

Works on finding solutions of denominated and indexed FX mortgage loans problem have been continued for the whole year, what had significant influence on increasing listed on the WSE banks' shares price volatility.

The capital requirements for the banking sector were tightened due to the implementation of EU regulations. Among others, the KNF decided to increase the capital buffers, introducing requirements for other financial institutions of systemic importance.

Competition in the sector remained high, especially in the most attractive areas, what has limited sector capacity to improve margins.

Banks continued investments in innovative solutions and new technologies, including remote channels of contact, especially on the Internet and mobile banking as well as mobile payments.

Favourable economic conditions and improvement of labour market supported assets quality, which has been steadily improving.

## Major sources of risk and threats

### Risk management

Effective risk management is a prerequisite for maintaining a high level of security of the funds entrusted to the Group, and for achieving a sustainable and balanced profit growth within the risk appetite assumed by the Group.

The key risks material for the Group include credit risk, liquidity and market risks and operational risk. Moreover, business, real estate, financial investment, model, macroeconomic, reputation, compliance risks, the risk of excessive leverage and bancassurance risk are also recognized.

The Group has adopted a comprehensive and consolidated approach to risk management. It extends to all units of the Group. Risks are monitored and controlled with respect to profitability and the funds necessary to cover the exposure.

The Management Board is responsible for achieving the strategic risk management goals, while the Supervisory Board, supported by the Risk Committee, oversees whether the Group's policy of taking various risks is compliant with the overall strategy and financial plan. The Credit Committee plays an important role in the credit risk management, the Asset, Liability and Risk Committee and Liquidity and Market Risk Committee in market and liquidity risk management, and management of the operational risk falls within the scope of responsibility of the Operational Risk Committee.

The rules of managing each of the risks are defined in internal procedures and are subject to the assumptions of the credit and investment policies and the Operational Risk Strategy and Policy accepted annually by the Management Board and approved by the Supervisory Board.

Credit, liquidity, market and operational risk reports analyzing details of their development are presented to the Management Board and the Supervisory Board.

The rules and instruments of managing each of the risks and information on the risk exposure are included in Note 6 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on December 31, 2016 and in the document "Information in respect to capital adequacy of Bank Pekao S.A Group as at 31 December 2016" published on the Bank's website.

## Credit risk

Managing credit risk and maintaining it at a safe level is vital for the Bank's financial performance. In order to minimize credit risk, special procedures have been established, pertaining in particular to the rules of assessing transaction risk, collateralization of loan and lease receivables, credit decision powers, and restrictions on lending to certain types of businesses.

Lending activities are subject to limits following both from the Banking Law and the Bank's internal standards, including limits concerning exposure concentration ratios for individual sectors of the economy, limit on the share of large exposures in the Bank's loan portfolio and limits of exposures to countries, foreign banks and domestic financial institutions.

The credit decision powers, lending restrictions as well as internal and external prudential standards, pertain to loans and guarantees as well as derivative transactions and debt instruments. The quality of the loan portfolio is also protected by periodic reviews and ongoing monitoring of the timely servicing of loans and the financial standing of customers.

The Bank has continued to work on further rationalization of the credit process with an aim to obtaining better efficiency and security, including in particular enhancement of the procedures and tools for risk measurement and monitoring.

### Credit risk concentration limits

According to the Banking Law the total exposure of a bank to the risks associated with the single borrower or a group of borrowers in which entities are related by capital or management may not exceed 25% of a bank's equity. In 2016, the maximum exposure limits set forth in the Banking Law were not exceeded.

### Sector exposure concentration

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

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

## Compliance risk

Compliance risk is the risk resulting from breaching laws, internal regulations and market standards in the processes functioning within the Bank. Compliance risk can lead to criminal or administrative sanctions, material financial losses, diminished reputation, reduced brand value, reduced development potential and inability to perform contracts, as well as reduction or loss of business opportunities.

There is a separate unit for compliance matters functioning within the Bank, Compliance Department, organisationally and operationally independent and subordinated directly to the President of the Management Board. Compliance Department is the key element of ensuring compliance within the Bank.

The Bank ensures compliance through application of control mechanisms and compliance risk management process carried out by Compliance Department and encompassing identification, assessment, control and monitoring of compliance risk of the Bank's activity and presentation of reports in this scope. The reports on performance of tasks by Compliance Department together with the level of assessed compliance risk are presented to the Management Board and Supervisory Board. The oversight of compliance risk related to the activities of subsidiaries is performed in the Bank.

Assumptions of compliance risk management process were defined in Bank Pekao S.A. Compliance Policy developed by the Management Board and approved by the Supervisory Board. There are following key elements supporting compliance risk management process:

- supervision of the Supervisory Board and responsibility of the Management Board for the effective management of compliance risk and observance of the Compliance Policy,
- responsibility of the Bank's employees for ensuring compliance within the scope of their duties,
- properly defined organisational structure including appropriate location of Compliance Department,
- internal regulations on compliance matters,
- training,
- regular cooperation of Compliance Department with Internal Audit Department and other internal control system units.

# Activity of Bank Pekao S.A. Group

As part of compliance with laws, internal regulations and market standards each employee of the Bank applies appropriate control mechanisms and performs independent monitoring of adherence to control mechanisms, within the scope of duties assigned to him/her.

Implementation and application of the compliance risk management standards are key factors in creating the enterprise value, reinforcing and protecting the Bank's reputation, and winning public trust in the Bank's activities and its standing.

## Capital adequacy

Capital ratios are the basic measures applied for the measurement of capital adequacy according to Regulation of the European Parliament and of the Council (EU) No 575/2013 of June 26, 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR Regulation), which entered into force since January 1, 2014 together with further amendments as well as Commission Implementing Regulations or Delegated Regulations (EU).

Capital ratios, capital requirements and own funds have been calculated in accordance with the CRR Regulation using national options defined in Banking Act, article 171a as well as recommendations of the Polish Financial Supervision Authority (KNF). In particular, this applies to the risk weights for claims secured by mortgages and number of ratios regulating method of own funds calculation.

The minimum value of capital ratios required by law is the sum of minimal capital requirement defined by CRR Regulation (equal to 8.0% for TCR and 6.0% for T1) and combined buffer requirement as defined in Act of 5 August 2015 on macroprudential supervision over the financial system and crisis management. On 4th October, 2016 KNF issued the Decision regarding the identification of Bank as the other systemically important institutions and imposed on Bank, on a consolidated and individual basis, capital buffer of the other systemically important institution in the amount of the equivalent to 0.75% of the total amount of the risk exposure.

According to recommendation of KNF total capital ratio of the Group, including combined buffer requirement (Capital conservation buffer of 1.25% and, Other Systemically Important Institution buffer of 0.75%) must be not less than 14.00% and Tier I capital ratio not less than 11.00%. Both levels are increased by additional capital requirement imposed by KNF1.

At the end of December 2016 for Bank Pekao S.A. Group, total capital ratio amounted to 17.64% and was significantly higher than the minimum level required by the law and level recommended by the KNF.

The table below presents the basic data concerning Bank Pekao S.A. Group capital adequacy as of December 31, 2016, and December 31, 2015 according to regulation which were in force at those dates.

(in PLN thousand)

| CAPITAL REQUIREMENT | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Credit risk | 8,323,345 | 8,202,427 |
| Exceeding large exposure limits | – | – |
| Market risk | 44,022 | 63,578 |
| Counterparty credit risk including CVA | 187,820 | 325,240 |
| Operational risk | 493,557 | 564,787 |
| Total capital requirement | 9,048,744 | 9,156,032 |
| | | |
| **OWN FUNDS** | | |
| Common Equity Tier I Capital | 19,954,579 | 20,209,595 |
| **Own funds for total capital ratio** | **19,954,579** | **20,209,595** |
| | | |
| **Common Equity Tier I Capital ratio (%)** | **17.64%** | **17.66%** |
| **Total capital ratio (%)** | **17.64%** | **17.66%** |

Total capital ratio as at the end of 2016 compared with the end of 2015 decreased by 0.02 p.p. due to decrease in own funds by 1.3%, while decreasing the total capital requirement by 1.2%.

Total capital requirement decreased as at the end of December 2016 as a result of decrease of capital requirements for counterparty risk including CVA. operational risk and market risk.

[1] In case of Bank Pekao S.A. Group, additional capital requirement imposed by the KNF on total capital ratio is equal to 0.01 p.p. and for Tier I capital 0.0075 p.p.

## Bank Pekao S.A. on the Polish banking market

Bank Pekao S.A. is a universal commercial bank providing a full range of banking services to individual and institutional clients mainly in Poland. Bank Pekao S.A. Group includes financial institutions operating in banking, asset management, pension funds, brokerage services, transactional advisory, leasing and factoring markets.

### Distribution channels

The Bank offers to its clients a broad distribution network with ATMs and outlets conveniently located throughout Poland.

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Total number of outlets | 928 | 975 |
| Total number of own ATMs | 1,761 | 1,759 |

The Bank's clients can also make commission-free cash withdrawals from the European network of the UniCredit Group ATMs.

As at the end of December 2016, the Bank maintained 5,480.1 thousand PLN-denominated current accounts, 328.1 thousand mortgage loan accounts and 572.1 thousand "Pożyczka Ekspresowa" (Express Loan) loan accounts.

(in thousand)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Total number of PLN current accounts (*) | 5,480.1 | 5,314.4 |
| of which packages | 4,053.9 | 3,961.1 |
| Number of mortgage loans accounts (**) | 328.1 | 309.9 |
| of which PLN mortgage loans accounts | 293.6 | 273.8 |
| Number of "Pożyczka Ekspresowa" loan accounts (***) | 572.1 | 576.0 |

(*) Number of accounts including accounts of pre-paid cards.
(**) Retail customers accounts.
(***) "Pożyczka Ekspresowa", Pożyczka Ekspresowa Biznes.

### Individual clients

In 2016, Bank Pekao S.A. consequently realized the strategy of growth in retail customer segment providing services for individual clients and small and micro enterprises.

The total value of new key loans for individual customers, including cash and PLN mortgage loans in 2016 amounted to over PLN 14.5 billion and was higher by 4.3% in comparison to 2015.

The value of deposits of individual clients and small and micro enterprises placed in the Bank increased by PLN 7.4 billion during the last 12 months which resulted in an increase in the total balance of retail deposits by 10.7% in comparison to 2015.

Bank Pekao S.A. is one of the leaders in electronic banking in Poland. In terms of electronic banking, the Bank offers to its clients wide range of solutions such as: Internet and mobile service, mobile application on phones and tablets as well as PeoPay mobile transfers.

Thanks to the PeoPay application the Banks' clients have the opportunity to make fast transfers between the application users, non-cash payments in POS terminals (425 thousand of terminals in Poland and nearly 4 million abroad) and online (in majority of online shops in Poland and in 250 thousand online shops abroad with Masterpass logo). In March 2016, Bank Pekao S.A., as the first bank in the world, allowed users of mobile phones with Windows 10 Mobile system to make contactless payments in HCE technology via the PeoPay application. In October, Bank Pekao S.A., as the first in Poland, provided the opportunity to make mobile payments in selected public administration offices in Poland, so that the customers can pay faster and more convenient for, among others, issue of driving license or vehicle registration directly at the office. Furthermore, the PeoPay mobile payments system was enriched with the opportunity to make contactless transactions in off-line mode and opportunity to top-up mobile phones on prepaid card.

Another innovative product offered by Bank Pekao S.A. on the Polish market is Elektroniczna Legitymacja Studencka (Electronic Student Card), which combines functionality of student and payment card with the opportunity to combine another services such as library card or public transport ticket. In 2016, the Bank issued Electronic Student Cards in the next five Polish universities.

As part of the government Family 500 plus Program realization, Bank Pekao S.A., as one of the first banks in Poland, allowed customers of the Pekao24 Internet banking system to submit applications. Additionally, there was prepared website for the government Family 500 plus Program and a dedicated offer for a family.

#### Lending products

The Bank offers to its individual clients a wide range of lending products, including first of all PLN mortgage loans and consumer loans Express Loan (Pożyczka Ekspresowa). In 2016, the Bank consequently realized the strategy of strengthening its position on housing and consumer goods financing market.

***Mortgage loans***

In 2016, the Bank maintained its strong market position in the area of mortgage loans, granting the loans in the amount of PLN 6.9 billion what translated into 9.3% of increase of PLN mortgage loans volume year on year and secured the market share at the level of ca.18% as at the end of 2016.

The Bank takes also a leading position in mortgage loans granting under the government program "Mieszkanie dla Młodych" ("Apartment for the Young") supporting the persons aged up to

35 in acquisition of the first new apartment. The Bank conducted also local and country-wide promotional activities of mortgage loans, including promotional campaigns on the Internet and internal channels of marketing communication as well as participated on a regular basis in real estate fairs organized all over the country.

*Consumer lending*

In 2016, the value of cash loans granted amounted to PLN 7.7 billion, an increase by 18.3% in comparison to 2015. Cash loans portfolio for individual clients increased in 2016 by 13.6%.

In 2016, the Bank continued the activities aiming at ensuring the clients transparent offer of Express Loan concentrating on strengthening the relationship with customers, among others, through preparation of individual loan offers with the use of CRM tools as well as electronic channels including website dedicated to consumer loans, the Pekao24 system and mobile application.

Within the framework of loan granting process „na klik" ("by click"), the Bank offered also fast and fully automated cash loan granting process in the Internet service and mobile applications on smartphones and tablets. In the offer "Klik Gotówka" ("Cash Click"), loan disbursement is automatically processed after approval of agreement in the Pekao24 system.

The Bank conducted also promotional campaign of Express Loan in the main TV channels with the largest coverage and thematic channels as well as on the Internet portals, including YouTube and Facebook.

### Payment cards

In 2016, the Bank focused on promotion of the latest card products introduced to its offer in 2015. Multicurrency debit card and Flexia credit card became the most popular products chosen by the Bank's customers.

Multicurrency debit card is one of the most innovative products on the market that enables execution of transactions in PLN as well as selected foreign currencies without FX rate conversion thanks to card's connection with corresponding currency accounts. The Bank's multicurrency debit card is used abroad most frequently for transactions in EUR realized in the European Union countries. In 2016, the Bank conducted multicurrency debit card promotion on popular Internet portals as well as through posting in magazines cyclical newsletters „Pieniądze na wakacje" ("Money for holiday"), where the issue related to effective cash management during travel was discussed.

Flexia credit card is an innovative solution, that combines the advantages of a credit card with the ability to reschedule selected payments for purchases. Growing share of Flexia cards in total number of credit cards issuance confirms that this card meets the customer's expectations in terms of financing of expenditures and cheap and easy access to additional funds.

Within the framework of payment cards promotion, there were conducted marketing campaigns mainly on the Internet and radio. The Bank's payment cards were also promoted by bloggers who used them while shopping or travelling abroad and published opinion on their websites.

The Bank provides to customers the ability to customize image of payment card by selecting from proposals of 72 images available in the catalogue. More than half of newly issued debit cards are cards with selected image from the catalogue.

The effectiveness of the Bank is confirmed by increasing number of payment cards in circulation, higher by 224.6 thousand (6.6%) as compared to the end of 2015, of which the credit card number increased by 64.9 thousand (11.8%).

### Savings and investment products

Thanks to a wide range of deposit products of the Bank, during the last 12 months deposits volume of individual customers increased by 11.0% in comparison to the end of 2015.

An important support for increase of savings volume were regular inflows to the accounts of the Bank's individual customers as well as term deposits placed in electronic channels and PLN negotiated deposits. In addition, there was an increase in volumes on saving accounts Mój Skarb dedicated to children.

The Bank continued activities to increase, among the customers, knowledge about the idea of regular saving in retirement programs. Focus of such activities among selected groups of customers translated directly into further increase in the number of new IKE and IKZE accounts as well as an increase in the level of payments realized by the customers who possessed these products before.

In 2016, the Bank continued development of the Premium Personal Banking and introduced to its offer a new Kontakt Premium (Contact Premium) service. The service allows customers, among others, to purchase the majority of products from the Bank's offer during a phone conversation with a dedicated Personal Advisor. Kontakt Premium service increases significantly customer service standards in the area of affluent client. Currently, the service is available in several largest cities.

In order to provide customers with more opportunities in terms of products selection and access to new markets, in 2016, the Bank introduced to its offer new investment funds and structured products which ensures 100% capital protection at the end of investment:

- Pioneer Strategii Globalnej – konserwatywny with a lower investment risk level (equity part of the portfolio accounts for 30% of its assets), at the same time IKE and PAK offer was expanded by new investment fund,
- Pioneer Dochodu USD – mixed fund of a global nature investing in different types of assets with opportunity to invest in USD as

well as in PLN, at the same time PAK offer was expanded by this investment fund,
- IKE offer was expanded by Pioneer Pieniężny Plus and IKZE offer was expanded by Pioneer Strategii Globalnej and Pioneer Strategii Globalnej- konserwatywny funds,
- program of regular savings Moja Perspektywa was also expanded by new portfolios: Portfel obligacyjny Rodzina Plus and Portfel konserwatywny Rodzina Plus,
- in the scope of the structured products, three certificates based on EUR/PLN exchange rate and one certificate based on a basket of European companies were issued.

**Brokerage activity**

Bank Pekao S.A. Group offers a wide range of capital market products and services through retail brokerage entities: Dom Maklerski Pekao (Dom Maklerski), a subsidiary Centralny Dom Maklerski Pekao S.A. (CDM) and associated entity Dom Inwestycyjny Xelion Sp. z o.o. (Xelion).

As at the end of December 2016, the retail brokerage entities of the Group maintained 340.0 thousand investment accounts. The Group's brokerage entities were serving 181.6 thousand accounts with an active access to services through remote channels.

As of December 31, 2016, the total value of assets deposited on investment accounts run by the Group's retail brokerage entities amounted to PLN 23.5 billion.

In 2016, activities of the Group's brokerage entities focused on acquisition of new customers as well as improving tools and the range of remote services.

In 2016, the brokerage entities of the Group participated in seven IPO's allowing individual customers access to over 70% of IPO and SPO offers on the Polish market.

CDM, as the first on the Polish market, introduced to offer Goldman Sachs Asset Management (GSAM) investment funds. Furthermore, CDM product offer was also expanded by Structured certificates with no capital protection, barrier reverse convertible on the shares of foreign companies: Daimler AG, Continental AG and Hugo Boss AG, issued by UniCredit Bank AG.

In the first half of 2016, CDM expanded its offer on foreign markets by pre-market orders. CDM is currently the only provider of this service in Poland offering customers access to pre-market on U.S. stock exchanges.

In 2016, Xelion implemented innovative paid service of investment advisory which is based on own automatic model of assets allocation.

In 2016, CDM and Dom Maklerski were among five the best-rated brokerage entities in Ogólnopolskie Badanie Inwestorów (National Survey of Investors) organized by Stowarzyszenie Inwestorów Indywidualnych (Association of Individual Investors).

**Private Banking**

Private Banking of Bank Pekao S.A. is the market leader in Private Banking area in terms of the value of assets. Client service model is based on cooperation with dedicated Relationship Managers, who provide customers with product solutions tailored to their individual needs and market situation. A group of Relationship Managers consists of experienced employees who hold certificates of European Financial Planning Association. Relationship Managers are supported by assistants and product specialists teams what, combined with a unique experience and knowledge of markets allows, to maintain high level of services and to develop an offer for the most demanding customer segment. Both the customers and experts appreciate Private Banking of Bank Pekao S.A. awarding prizes and high positions in rankings.

In 2016, the activity in the area of Private Banking covered, in particular, intensive development of the Bank's offer, including investment offer as well as initiatives aiming at new clients acquisition and strengthening existing relations.

In the first quarter of 2016, the customers were provided with opportunity to open and maintain Eurokonto Walutowe account on individual terms in 9 additional currencies: Norwegian krone (NOK), Swedish krona (SEK), Danish krone (DKK), Canadian dollar (CAD), Australian dollar (AUD), Russian ruble (RUB), Japanese yen (JPY), dirham of the United Arab Emirates (AED) and Chinese yuan (CNY).

Since June 2016, Private Banking customers can benefit from the offer of investment funds managed by Goldman Sachs Asset Management (GSAM), which is the part of The Goldman Sachs Group, one of the largest investment banks in the world. From this moment for a period of eighteen months, Bank Pekao S.A. Group will be the exclusive distributor of GSAM solutions in Poland. Private Banking clients have a choice of nine selected funds from the GSAM offer available through the CDM. The offer on the Polish market consists of 3 debt funds, one alternative fund and 5 equity funds. In 2016, the co-operation with GSAM translated into investing of over PLN 100 million of assets in investment solutions offered to Private Banking customers.

Investment Advisory was very popular among customers – this service covered clients assets with total value amounting to over PLN 2.4 billion as at the end of 2016.

In the third quarter of 2016, investment offer was enriched with a new product group – structured certificates without capital protection. This innovative solution, the result of which is dependent on carefully selected base instrument and adopted formula of profit payment, was addressed to Private Banking clients accepting higher level of risk. The issuer of certificates is German UniCredit Bank AG, one of the leaders of the European market for structured products.

# Activity of Bank Pekao S.A. Group

Experts from UniCredit Bank AG as well as from Global Investment Strategy Department of Bank Pekao S.A. and Biuro Analiz of CDM determine base instrument and basic parameters of the product, ensuring the highest probability of expected profit, which may significantly exceed bank deposits interest rates.

In 2016, subscriptions of Indeks na Zysk deposits were conducted, including deposits based on the average exchange rate of foreign currencies (USD/PLN, EUR/PLN). The offer of investment funds was further expanded with selected solutions in the area of opened-end investment funds offered by Pioneer TFI and insurance capital funds offered by TU Allianz as well as by 9 new products for the most wealthiest clients in the area of closed-ended investment funds, including also products based on absolute return strategy. These products respond to the clients interest in such types of solutions resulting from high volatility on financial markets.

Within the scope of prestigious credit cards offer, special regulations of credit limits agreements and credit cards were implemented with Private Banking customers to support distribution of these products.

In 2016, a series of investment meetings were organized in the largest Polish cities, during which experts from the Bank and selected Investment Funds were presenting to the customers the directions and trends in the financial markets.

In 2016, Private Banking customers also had the opportunity to participate in events sponsored by the Bank, such as the Champions League and the European League, Paszporty Polityki (Passports of the Polityka magazine) awards ceremony, Film and Art Festival Dwa Brzegi and Pekao Szczecin Open Tennis Tournament as well as at prestigious meeting associated with publication of a List of 100 Polish billionaires 2016 of the Forbes magazine. The Bank was also a partner of the Congress CFO of the Year organized by Rzeczpospolita magazine and the Silesian Gala of Business Center Club and the Official International Showjumping Competition CSIO 5* and gala of the Jan Wejchert award of the Polish Business Roundtable. These meetings were designed to strengthen customers relationship and establish new business contacts.

### Electronic banking for individuals

The Bank's individual clients are provided with system that enables remotely to realize almost all operations available in the Bank's outlet. The mobile application, which is one of the most advanced application on the market, allows to execute majority of operations available in the Internet system and access to additional functionalities such as geo-location of ATMs, branches and rebate points as well as to track market information.

The Pekao24 electronic banking system and mobile application additionally allow the individual clients to manage funds on brokerage accounts held by Dom Maklerski. In addition, clients of CDM and Xelion may use dedicated systems CDM24 and Xelion Internet platform for service of accounts held by these entities.

Individual clients may also use innovative mobile application dedicated for tablets – "Pekao24 na tablety". The application, apart from main transactional functions known from the Pekao24 Internet system was equipped with a tool of financial analysis that helps clients to overview revenue and expenditure on their account. A new, simplified form of transfer and advanced search transactions history facilitate day-to-day usage of bank account. The "Pekao24 na tablety" application is available on devices with Android and iOS operating systems. The functionality of the new application "Pekao24 na tablety" is systematically developed. In 2016, the application users were provided with ability to display operations register in the Pekao24 electronic banking. They were also provided with an opportunity to manage access to the Pekao24 services, SMS notifications and credit cards (i.e. automatic repayment, download statement).

The Bank regularly expands the scope of functions available for execution through remote access channels. In 2016, the possibility of fast and convenient activation of electronic banking through delivery of PIN via SMS was introduced.

In 2016, the Bank implemented also improvements in foreign transfers processing, providing a new, simplified form adapted to requirements of Sepa End Date and mechanism of automatically determined SWIFT / BIC code of recipient's bank based on account number.

In the Pekao24 Internet system, the Bank provided the customers with opportunity to convert investment fund units and recurrent money transfers on Indywidualne Konto Emerytalne as well as direct payments and recurrent money transfers on Indywidualne Konto Zabezpieczenia Emerytalnego.

The Bank offers to its clients convenient and secure system of mobile payments PeoPay that allows, among others, payments execution in terminals accepting contactless payments in Poland and abroad, immediate payments to system users to telephone number and cash withdrawal from the Bank's ATMs without payment card.

As at the end of December 2016, the number of individual users with an access to the Pekao24 system amounted to 3,176.9 thousand and was higher by 277.5 thousand as compared to the end of December 2015. In the fourth quarter of 2016, 1,708.6 thousand individual users logged in to the electronic banking services.

As at the end of December 2016, the number of individual users with an access to mobile banking amounted to 1,495.7 thousand and was higher by 481.1 thousand as compared to the end of December 2015. In the fourth quarter of 2016, 672.3 thousand of individual users logged in to the mobile service m.pekao24.pl, the Pekao24 mobile banking application (on phone or tablet) and the PeoPay application.

(in thousand)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Number of individual users with an access to electronic banking Pekao24 as at the end of period | 3,176.9 | 2,899.4 |
| Number of individual users actively using electronic banking Pekao24 (*) | 1,708.6 | 1,576.8 |
| Number of individual users with an access to mobile banking as at the end of period (**) | 1,495.7 | 1,014.6 |
| Number of individual users actively using mobile banking (***) | 672.3 | 509.2 |

(*) User actively using electronic banking is a user who logged in to the system at least once during the last quarter.
(**) User actively using at least one of the following mobile solutions: the mobile service m.pekao24.pl, the Pekao24 mobile banking application or the PeoPay application.
(***) User actively using mobile banking is a user who logged in to the mobile service m.pekao24.pl or the Pekao24 mobile banking application or the PeoPay application at least once during the last quarter.

### Small and micro enterprises (SME)

In 2016, the Bank continued activities aimed at enrichment and promotion of products offer, acquisition of new customers, and, as a consequence, further strengthening its market position in the area of small and micro enterprises.

In 2016, the Bank extended offer of Pożyczka Ekspresowa Biznes (Business Express Loan) for customers with simplified form of accounting, and introduced also loan for the customers with annual sales revenue exceeding PLN 1.5 million. Entrepreneurs can be granted with a loan in the amount of up to PLN 100 thousand for the period of five years. Thanks to this offer the enterprises get access to an additional source of financing, which can use for any purpose associated with their business activity, among others, financing of current activity, purchase of small machines and devices without need to document expenditures.

In 2016, there were launched promotional campaigns of loans which supported granting process of Business Express Loan, Pożyczka Ekspresowa Agro (Agro Express Loan) and loans offered to individual farmers under the Agromania project.

The Bank focused also its activity on long-term financing through campaigns addressed to the Bank's clients with positive credit history.

The Bank continued special promotional campaigns of loans „SLK – szybko dostępny limit kredytowy" ("SLK – quickly available credit limit") addressed to the selected customers with dedicated short term loans offer and credit and charge cards limits available in simplified loans granting process. SLK offer was very popular among the customers, the almost three times more customers used this offer in comparison to 2015.

One of the supporting instruments of loans granting process were the portfolio guarantees of Bank Gospodarstwa Krajowego (BGK) and Europejski Fundusz Inwestycyjny (EFI). As at the end of 2016, Bank Pekao S.A. granted 14 thousand de minimis guarantees in the amount of PLN 3.4 billion. In October 2016, it was completed the realization of EU program Konkurencyjność i Innowacja (Competitiveness and Innovation) under which the Bank offered investment and operating loans (also for start-up's) with free of charge guarantee of EFI.

Small and micro enterprises were provided also with preferential investment financing within the credit line form of Bank Rozwoju Rady Europy (Council of Europe Development Bank) in June 2015. So far, small and micro enterprises were granted with 1.2 thousand loans with the value of almost PLN 500 million.

Within the payment cards product offer development, the Bank implemented a new credit card MasterCard Business DUO Komfort for SME customers with the ability to reschedule the whole or a part of debt due to purchases. Additional advantage of the card is the ability to choose graphics of payment card by selecting from the catalogue, which consists of 72 images, tailored to needs and expectations of the customers.

In 2016, the Bank provided to its business clients an opportunity to place negotiated deposits through the PekaoBiznes24 Internet banking system. Within this functionality, there are available deposits in PLN, USD and GBP. Interest rate depends on deposit amount, deposit period and current deposit rate on the market.

In the first quarter of 2016, the Bank presented the sixth edition of report "Raport o sytuacji mikro i małych firm" (Report on the situation of SME clients) during dedicated conference held in Warsaw. The report has been prepared based on 7 thousand interviews conducted with the enterprises' owners. The main theme of this edition was the start-up businesses. Outcomes of this report were also presented at conferences organized in each voivodeships.

In October 2016, at the VI Europejski Kongres Małych i Średnich Przedsiębiorstw (the 6th European Congress of SME) in Katowice, Bank Pekao S.A. was honored with the title and statue „Ambasadora MŚP".

Thanks to offer development and activities supporting card products distribution in 2016, the number of cards offered by the Bank to business clients increased by 15.7%.

As a result of product offer development (including possibility of transaction realization of Dynamic Currency Conversion and Cash Back service) and thanks to increased activities of business customer advisors in the area of payment cards acceptance, there was an increase by over 30% in portfolio of SME customers using the Bank's terminals.

# Activity of Bank Pekao S.A. Group

**Electronic banking for SME customers**
SME customers of the Bank use the PekaoBiznes24 system (with extensive Internet banking and fully transactional mobile application) while the Pekao24 dla firm system (the Pekao24 system for entrepreneurs) is dedicated to self-employed customers. Both systems are an integral part of Pakiety Mój Biznes (My Business Packages).

In 2016, the mobile offer for business customers using the Pekao24 dla firm system was implemented within m.pekao24.pl service, which is adapted to browsers on mobile devices.

Customers using the PekaoBiznes24 system were provided with new, simplified form of credit transfer adapted to requirements of Sepa End Date.

As at the end of December 2016, 254.7 thousand business users had an access to the electronic banking systems, of which 169.3 thousand were active users. The number of business users with an access to the electronic banking systems increased by 7.1 thousand compared to the end of December 2015.

(in thousand)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Number of business users (SME) with an access to the electronic banking systems as at the end of period | 254.7 | 247.6 |
| Number of business users (SME) actively using electronic banking systems (*) | 169.3 | 164.6 |

(*) User actively using electronic banking is a user who logged in to the systems at least once during the last quarter.

As at the end of December 2016, 21.8 thousand business users had an access to the mobile banking application, of which 12.0 thousand were active users. The number of business users with an access to the mobile banking application increased by 4.0 thousand compared to the end of December 2015.

(in thousand)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Number of business users (SME) with an access to the mobile banking as at the end of period | 21.8 | 17.8 |
| Number of business users (SME) actively using the mobile banking (*) | 12.0 | 10.7 |

(*) User actively using mobile banking is a user who logged in to the system at least once during the last quarter.

## Corporate customers

Bank Pekao S.A. is the largest corporate bank in Poland financing major strategic projects. A wide range of products, innovative solutions and an individual approach provide comprehensive financial services to enterprises, institutions and budgetary units.

The Bank is available to clients at every stage of the business activity, from support for the processes of financial management of the production and sales network to automation of service processes, financing the development of the product and service offer, as well as advisory services and the provision of funds for investments and international expansion.

"Tailor-made" solutions of Bank Pekao S.A. for corporate banking are recognized both in Poland and internationally. The safety and convenience of on-line services, trading in Treasury securities, custodian business, trade finance and cash management are areas of corporate banking appreciated by clients and a group of independent, national and international, experts. The market also recognizes the solutions used by the Bank to improve the service and to support relations with clients, such as the Digital Gate – Pekao General Agreement.

Participation in the most difficult and most prestigious transactions, strong position in the corporate banking market and numerous awards are a proof of confidence in the expertise and experience of the Bank's specialists and the value that the Bank creates for the clients.

**Transactional services**
The Bank holds a leading market position in the comprehensive range of services and transactional products and the prizes awarded by independent institutions confirm the high quality of services offered.

In the area of transaction banking, in 2016, the Bank continued activities to simplify the procedures, processes and improve the safety and convenience of corporate clients.

Key achievements in the area of transaction banking in 2016 include:
- expanding the offer to include the Digital Gate – Pekao General Agreement, which makes the handling of the current account simpler, faster and more comfortable. Under a single General Agreement, the client gains access to a basic set of most frequently used products, and may activate other products using simple applications,
- introduction in the offer for the public sector of opłatomat – a device for making payments to Municipal Offices without necessity to visit the Bank's branch. Charges for the operations performed by the offices and taxes on their behalf may be made in cash or by card,
- introduction of a number of changes arising from the Regulation 260/2012 of March 14, 2012 of the European Parliament and the Council of the European Union, which establishes technical and trade requirements in connection with credit transfers and direct debits in EUR. These changes implement, among others, the obligation to make SEPA payments in a format compatible with the XML standard, based on ISO 20022,
- the possibility of making other non-SEPA payment orders compatible with the XML standard and offering additional facilities for clients using foreign orders in the electronic banking system,

– providing the fastest international settlements using the TARGET-2 system, which enable settlement with the contractual partner in ca. 1.5 hours,
– implementation in electronic banking, new, more efficient and open application architecture for the PekaoBiznes24 system, which provides easier management of the optimized infrastructure, unified software development model, resulting in shorter Time to Market time, more efficient and more stable performance and better application scalability.

The strengthening of the position of market leader in transaction banking in 2016 is confirmed by:
– a 15% increase year on year of the number of issued corporate credit cards, including new card products for corporate clients, i.e. multicurrency card and credit card,
– a 34% increase year on year in the number of domestic transfers,
– an increase in the number of foreign outgoing transfers, incoming transfers and SEPA transfers, by respectively over 16%, over 14% and nearly 28% year on year,
– the number of available solutions integrating financial systems of corporates with the Bank and the volume of transactions performed via these channels. In 2016, a total of over 23 million orders were completed through alternative channels (Pekao Connect, PekaoInMail, web service), which means a 7-fold increase as compared to 2015.

**Electronic banking**
The Bank provides corporate clients with easy and quick access to financial products and services through electronic channels. Electronic banking is constantly developing in terms of user convenience and improvements in the settlements.

In 2016, the most important changes in this area included:
– introduction of order confirmation, a tool providing automated information on the execution of payment and improving the flow of information inside the company and with its counterparties and notifications – a tool automatically sending information to the client concerning, among others, the security of the system and transactions,
– introduction of additional functions parametrization of corporate payment cards. Thereby, the clients gained tools for flexible cards management, i.e. the possibility of establishing limits for non-cash transactions for MasterCard Corporate Debit FX Pekao card,
– access to a universal, dynamic „Foreign transfer" form dedicated to, among others, the handling of SEPA transfers (foreign and currency transfers) to Poland, enabling a wider range of user interaction, dynamic determination of modes and available options, additional guidance and simplifying order entry. Users gained, among others, automatic identification of the SWIFT BIC code of the beneficiary's bank on the basis of the IBAN account for all accounts in this format and more effective verification of the correctness of the entered data,
– an access to a proprietary solution to convert the electronic form of a statement taken from the PekaoBiznes24 to a single structure (JPK) required by law, under the obligation imposed under the Tax Code. The solution prepared by the Bank eliminates the need for costly customization of financial and accounting systems of the clients to the required structure and allows to convert a statement from any period specified by the client.

The effect of the introduced changes and facilities includes increased automation and quicker service of the PekaoBiznes24 users. Clients, to a greater extent, make use of the management of the rights to the PekaoBiznes24 through electronic applications, appreciating the convenience, speed, accuracy and cost savings. Owing to this, the ratio of applications submitted electronically and applications submitted in paper form stands, as at the end of the year, at 70/30.

In the second half of the year, the use of a marketing tool, which allows for profiled campaigns encouraging users to remotely and easily activate new products and additional services, was intensified. Wider use of the functionality offered to clients by the PekaoBiznes24 system leads to increase in revenues from additional services and increases customer loyalty to Bank Pekao S.A.

**Trade finance**
In the area of financing of domestic and foreign trade, the Bank continued to strengthen its leading position in product solutions.

In co-operation with the Pekao Factoring, the Bank introduced a new hybrid model of debt financing of corporate clients co-operating with the Group. An effective model of sale and implementation of products financing receivables was initiated within the project, which provided clients with access to the offer using elements of the Bank's products and Pekao Factoring. The entire financing is structured by one transaction specialist. The objectives of the sales team, as well as performance monitoring, is conducted on a portfolio of all products serving the receivables of the Group regardless of product and operations structure.

The most important projects realized in 2016, in the area of trade finance included, among others,:
– introduction of a new monitoring process for the product Kredyt Zaliczka (Loan Advance) and transfer of service to the new trading system that influence on increasing of the client's transactions security,
– implementation of a number of hardware and regulatory adjustments for the systems that support document products in connection with the recommendations of the KNF,
– launching of the „Trade Finance Infoline" for clients and companies potentially interested in trade finance products supported by experts in the field,
– implementation of new IT hardware infrastructure ensuring more stable operation, service efficiency and scalability of products,
– providing clients with new reporting and analytical tools in the electronic access channels.

# Activity of Bank Pekao S.A. Group

Trade Finance Team conducted systematic training and workshops for employees of the Bank, which ensured that customer advisors had actual knowledge of the products offered and the market situation.

### Depositary services

In 2016, the Bank realized the project to adapt to the new, expanded responsibilities of the depositary bank, under the amended Act on Investment Funds and Managing Alternative Investment Funds.

### Cooperation with international clients

In 2016, the Bank continued the realisation of the UniCredit Group project "Internationalisation" aimed at using to the fullest extent the potential of the Unicredit Group, based on its position in the European countries. Under the project, the Bank strengthened relations with existing international clients of the Group, and attracted new customers, in close co-operation with the Group advisors, senior bankers and employees of international outlets of the banks, being members of the Unicredit Group.

The Bank implemented new procedures aimed at developing international co-operation, such as the procedure for intra-group guarantees, the terms and conditions for cross-border lending activities within the UniCredit Group and the documentation of the Single Bank Account Agreement in the UniCredit Group.

The Bank's International Customer Office, along with the Polish-Italian Chamber of Commerce, the Italian Institute for Foreign Trade and the Italian Embassy, co-organized events enhancing the Bank's image as a partner for foreign companies operating in Poland under the patronage of key customers such as: Macfrut, SIAD and ANCE.

### Investment banking, structured finance and commercial real estates

The Bank consistently supports the development of enterprises and infrastructure through financing, organising and securing the transactions. It offers to clients a wide range of services in the field of project financing, structured financing and commercial real estate project financing.

In 2016, the Bank's strong position in the area of financing was confirmed by, among others: the issue of medium-term bonds for a total amount of PLN 2.8 billion, the organization of the largest transactions in 2016 in the market of mergers and acquisitions in the amount of over PLN 1 billion (advisor/investor of this transaction was a subsidiary of the Bank – Pekao Investment Banking S.A.), participation in the largest merger and acquisition transaction carried out on the Polish market in the amount of USD 3.25 billion, and financing of housing developers in the amount of PLN 663 million.

The Bank participated also in the following investment projects of the institutional clients:

- financing the production of an enterprise in the biofuel sector in the amount of over PLN 400 million,
- financing the investment needs of a leading enterprise in the food industry in the amount of over PLN 300 million,
- participation in syndicated loan in automotive sector in the amount of over PLN 300 million,
- financing of a new industrial plant for one of the leaders in the energy industry in the amount of over PLN 280 million,
- financing of enterprise operating in agri sector in the amount of PLN 250 million.

Within the scope of commercial real estate financing, the Bank participated in the following transactions:

- refinancing of shopping centre in the amount of over PLN 550 million,
- financing the construction of a modern complex of varied purposes in the amount of over PLN 400 million,
- financing a residential and retail complex located in Warsaw in the amount of over PLN 160 million.

### Financial market and commercial debt instruments

In the area of organization and management of commercial debt securities, Bank Pekao S.A. has nearly 20% market share (2nd place), as at 30 November 2016 (data based on the Rating&Market bulletin published by Fitch Polska). In the segment of medium-term corporate bonds, the Bank has 1st place with nearly 25% of market share.

In 2016, medium-term debt securities of enterprises and banks were issued through the Bank for a total amount of ca. PLN 4.5 billion, among which the following transactions deserve special attention:

- issue of four series with a 5- and 7-year maturity of unsecured bonds denominated in EUR and PLN for a leading manufacturer of packaging for a total amount equivalent to ca. PLN 1.1 billion,
- issues of medium-term debt securities (maturity period of 2-4 years) for commercial banks operating in Poland, in the total amount of nearly PLN 700 million,
- placing on the market several series of 5-year bonds for stock exchange listed companies from the construction industry for a total amount of PLN 400 million,
- organizing the issue of 5-year public bonds secured by mortgage in the amount of PLN 200 million for the largest hotel group in Eastern Europe.

Bank Pekao S.A. was among 14 dealers of treasury securities (TSD), who were selected for 2016 by the Ministry of Finance.

Bank Pekao S.A. belongs also to the group of 13 dealers of money market (DRP), who were selected for 2016 by the Polish National Bank.

### Comprehensive services for the public finance sector

The Bank continues the strategy for maintaining a substantial share in the financing of Polish local government authorities and provides a full range of services designed to support their budgets.

In 2016, the Bank participated in the financing of the following local government infrastructure projects:
- a pioneering project for organizing the financing for the revitalization of urban infrastructure,
- financing the modernization of Łódzkie zoo and its expansion with a modern orientarium in the form of a bond issue program,
- increased the financing for medical investment projects in the Łódzkie voivodeship,
- financing, in the form of a bond issue program for the Municipal Sports and Recreation Centre in Radom Sp. z o.o. to build a new football stadium, a new sports hall, tennis courts and a modern system of city bikes,
- a long-term loan to finance the expenses associated with the expansion of the tram network in one of the Polish cities,
- financing, in the form of the issuance of bonds, the expansion and modernization of the municipal heating network in Lublin,
- a bond issue program in the amount of PLN 30 million to finance the preparatory process of building a thermal waste incineration plant.

In addition, the Bank was the sole organizer and agent of the issue of municipal bonds of the City of Kraków, with a total value of PLN 200 million. It is the largest single municipal bond issue in 2016 with 10-year maturity and a fixed rate.

The Bank also signed an agreement with the City of Gdańsk, including support for the budget of the city and all of its budgetary units in the years 2016-2021 and granted one year overdraft facility to one of the voivodeships.

In the second half of 2016, the Bank signed contracts with two other voivodeship towns, covering the support for the budgets of these towns and all their organizational units for the next five years.

**Cooperation with international and domestic financial institutions**

Bank Pekao S.A. maintains correspondent relations with 1.6 thousand Polish and foreign banks (according to the number of swift keys).

As at the end of 2016, the Bank maintains 71 nostro accounts in 48 banks in 26 countries; it runs 223 loro accounts for 208 foreign clients (banks and other financial institutions) from 48 countries and 42 current accounts for 40 foreign financial institutions.

The Bank also intermediates in the execution of transactions on behalf of clients of other domestic banks, running 33 loro accounts for 12 Polish banks and keeping 6 nostro accounts in one Polish bank, used for settlement of securities transactions and other custodian operations.

The Bank renders also services for Polish banks and branches of foreign banks in Poland in terms of purchase and sale of foreign and domestic currency.

In 2016, the Bank enhanced its product offer for clients of correspondent banking and clearing services for banks, for which it runs Loro accounts and acquired 10 new banks for cooperation and service in the field of clearing in PLN and foreign currencies.

The Bank maintains a high level of STP transactions (straight through processing) rate amounting for 98% of outgoing client and interbank transactions.

In accordance with the requirements of Basel III, the Bank introduced modifications for formatting MT910 messages (Confirmation of Credit), which allow clients for effective reporting of transactions and liquidity management.

## Major areas of activities of the Group's subsidiaries

Bank Pekao S.A. is one of the leading providers of banking services and groups together a number of financial institutions active in the asset management, pension funds, brokerage services, transactional advisory, leasing and factoring markets.

Dom Maklerski, CDM and Xelion render brokerage services within the Group providing retail customers with a wide range of products and services on the capital markets. For detailed description of the brokerage activity refer to the point 6.4.1.

Below are described the areas of operations of the Group's key companies from the financial sector.

### Banking activity

***Pekao Bank Hipoteczny S.A. – Pekao Bank Hipoteczny***

In 2016, Pekao Bank Hipoteczny, as a specialized mortgage bank, continued to pursue its strategy focused on the creation of a secure loans portfolio, strived to maintain competitive position on the market of commercial properties, as well as loans for purchase, construction, refurbishment or modernization of housing loans to individuals.

As at the end of 2016, net value of loans portfolio of Pekao Bank Hipoteczny amounted to PLN 2,024.2 million, a decrease by PLN 39.3 million, i.e. 1.9% in comparison to 2015. Loans granted to corporates and local governments represent 54.0% and loans granted to individual clients represent 46.0% of loan portfolio structure.

In 2016, within the framework of a strategy focused on co-operation with Bank Pekao S.A., the volume of new commercial real estate loans accounted for 65.5% of total new loans.

In 2016, within the second Program of Covered Bonds to bearer, bank successfully conducted one public issuance of covered bonds. The total value of liabilities due to covered bonds amounted to PLN 1,282.7 million as of December 31, 2016.

# Activity of Bank Pekao S.A. Group

## Assets management

***Pioneer Pekao Investment Management S.A. – PPIM***
As of December 31, 2016, the net asset value of investment funds of Pioneer Pekao TFI S.A. (a subsidiary of Pioneer Pekao Investment Management S.A, in which the Bank holds a 49% share) amounted to PLN 16,793.9 million, an increase of PLN 91.4 million, i.e. 0.5% as compared to the end of 2015. In August 2016, Pioneer Pekao TFI S.A. received license for customer portfolios management and after transfer of operational activities within the scope of management of financial instruments portfolios started to manage of the assets from October 1, 2016. Value of these assets as at the end of 2016 amounted to PLN 1,450.7 million.

***Pekao Pioneer Powszechne Towarzystwo Emerytalne S.A. – Pekao Pioneer PTE***
Pekao Pioneer PTE activity is the management of an open-end pension fund Pekao OFE, in which pension contributions are pooled and invested with the aim of their distribution to unit holders after they reach retirement age and voluntary pension fund Pekao DFE which allows collecting of additional funds with a number of advantages of this form of saving.

As at the end of 2016, the value of the pension fund's net assets was PLN 2,262.6 million and Pekao OFE held 1.5% share in the market of open-end pension funds, i.e. on the similar level in comparison to 2015.

## Leasing activity

***Pekao Leasing Sp. z o.o. – Pekao Leasing***
Pekao Leasing provides financial services supporting purchases and sale of fixed assets, i.e. vehicles, plant and equipment, and office space, both in the form of operating and finance leases.

In 2016, the Company concluded 10,451 new agreements. The value of leased assets increased in comparison to 2015 by 14.5% and amounted to PLN 2,161.7 million, of which 62.4% were vehicles, 31.6% – plant and equipment, 1.9% – real estates and 4.1% – others.

Under the program of co-operation between Pekao Leasing and Bank Pekao S.A. in the area of sale, the value of assets leased via the Bank's branches amounted to PLN 1,484.9 million and increased by 12.5% in comparison to 2015.

## Factoring activity

***Pekao Faktoring Sp. z o.o. – Pekao Faktoring***
The Company, besides the full range of factoring services (recourse and non-recourse factoring), offers additional services, such as collecting information on debtors' standing, payments collection, debt recovery, settlements accounting and monitoring of payments on an ongoing basis. Additionally, the Company offers settlement of mass transactions, financial advisory and consulting services regarding selection of business financing methods, as well as extending factoring-related loans. The Company co-operates with Bank Pekao S.A. in developing new sales channels and enhancing sales through the existing ones.

The Company is ranked the fifth on the Polish factoring market, with 8.7% of market share.

## Transactional advisory

***Pekao Investment Banking S.A. – PIB***
PIB operates as brokerage house, focusing on institutional and corporate clients service. The scope of services provided by PIB include in particular receiving and transferring financial instruments to buy or sell orders, execution of these orders on the account of orders provider, offering financial instruments, advisory for corporates within capital structure, corporate strategy or other issues related to such structure or strategy. PIB offers also advisory and other services related to mergers, demergers and corporates acquisition.

PIB acts also as an animator both on equities as well as on derivative instruments market, being one of the most active animators. As at the end of 2016, PIB was the animator for 22 companies.

In 2016, PIB acted as an intermediary entity in tender offer for the sale of the shares and in obligatory redemption of shares of two companies listed on the WSE, acted as a global coordinator and serves as a bookrunner for shares of non-banking sector company, which was the largest transaction of this type on the WSE in 2016 and successfully completed the first IPO of the company on the WSE.

PIB acted as entity offering retail bonds issued by a leading developer of commercial real estate in Poland (eight series of bonds were issued for retail investors and one series for institutions, which were introduced to trading on the regulated market). PIB successfully provided its advisory in processes of disposal/acquiring of the companies (including, among others, disposal of a company operating in waste utilization sector, and acquiring of a company operating in retail sector), in process of strategic options review, acquiring a strategic investor for a company from financial services sector and acquisition of companies (among others from packaging industry).

## Other financial services

***Centrum Bankowości Bezpośredniej Sp. z o.o. – CBB***
CBB offers services of a financial intermediary, as well as comprehensive services through alternative channels of communication for clients from non-banking sector.

CBB supports Bank Pekao S.A., as a major customer, in the use of online banking, cards and call center products. The company in its operations serves customers through alternative channels of communication, including, above all, by phone and mailing (both traditional way and electronic). The main channel of communication are the phone calls – in 2016, CBB handled 15.6 million calls (an increase of 23% compared to 2015).

The company runs with the Bank a number of projects aimed at developing communication with customers of Bank Pekao S.A. using mobile banking.

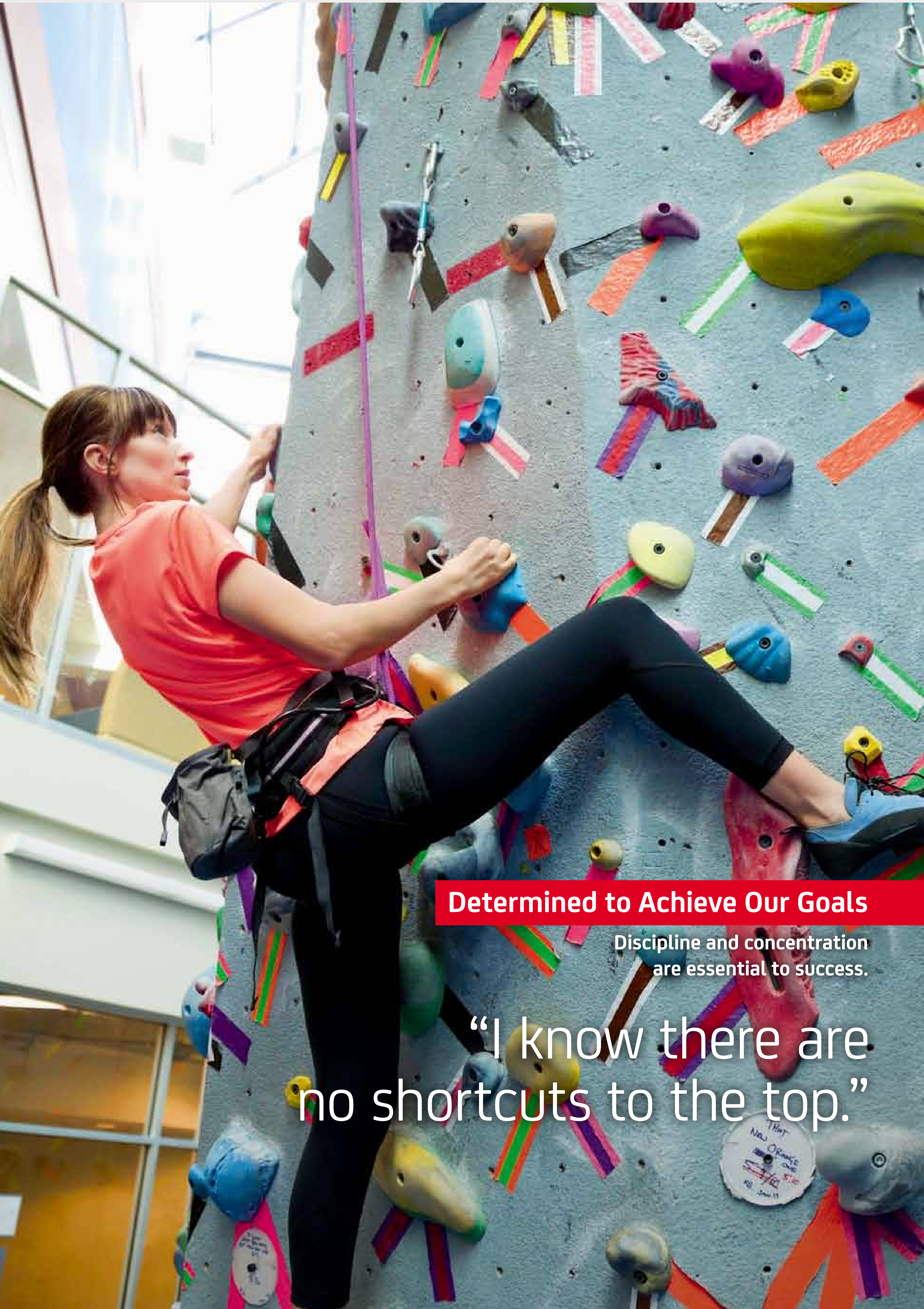
***Pekao Financial Services Sp. o.o. – PFS***
PFS outsourcing services to financial institutions in the field of operational solutions and technology, use of fund participants, as well as independent distribution of the funds. Operational and technological solutions are focused on providing customers with services of the highest quality and safety. PFS specialises in registers of participants in mutual and pension funds.

Among the clients served by the PFS there are companies with established market position. As at the end of December 2016, the company maintained its leading position in the OFE funds serving using the services of external Transfer Agent.

***Centrum Kart S.A. – CK S.A.***
The Company renders comprehensive services that include, among others, maintenance of payment card management systems, authorization of transactions and card personalization.

In 2016, CK S.A. continued realization of important IT projects allowing the extension of a range of products offered by Bank Pekao S.A.

The main projects realized in 2016 included the implementation of mobile phones top-ups services in two distribution channels: the Pekao24 and the PeoPay application as well as development in the area of personalized image of payment cards.



## Determined to Achieve Our Goals

**Discipline and concentration are essential to success.**

"I know there are no shortcuts to the top."

# Statement of Financial Position and Financial Results

# Statement of Financial Position and Financial Results

## Statement of Financial Position and Financial Results

Consolidated income statement containing cumulated items for the period from 1 January to 31 December, 2016 and 2015 respectively is presented in the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

The Report on activities of Bank Pekao S.A. Group for 2016 includes statement of financial position in a short form and income statement in a presentation form as well as the key, selected items from these statements are discussed.

**The Bank's share in transaction of acquisition of Visa Europe Ltd. by Visa Inc.**

In accordance with an agreement signed between Visa Europe Ltd. and Visa Inc. on November 2, 2015, on takeover of Visa Europe Ltd. by Visa Inc., in the second quarter of 2016, Bank Pekao S.A. as one of the beneficiaries of the transaction received payment resulting from the transaction settlement in the amount of EUR 43.6 million and 15,818 preferred shares series C of Visa Inc. After three years of completion of the transaction, the Bank will receive deferred payment in cash.

More detailed information on the Bank's share in transaction of acquisition of Visa Europe Ltd. by Visa Inc. is included in the Note 31 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

## Structure of the consolidated statement of financial position – short form

The balance sheet of Bank Pekao S.A. determines the amount of total assets in balance sheet and the structure of the assets and liabilities of the Group. As at the end of December 2016, the total assets of Bank Pekao S.A. constitutes 98.1% of the total assets of the whole Group.

The table below presents the Group's statement of financial position – short form.

| | 31.12.2016 | | 31.12.2015 | | |
|---|---|---|---|---|---|
| ASSETS | PLN MILLION | STRUCTURE | PLN MILLION | STRUCTURE | CHANGE |
| Cash and due from Central Bank | 5,872.9 | 3.4% | 7,881.6 | 4.7% | (25.5%) |
| Loans and advances to banks (*) | 3,258.5 | 1.9% | 7,319.0 | 4.3% | (55.5%) |
| Loans and advances to customers (**) | 122,663.2 | 70.4% | 117,299.4 | 69.5% | 4.6% |
| Reverse repo transactions | – | x | 4,755.5 | 2.8% | x |
| Securities (***) | | 35,853.1 | 22,308.5 | 13.2% | 60.7% |
| Investments in associates | 136.2 | 0.1% | 149.0 | 0.1% | (8.6%) |
| Property, plant and equipment and intangible assets | 2,019.1 | 1.2% | 2,097.4 | 1.2% | (3.7%) |
| Other assets | 4,411.9 | 2.4% | 6,975.2 | 4.2% | (36.7%) |
| **Total assets** | **174,214.9** | **100.0%** | **168,785.6** | **100.0%** | **3.2%** |

(*) Including net investments in financial leases to banks.
(**) Including debt securities eligible for rediscounting at Central Bank and net investments in financial leases to customers.
(***) Including financial assets held for trading and other financial instruments at fair value through profit and loss.

| | 31.12.2016 | | 31.12.2015 | | |
|---|---|---|---|---|---|
| EQUITY AND LIABILITIES | PLN MILLION | STRUCTURE | PLN MILLION | STRUCTURE | CHANGE |
| Amounts due to Central Bank | 6.1 | 0.0% | 0.9 | 0.0% | > 100% |
| Amounts due to other banks | 4,823.4 | 2.8% | 5,958.4 | 3.5% | (19.0%) |
| Amounts due to customers | 136,379.7 | 78.3% | 124,398.8 | 73.7% | 9.6% |
| Debt securities issued | 1,523.0 | 0.9% | 2,903.2 | 1.7% | (47.5%) |
| Repo transactions | 1,436.2 | 0.8% | 4,468.9 | 2.6% | (67.9%) |
| Other liabilities | 7,134.6 | 4.0% | 7,631.2 | 4.5% | (6.5%) |
| Total equity, including | 22,911.9 | 13.2% | 23,424.2 | 13.9% | (2.2%) |
| non-controlling interests | 14.9 | 0.0% | 16.0 | 0.0% | (6.9%) |
| **Total equity and liabilities** | **174,214.9** | **100.0%** | **168,785.6** | **100.0%** | **3.2%** |

## Assets

### Changes in the structure of assets

Loans and advances to customers and securities represent items of the largest value under assets. As at the end of 2016, they accounted for 70.4% and 20.6% of the total assets respectively in comparison with 69.5% and 13.2% respectively as at the end of 2015.

*Cash and due from Central Bank*

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| **Cash and due from Central Bank, including:** | **5,872.9** | **7,881.6** | **(25.5%)** |
| Cash | 2,639.5 | 2,951.4 | (10.6%) |
| Current account at Central Bank | 1,713.3 | 4,930.0 | (65.2%) |
| Other | 1,520.1 | 0.2 | > 100% |

### Customers' Financing

*Customer structure of loans and advances*

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| **Loans and advances at nominal value (*)** | **127,421.6** | **122,363.1** | **4.1%** |
| Loans (**) | 115,020.0 | 110,026.2 | 4.5% |
| Retail | 58,109.9 | 53,944.6 | 7.7% |
| Corporate | 56,910.1 | 56,081.6 | 1.5% |
| Non- quoted securities | 12,401.6 | 12,336.9 | 0.5% |
| Other (***) | 647.0 | 534.5 | 21.0% |
| Nominal value adjustment | 304.2 | 244.1 | 24.6% |
| Impairment losses | (5,709.6) | (5,842.3) | (2.3%) |
| **Total net receivables** | **122,663.2** | **117,299.4** | **4.6%** |
| **Securities issued by non-monetary entities (****)** | **882.7** | **892.3** | **(1.1%)** |
| Reverse repo transactions | – | 4,753.2 | x |
| **Total customers' financing (*****)** | **128,304.3** | **128,008.6** | **0.2%** |
| **Total customers' financing excluding reverse repo transactions** | **128,304.3** | **123,255.4** | **4.1%** |

(*) Excluding reverse repo transactions.
(**) Including debt securities eligible for rediscounting at Central Bank and net investments in financial leases to customers.
(***) Including interest and receivables in transit.
(****) Securities issued by non-monetary entities being loans equivalents.
(*****) Total customers' financing includes loans and advances at nominal value, securities issued by non-monetary entities and reverse repo transactions.

As at the end of December 2016, loans and advances at nominal value and securities issued by non-monetary entities amounted to PLN 128,304.3 million, an increase of PLN 5,048.9 million, i.e. 4.1% in comparison to the end of December 2015 with significant growth in key strategic areas.

As at the end of December 2016, the volume of retail loans amounted to PLN 58,109.9 million, an increase of PLN 4,165.3 million, i.e. 7.7% in comparison to the end of December 2015.

The volume of corporate loans, non-quoted securities and securities issued by non-monetary entities amounted to PLN 70,194.4 million as at the end of December 2016, an increase of PLN 883.6 million, i.e. 1.3% as compared to the end of December 2015.

As at the end of December 2016, there were no reverse repo transactions. As of December 31, 2015, reverse repo transactions amounted to PLN 4,753.2 million.

# Statement of Financial Position and Financial Results

### *Receivables and impairment losses*

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| **Gross receivables (*)** | **127,815.4** | **122,677.8** | **4.2%** |
| Not impaired | 120,154.8 | 114,705.8 | 4.8% |
| Impaired | 7,660.6 | 7,972.0 | (3.9%) |
| Impairment losses | (5,709.6) | (5,842.3) | (2.3%) |
| Interest | 557.4 | 463.9 | 20.2% |
| **Total net receivables** | **122,663.2** | **117,299.4** | **4.6%** |

(*) Including debt securities eligible for rediscounting at Central Bank, net investments in financial leases to customers, non-quoted securities and excluding reverse repo transactions.

As of December 31, 2016, the ratio of impaired receivables to total receivables excluding reverse repo transactions amounted to 6.0% as compared to 6.5% as at the end of December 2015.

Impairment losses as at the end of December 2016 amounted to PLN 5,709.6 million.

### *Loans and advances to customers by currency (*)*

| | 31.12.2016 | | 31.12.2015 | | |
|---|---|---|---|---|---|
| | PLN MILLION | STRUCTURE | PLN MILLION | STRUCTURE | CHANGE |
| Denominated in PLN | 103,891.3 | 80.9% | 100,977.2 | 82.0% | 2.9% |
| Denominated in foreign currencies (**) | 24,481.5 | 19.1% | 22,164.5 | 18.0% | 10.5% |
| **Total** | **128,372.8** | **100.0%** | **123,141.7** | **100.0%** | **4.2%** |
| Impairment losses | (5,709.6) | x | (5,842.3) | x | (2.3%) |
| **Total net** | **122,663.2** | **x** | **117,299.4** | **x** | **4.6%** |

(*) Including interest and receivables in transit and excluding reverse repo transactions.
(**) Including indexed loans.

The currency structure of loans and advances to customers is dominated by amounts expressed in the Polish złoty; as at the end of December 2016, their share was 80.9%. The largest portion of foreign currency loans and advances to customers were represented by those denominated in EUR (64.9%), CHF (19.4%) and USD (14.9%).

### *Loans and advances to customers by contractual maturities (*)*

| | 31.12.2016 | | 31.12.2015 | | |
|---|---|---|---|---|---|
| | PLN MILLION | STRUCTURE | PLN MILLION | STRUCTURE | CHANGE |
| Current and up to 1 month | 15,047.9 | 11.7% | 12,651.3 | 10.3% | 18.9% |
| 1 to 3 months | 3,271.3 | 2.5% | 4,363.2 | 3.5% | (25.0%) |
| 3 months to 1 year | 13,330.4 | 10.4% | 13,375.8 | 10.9% | (0.3%) |
| 1 to 5 years | 39,666.9 | 30.9% | 39,562.3 | 32.1% | 0.3% |
| Over 5 years | 56,409.3 | 43.9% | 52,654.6 | 42.8% | 7.1% |
| Other | 647.0 | 0.6% | 534.5 | 0.4% | 21.0% |
| **Total** | **128,372.8** | **100.0%** | **123,141.7** | **100.0%** | **4.2%** |
| Impairment losses | (5,709.6) | x | (5,842.3) | x | (2.3%) |
| **Total net** | **122,663.2** | **x** | **117,299.4** | **x** | **4.6%** |

(*) Including interest and receivables in transit and excluding reverse repo transactions.

As at the end of December 2016, loans and advances with maturity over 5 years represents 43.9% of total loans and advances (mainly attributed to mortgage loans and receivables for which the maturity date already passed).

Information on loan concentration is included in the Note 28 and 29 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on December 31, 2016.

### *Credit exposures towards Ukraine*

In 2016, the Group exposure towards Ukraine in the form of interbank placements were repaid in full.

As at December 31, 2016, the net balance sheet value of remaining exposures towards Ukraine amounted to PLN 111 million (which constitutes 0.1% of total Group exposures), less by PLN 481 million in comparison to the end of December 2015.

## Liabilities

### Changes in the structure of liabilities

Amounts due to customers were the main item under the Group's liabilities and equity. As at the end of 2016, amounts due to customers and debt securities issued totaled PLN 137,902.7 million, and their share in the total assets was 79.2%, compared with 75.4% as at the end of 2015. The share of total shareholder's equity in the total assets was 13.2% as at the end of 2016, compared with 13.9% as at the end of 2015.

*External sources of financing*

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| Amounts due to Central Bank | 6.1 | 0.9 | > 100% |
| Amounts due to other banks | 4,823.4 | 5,958.4 | (19.0%) |
| Amounts due to customers | 136,379.7 | 124,398.8 | 9.6% |
| Debt securities issued | 1,523.0 | 2,903.2 | (47.5%) |
| Repo transactions | 1,436.2 | 4,468.9 | (67.9%) |
| **Total external sources of financing** | **144,168.4** | **137,730.2** | **4.7%** |

The deposit base is widely diversified and the deposits sourced from retail and corporate customers. In addition, the Group uses also funds borrowed on the interbank market. The Group is not dependent on any single customer nor group of customers.

As at the end of 2016, the geographical structure of deposits acquired through the Bank's domestic branches was as follows:

| REGION | % OF TOTAL DEPOSITS |
|---|---|
| Warszawski | 29.4% |
| Mazowiecki | 20.6% |
| Małopolski | 10.4% |
| Centralny | 9.5% |
| Południowo-Wschodni | 8.6% |
| Wielkopolski | 4.7% |
| Pomorski | 4.3% |
| Śląski | 4.3% |
| Dolnośląski | 4.1% |
| Zachodni | 4.1% |
| **Total** | **100.0%** |

*Total customer savings*

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| **Corporate deposits** | **65,764.5** | **60,738.8** | **8.3%** |
| Non-financial entities | 48,932.4 | 47,225.8 | 3.6% |
| Non-banking financial entities | 9,024.7 | 7,903.2 | 14.2% |
| Budget entities | 7,807.4 | 5,609.8 | 39.2% |
| **Retail deposits** | **70,183.2** | **63,254.4** | **11.0%** |
| Other (*) | 432.0 | 405.6 | 6.5% |
| **Amounts due to customers (**)** | **136,379.7** | **124,398.8** | **9.6%** |
| **Debt securities issued, of which** | **1,523.0** | **2,903.2** | **(47.5%)** |
| Structured Certificates of Deposit (SCD) | 168.9 | 257.7 | (34.5%) |
| Certificates of Deposit | 130.0 | 1,393.1 | (90.7%) |
| Pekao Bank Hipoteczny S.A. covered bonds | 1,214.8 | 1,227.4 | (1.0%) |
| Interest | 9.3 | 25.0 | (62.8%) |
| **Amounts due to customers and debt securities issued, total (**)** | **137,902.7** | **127,302.0** | **8.3%** |
| Repo transactions | 1,436.2 | 4,468.9 | (67.9%) |
| **Investment funds of Pioneer Pekao TFI** | **16,793.9** | **16,702.5** | **0.5%** |
| Bond and money market funds | 12,108.2 | 11,366.4 | 6.5% |
| Balanced funds | 2,418.1 | 2,780.5 | (13.0%) |
| Equity funds | 2,267.6 | 2,555.6 | (11.3%) |
| including distributed through the Group's network | 16,470.2 | 16,363.6 | 0.7% |

(*) Other item includes interest and funds in transit.
(**) Excluding repo transactions.

As at the end of December 2016, the total amounts due to the Group's customers and debt securities issued amounted to PLN 137,902.7 million, an increase of PLN 10,600.7 million, i.e. 8.3% in comparison to the end of December 2015.

The total volume of retail customers deposits, Structured Certificates of Deposit and other amounted to PLN 70,724.8 million as at the end of December 2016, an increase of PLN 6,859.5 million, i.e. 10.7% in comparison to the end of December 2015.

# Statement of Financial Position and Financial Results

The total volume of corporate deposits, Certificates of Deposit, Pekao Bank Hipoteczny S.A. covered bonds, interest and other amounted to PLN 67,177.9 million as at the end of December 2016, an increase of PLN 3,741.2 million, i.e. 5.9% as compared to the end of December 2015 while continuing selective pricing approach and focus on securing liquidity needs of the Group.

Repo transactions amounted to PLN 1,436.2 million as at the end of December 2016, a decrease by PLN 3,032.7 million, i.e. 67.9% in comparison to the end of December 2015.

The value of net assets of investment funds managed by Pioneer Pekao TFI S.A. amounted to PLN 16,793.9 million as at the end of December 2016, an increase of PLN 91.4 million, i.e. 0.5% in comparison to the end of December 2015.

***Amounts due to customers by currency (*)***

| | 31.12.2016 | | 31.12.2015 | | |
|---|---|---|---|---|---|
| | PLN MILLION | STRUCTURE | PLN MILLION | STRUCTURE | CHANGE |
| Denominated in PLN | 113,654.0 | 83.3% | 102,079.2 | 82.1% | 11.3% |
| Denominated in foreign currencies | 22,725.7 | 16.7% | 22,319.6 | 17.9% | 1.8% |
| **Total** | **136,379.7** | **100.0%** | **124,398.8** | **100.0%** | **9.6%** |

(*) Including interest and amounts due in transit and excluding repo transactions.

The bulk of the amounts due to customers are denominated in the Polish currency and its share as at the end of December 2016 amounted to 83.3%. The majority of amounts due to customers denominated in foreign currencies were in EUR (59.0%) and USD (32.9%).

***Amounts due to customers by contractual maturities (*)***

| | 31.12.2016 | | 31.12.2015 | | |
|---|---|---|---|---|---|
| | PLN MILLION | STRUCTURE | PLN MILLION | STRUCTURE | CHANGE |
| Current accounts and overnight deposits | 79,090.1 | 58.2% | 67,564.5 | 54.5% | 17.1% |
| Term deposits | 56,857.6 | 41.8% | 56,428.7 | 45.5% | 0.8% |
| **Total deposits** | **135,947.7** | **100.0%** | **123,993.2** | **100.0%** | **9.6%** |
| Interest accrued | 198.5 | x | 219.0 | x | (9.4%) |
| Funds in transit | 233.5 | x | 186.6 | x | 25.1% |
| **Total** | **136,379.7** | **x** | **124,398.8** | **x** | **9.6%** |

(*) Excluding repo transactions.

## Off–balance sheet items

### Statement of Off-balance sheet items

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| Contingent liabilities granted and received | 54,592.2 | 56,968.3 | (4.2%) |
| Liabilities granted: | 43,564.2 | 45,008.7 | (3.2%) |
| financial | 32,304.3 | 30,935.9 | 4.4% |
| guarantees | 11,259.9 | 14,072.8 | (20.0%) |
| Liabilities received: | 11,028.0 | 11,959.6 | (7.8%) |
| financial | 209.1 | 285.1 | (26.7%) |
| guarantees | 10,818.9 | 11,674.5 | (7.3%) |
| Derivative financial instruments | 196,569.9 | 226,692.6 | (13.3%) |
| interest rate transactions | 96,486.1 | 133,104.3 | (27.5%) |
| transactions in foreign currency and in gold | 99,253.8 | 92,934.2 | 6.8% |
| transactions based on commodities and equity securities | 830.0 | 654.1 | 26.9% |
| **Total off-balance sheet items** | **251,162.1** | **283,660.9** | **(11.5%)** |

More detailed information on off-balance-sheet items is included in the Notes 27 and 48 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

## The structure of the net profit

The structure of the net profit of the Group is presented in the table below:

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| **Net profit of Bank Pekao S.A.** | **2,278.4** | **2,290.4** | **(0.5%)** |
| **Entities consolidated under full method** | | | |
| Pekao Leasing Sp. z o.o. | 40.0 | 53.9 | (25.8%) |
| Centralny Dom Maklerski Pekao S.A. | 25.3 | 44.2 | (42.8%) |
| Pekao Investment Banking S.A. | 24.4 | 6.8 | > 100% |
| Pekao Faktoring Sp. z o.o. | 9.7 | 9.3 | 4.3% |
| Pekao Bank Hipoteczny S.A. | 8.7 | 5.0 | 74.0% |
| Pekao Financial Services Sp. z o.o. | 7.5 | 8.0 | (6.3%) |
| Centrum Bankowości Bezpośredniej Sp. z o.o. | 3.4 | 2.7 | 25.9% |
| Pekao Pioneer PTE S.A. | 1.4 | 2.9 | (51.7%) |
| Pekao Leasing Holding S.A. w likwidacji (*) | 0.4 | 61.4 | (99.3%) |
| Centrum Kart S.A. | 0.3 | 0.6 | (50.0%) |
| Pekao Fundusz Kapitałowy Sp. z o.o. | 0.3 | 0.2 | 50.0% |
| FPB "Media" Sp. z o.o. | (0.2) | 0.2 | x |
| Pekao Property S.A. | (0.3) | (0.2) | 50.0% |
| **Entities valued under the equity method** | | | |
| Pioneer Pekao Investment Management S.A. | 36.4 | 44.6 | (18.4%) |
| Dom Inwestycyjny Xelion Sp. z o.o. | 2.2 | 2.0 | 10.0% |
| Krajowa Izba Rozliczeniowa S.A. (**) | – | 5.5 | x |
| **Exclusions and consolidation adjustments (***)** | **(158.6)** | **(245.0)** | **(35.3%)** |
| **Net profit of the Group attributable to equity holders of the Bank** | **2,279.3** | **2,292.5** | **(0.6%)** |

(*) On September 20, 2016 Pekao Leasing Holding S.A. w likwidacji was removed from the National Court Register. The result of Pekao Leasing Holding S.A. w likwidacji for 2015 includes mainly the dividend received from Pekao Leasing Sp. z o.o.

(**) Krajowa Izba Rozliczeniowa S.A. was consolidated till June 30, 2015. On July 15, 2015 the Bank sold 3,125 shares of Krajowa Izba Rozliczeniowa S.A. As a result of the transaction, the Bank's share in the share capital and the votes in the General Meeting of the Company was reduced from 34.44% to 5.74%.

(***)Includes, among others, transactions within the Group (including dividends from subsidiaries for the previous year) and net profit attributable to non-controlling interest.

# Statement of Financial Position and Financial Results

## The results of Bank Pekao S.A.

The main items from the Bank's income statement in presentation form are as follows: (in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Net interest income | 4,266.9 | 4,039.6 | 5.6% |
| Dividend income | 132.8 | 210.6 | (36.9%) |
| Total net interest income and dividend income | 4,399.7 | 4,250.2 | 3.5% |
| Net non-interest income | 2,636.3 | 2,541.8 | 3.7% |
| **Operating income** | **7,036.0** | **6,792.0** | **3.6%** |
| **Operating costs** | **(2,991.4)** | **(2,992.6)** | **(0.0%)** |
| **Gross operating profit** | **4,044.6** | **3,799.4** | **6.5%** |
| Net impairment losses on loans and off-balance sheet commitments | (491.4) | (514.0) | (4.4%) |
| **Net operating profit** | **3,553.2** | **3,285.4** | **8.2%** |
| Net result on other provisions | (15.5) | (28.6) | (45.8%) |
| Guarantee funds charges | (260.3) | (273.1) | (4.7%) |
| One-off charges in favour of the Bank Guarantee Fund and contribution to Borrowers Support Fund (*) | (16.6) | (256.0) | (93.5%) |
| Tax on certain financial institutions | (449.5) | – | x |
| Net result on investment activities | 51.9 | 63.9 | (18.8%) |
| **Profit before tax** | **2,863.2** | **2,791.6** | **2.6%** |
| **Net profit** | **2,278.4** | **2,290.4** | **(0.5%)** |

(*) One-off charges in favour of the Bank Guarantee Fund and contribution to Borrowers Support Fund include:
– in 2016 – charge related to bankruptcy of Bank Spółdzielczy in Nadarzyn,
– in 2015 – charge related to bankruptcy of SBRiR in Wołomin and contribution to Borrowers Support Fund.

In 2016, the Bank's net profit amounted to PLN 2,278.4 million, a decrease of PLN 12.0 million, i.e. 0.5% in comparison to 2015.

Underlying net profit of Bank Pekao S.A. i.e. excluding net impact of significant extraordinary charges and one-off non-recurring items in 2016 would amount to PLN 2,366.9 million and would be higher by PLN 187.1 million, i.e. 8.6% than comparable net profit achieved in 2015.

The main Bank's financial information are as follows: (in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| **STATEMENT OF FINANCIAL POSITION – SELECTED ITEMS** | | | |
| Loans and advances at nominal value (*) | 123,660.5 | 118,662.9 | 4.2% |
| Securities issued by non-monetary entities (**) | 882.7 | 892.3 | (1.1%) |
| Reverse repo transactions | – | 4,753.2 | x |
| Amounts due to customers | 136,629.9 | 124,788.0 | 9.5% |
| Structured Certificates of Deposit | 168.9 | 257.7 | (34.5%) |
| Certificates of Deposit | 130.0 | 1,393.1 | (90.7%) |
| Repo transactions | 1,436.2 | 4,468.9 | (67.9%) |
| Total assets | 170,988.9 | 165,760.7 | 3.2% |
| Investment funds distributed through the Bank's network | 15,583.6 | 15,388.9 | 1.3% |
| **SELECTED RATIOS** | | | |
| Impaired receivables to total receivables in %(***) | 5.8% | 6.3% | (0.5) p.p. |
| TCR (Basel III) in % | 18.2% | 18.2% | 0.0 p.p. |

(*) Including loans and non-quoted securities.
(**) Securities issued by non-monetary entities being loans equivalents.
(***) Excluding reverse repo transactions.

As at the end of December 2016, loans and advances at nominal value and securities issued by non-monetary entities amounted to PLN 124,543.2 million, an increase of PLN 4,988.0 million, i.e. 4.2% in comparison to the end of December 2015. As at the end of December 2016, the volume of retail loans amounted to PLN 57,176.3 million and the volume of corporate loans, non-quoted securities and securities issued by non-monetary entities amounted to PLN 67,366.9 million.

As at the end of December 2016, the amounts due to the customers, Structured Certificates of Deposit and Certificates of Deposit amounted to PLN 136,928.8 million, an increase of PLN 10,490.0 million, i.e. 8.3% in comparison to the end of December 2015 with improved structure of liabilities thanks to growth of share of retail customers deposits.

The value of net assets of investment funds managed by Pioneer Pekao TFI S.A. distributed through the Bank's network amounted to PLN 15,583.6 million as at the end of December 2016, an increase of PLN 194.7 million, i.e. 1.3% in comparison to the end of December 2015.

### Results of the Bank's major related entities

***Pioneer Pekao Investment Management S.A. – PPIM***
In 2016, consolidated net profit of PPIM amounted to PLN 74.3 million compared with PLN 91.1 million in 2015. The Bank's share in the company's profit was PLN 36.4 million. The result of 2016 was influenced by situation on capital markets and change of customers' preferences in terms of the level of acceptable risk.

***Pekao Leasing Sp. z o.o. – Pekao Leasing***
In 2016, Pekao Leasing reported a net profit of PLN 40.0 million compared with PLN 53.9 million in 2015. Pekao Leasing result for 2015 included positive impact of VAT related settlements.

***Centralny Dom Maklerski Pekao S.A. – CDM***
In 2016, net profit of CDM amounted to PLN 25.3 million compared with PLN 44.2 million profit earned in 2015, influenced by situation on capital markets, lower turnover on the WSE and lower revenues on mutual funds.

***Pekao Investment Banking S.A. – PIB***
In 2016, PIB reported net profit of PLN 24.4 million compared with PLN 6.8 million in 2015 mainly thanks to completion of several transactions within the scope of advisory in processes of acquiring and disposal of companies, shares and bonds offering as well as realization on behalf of a customer the tender offer for the sale of shares of the company listed on the WSE.

***Pekao Faktoring Sp. z o.o. – Pekao Faktoring***
In 2016, Pekao Faktoring reported a net profit of PLN 9.7 million and it was at a similar level to the net profit achieved in 2015.

***Pekao Bank Hipoteczny S.A. – Pekao Bank Hipoteczny***
In 2016, Pekao Bank Hipoteczny reported a net profit of PLN 8.7 million compared with PLN 5.0 million in 2015. The 2015 results was under negative influence of external conditions, higher charges in favour of the BFG (including the contribution to the BFG for the purpose of payments of the funds guaranteed to the depositors of the bankrupt Spółdzielczy Bank Rzemiosła i Rolnictwa in Wołomin) and the cost of provision for Borrowers Support Fund.

***Pekao Financial Services Sp. z o.o. – PFS***
In 2016, PFS reported a net profit in the amount of PLN 7.5 million compared with PLN 8.0 million in 2015.

## The consolidated income statement – presentation form

Net profit of Bank Pekao S.A. Group attributable to equity holders for 2016 amounted to PLN 2,279.3 million after tax on certain financial institutions in the amount of PLN 449.5 million and the extraordinary one-off charge of PLN 16.6 million to the Bank Guarantee Fund in relation to bankruptcy of Bank Spółdzielczy in Nadarzyn. Strong contribution to the results was brought by a substantial growth of loan and deposit volumes in key strategic areas, further progress in cost optimization and lower cost of risk, also thanks to successful recoveries from vindication activity.

Underlying net profit of Bank Pekao S.A. Group i.e. excluding net impact of significant extraordinary charges and one-off non-recurring items in 2016 would amount to PLN 2,367.8 million and would be higher by PLN 185.9 million, i.e. 8.5% than comparable net profit achieved in 2015.

Thanks to the effective commercial activity of the Group in 2016 a significant growth in loan volumes was reported in the area of retail loans (an increase of 7.7% year on year) and a 1.3% year on year growth in the area of corporate loans and non-quoted securities. Such increase in lending was financed by higher volumes of retail deposits growing 11.0% year on year.

The solid liquidity structure of Bank Pekao S.A. Group is reflected by net loans to deposits ratio at 88.9% as at the end of December 2016. This, together with high equity level reflected by total capital ratio (Basel III) amounting to 17.6%, enables for further sound and stable development of the Group's activities.

# Statement of Financial Position and Financial Results

The consolidated income statement – presentation form

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Net interest income | 4,382.0 | 4,166.6 | 5.2% |
| Dividend income and income from equity investments | 55.4 | 65.7 | (15.7%) |
| **Total net interest income, dividend income and other income from equity investments** | **4,437.4** | **4,232.3** | **4.8%** |
| Net fee and commission income | 1,959.0 | 2,005.5 | (2.3%) |
| Trading result | 763.1 | 662.7 | 15.2% |
| Net other operating income and expenses | 187.7 | 158.1 | 18.7% |
| **Net non-interest income** | **2,909.8** | **2,826.3** | **3.0%** |
| **Operating income** | **7,347.2** | **7,058.6** | **4.1%** |
| **Operating costs** | **(3,211.9)** | **(3,219.7)** | **(0.2%)** |
| **Gross operating profit** | **4,135.3** | **3,838.9** | **7.7%** |
| Net impairment losses on loans and off-balance sheet commitments | (500.6) | (517.5) | (3.3%) |
| Net operating profit | 3,634.7 | 3,321.4 | 9.4% |
| Net result on other provisions | (14.5) | (28.8) | (49.7%) |
| **Guarantee funds charges** | **(262.9)** | **(274.4)** | **(4.2%)** |
| One-off charges in favour of the Bank Guarantee Fund and contribution to Borrowers Support Fund (*) | (16.6) | (260.5) | (93.6%) |
| **Tax on certain financial institutions** | **(449.5)** | **–** | **x** |
| **Net result on investment activities** | **5.3** | **73.4** | **(92.8%)** |
| Profit before tax | 2,896.5 | 2,831.1 | 2.3% |
| **Income tax expense** | **(616.7)** | **(537.6)** | **14.7%** |
| **Net profit** | **2,279.8** | **2,293.5** | **(0.6%)** |
| Attributable to equity holders of the Bank | 2,279.3 | 2,292.5 | (0.6%) |
| Attributable to non-controlling interest | 0.5 | 1.0 | (50.0%) |

(*) One-off charges in favour of the Bank Guarantee Fund and contribution to Borrowers Support Fund include:
– in 2016 – charge related to bankruptcy of Bank Spółdzielczy in Nadarzyn,
– in 2015 – charge related to bankruptcy of SBRiR in Wołomin and contribution to Borrowers Support Fund.

## Operating income

In 2016, the Group's operating income amounted to PLN 7,347.2 million, an increase of PLN 288.6 million, i.e. 4.1% in comparison to 2015 thanks to both higher net interest income, dividend income and income from equity investment and higher net non-interest income.

### Total net interest income, dividend income and income from equity investments

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Interest income | 5,448.5 | 5,456.4 | (0.1%) |
| Interest expense | (1,066.5) | (1,289.8) | (17.3%) |
| **Net interest income** | **4,382.0** | **4,166.6** | **5.2%** |
| Dividend income | 16.8 | 13.6 | 23.5% |
| Income from equity investments | 38.6 | 52.1 | (25.9%) |
| **Total net interest income, dividend income and income from equity investments** | **4,437.4** | **4,232.3** | **4.8%** |

Total net interest income, dividend income and income from equity investments in 2016 amounted to PLN 4,437.4 million and was higher by PLN 205.1 million, i.e. 4.8% compared to 2015 driven by higher volumes.

### Net non-interest income

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Fee and commission income | 2,252.1 | 2,388.5 | (5.7%) |
| Fee and commission expense | (293.1) | (383.0) | (23.5%) |
| **Net fee and commission income** | **1,959.0** | **2,005.5** | **(2.3%)** |
| Trading result | 763.1 | 662.7 | 15.2% |
| of which gains on disposal of AFS assets | 276.5 | 229.6 | 20.4% |
| Net other operating income and expense | 187.7 | 158.1 | 18.7% |
| **Net non-interest income** | **2,909.8** | **2,826.3** | **3.0%** |

Net non-interest income in 2016 amounted to PLN 2,909.8 million, higher by PLN 83.5 million, i.e. 3.0% in comparison with 2015 thanks to higher trading result supported also by gains on settlement of the transaction of the acquisition of Visa Europe Limited by Visa Inc. and by higher net other operating income supported by disposal of loans, with net fee and commission income lower by 2.3% compared to 2015 mainly due to some pressure observed on capital market related fees.

The Group's net fee and commission income in 2016 amounted to PLN 1,959.0 million and was lower by PLN 46.5 million, i.e. 2.3% in comparison with 2015 mainly due to lower net fee and commission income on mutual funds.

The table below presents the Group's net fee and commission income divided according to the main areas of the activity.

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| **Net fee and commission income** | **1,959.0** | **2,005.5** | **(2.3%)** |
| on loans | 524.5 | 486.2 | 7.9% |
| on cards | 380.2 | 370.7 | 2.6% |
| on mutual funds | 248.1 | 298.0 | (16.7%) |
| other | 806.2 | 850.6 | (5.2%) |

## Operating costs

The operating costs amounted to PLN 3,211.9 million in 2016. They were lower by PLN 7.8 million, i.e. 0.2% as compared with 2015.

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Personnel expenses | (1,896.8) | (1,908.5) | (0.6%) |
| Other administrative expenses | (974.2) | (979.7) | (0.6%) |
| Depreciation and amortization | (340.9) | (331.5) | 2.8% |
| **Operating costs** | **(3,211.9)** | **(3,219.7)** | **(0.2%)** |

In 2016, cost / income ratio amounted to 43.7% in comparison with 45.6% in 2015.

As of December 31, 2016, the Group employed 17,757 employees (in the Bank and the companies consolidated under full consolidation method) as compared to 18,327 employees as at the end of December 2015.

As of December 31, 2016, the Bank employed 15,882 employees as compared to 16,387 employees as at the end of December 2015.

### Guarantee funds charges

Guarantee funds charges in 2016, amounted to PLN 262.9 million, a decrease of PLN 11.5 million, i.e. 4.2% in comparison with 2015.

### Tax on certain financial institutions

On February 1, 2016 tax on certain financial institutions under the Act on tax on certain financial institutions was introduced. In 2016, it amounted to PLN 449.5 million.

### One-off charges related to bankruptcy of Bank Spółdzielczy in Nadarzyn

In 2016, the Group additionally incurred one-off charges in the amount of PLN 16.6 million related to the contribution to the BGF for the purpose of payments of the funds guaranteed to the depositors of the bankrupt Bank Spółdzielczy in Nadarzyn.

### Net impairment losses

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Impairment losses on loans | (401.4) | (500.3) | (19.8%) |
| Impairment losses on off-balance sheet commitments | (99.2) | (17.2) | > 100% |
| **Total** | **(500.6)** | **(517.5)** | **(3.3%)** |

The Group's net impairment losses on loans and off-balance sheet commitments amounted to PLN 500.6 million in 2016, a decrease of PLN 16.9 million, i.e. 3.3% as compared with 2015.

### Provisions, deferred tax assets and liabilities

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| **Total provisions** | **560.4** | **425.4** | **31.7%** |
| of which: | | | |
| provisions for off-balance sheet commitments | 221.0 | 120.8 | 82.9% |
| provisions for liabilities to employees | 316.7 | 293.4 | 7.9% |
| other provisions | 22.7 | 11.2 | > 100% |
| **Deferred tax liabilities** | **4.9** | **4.9** | **0.0%** |
| **Deferred tax assets** | **1,003.4** | **915.2** | **9.6%** |

# Statement of Financial Position and Financial Results

## Quarterly Income Statement

### Consolidated income statement – long form

**Consolidated income statement for 2016 –** Provided for comparability purposes.

(in PLN thousand)

| | Q4 2016 | Q3 2016 | Q2 2016 | Q1 2016 |
|---|---|---|---|---|
| Interest income | 1,374,829 | 1,382,257 | 1,338,188 | 1,353,216 |
| Interest expense | (262,018) | (264,806) | (256,183) | (283,478) |
| **Net interest income** | **1,112,811** | **1,117,451** | **1,082,005** | **1,069,738** |
| Fee and commission income | 578,725 | 559,541 | 575,789 | 538,030 |
| Fee and commission expense | (78,191) | (69,592) | (70,648) | (74,690) |
| **Net fee and commission income** | **500,534** | **489,949** | **505,141** | **463,340** |
| **Dividend income** | **236** | **151** | **16,410** | **1** |
| **Result on financial assets and liabilities held for trading** | **121,861** | **117,300** | **125,406** | **120,842** |
| **Result on fair value hedge accounting** | **5,265** | **1,449** | **(2,533)** | **(2,868)** |
| **Net result on other financial instruments at fair value through profit and loss** | **–** | **–** | **–** | **–** |
| **Gains (losses) on disposal of:** | **4,209** | **7,811** | **273,500** | **150,383** |
| loans and other financial receivables | 3,773 | – | 5,796 | 149,924 |
| available for sale financial assets and held to maturity investments | 460 | 7,862 | 267,707 | 464 |
| financial liabilities | (24) | (51) | (3) | (5) |
| **Operating income** | **1,744,916** | **1,734,111** | **1,999,929** | **1,801,436** |
| **Net impairment losses on financial assets and off-balance sheet commitments:** | **(106,179)** | **(133,882)** | **(131,179)** | **(129,389)** |
| loans and other financial receivables | (68,911) | (131,532) | (72,740) | (128,226) |
| off-balance sheet commitments | (37,268) | (2,350) | (58,439) | (1,163) |
| **Net result on financial activity** | **1,638,737** | **1,600,229** | **1,868,750** | **1,672,047** |
| **Administrative expenses** | **(920,340)** | **(895,948)** | **(911,446)** | **(874,590)** |
| personnel expenses | (482,836) | (469,837) | (472,983) | (471,180) |
| other administrative expenses (*) | (437,504) | (426,111) | (438,463) | (403,410) |
| **Depreciation and amortization** | **(84,359)** | **(85,037)** | **(85,677)** | **(85,793)** |
| **Net result on other provisions** | **(4,994)** | **(6,628)** | **(2,024)** | **(829)** |
| **Net other operating income and expenses** | **8,006** | **12,010** | **3,971** | **6,541** |
| **Operating costs** | **(1,001,687)** | **(975,603)** | **(995,176)** | **(954,671)** |
| **Gains (losses) on subsidiaries and associates** | **8,908** | **9,862** | **9,788** | **10,003** |
| **Gains (losses) on disposal of property, plant and equipment, and intangible assets** | **98** | **3,617** | **363** | **1,281** |
| **Profit before income tax** | **646,056** | **638,105** | **883,725** | **728,660** |
| Income tax expense | (151,172) | (117,330) | (193,098) | (155,182) |
| **Net profit for the period** | **494,884** | **520,775** | **690,627** | **573,478** |
| **Attributable to equity holders of the Bank** | **494,712** | **520,654** | **690,513** | **573,396** |
| Attributable to non-controlling interest | 172 | 121 | 114 | 82 |

(*) Including one-off charge to the Bank Guarantee Fund in relation to bankruptcy of Bank Spółdzielczy in Nadarzyn, tax on certain financial institutions and guarantee funds charges.

**Consolidated income statement for 2015** – Provided for comparability purposes.

(in PLN thousand)

| | Q4 2015 | Q3 2015 | Q2 2015 | Q1 2015 |
|---|---|---|---|---|
| Interest income | 1,369,470 | 1,365,004 | 1,323,599 | 1,398,296 |
| Interest expense | (308,959) | (317,370) | (308,104) | (355,366) |
| **Net interest income** | **1,060,511** | **1,047,634** | **1,015,495** | **1,042,930** |
| Fee and commission income | 582,260 | 606,051 | 616,307 | 583,905 |
| Fee and commission expense | (78,351) | (98,251) | (103,057) | (103,338) |
| **Net fee and commission income** | **503,909** | **507,800** | **513,250** | **480,567** |
| **Dividend income** | **1** | **297** | **13,336** | **1** |
| **Result on financial assets and liabilities held for trading** | **124,074** | **103,916** | **94,931** | **105,127** |
| **Result on fair value hedge accounting** | **529** | **(223)** | **3,007** | **2,234** |
| **Net result on other financial instruments at fair value through profit and loss** | **–** | **–** | **–** | **–** |
| **Gains (losses) on disposal of:** | **58,476** | **16,162** | **2,019** | **152,944** |
| loans and other financial receivables | 132 | – | 58 | 344 |
| available for sale financial assets and held to maturity investments | 58,486 | 16,350 | 2,089 | 152,626 |
| financial liabilities | (142) | (188) | (128) | (26) |
| **Operating income** | **1,747,500** | **1,675,586** | **1,642,038** | **1,783,803** |
| **Net impairment losses on financial assets and off-balance sheet commitments:** | **(120,277)** | **(130,067)** | **(130,082)** | **(137,132)** |
| loans and other financial receivables | (117,113) | (147,171) | (89,181) | (146,890) |
| off-balance sheet commitments | (3,164) | 17,104 | (40,901) | 9,758 |
| **Net result on financial activity** | **1,627,223** | **1,545,519** | **1,511,956** | **1,646,671** |
| **Administrative expenses** | **(1,043,824)** | **(795,962)** | **(797,373)** | **(789,433)** |
| personnel expenses | (471,865) | (484,565) | (480,167) | (471,922) |
| other administrative expenses (*) | (571,959) | (311,397) | (317,206) | (317,511) |
| **Depreciation and amortization** | **(84,808)** | **(81,888)** | **(83,031)** | **(81,738)** |
| **Net result on other provisions** | **1,587** | **(3,714)** | **(767)** | **(25,872)** |
| **Net other operating income and expenses** | **10,635** | **22,843** | **117,895** | **9,623** |
| **Operating costs** | **(1,116,410)** | **(858,721)** | **(763,276)** | **(887,420)** |
| **Gains (losses) on subsidiaries and associates** | **10,622** | **72,426** | **14,599** | **15,556** |
| **Gains (losses) on disposal of property, plant and equipment, and intangible assets** | **11,171** | **628** | **(54)** | **628** |
| **Profit before income tax** | **532,606** | **759,852** | **763,225** | **775,435** |
| Income tax expense | (93,960) | (149,008) | (143,806) | (150,866) |
| **Net profit for the period** | **438,646** | **610,844** | **619,419** | **624,569** |
| **Attributable to equity holders of the Bank** | **438,364** | **610,469** | **619,209** | **624,417** |
| Attributable to non-controlling interest | 282 | 375 | 210 | 152 |

(*) Including one-off charge to the Bank Guarantee Fund in relation to bankruptcy of SBRiR in Wołomin, contribution to the Borrowers Support Fund and guarantee funds charges.

# Statement of Financial Position and Financial Results

## Consolidated statement of comprehensive income

### Consolidated statement of comprehensive income for 2016

(in PLN thousand)

| | Q4 2016 | Q3 2016 | Q2 2016 | Q1 2016 |
|---|---|---|---|---|
| **Net profit** | **494,884** | **520,775** | **690,627** | **573,478** |
| **Attributable to equity holders of the Bank** | **494,712** | **520,654** | **690,513** | **573,396** |
| Attributable to non-controlling interest | 172 | 121 | 114 | 82 |
| **Other comprehensive income** | | | | |
| **Items that are or may be reclassified subsequently to profit or loss:** | | | | |
| Foreign currency translation differences | – | – | – | – |
| Change in fair value of available-for-sale financial assets | (342,128) | 17,670 | (313,460) | 29,099 |
| Change in fair value of cash flow hedges | (44,063) | 4,712 | (6,281) | 40,075 |
| Income tax expense on other comprehensive income | 73,376 | (4,253) | 60,751 | (13,143) |
| **Items that will never be reclassified to profit or loss:** | | | | |
| Re-measurements of the defined benefit liabilities | (11,560) | – | – | – |
| Share in re-measurements of the defined benefit liabilities of associates | 18 | – | – | – |
| Tax on items that will never be reclassified to profit or loss | 2,196 | – | – | – |
| **Other comprehensive income (net)** | **(322,161)** | **18,129** | **(258,990)** | **56,031** |
| **Total comprehensive income** | **172,723** | **538,904** | **431,637** | **629,509** |
| **Attributable to equity holders of the Bank** | **172,551** | **538,783** | **431,523** | **629,427** |
| Attributable to non-controlling interest | 172 | 121 | 114 | 82 |

Note: Net profit includs one-off charge to the Bank Guarantee Fund in relation to bankruptcy of Bank Spółdzielczy in Nadarzyn and tax on certain financial institutions.

## Consolidated statement of comprehensive income for 2015

(in PLN thousand)

| | Q4 2015 | Q3 2015 | Q2 2015 | Q1 2015 |
|---|---|---|---|---|
| **Net profit** | **438,646** | **610,844** | **619,419** | **624,569** |
| **Attributable to equity holders of the Bank** | **438,364** | **610,469** | **619,209** | **624,417** |
| Attributable to non-controlling interest | 282 | 375 | 210 | 152 |
| **Other comprehensive income** | | | | |
| **Items that are or may be reclassified subsequently to profit or loss:** | | | | |
| Foreign currency translation differences | (1,146) | (10) | (19) | 6 |
| Change in fair value of available-for-sale financial assets | 98,833 | 191,550 | (441,980) | (85,527) |
| Change in fair value of cash flow hedges | 41,738 | (26,197) | (52,662) | (56,220) |
| Income tax expense on other comprehensive income | (26,708) | (31,417) | 93,982 | 26,932 |
| **Items that will never be reclassified to profit or loss:** | | | | |
| Re-measurements of the defined benefit liabilities | 12,900 | – | – | – |
| Share in re-measurements of the defined benefit liabilities of associates | 18 | – | – | – |
| Tax on items that will never be reclassified to profit or loss | (2,451) | – | – | – |
| **Other comprehensive income (net)** | **123,184** | **133,926** | **(400,679)** | **(114,809)** |
| **Total comprehensive income** | **561,830** | **744,770** | **218,740** | **509,760** |
| **Attributable to equity holders of the Bank** | **561,548** | **744,395** | **218,530** | **509,608** |
| Attributable to non-controlling interest | 282 | 375 | 210 | 152 |

Note: Net profit includs one-off charge to the Bank Guarantee Fund in relation to bankruptcy of SBRiR in Wołomin and contribution to the Borrowers Support Fund.

# Statement of Financial Position and Financial Results

## Consolidated income statement – presentation form

### Consolidated income statement for 2016

(in PLN thousand)

| | Q4 2016 | Q3 2016 | Q2 2016 | Q1 2016 |
|---|---|---|---|---|
| Net interest income | 1,112,811 | 1,117,451 | 1,082,005 | 1,069,738 |
| Dividend income and income from equity investments | 9,143 | 10,033 | 26,198 | 10,004 |
| **Total net interest income, dividend income and other income from equity investments** | **1,121,954** | **1,127,484** | **1,108,203** | **1,079,742** |
| Net fee and commission income | 500,534 | 489,949 | 505,141 | 463,340 |
| Trading result | 127,562 | 126,560 | 390,577 | 118,433 |
| Net other operating income and expenses | 11,470 | 11,351 | 9,095 | 155,823 |
| **Net non-interest income** | **639,566** | **627,860** | **904,813** | **737,596** |
| **Operating income** | **1,761,520** | **1,755,344** | **2,013,016** | **1,817,338** |
| **Operating costs** | **(793,808)** | **(793,841)** | **(812,143)** | **(812,115)** |
| **Gross operating profit** | **967,712** | **961,503** | **1,200,873** | **1,005,223** |
| Net impairment losses on loans and off-balance sheet commitments | (106,179) | (133,882) | (131,179) | (129,389) |
| **Net operating profit** | **861,533** | **827,621** | **1,069,694** | **875,834** |
| Net result on other provisions | (4,994) | (6,628) | (2,024) | (829) |
| Guarantee funds charges | (66,016) | (65,758) | (64,104) | (66,986) |
| One-off charge in favour of the Bank Guarantee Fund related to bankruptcy of Bank Spółdzielczy in Nadarzyn | (16,604) | – | – | – |
| Tax on certain financial institutions | (127,962) | (120,727) | (120,204) | (80,640) |
| Net result on investment activities | 99 | 3,597 | 363 | 1,281 |
| **Profit before income tax** | **646,056** | **638,105** | **883,725** | **728,660** |
| Income tax expense | (151,172) | (117,330) | (193,098) | (155,182) |
| **Net profit** | **494,884** | **520,775** | **690,627** | **573,478** |
| **Attributable to equity holders of the Bank** | **494,712** | **520,654** | **690,513** | **573,396** |
| Attributable to non-controlling interest | 172 | 121 | 114 | 82 |

## Consolidated income statement for 2015

(in PLN thousand)

| | Q4 2015 | Q3 2015 | Q2 2015 | Q1 2015 |
|---|---|---|---|---|
| Net interest income | 1,060,511 | 1,047,634 | 1,015,495 | 1,042,930 |
| Dividend income and income from equity investments | 10,623 | 11,666 | 27,935 | 15,502 |
| **Total net interest income, dividend income and other income from equity investments** | **1,071,134** | **1,059,300** | **1,043,430** | **1,058,432** |
| Net fee and commission income | 503,909 | 507,800 | 513,250 | 480,567 |
| Trading result | 182,947 | 119,855 | 99,899 | 259,961 |
| Net other operating income and expenses | 9,784 | 21,814 | 117,369 | 9,131 |
| **Net non-interest income** | **696,640** | **649,469** | **730,518** | **749,659** |
| **Operating income** | **1,767,774** | **1,708,769** | **1,773,948** | **1,808,091** |
| **Operating costs** | **(798,613)** | **(808,475)** | **(811,221)** | **(801,363)** |
| **Gross operating profit** | **969,161** | **900,294** | **962,727** | **1,006,728** |
| Net impairment losses on loans and off-balance sheet commitments | (120,277) | (130,067) | (130,082) | (137,132) |
| **Net operating profit** | 848,884 | 770,227 | 832,645 | 869,596 |
| Net result on other provisions | 1,587 | (3,714) | (767) | (25,872) |
| Guarantee funds charges | (68,487) | (68,346) | (68,599) | (68,972) |
| One-off charges in favour of the Bank Guarantee Fund related to bankruptcy of SBRiR in Wołomin and contribution to Borrowers Support Fund | (260,549) | – | – | – |
| **Net result on investment activities** | **11,171** | **61,685** | **(54)** | **683** |
| **Profit before income tax** | **532,606** | **759,852** | **763,225** | **775,435** |
| Income tax expense | (93,960) | (149,008) | (143,806) | (150,866) |
| **Net profit** | **438,646** | **610,844** | **619,419** | **624,569** |
| **Attributable to equity holders of the Bank** | **438,364** | **610,469** | **619,209** | **624,417** |
| Attributable to non-controlling interest | 282 | 375 | 210 | 152 |

# Statement of Financial Position and Financial Results

## Reconciliation of income statement – presentation form and long form

### Consolidated income statement for 2016

(in PLN thousand)

| INCOME STATEMENT – PRESENTATION FORM'S ITEMS | LONG FORM'S ITEMS RECLASSIFFIED TO PRESENTATION FORM | 2016 | COMMENTS |
|---|---|---|---|
| Net interest income | | 4,382,005 | |
| Dividend income and income from equity investments | | 55,378 | |
| | Dividend income | 16,798 | |
| | Gains (losses) on subsidiaries and associates | 38,580 | |
| **Total net interest income, dividend income and other income from equity investments** | | **4,437,383** | |
| Net fee and commission income | Net fee and commission income | 1,958,964 | |
| Trading result | | 763,132 | |
| | Result on financial assets and liabilities held for trading | 485,409 | |
| | Result on fair value hedge accounting | 1,313 | |
| | Net result on other financial instruments at fair value through profit and loss | – | |
| | Gains (losses) on disposal of available for sale financial assets and held to maturity investments | 276,493 | |
| | (Gains) losses on disposal of financial liabilities | (83) | |
| Net other operating income and expenses | | 187,739 | |
| | Net other operating income and expenses | 30,528 | |
| | less – Refunding of administrative expenses | (2,282) | /1 |
| | Gains (losses) on disposal of loans and other financial receivables | 159,493 | |
| **Net non-interest income** | | **2,909,835** | |
| **Operating income** | | **7,347,218** | |
| Operating costs | | (3,211,907) | |
| | Personnel expenses | (1,896,836) | |
| | Other administrative expenses | (1,705,488) | |
| | less –Guarantee funds charges | 262,864 | |
| | less – One-off charges related to bankruptcy of Bank Spółdzielczy in Nadarzyn | 16,604 | |
| | less – tax on certain financial institutions | 449,533 | |
| | Refunding of administrative expenses | 2,282 | /1 |
| | Depreciation and amortization | (340,866) | |
| **Gross operating profit** | | **4,135,311** | |
| Net impairment losses on loans and off-balance sheet commitments | | (500,629) | |
| | Net impairment losses on loans | (401,409) | |
| | Net impairment provision for off-balance sheet commitments | (99,220) | |
| **Net operating profit** | | **3,634,682** | |
| Net result on other provisions | Net result on other provisions | (14,475) | |
| Guarantee funds charges | Guarantee funds charges | (262,864) | |
| One-off charges related to bankruptcy of Bank Spółdzielczy in Nadarzyn | One-off charges related to bankruptcy of Bank Spółdzielczy in Nadarzyn | (16,604) | |
| Tax on certain financial institutions | Tax on certain financial institutions | (449,533) | |
| Net result on investment activities | | 5,340 | |
| | Gains ( losses) on disposal of property, plant and equipment and intangible assets. | 5,359 | |
| | Impairment losses on subsidiaries and associates | – | |
| | Gains (losses) on disposal of subsidiaries and associates | (19) | |
| **Profit before income tax** | | **2,896,546** | |
| Income tax expense | Income tax expense | (616,782) | |
| **Net profit for the period** | **Net profit for the period** | **2,279,764** | |
| **Attributable to equity holders of the Bank** | **Attributable to equity holders of the Bank** | **2,279,275** | |
| Attributable to non-controlling interest | Attributable to non-controlling interest | 489 | |

1/ In the long form the item "Refunding of administrative expenses" included in the item "Net other operating income/expenses", in a presentation form included in "Operating cost".

## Consolidated income statement for 2015

(in PLN thousand)

| INCOME STATEMENT – PRESENTATION FORM'S ITEMS | LONG FORM'S ITEMS RECLASSIFFIED TO PRESENTATION FORM | 2015 | COMMENTS |
|---|---|---|---|
| Net interest income | | 4,166,570 | |
| Dividend income and income from equity investments | | 65,726 | |
| | Dividend income | 13,635 | |
| | Gains (losses) on subsidiaries and associates | 52,091 | |
| **Total net interest income, dividend income and other income from equity investments** | | **4,232,296** | |
| Net fee and commission income | Net fee and commission income | 2,005,526 | |
| Trading result | | 662,662 | |
| | Result on financial assets and liabilities held for trading | 428,048 | |
| | Result on fair value hedge accounting | 5,547 | |
| | Net result on other financial instruments at fair value through profit and loss | – | |
| | Gains (losses) on disposal of available for sale financial assets and held to maturity investments | 229,551 | |
| | (Gains) losses on disposal of financial liabilities | (484) | |
| Net other operating income and expenses | | 158,098 | |
| | Net other operating income and expenses | 160,996 | |
| | less – Refunding of administrative expenses | (3,432) | /1 |
| | Gains (losses) on disposal of loans and other financial receivables | 534 | |
| **Net non-interest income** | | **2,826,286** | |
| **Operating income** | | **7,058,582** | |
| Operating costs | | (3,219,672) | |
| | Personnel expenses | (1,908,519) | |
| | Other administrative expenses | (1,518,073) | |
| | less –Guarantee funds charges | 274,404 | |
| | less – One-off charges related to bankruptcy of SBRiR in Wołomin and contribution to Borrowers Support Fund | 260,549 | |
| | Refunding of administrative expenses | 3,432 | /1 |
| | Depreciation and amortization | (331,465) | |
| **Gross operating profit** | | **3,838,910** | |
| Net impairment losses on loans and off-balance sheet commitments | | (517,558) | |
| | Net impairment losses on loans | (500,355) | |
| | Net impairment provision for off-balance sheet commitments | (17,203) | |
| **Net operating profit** | | **3,321,352** | |
| Net result on other provisions | Net result on other provisions | (28,766) | |
| Guarantee funds charges | Guarantee funds charges | (274,404) | |
| One-off charges related to bankruptcy of SBRiR in Wołomin and contribution to Borrowers Support Fund | less – One-off charges related to bankruptcy of SBRiR in Wołomin and contribution to Borrowers Support Fund | (260,549) | |
| Net result on investment activities | | 73,485 | |
| | Gains ( losses) on disposal of property, plant and equipment and intangible assets. | 12,373 | |
| | Impairment losses on subsidiaries and associates | – | |
| | Gains (losses) on disposal of subsidiaries and associates | 61,112 | |
| **Profit before income tax** | | **2,831,118** | |
| Income tax expense | Income tax expense | (537,640) | |
| **Net profit for the period** | **Net profit for the period** | **2,293,478** | |
| **Attributable to equity holders of the Bank** | **Attributable to equity holders of the Bank** | **2,292,459** | |
| Attributable to non-controlling interest | Attributable to non-controlling interest | 1,019 | |

1/ In the long form the item "Refunding of administrative expenses" included in the item "Net other operating income/expenses", in a presentation form included in "Operating cost".

# For the Good of our Customers

Customers are the basis of our operations,
and the main reason for the existence of Bank Pekao S.A.

“I love to be the centre of attention.”

# Other Information

# Other Information

## Information required pursuant to Art. 111a of the Banking Law

Bank Pekao S.A. is a universal commercial bank providing a full range of banking services to individual and institutional clients in Poland. Bank Pekao S.A. Group includes financial institutions operating in banking, asset management, pension funds, brokerage services, transactional advisory, leasing and factoring markets.

The Bank and all subsidiaries of the Bank, within a consolidated basis under article 4, section 1, point 48 of the Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, run its activities on territory of Poland.

As at the end of December 2016, the number of full-time jobs in the Group was 17,304 compared to 17,933 as at the end of 2015.

In 2016, the Group's operating income amounted to PLN 7,347.2 million, an increase of PLN 288.6 million, i.e. 4.1% in comparison to 2015 thanks to both higher net interest income, dividend income and income from equity investment and higher net non-interest income.

Profit before tax of Bank Pekao S.A. Group in 2016 amounted to PLN 2,896.5 million and was higher by PLN 65.4 million, i.e. 2.3% in comparison to 2015. Income tax expense in 2016 amounted to PLN 616.7 million vs. PLN 537.6 million in 2015 and was higher by 14.7%.

As at the end of December 2016, the return on assets (ROA) of the Group was 1.4% and was at the same level as at the end of December 2015.

In 2016, the Bank do not conclude any agreements according to article 141t, section 1 of the Banking Law Act.

## Management Board position regarding the possibility of achieving previously published forecasts

The Bank has not published the forecast of the financial results for 2016.

## Management Board remunerations

The amount of remunerations or benefits (in cash, payments in kind or in any form) paid or due to the Management Board Members in 2016 (*).

Fix remuneration

(in PLN thousand)

| | BASE SALARY FOR 2016 |
|---|---|
| Luigi Lovaglio | 4,367 |
| Diego Biondo | 1,030 |
| Andrzej Kopyrski | 1,326 |
| Adam Niewiński | 839 |
| Grzegorz Piwowar | 1,286 |
| Stefano Santini | 645 |
| Marian Ważyński | 883 |

Variable remuneration

(in PLN thousand)

| VARIABLE REMUNERATION (CASH PART) PAID FOR | 2012 | 2014 | 2015 |
|---|---|---|---|
| Luigi Lovaglio | 793 | 1,189 | 1,842 |
| Diego Biondo | 112 | 168 | 231 |
| Andrzej Kopyrski | 179 | 215 | 320 |
| Adam Niewiński | 0 | 40 | 140 |
| Grzegorz Piwowar | 174 | 283 | 380 |
| Stefano Santini | 0 | 67 | 45 |
| Marian Ważyński | 87 | 107 | 150 |

Variable remuneration paid to the Management Board Members also includes phantom shares for 2011-2013 calculated base on the average share price PLN 149.80 (for the period from 16 May, 2016 to 15 June, 2016). Phantom shares relating the year 2011, 2012 and 2013 respectively: Mr. Luigi Lovaglio 5 611, 9 387, 8 985 shares, Mr. Diego Biondo 960, 1 460, 1 336 shares, Mr. Andrzej Kopyrski 1 415, 2 196, 1 932 shares, Mr. Adam Niewiński 0, 0, 431 shares, Mr. Grzegorz Piwowar 1 569, 2 130, 2 099 shares, Mr. Stefano Santini 0, 0, 672 shares, Mr. Marian Ważyński 613, 1 071, 857 shares.

Due portion of Members of the Management Board variable remuneration in phantom shares is 50,505 shares. The value of this portion of the variable remuneration will depend on the Bank's share price at the settlement date.

Other payments related to benefits received in 2016 for Management Board Members: Mr. Luigi Lovaglio PLN 149 thousand, Mr. Diego Biondo PLN 1 thousand, Mr. Andrzej Kopyrski PLN 112 thousand, Mr. Adam Niewiński PLN 81 thousand, Mr. Grzegorz Piwowar PLN 112 thousand, Mr. Stefano Santini PLN 1 thousand, Mr. Marian Ważyński PLN 31 thousand.

In 2016, the Management Board Members did not receive nor are due any compensation from subsidiaries and associated entities.

Additional payments related to secondment package in 2016 for Management Board Members: Mr. Luigi Lovaglio PLN 1,297 thousand, Mr. Diego Biondo PLN 1,056 thousand, Mr. Stefano Santini PLN 519 thousand.

(*) the remuneration for expats is presented in pln rate valid for compensation payout on monthly basis

## Supervisory Board remunerations

The amount of remunerations or benefits (in cash, payments in kind or in any form) paid or due to the Supervisory Board Members in 2016:

(in PLN thousand)

| | TOTAL | NOTES |
|---|---|---|
| Jerzy Woźnicki | 233 | |
| Gianni Papa (from June 17, 2016) | – | Did not receive remuneration according to the Group's policy |
| Leszek Pawłowicz | 215 | |
| Alessandro Decio ( until June 16, 2016) | 86 | |
| Massimiliano Fossati (from June 17, 2016) | – | Did not receive remuneration according to the Group's policy |
| Dariusz Filar | 191 | |
| Katarzyna Majchrzak | 133 | |
| Roberto Nicastro ( until June 16, 2016) | 79 | |
| Laura Penna | – | Did not receive remuneration according to the Group's policy |
| Wioletta Rosołowska | 133 | |
| Doris Tomanek | – | Did not receive remuneration according to the Group's policy |

In 2016, the Supervisory Board Members did not receive nor are due any compensation from subsidiaries and associated entities.

## The Incentive Programs

As at December 31, 2016, the following long-term incentive programs are realized in Bank Pekao S.A. Group:
- the Long-term UniCredit Group Incentive Program 2007 – in terms of the options 32 employees of Bank Pekao S.A. Group have been covered by the program, including 4 Members of the Management Board. The options expire in 2017,
- the Long-term UniCredit Group Incentive Program 2008 – in terms of the options 49 employees of Bank Pekao S.A. Group have been covered by the program, including 4 Members of the Management Board. The options expire in 2018.

## Shares in the Bank and related entities held by the Bank's Directors

According to information available to the Bank as at December 31, 2016, the Members of the Bank's management and supervisory bodies held 73,535 shares of Bank Pekao S.A. with face value of PLN 73,535. The number of the Bank's shares held by the Members of the Bank's management and supervisory bodies and its face value remained unchanged as the date of submitting of this report.

The table below presents the number of shares held by the Management Board Members:

| | AS AT THE DATE OF SUBMITTING THE REPORT | | |
|---|---|---|---|
| | FOR THE YEAR 2016 | FOR THE THIRD QUARTER OF 2016 | FOR THE YEAR 2015 |
| Luigi Lovaglio | 64,035 | 64,035 | 64,035 |
| Diego Biondo | 9,500 | 9,500 | 9,500 |
| **Total** | **73,535** | **73,535** | **73,535** |

Moreover, as at December 31, 2016 UniCredit S.p.A. shares were held by: Mr. Luigi Lovaglio – 69,566 shares without nominal value, Mr. Diego Biondo – 5,033 shares without nominal value, Mr. Massimiliano Fossati – 37,335 shares without nominal value, Mr. Andrzej Kopyrski – 1,152 shares without nominal value, Mr. Gianni Papa – 139,470 shares without nominal value, Ms. Laura Penna – 11,187 shares without nominal value, Mr. Grzegorz Piwowar – 1,807 shares without nominal value, Mr. Stefano Santini – 45,786 shares without nominal value, Ms. Doris Tomanek – 56,684 shares without nominal value, Mr. Marian Ważyński – 827 shares without nominal value.

## Information regarding contracts for post termination benefits

Employment agreements provide payment of compensation amounting to 18 times the value of the monthly base remuneration of the following Members of the Management Board of the Bank: Mr. Andrzej Kopyrski – Vice-president of the Management Board, Mr. Grzegorz Piwowar – Vice-president of the Management Board, Mr. Marian Ważyński – Vice-president of the Management Board, however, in case of Mr. Adam Niewiński – Vice-president of the Management Board, the employment contract provides payment of compensation amounting to 12 times of the monthly base remuneration for the last month. Payment of the compensation follows, among others, in the event of tenure expiration without appointment for the next tenure or dismissing from the function.

The above mentioned provisions do not apply in case of dismissal for reasons stipulated in art. 52 or art. 53 of the Labour Code or in case of, among others, failure to adequately execute responsibilities or infringement of the Bank Statute, resolutions of the Management Board and the Supervisory Board.

Moreover, the abovementioned Members of the Management Board have concluded non-competition agreements with the Bank, which define the rights and obligations of agreement parties in the scope covered by non-competition agreements during and after the employment period.

Employment contracts of the remaining Management Board Members do not provide compensations of this kind.

The Bank has no liabilities arising from pensions and similar benefits for former managers, supervisors or former members of the administrative bodies.

## Agreements with companies entitled to auditing of financial reports

On the basis of the agreement concluded on June 17, 2013, Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. is the company appointed to audit and review the financial statements of Bank Pekao S.A. and Bank Pekao S.A. Group for the years 2013 – 2017.

Audit remuneration for services of Bank Pekao S.A. Group.

(in PLN thousand)

| | 2016 | 2015 |
|---|---|---|
| Fee for the audit of annual financial statements | 3,295 | 3,351 |
| Fee for other attestation services, including review of financial statements | 2,362 | 1,827 |

The amounts above do not include value added tax (VAT).

## Average interest rates in Bank Pekao S.A. in December 2016

The average nominal interest rates for the basic types of PLN deposits for non-financial sector residents:

| | |
|---|---|
| PLN retail deposits | 0.8% p.a. |
| PLN corporate clients deposits | 0.8% p.a. |

The average nominal interest rates for the PLN loans for non-financial sector residents:

| | |
|---|---|
| Total retail loans | 4.3% p.a. |
| Mortgage | 3.4% p.a. |
| Consumption | 8.3% p.a. |
| Other | 5.6% p.a. |
| Corporate loans | 3.3% p.a. |

## Number and value of titles of execution and value of collaterals

Bank Pekao S.A. has established specific policy with regard to collateral accepted to secure loans and guarantees.

This policy is reflected under internal rules and regulations in the Bank. The type of collateral and its value are carefully analyzed and chosen regarding the particular risk of the secured transaction.

The Bank obeys the rule, according to which the value of collateral should relate directly to the value of secured liability, that is cash provided by the Bank to a client (capital or the amount of off-balance sheet commitments granted by the Bank) together with extraneous amounts due, for example, interest or commissions.

In order to hedge risk related to lending activities the Bank accepts legal collateral under the Civil Code, the law on bills of exchange or resulting from the habits adopted in domestic or foreign trade, i.e. bank guarantees, guarantee under the Civil Code, blank of promissory notes, aval, transfer of debts, mortgages, registered pledges, pledges, assignment as collateral, transfer of assets in bank account, blockade assets on client's account.

For corporate clients, the total value of the collateral for impaired transactions as at December 31, 2016 amounted to PLN 1,646.3 million. For retail clients, the total value of the collateral for impaired transactions as at December 31, 2016 amounted to PLN 595.0 million. In 2016, there were no titles of execution issued on behalf of the Bank.

## Pending litigations

In 2016, the number of the legal proceedings pending before courts, arbitration bodies or public administration authorities in respect of the Group's liabilities was 666 with the total value amounting to PLN 1,091.6 million. The number of legal proceedings in respect of receivables was 18,524 with the total value of PLN 1,629.5 million.

In 2016, there were no legal proceedings relating to the liabilities and/or receivables of the Group in which asserted claims accounted for at least 10% of the Bank's own funds.

In the opinion of the Bank none of the individual pending proceedings before any courts, arbitration bodies or public administration authorities during the year 2016, nor the proceedings in aggregate pose any threat to the Bank's financial liquidity.

## Related party transactions

In 2016, the Bank and its subsidiaries have not concluded any significant transactions (single or aggregate) with related entities other than those executed on arm's length.

In 2016, the Bank and its subsidiaries did not provide any sureties in respect of loans or advances or did not provide any guarantees for repayment of loans or advances to an entity or a subsidiary of such entity, as a result of which the total value of sureties and guarantees at the balance sheet date would have equaled or exceeded 10% of the Bank's equity.

Detailed information on related party transactions is included in Note 53 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

## Information on significant agreements

In 2016, there have been no significant agreements concluded by the Bank, in particular the Bank has not concluded material agreements with central bank or the competent supervision authorities.

## Information on derivative financial instruments and hedge accounting

Information on derivative financial instruments and hedge accounting is included in Note 27 and 30 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

## Accounting principles adopted in the preparation of the report

Accounting principles adopted in the preparation of the report are described in Note 5 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

## Issuance, redemption and repayment of debt securities

### Structured Certificates of Deposit

Structured Certificates of Deposit are investment products for the Bank's clients that form an alternative to traditional banks' deposits. The total value of the Bank's liabilities relating to these products amounted to PLN 168.9 million (principal value) as at the end of December 2016. There are 4 issues of Structured Certificates of Deposit open in PLN with the maturity date on February 05, 2018. Those liabilities that mature in 2017 and 2018 account for 48.3%, and 51.7% of its total value, respectively.

### Certificates of Deposit

Certificates of Deposit are investment products denominated in PLN that guarantee 100% protection of invested funds also in case of termination before redemption date. The total value of the Bank's liabilities under these products amounted to PLN 130.0 million (principal value) as at the end of December 2016. There are 2 issues of Certificates of Deposit with the maturity date up to 3 months.

### Pekao Bank Hipoteczny S.A. covered bonds

The total value of liabilities due to covered bonds amounted to PLN 1,282.7 million as at the end of December, 2016. The liabilities under covered bonds with maturity date up to 1 year account for 12.3%, with maturity date from 1 up to 3 years account for 21.3%, with maturity date from 3 up to 5 years account for 50.9% and with maturity date from 5 up to 10 years account for 15.5% of the total nominal value.

## Subsequent events

On January 13, 2017, the Management Board of Bank Pekao S.A. informed, in the current report No. 2/2017, on resignations of Mr. Gianni Papa, Mr. Massimiliano Fossati, Ms. Laura Stefania Penna and Ms. Doris Tomanek from the positions of Members of the Supervisory Board of the Bank subject to the condition and with effect as of the date of: (i) the indirect sale by UniCredit S.p.A. of 52,494,007 shares in the Bank to Powszechny Zakład Ubezpieczeń S.A. and (ii) the direct sale by UniCredit S.p.A. of 26,247,003 shares in the Bank to Polski Fundusz Rozwoju S.A.

# Corporate Governance

# Corporate Governance

## Introduction – Fundamentals of Corporate Governance

General rules of corporate governance in the Bank i.e. a system of regulations and procedures specifying operational guidelines for the Bank's bodies, including in relations to external entities interested in its activity (stakeholders), result from legal regulations, in particular the Commercial Companies Code and the Banking Act, regulations on capital market functioning and rules included in the documents: Code of Best Practice for WSE Listed Companies 2016, Corporate Governance Rules for the Supervised Institutions issued by the Financial Supervision Authority on 22 July 2014 and Code of Banking Ethics of the Polish Bank Association as well as included in UniCredit Group Integrity Charter.

As required under the Act on Trading in Financial Instruments of 29 July 2005, the Bank has implemented internal procedures designed to monitor the performance of obligations related to inside information, the ban on transactions in the Bank's instruments during restricted periods, and on disclosing information on transactions in financial instruments related to with securities issued by the Bank made by important persons related to the Bank.

In order to ensure the stability of the Pekao Group, the Bank coordinates and controls the operations of its subsidiaries through the Bank's representatives in the governing bodies of such subsidiaries.

As required under the Regulation of the Minister of Finance of 19 February 2009 on current and periodic information published by issuers of securities and conditions for recognising as equivalent information required by laws of non-member states, the Bank attaches incorporates a statement in its annual report concerning the application of corporate governance rules, established according to the said Regulation.

The statement of Bank Polska Kasa Opieki S.A. concerning the application of corporate governance rules in 2016 is provided on page 127 of this Report.

Making its statement on the application of corporate governance rules, the Bank also applies recommendations of the European Commission of 9 April 2014 on the quality of corporate governance reporting ("comply or explain" approach).

## Compliance with the *Code of Best Practice for WSE Listed Companies*

Bank Pekao S.A. has followed the Code of Best Practice for WSE Listed Companies since 2002, when the Supervisory Board of the Warsaw Stock Exchange (WSE) for the first time formulated a set of corporate governance guidelines.

On 22 December 2015, by virtue of Resolution No. 497/XII/15, the Bank's Management Board adopted, to be applied by the Bank, the Best Practice for GPW Listed Companies 2016 issued by Warsaw Stock Exchange by virtue of Resolution No. 26/1413/2015 of the Supervisory Board of WSE dated 13 October 2015. The introduction to the said document provides that "the aim of corporate governance is to create tools supporting effective management, supervision and respect towards the rights of shareholders and transparent communication of the company to the market. The Code of Best Practice for WSE Listed Companies 2016, being a set of corporate governance rules and principles of conduct having an impact on the development of relations of listed companies with their market environment, are an important element in establishing a competitive position of those companies and make an important contribution to strengthening the attractiveness of the Polish capital market".

In 2016 the Bank applied all the recommendations and detailed rules included in the Code of Best Practice for WSE Listed Companies 2016. Recommendation No. IV.R.2 concerning enabling shareholders to participate in the General Meeting of Shareholders using electronic communication means did not apply to the Bank due to its shareholder's structure, lack of information regarding the shareholders' expectations concerning the mode of conducting General Meetings with the use of electronic communication means and lack of possibility to ensure a technical infrastructure necessary to efficiently conduct General Meetings with the use of electronic communication means and to maintain an appropriate level of electronic communication security during General Meetings.

Relevant information concerning participation in the General Meeting was included in the announcement on convening the Ordinary General Meeting of Bank Polska Kasa Opieki Spółka Akcyjna published in the current report No. 5/2016 dated 12 May 2016.

## Compliance with the *Principles of Corporate Governance for Supervised Institutions issued by the Polish Financial Supervision Authority on 22 July 2014*

On 14 October 2014, by virtue of Resolution No. 356/X/14, the Bank's Management Board adopted to follow the Principles of Corporate Governance for Supervised Institutions issued by the Polish Financial Supervision Authority on 22 July 2014. The Bank's Supervisory Board, on 5 November 2014, by virtue of its Resolution No. 33/14, expressed its positive opinion on the adoption by the Bank of the aforementioned Principles.

The Principles of Corporate Governance for Supervised Institutions are a set of rules that determine the internal and external relations of supervised institutions, including their relations with shareholders and clients, their organisation, the functioning of internal supervision and the key internal systems and functions, as well as statutory bodies and the principles of their cooperation. The objectives of the Principles of Corporate Governance for Supervised Institutions are as follows: raising the level of corporate governance in financial institutions; increasing the transparency of their activities; building greater trust in the financial market in Poland.

Since 1 January 2015, the Bank has been applying the Principles of Corporate Governance for Supervised Institutions, except for:
– Chapter 9 concerning asset management at the client's risk as the Bank does not carry out any activities in this area,
– Art. 49(4) and Art. 52(2) as the Bank has an audit unit and a compliance unit,
– Art. 45(2) concerning the estimation of the risk of failure to achieve the objectives of the system of internal control, due to adjustment works under way.

Furthermore, as the Bank could not provide any technical solutions necessary to identify shareholders correctly and ensure the appropriate level of security of electronic communication at the Bank's General Meeting for 2015, particularly during the voting at the General Meeting, the Bank's Management Board decided that the participation in that General Meeting using electronic communication would not be possible; hence, the Bank derogated from Art. 8(4) of the Principles of Corporate Governance for Supervised Institutions.

In the notice convening the Ordinary General Meeting of Bank Polska Kasa Opieki Spółka Akcyjna, published in the current report No. 5/2016 dated 12 May 2016, the Bank informed that: "Considering the fact that the Shareholder Structure of the Bank is characterised by a large number of shareholders and geographical and linguistic diversity, which means that the correct identification of shareholders and ensuring the appropriate level of security of electronic communication would require that the Bank should use advanced technological solutions that it currently does not have, in accordance with Art. 4065 § 2 of the Commercial Companies Code and Art. 8a(2) of the Bank's Statute, the Bank's Management Board decided that the participation in the Ordinary General Meeting of the Bank for 2015 using electronic communication would not be possible".

The Bank's Management Board allows the participation in General Meetings using electronic communication if the Bank meets the technical conditions required to enable the participation in General Meetings using electronic communication.

The derogation notices for the aforementioned principles were published by the Bank on its website, in accordance with the requirements of the Principles of Corporate Governance for Supervised Institutions.

## Compliance with Applicable Laws and Market Standards

Compliance risk is the risk resulting from breaching laws, internal regulations and market standards in the processes functioning within the Bank. Compliance risk can lead to criminal or administrative sanctions, material financial losses, impaired reputation, reduced brand value, reduced development potential and inability to perform contracts, as well as reduction or loss of business opportunities.

There is a separate unit for compliance matters functioning within the Bank – the Compliance Department, organisationally and operationally independent and reporting directly to the President of the Management Board. The Compliance Department is a key element of ensuring compliance within the Bank.

The Bank ensures compliance through application of control mechanisms and compliance risk management processes carried out by the Compliance Department and encompassing identification, assessment, control and monitoring of compliance risk of the Bank's activity and presentation of reports in that respect. The reports on performance of tasks by the Compliance Department together with the level of the assessed compliance risk are submitted to the Management Board and Supervisory Board. The oversight of compliance risk related to the activities of subsidiaries is performed in the Bank.

The assumptions underlying the compliance risk management process were defined in the Bank Pekao S.A. Compliance Policy developed by the Management Board and approved by the Supervisory Board. The key elements supporting the compliance risk management process are as follows:
a) supervision by the Supervisory Board and responsibility of the Management Board for effective management of compliance risk and observance of the Compliance Policy,
b) responsibility of the Bank's employees for ensuring compliance within the scope of their duties,
c) a properly defined organisational structure including appropriate location of Compliance Department,
d) internal regulations on compliance matters,
e) training,
f) regular cooperation of the Compliance Department with the Internal Audit Department and other internal control system units.

As part of compliance with laws, internal regulations and market standards, each employee of the Bank applies appropriate control mechanisms and performs independent monitoring of adherence to control mechanisms, within the scope of duties assigned to him/her.

Implementation and application of the compliance risk management standards are key factors in creating the enterprise value, reinforcing and protecting the Bank's reputation, and winning public trust in the Bank's activities and its standing.

# Corporate Governance

## Code of Conduct of Pekao Group

The Bank's commitment to ensure compliance with applicable standards has been manifested by the development and implementation of the Code of Conduct of Pekao Group ("Code").

The Code is a set of rules identifying the appropriate way to take decisions and correct conduct in specific situations. It sets forth the duties and the proper conduct expected from the Employees, i.e. all persons employed by Bank Pekao S.A. or other Legal Entities of the Capital Group of Bank Pekao S.A. ("Group") under employment contracts or on the basis of any other legal relationship of a similar nature, including members of statutory bodies of member Companies of the Group ("Company").

The observance of the rules set forth in the Code guarantees the conduct complying with the values, mission and corporate culture of the Group and a manifestation of the commitment to the highest standards related to the performance of employee duties, the provision of services and the protection of the Group's reputation.

The Code sets forth the rules of conduct for all employees, striving to reconcile the mission of the Companies with the challenges of daily work. The employees should refer to the rules set forth in the Code at all times, as they support them in ensuring compliance with law, recommendations of regulators, internal regulations and the standards of conduct approved by the Bank.

In accordance with the provisions of the Code, each employee is expected to act ethically, to be honest and loyal, to manifest an attitude promoting collaboration in achieving the Group's objectives, to respect and use the Group's assets in a prudent way, in particular:
– to perform their duties according to the highest professional standards in order to meet customers' expectations and to avoid behaviour which could be misinterpreted or interpreted in a manner not intended by an employee,
– to act in the best interests of the customers,
– to observe applicable laws and recommendations of regulators,
– to observe the Code and other internal regulations.

## General Meeting of Shareholders

### General Meeting of Shareholders

General Meetings of Shareholders are convened in accordance with the applicable laws and the provisions of the Bank's Statute, which are consistent with the law.

Annual General Meetings of Shareholders are convened by the Bank's Management Board. They should be held no later than in June. The Bank's Supervisory Board is entitled to convene the Annual General Meeting if the Management Board has failed to do so by the prescribed time.

Extraordinary General Meetings of Shareholders are convened when needed, either by the Bank's Management Board acting on its own initiative, or upon the Supervisory Board's request. Shareholders representing at least one twentieth of the share capital may also request that an Extraordinary General Meeting of Shareholders be convened and specific items be placed on its agenda. An Extraordinary General Meeting may also be called by the Supervisory Board, if it deems it advisable, or by shareholders representing at least a half of the share capital or at least a half of the total vote at the Bank.

As prescribed by the Commercial Companies Code, on the same day on which the convening of a General Shareholders Meeting of the Bank is announced – all documents to be submitted to the General Shareholders Meeting, including draft resolutions, are also published at the Bank's website.

All matters submitted for consideration to the General Meeting must have the Supervisory Board's recommendation. Pursuant to Section 9 of the Bank's Statute, all matters proposed to be debated by the General Meeting of Shareholders should be first submitted for the Supervisory Board's consideration.

General Shareholders Meetings are attended by members of the Bank's Supervisory and Management Boards, who provide shareholders with any desired explanations and information. The Bank's external auditor is obliged to attend the General Meeting convened to deal with the Bank's finances, including to review and approve the Bank's financial statements, the Management Board report on the Bank's operations, the consolidated financial statements of the Bank's Group and the report on the operations of the Bank's Group.

### Powers of the General Meeting

The scope of powers vested with the General Meeting of Shareholders is defined in applicable laws, including the Commercial Companies Code and the Banking Act, as well as in the Bank's Statute. The aforementioned powers are discussed in more detail in the Corporate Governance Statement.

### Rules of Procedure

The General Meeting of Shareholders operates in accordance with the Rules of Procedure for General Meetings of Shareholders of Bank Polska Kasa Opieki Spółka Akcyjna, adopted by virtue of Resolution No. 19 of the General Meeting of Shareholders of April 8, 2003, amended with Resolution No. 41 of 5 May 2009 and Resolution No. 41 of 1 June 2012. By Resolution No. 42 of 16 June 2016 into the Rules of Procedure for General Meetings of Shareholders of Bank were introduced changes which come into force from the next General Meeting of the Bank.

The Rules of Procedure for General Meetings of Shareholders set out detailed procedures for holding meetings and adopting resolutions.

The mode of operations of the General Meeting of Shareholders is presented in the Statement of Bank Polska Kasa Opieki S.A. on application of Corporate Governance Standards in 2015.

The text of the Rules of Procedure for General Meetings of Shareholders is available at the Bank's website.

### Majority Rule and Protection of the Minority Shareholders

As required under Art. 20 of the Commercial Companies Code, the Bank makes sure that all shareholders, irrespective of the size of their holdings, are given equal treatment in similar circumstances so that they are able to exercise their property and procedural rights defined in the Commercial Companies Code and in the Bank's Statute, such as the right to share in the Bank's profits or the right to obtain information about the Bank (as a rule, the right is exercised during General Meetings of Shareholders, as provided for in Art. 428 of the Commercial Companies Code), and that they have equal access to inside information of the Bank as a public company, which is communicated to the public by way of current and periodic reports published at the Bank's website in the manner prescribed in Art. 56 of the Act on Public Offering, Conditions Governing Introduction of Financial Instruments to Organised Trading, and Public Companies, dated 29 July 2005.

## Supervisory Board of the Bank

### Appointment, Composition and Qualifications

Pursuant to Section 14.1 of the Bank's Statute, the Supervisory Board is composed of seven to nine members, appointed by the General Meeting of Shareholders for a joint three-year term of office. The number of Supervisory Board members is determined by the General Meeting of Shareholders. The General Meeting may remove a Supervisory Board member from office at any time.

The Supervisory Board elects from among its members the Chairperson, two Deputy Chairpersons and the Secretary.

In the period from 1 January to 31 December 2016 the Supervisory Board was composed of nine members.

Pursuant to Section 14.3 of the Bank's Statute, at least half of the members of the Supervisory Board, including its Chairperson, should possess a thorough knowledge of the Polish banking market, i.e. they should meet all of the following criteria:
- they must have professional experience gained on the Polish market, relevant for the performance of a supervisory function at the Bank,
- they must be permanently domiciled in Poland,
- they must have command of the Polish language.

As at the end of 2016, the aforementioned criteria were met by 5 members of the Supervisory Board, including the Chairman.

The members of the Supervisory Board of Bank Pekao S.A. have the knowledge and experience required to perform their duties.

Their professional backgrounds with detailed information about their qualifications are available at the Bank's website.

**Prof. Jerzy Woźnicki**, Chairman of the Supervisory Board, Member of the Audit Committee, Nomination and Remuneration Committee.

From 10th September 1999 to 19th January 2005 Deputy Chairman of the Supervisory Board of Bank Pekao S.A.; from 20th January 2005 to 1st June 2011 Chairman of the Supervisory Board; from 1st June 2011 to 1st June 2012 Deputy Chairman of the Supervisory Board; from 2nd June 2012 member and from 24th July 2012 Chairman of the Supervisory Board.

Mr J. Woźnicki is professor of technical science (in electronics), also having academic achievements in the field of social science (in public politics science). public. He went through all stages of academic career, from junior lecturer to full professor at the Warsaw University of Technology. The scope of his research covers the issues of IT and such fields as knowledge society, innovation and knowledge-based economy. He was Dean of the Electronics and IT Faculty and, subsequently, Rector of the Warsaw University of Technology. He was also President of the Conference of Rectors of Academic Schools in Poland, and for many years of the Organization and Legislation Committee in KRASP. Professor J. Woźnicki held a number of positions at various companies, including the position of President of Softex Sp. z o.o., Deputy Chairman of the Supervisory Board of PKN Orlen, and member of the Board of the FIRE Innovation Centre. In years 2013-2015, he was member of the Economic Committee of the Strategic Thinking appointed by the Minister of Economy. In January 2017 was elected member of the Sector Council for the Financial Sector Competences.

Currently Prof. J. Woźnicki is the President of the Polish Rectors Foundation and Director of the Institute of Knowledge Society, Chairman of the National Council for Science and Higher Education. He is also a member of the Committee of Ethics in Science operating at the Presidium of the Polish Academy of Sciences. He is the originator and co-author of the 'Code of Best Practices for Higher Education Institutions'.

During his over 15 year tenure on the Supervisory Board of Bank Pekao S.A. professor J. Woźnicki gained substantial expertise and experience in banking and in the Bank's operations. He was honoured with a medal 'For Merit to Banking' by the President of the National Bank of Poland. Moreover, he was awarded the Commander's Cross with the Star of the Order of the Rebirth of Poland and the Knight Cross of the French National Order of the Legion of Honour. In 2013 the Wrocław University of Environmental and Life Sciences awarded prof. J. Woźnicki with the title of Doctor Honoris Causa.

In 2015, Prof. J. Woźnicki was awarded the title of Doctor Honoris Causa by the University of Warmia and Mazury in Olsztyn. In March 2015, Prof. J. Woźnicki was elected Active Member of the European Academy of Science and Arts in the Class of Social Sciences, Law and Economics. In December 2016, he was awarded a special prize on the occasion of the 25th anniversary of the Polish Bank Association for the achievements for development of the banking industry.

**Gianni Franco Papa**, Member of the Supervisory Board since 17th June 2016, Deputy Chairman of the Supervisory Board of Bank Pekao S.A. since 22nd July 2016, member of the Nomination and Remuneration Committee since 22nd July 2016.

He completed a law degree at Università Cattolica in Milan, Italy in 1979.

He is General Manager of UniCredit, being responsible for all business-related activities across the Group.

He started his career at Credito Italiano in 1979.

Gianni Franco Papa was appointed manager in the International Division in 1986. From 1988 to 1992, he served as Assistant General Manager at Credito Italiano in Hong Kong.

Gianni Franco Papa was appointed General Manager of the Singapore Branch in 2000. Following this, his responsibilities were extended to additionally include the role of Director for Asia (ex China) for UniCredit.

Between 2003 and 2005, he worked as General Manager of the New York branch, serving at the same time as Director for the Americas for UniCredit.

Gianni Franco Papa further pursued his international career in the Central and Eastern Europe Division for which he took over responsibility in 2010. During that period, in addition to senior management positions held at UniCredit's banks in Slovakia and Ukraine, Mr. Papa held various positions on the Division's control and steering committees, including: Chairman of the Supervisory Board of UniCredit Bank Slovenija, Deputy Chairman of the Turkish companies Koc Finansal Hizmetler AS and Yapi ve Kredi Bankasi AS, and Deputy Chairman of the Supervisory Board of PJSC Ukrsotsbank.

From January 2015 to August 2016, Gianni Franco Papa acted as Group Deputy General Manager and Head of Corporate & Investment Banking Division.

He is member of the UniCredit Executive Management Committee.

Furthermore, he holds the positions of Chairman of the Supervisory Board and Nomination Committee of UniCredit Bank AG, Member of the Supervisory Board of UniCredit Bank Austria AG, Deputy Chairman of the Supervisory Board since 22nd July 2016.

In 2013, has been appointed Commendatore Ordine al Merito della Repubblica Italiana.

**Prof. Leszek Pawłowicz**, Deputy Chairman of the Supervisory Board, member of the Audit Committee and the Risk Committee.

Member of the Supervisory Board since 8th January 1998, Deputy Chairman of the Supervisory Board since 7th November 2012. Member of the Audit Committee since 24th January 2000.

He graduated in economics from the University of Gdańsk in 1973.

In 1977 he obtained a Ph.D. in economics and in 1988 habilitacja (the highest Polish academic qualification) in economics.

Since the beginning of his professional career he has been in the Faculty of Production Economy (now: the Faculty of Management) in the University of Gdańsk where he passed by all levels of academic career. In 1993 he obtained the title of Professor of the University of Gdańsk. Since 2003 he is Director of Banking Department of the University of Gdańsk.

Since 1990 he is Deputy President of the Board of "Instytut Badań nad Gospodarką Rynkową" (The Gdańsk Institute for Market Economics).

Since 1992 he has been Director of the Gdańsk Academy of Banking.

Previously he was Chairman and then Member of the Supervisory Board of Bank Gdański S.A., Member of the Expert Group for VBM of Telekomunikacja Polska S.A., Member of the Scientific Board of Bank Gospodarki Żywnościowej S.A., Chairman of Economic Section in Scientific Research Committee, Member of the Board of PPUP Poczta Polska, President and next Member of the Supervisory Board of the Warsaw Stock Exchange and Vice-Chairman of the Supervisory Board of PKN Orlen S.A.

Currently, prof. L. Pawłowicz is Vice President of the Supervisory Board of BEST S.A., Member of the Programme Board of the Finansowanie Nieruchomości (Real Estate Finance) quarterly and Member of the Programme and Scientific Council of the Bezpieczny Bank (Safe Bank) journal. He is Member of the Committee of Financial Sciences of the Polish Academy of Sciences.

Prof. L. Pawłowicz is an expert in the domain of banking and goodwill management; he is an author of numerous dissertations and articles on the subject.

**Massimiliano Fossati**, Member of the Supervisory Board since 17th June 2016, Secretary of the Supervisory Board Member since 22nd July 2016, chairman of the Risk Committee, member of the Audit Committee and Financial Committee.

Graduate of faculty of economics from Bocconi University in Milan, he did his master in banking management.

He started his working career in 1993 in Milan with a brokerage firm operating on the Italian Stock Exchange. In 1995 he moved to Centrobanca S.A. where he remained till 2000, covering various positions in the Credits area.

In December 2000 he joined Locat S.A. leasing company belonging to UniCredit Group, as Senior Credit Analyst. In Locat he also had an experience in the Organization area.

In 2002 he moved to UniCredito Italiano S.A. as member of the newly created Foreign Banks Credits team, within the Credits Department.

Between 2004 and 2008 he covered various roles in the Czech Republic within the Group's Legal Entity in such country, including those of Chief Risk Officer (CRO), Head of Global Banking Service Division (GBS) and member of the Board of Directors. In 2008 and up to 2010 he moved to Turkey to take on the responsibility of Chief Risk Officer in Yapi Kredi Bank and Koc Financial Services.

Over the two years period 2010-2012 he covered the role of member of the Management Board of UniCredit Bank Austria with responsibility for Risk Management in Austria and in the Central and Eastern Europe Division countries.

At the end of 2012 he got back to Italy as Chief Risk Officer Italy.

On October 1st , 2015 he has been appointed Head of UniCredit's Group Risk Management and as such he is member of the Executive Management Committee with the Senior Executive Vice President title.

**Dariusz Filar**, Member of the Supervisory Board, Chairman of the Audit Committee, Member of the Nomination and Remuneration Committee.

In 1973, he graduated from the University of Gdansk with a degree in foreign trade. In 1976 he did Ph.D. in economics, and in 1989 post-doctoral lecturing degree (habilitation) in economics. After graduating from the university he stayed at the University progressing from the assistant lecturer to the associate professor of the University of Gdańsk since 1992.

He is the Emeritus Professor at University of Gdansk since 1 October 2016.

From 1992 to 1995 he was visiting professor at the University of Michigan. From 1999 to 2004 he took up the position of the chief economist of Bank Pekao S.A. Next in 2004 he was appointed to the Monetary Policy Council of NBP and he held that function until 2010. From 2010 to 2014 he was Member of the Economic Council to the Prime Minister.

In the past prof. D.Filar was Member of the Supervisory Board of PZU S.A. and chairman of the Audit Committee of PZU S.A.

Currently he is Member of the Supervisory Board of BEST S.A., chairman of the Audit Committee of BEST S.A. and Member of the Supervisory Board of the Institute for Analyses and Rating (IAiR).

**Prof. Katarzyna Majchrzak**, Member of the Supervisory Board, member of the Risk Committee, chairwoman of the Nomination and Remuneration Committee since 6 February 2017.

Associate Professor (Profesor nadzwyczajny) of the Warsaw School of Economics (SGH), director of the Institute of Value Creation, head of the Value-Based Marketing Department. In 1995 she did a Ph.D. in economics, and in 2012 post-doctoral lecturing degree (habilitation) in economics in the scope of management, Member of the Collegium of Business Administration SGH, and member of Learned Society of Praxiology.

Since 2009 prof. K. Majchrzak has been Corporate Communications Director, Member of Board of Directors in EDF Polska S.A. From 1999 to 2007 she was Director of the PR and Promotion Office in PKN Orlen S.A. with the responsibility of planning and supervision over implementation of the information and promotional and advertising policy of the company. She also worked in ICENTIS Corporate Solutions, ICENTIS Capital, Zachodni Fundusz Inwestycyjny NFI S.A., International Westfund Holdings LTD and in Hortex Sp. z o.o.

**Laura Penna**, member of the Supervisory Board, member of the Audit Committee and Financial Committee.

Ms Laura Penna got a degree in Economics at Bocconi University, Milan, in 1989.

In January 1990 she started her career in the strategic consulting industry working for Accenture, where she remained till 1999 as Senior Engagement Manager for strategic services.

In November 1999 she joined Rolo Banca (an Italian bank then merged in UniCredito Italiano) as Head of Planning and Control. In June 2001 she was appointed Head of Group Planning for UniCredit Group. She covered such position till October 2005, when she was given the Financial Controlling responsibility within the Integration Office, a unit set up to manage the HVB integration in the UniCredit Group.

After setting up and heading, between September 2006 and March 2007, the Strategic Business Development Structure, in April 2007 she was appointed Head of UniCredit Management Consultancy,a highly specialized unit aiming at providing in-house high level strategic advisory to the Group.

Member of the Board of Directors of Finecobank S.p.A.

# Corporate Governance

**Wioletta Rosołowska**, member of the Supervisory Board of Bank Pekao S.A. to 31st December 2016. Member of the Nomination and Remuneration Committee to 31st December 2016.

Wioletta Rosołowska developed her leadership skills, acquired business knowledge at senior manager courses in Insead, Harvard and Oxford. She got postgraduate degrees in journalism from the University of Warsaw and in social rehabilitation at the Academy of Special Education.

From 1991 to 1993 she worked for international advertising agencies Young & Rubicam and Saatchi & Saatchi and was responsible for developing media strategies and purchasing of media for customers of the Agencies.

In 1993 she started work for Tchibo in Poland, where she held the position of marketing director in Poland and Baltic countries. She was also responsible for international marketing for the Tchibo brand in Tchibo GmbH in Hamburg.

From 2000 to 2007 she was general manager of Tchibo with responsibility for the FMCG business in Poland and Baltic countries, operations of Tchibo shops and a factory in Poland.

As member of the Management Board of Tchibo GmbH in Hamburg, from 2007 to 2013, she was responsible for developing the FMCG business, retail and e-commerce in eleven countries of Eastern Europe.

She was recognized twice by the Financial Times Deutschland as one of the most influential women in business.

In January 2014 Wioletta Rosołowska joined L'Oréal Group and in July 2014 she took up the position of the President of L'Oréal Polska.

In L'Oréal Polska she manages the group of over 900 people and she is jointly responsible for the operations of Kosmepol in Poland, which is one of the most important factories of the L'Oréal Group.

**Doris Tomanek**, member of the Supervisory Board of Bank Pekao S.A. and member of its Nomination and Remuneration Committee

She holds a Master's degree in Macroeconomics from the University of Economics, Vienna/Austria.

She started her professional career 1975 in Creditanstalt-Bankverein before joining in 1982 the HR department of MobilOil Austria AG. In 1988 she moved to Coca-Cola where she held regional Human Resources positions with increasing responsibility, covering all Central and Eastern European countries as well as Austria, Italy, Switzerland and Nigeria.

In 2005 she joined UniCredit Bank Austria AG where she became Head of Human Resources for Austria and CEE in 2006. In 2008 she was appointed Executive Vice President and in 2010 she became a Member of the Board of Bank Austria.

Since October 2016 she is Head of HR Austria.

She was a member of the Supervisory Board of Ukrsotsbank, Ukraine 2011 – 2016 and a member of the Supervisory Board of UniCredit Integrated Solutions from 2013 – 2014. Since 2015 she is Member of the Board of Directors of UniCredit & Universities Foscolo Foundation, Italy.

**Roberto Nicastro**, Deputy Chairman of the Supervisory Board of Bank Pekao S.A., Member of the Financial Committee and Chairman of the Nomination and Remuneration Committee until 16th June 2016.

Member of the Bank's Supervisory Board in the years 1999-2003; from 29th April 2010 member and from 16th June 2010 to 1st June 2012 Deputy Chairman of the Supervisory Board. From 30th April 2014 to 16th June 2016 Chairman of the Nomination and Remuneration Committee.

He studied at the Bocconi University, where he became guest researcher after his degree in Business Administration.

He worked for Salomon Brothers (London) and McKinsey & Co (Milan) as Strategic Advisor, developing organizational-strategic projects for Financial and Regulatory Organization and Consumer Companies based in Italy and South America.

Before joining UniCredit Group in 1997, he became Head of Planning & Participations in Credito Italiano. Later he was appointed as Group Deputy General Manager and Head of the New Europe Division of the UniCredito, to develop a brand new leader position in Central and Eastern Europe.

In 2003 he was appointed Head of Retail Division and CEO of UniCredit Banca. In 2007 he took the position of Deputy CEO of the Group.

Starting from 2010 till September 2015 he was General Manager of UniCredit, with responsibility for Austria, Central and Eastern Europe, Marketing Retail and Multichannel, Group Internal Control System, Fineco and relationships with the Regulators.

He was member of the Supervisory Board of UniCredit Bank Austria – Vienna, and UniCredit Bank Zao – Moscow, Comitato Esecutivo ABI and Comitato Direttivo Assonime.

From 2009 until 2012 he served as Chairman of EFMA (European Financial Marketing Association).

**Alessandro Decio**, Secretary of the Supervisory Board, member of the Audit Committee and Financial Committee until 16th June 2016.

Member of the Bank's Supervisory Board from 19th April 2011; from 1st June 2011 to 1st June 2012 Secretary of the Supervisory Board;

from 2nd June 2012 member and from 24th July 2012 to 16th June 2016 Secretary of the Supervisory Board.

A graduate from the Department of Economics, Commerciale L. Bocconi University, Alessandro Maria Decio holds an MA from INSEAD (the European Institute for Business Administration) and worked as a research assistant for six months at Commerciale L. Bocconi University.

Starting his finance career at IMI International, Mr. A. Decio held the post of Vice President until 1991. Subsequently, he was employed by Morgan Stanley International as an associate and afterwards by McKinsey until 1994 at the same position.

At the end of 1994 Alessandro M. Decio joined the European Bank for Reconstruction and Development (EBRD) and left in 2000 as a Director.

In June 2000, he joined UniCredit Group as the Head of Foreign Banks Strategy, Mergers, Acquisitions, Planning and Control Group. In October 2002 he was appointed Chief Operating Officer (COO) for Zagrebacka Banka within UniCredit Group. He served as COO at Bulbank in Bulgaria, another UniCredit Group company between 2003 and 2005.

Mr A. Decio was appointed Manager of UniCredit Group's Germany Integration Project at the beginning of 2006, before going on to serve as UniCredit Group Deputy Head of Integration Office from July 2006 to July 2007. Appointed as Executive Director of Yapi Kredi on

26th April 2007, he also became the Chief Operating Officer of the Bank on 1st July 2007. As of 30th January 2009 A. Decio has been appointed as the Deputy CEO of Yapi Kredi.

In February 2011 he became Head of Family & SME Division in UniCredit, Responsible for Retail and SME for Italy, Austria, Germany and also Responsible for Global Leasing, Factoring, Consumer Finance, Asset Gathering (CEE Countries).

From 1st August 2012 till end of 2015, he was Group Chief Risk Officer and Member of the Executive Management Committee of UniCredit.

He was also: Member of the Board of Mediobanca S.p.A., Member of the Board of Borsa Italiana S.p.A. – London Stock Exchange Group, Member of the Board of UBIS Scpa – UniCredit Business Integrated Solution, Member of the Supervisory Board of UniCredit Bank Austria and ZAO UniCredit Bank.

### Powers of the Supervisory Board

In addition to other rights and obligations provided for in the Commercial Companies Code and in the Bank's Statute, the scope of powers and duties of the Supervisory Board includes in particular:

- reviewing the Management Board's Report on the Bank's operations and the Bank's financial statements for the previous financial year,
- reviewing the Management Board's recommendations concerning the distribution of profit or coverage of loss,
- reviewing the Management Board's Report on the Group's operations and the consolidated financial statements for the previous financial year,
- presenting the General Meeting of Shareholders with a report on the results of the above reviews and a report on the Supervisory Board's activities in the previous financial year,
- requesting approval from the Polish Financial Supervision Authority for appointment of the President of the Management Board and the member of the Management Board supervising the management of significant risk in Bank operations and to entrust this function to the appointed member of the Management ,
- appointing and removing from office the President of the Management Board and, upon the President's request, Vice Presidents and members of the Management Board,
- suspending from office a member (members) of the Management Board for important reasons,
- determining the terms and conditions of contracts governing employment relationships or other legal relationships between members of the Management Board and the Bank,
- approving of long-term development plans and issuing opinions on annual financial plans of the Bank,
- giving opinions on the Management Board's proposals concerning establishment of other companies or joining other companies as a shareholder, as well as disposal of shares or other equity interests, where a given transaction is related to a long-term strategic investment,
- approving the establishment or liquidation of foreign branches and representative offices of the Bank,
- adopting, upon the Management Board's request, rules governing the creation and use of funds specified in the Statute,
- approving the Management Board's proposals concerning purchase, encumbrance, or sale of real estate, an interest in or perpetual usufruct rights to real estate, where the value of a given transaction exceeds PLN 5 M,
- approving the Management Board's proposals concerning assumption of an obligation or disposal of assets, where the value of a given transaction executed with a single entity exceeds 5% of the Bank's equity,
- approving the Management Board's proposals to outsource services, where the services pertain to a strategic area of the Bank's business or their value equals or exceeds EUR 1 M.

### Functioning of the Supervisory Board

In 2016, the Supervisory Board operated in accordance with the Rules of Procedure, adopted by virtue of Resolution No. 10/15 of 6 February 2015 and amended by Resolution No. 54/15 of 18 December 2015. The Rules of Procedure are available on the Bank's website.

Meetings of the Supervisory Board are held when needed, but not less frequently than once in two months. Pursuant to the Rules of Procedure, the meetings of the Supervisory Board are accessible and open to members of the Management Board, unless they deal with matters relating directly to the Bank's Management Board or its members, and in particular with the appointment or removal from office of the President of the Management Board or, upon the President's request, Vice Presidents or members of the Management Board, their suspension from office, their liability or determination of their remuneration.

According to the Statute and the Code of Best Practice for WSE Listed Companies 2016, every year the Supervisory Board submits to the General Meeting of Shareholders an annual report on its activities, including activities of its committees, and a concise evaluation of the Bank's standing, with special focus on the internal control system and the system for managing risks material to the Bank. The documents are made available to the shareholders before the General Meeting.

The Rules of Procedure of the Supervisory Board stipulate, in line with the principles set out in the Code of Best Practice for WSE Listed Companies 2016, that in the event of a conflict of interests, the Supervisory Board member concerned is obliged to inform the other Board members of its occurrence and refrain from discussing and voting on a resolution which relates to the matter in respect of which the conflict of interests has occurred.

The Bank has in place a procedure for obtaining information from members of the Supervisory Board on any personal, actual and organisational links. Such information is then disclosed in current and periodic reports in accordance with applicable laws and the Code of Best Practice for WSE Listed Companies 2016.

In 2016, the Supervisory Board held 9 meetings, reviewed 125 information notes, analyses and proposals, and adopted 83 resolutions.

### Independent Members of the Supervisory Board

In accordance with the Bank's Statute, at least half of the members of the Supervisory Board should be independent members, i.e. persons free from any relationships that could materially affect their ability to make impartial decisions.

Detailed criteria which must be satisfied by members of the Supervisory Board to be deemed independent members are set out in the Bank's Statute. Pursuant to Section 14.5 of the Statute, to be deemed independent, a member of the Supervisory Board must meet all of the following conditions:

1. is not and has not been in the period of the last 3 years employed at the Bank, its subordinated units as defined in the accounting act or in its parent company,
2. does not perform and has not performed in the period of the last 5 years in the Bank, its subordinated units as defined in the accounting act or in its parent company a function of a member of the Management Board or other managerial function,
3. is not and has not been in the period of the last 3 years a chartered public accountant, a partner or an employee of an entity providing, now or in the last 3 years, auditing services in favour of the Bank, its subordinated units as defined in the accounting act or parent company,
4. is not a shareholder with the right to execute 5% or more votes at the General Meeting, is not employed by such a shareholder, does not represent – in any manner whatsoever – such a shareholder, or does not have other direct or indirect relations with such shareholder,
5. has not received and is not receiving any additional remuneration in a major amount, from the Bank, its subordinated units as defined in the accounting act or its parent company, apart from the remuneration for membership in the Supervisory Board or fixed-amount remuneration within a pension plan for past work in the Bank, its subordinated unit as defined in the accounting act or its parent company, if a prerequisite for disbursement of such remuneration is not continuation of employment,
6. is not maintaining and has not maintained for the past year significant commercial relationships with the Bank, its subordinated unit as defined in the accounting act or its parent company, directly or as a partner, shareholder, member of the body or employee holding a managerial function,
7. is not a management board member in another company in which the member of the Management Board of the Bank is a supervisory board member and does not have any major relation with Bank Management Board members through shares in other companies or membership in other bodies,
8. is not and has not been in the period of the last 3 years a member of a close family of a Bank Management Board member, does not have other direct or indirect relations with a Bank Management Board member, and is not and has not been in the period of the last 3 years a member of close family of an employee occupying a managerial position in the Bank or persons referred to in items 1-7 above,
9. does not have direct or indirect relations with the Supervisory Board members,
10. does not have direct or indirect relations with companies affiliated with Bank's major shareholders, as defined in the Code of Commercial Companies.

According to the submitted representations, the independence criteria set forth in the Statute were satisfied as at the end of 2016 by five out of nine members of the Supervisory Board, i.e. J. Woźnicki, D. Filar, K. Majchrzak, L. Pawłowicz and W. Rosołowska.

### Committees of the Supervisory Board

The Supervisory Board performs its functions during meetings and through the problem committees: the Audit Committee, the Remuneration and Nomination Committee, the Finance Committee and the Risk Committee. Composition of the Committees is presented further on in the Corporate Governance Statement.

**The Audit Committee** operates in accordance with Art. 86 of the Act on Certified Auditors, their Self-Government, Entities Qualified to

Audit Financial Statements and on Public Supervision, dated May 7, 2009 (the Act on Certified Auditors).

The Audit Committee supports the Supervisory Board in the performance of its supervisory duties, related in particular to the adequacy and effectiveness of the Bank's internal controls, including risk identification, measurement and management, compliance with applicable laws and procedures governing the Bank's operations, correctness of the application of accounting principles in the process of drawing up financial statements, ensuring impartiality of external auditors, and resources at the Internal Audit Department.

The remit of the Audit Committee is defined in Art. 86.7 and 86.8 of the Act on Certified Auditors. The detailed scope of powers and duties of the Audit Committee is laid down in the Supervisory Board's Resolution No. 41/14 of December 12, 2014.

The remit of the Audit Committee includes in particular:
- assessment of the effectiveness of the Bank's internal control system,
- review of material conclusions based on the work of the Bank's Internal Audit team and inspections carried out by external entities, oversight of remedial actions,
- making recommendations to the Supervisory Board regarding selection of an auditing firm to audit the Bank's financial statements, and evaluation of the cooperation with the auditor,
- examination of the process of preparing financial statements.

The Audit Committee is composed of five persons elected from among members of the Supervisory Board, including three independent members.

Meetings of the Audit Committee are held as need arises, but not less frequently than four times a year, and the dates of these meetings coincide with key dates in the Bank's reporting cycle and the review of the annual internal audit plan.

In 2016, the Audit Committee held 4 meetings.

The Committee meetings are attended by the President of the Management Board and other top management staff if matters discussed fall within their respective scopes of responsibility. The Committee also holds meetings – without the presence of the Management Board representatives – with the Bank's external auditor and the Director supervising the operations of the Internal Audit Department.

**The Nomination and Remuneration Committee** operates under the Rules of Procedure of the Supervisory Board and on the basis of the Rules of Procedure of the Nomination and Remuneration Committee adopted on April 27, 2015 and amended by Resolution No. 75/16 dated October 11, 2016.

The aim of the Committee is to support the Supervisory Board in performing its duties by, among others:
- submission of recommendations regarding conditions of agreements that regulate employment relationship or other legal relationship between Members of the Management Board and the Bank, including the amount of remuneration to be paid to Members of the Management Board, and regarding approval of the policy on variable components of the remuneration for persons holding managerial positions in the Bank according to separate regulations and in order to submit recommendations to the General Shareholders Meeting regarding the remuneration to be paid to Members of the Supervisory Board,
- preparation of recommendations regarding fulfillment of suitability requirements for the purpose of appointment of Members of the Management Board and the Supervisory Board,
- preparation of report for the General Shareholders Meeting regarding assessment of functioning of the remuneration policy in the Bank.

The Committee meetings are held as need arises.

**The Finance Committee** operates under the Supervisory Board's resolution. Its role is to exercise supervision over the finances of the Bank.

The Committee members may use the services of professional advisers appointed under the Supervisory Board's resolutions. The advisers are obliged to keep confidential any information obtained while performing the tasks ordered by the Finance Committee.

**The Risk Committee** operates on the basis of "Rules of Procedure of the Risk Committee" set up by the Supervisory Board. Mission of the Committee is to support the Supervisory Board in fulfillment of its obligations concerning supervision over risk management system and assessment of the adequacy and effectiveness of the said system.

The annual reports on the activities of all Committees are available to shareholders.

## Management Board

### Appointment, Composition and Qualifications

The Management Board is composed of five to nine members. Members of the Management Board are appointed by the Supervisory Board for a joint three-year term of office.

The Bank's Management Board comprises: the President of the Management Board, Vice Presidents and Members of the Management Board. Vice Presidents and Members of the Management Board are appointed and removed upon request of the President. Appointment of the President and the member of the Management Board supervising the management of significant risk in

Bank operations and to entrust this function to the appointed member of the Management Board, is subject to approval by the Polish Financial Supervision Authority.

Applications to the Polish Financial Supervision Authority are submitted by the Supervisory Board. The Vice President of the Management Board, who is subject to approval by the Polish Financial Supervision Authority, is responsible for risk management, including credit risk, with the exception of managing compliance risk.

At least half of the members of the Management Board, including its President, should possess thorough knowledge of the Polish banking market, i.e. they should meet all of the following criteria:
- they must have professional experience gained on the Polish market, relevant for the performance of a managerial function at the Bank,
- they must be permanently domiciled in Poland,
- they must have command of the Polish language.

In the Management Board of the current term of office, all of the aforementioned criteria are met by six members.

The Management Board currently in office comprises seven members, including the President and six Vice Presidents.

All Management Board members have extensive knowledge and experience needed to perform their duties on the Board. Their professional backgrounds are available at the Bank's website.

**Mr Luigi Lovaglio**, President of the Bank's Management Board, CEO.

Luigi Lovaglio was elected the President of the Management Board, CEO of Bank Pekao in May 2011. Prior, since 2003 he hosted the position of Vice President and General Manager of Bank Pekao.

He has over 40-year experience in banking, most of this time devoted to the leading international banking group – UniCredit – which he joined in 1973. During next 20 years he held a number of management positions and in 1997 he assumed the responsibility of the Head of Strategic Planning of UniCredit Group where he participated in the process of mergers of newly acquired banks. Two years later, in 1999 he became one of the key founders of New Europe Division, and with regard to his broad experience in mergers, he was responsible for the integration of first acquired institution – Bank Pekao.

In the years 2000-2003 Luigi Lovaglio hosted the position of Deputy Chairman of the Management Board and Executive Director of Bulbank AD – the largest bank in Bulgaria.

In September 2003 he came back to Poland, assumed the responsibility of Vice President and General Manager at Bank Pekao, in 2011 he was elected the President of the Management Board, CEO of the Bank. He commenced strengthening the position of this Bank and as the result Bank Pekao has been recognized by major international financial institutions and magazines as one of the leading banks in Central and Eastern Europe. His focus on sustainable long term returns and ethical aspects led also to the decision not to offer CHF mortgage loans to retail customers, which was and exception in CEE.

Luigi Lovaglio was born in 1955 in Potenza, Italy. He is a graduate in Economics and Commerce at the University of Bologna. In 2008 he was awarded the title of Italy's Commander of the Order of the Star of Italian Solidarity by Giorgio Napolitano, President of Italy, in recognition of his outstanding contribution to the development of economic cooperation between Poland and Italy.

**Mr Diego Biondo**, Vice President of the Management Board.

He completed business management studies at the University of Turin.

Mr Biondo started his professional career in 1990 a t the Fiat Group in Turin, where he held a number of positions in the Finance Department. In 2000, he became Vice President and Deputy Treasurer of Fiat Finance North America of New York. In that role, he was responsible for the financing activities of the Fiat Group's companies in the US, Canada and Mexico. In the years 2001-2003, he was Vice President and Chief Financial Officer at Fiat Polska Sp. z o.o. in charge of the financing activities of the Fiat Group in Poland.

Mr Biondo joined Bank Pekao S.A. in 2003 as Executive Director, Head of the Risk Management Division (CRO).

Since December 11th 2008 he has served as Vice President of the Management Board, Chief Risk Officer.

**Andrzej Kopyrski**, Vice President of the Bank's Management Board.

He is a graduate of Warsaw University of Technology and the University of Strathclyde (Glasgow).

He started his career in the banking sector in 1992, when he joined Bank Pekao S.A. From 1993 to 1996, he worked in the corporate banking division at ING Bank Polska. Afterwards, he became Head of Structural Finance at Deutsche Bank Polska, and then from 1997 to 2001 he held the position of Head of Structural Finance and Capital Markets at ABN Amro Bank (Polska). In 2001, Mr. Kopyrski was appointed member of the Management Board at HSBC Financial Services (Poland).

Since April 2002, Mr. Andrzej Kopyrski worked for Bank BPH S.A. as Managing Director responsible for Sales, Structural Finance and Capital Markets. After the merger with Bank Pekao S.A., he took charge of the Investment Banking and Structural Finance Department.

On June 4th 2008, he was appointed Vice-President of the Management Board of Bank Pekao S.A.

Currently he supervises the Corporate Banking, Markets and Investment Banking Division.

Mr. Kopyrski is President of the Management Board of Pekao Faktoring Sp. z o.o. and Chairman of the Supervisory Boards of Pekao Leasing Sp. z o.o. and Pekao Investment Banking S.A.

**Adam Niewiński**, Vice President of the Management Board.

He is a graduate from the Warsaw School of Economics, faculty of Management and Marketing. He also completed courses at the American management schools: Stanford University Graduate School of Business and Harvard Business School.

Mr. Niewiński started his professional career in 1998 at the Boston Consulting Group, where he worked as consultant specialized in financial services sector. For nearly three years, he carried out many projects in the areas of reorganization and strategy development. Since 2000 he was completing a team, acquired financing and subsequently established the Expander company (FinFin S.A.) where he held position of the President. Initially the company was running Poland's largest website rendering financial advisory services and then it was transformed into a distributor of financial solutions with branches all over Poland. The new strategy enabled the company to achieve the leading position in financial advisory and intermediation in sale of mortgage loans.

Since 2002 up till now Mr. Niewiński has been associated with the Pekao Group.

In July 2002, he started working in Central Brokerage House of Bank Pekao S.A. (CDM) where he held the position of Vice-President of the Management Board. Then, from April 2004 to April 2015, he was President of the Management Board of Dom Inwestycyjny Xelion Sp. z o. o. In February 2013, he was appointed Executive Director of the Private Banking Division at Bank Pekao S.A. Since 30$^{th}$ April 2015, he is Vice-President of the Management Board of the Bank supervising Private Banking Division.

Mr. Niewiński is also Chairman of the Supervisory Board of Dom Inwestycyjny Xelion sp. z o.o, Chairman of the Supervisory Board of Private Equity Managers SA as well as Member of the Supervisory Board of Pekao Investment Banking S.A. and Member of the Management Board of the Society for the Encouragement of Fine Arts.

**Mr Grzegorz Piwowar**, Vice President of the Management Board.

He holds a master's degree in Electronics from the University of Science and Technology of Krakow and completed post-graduate studies in banking at the Krakow University of Economics.

He has been associated with the banking sector since 1992, when he joined Bank BPH S.A. In the years 1996-2000, he worked as Head of the Brokerage Office and for another two years as Director of the Retail Banking Southern Region. In 2002, he was promoted to the position of Sales and Distribution Managing Director of the Retail Banking Division. In October 2006, he was appointed member of the Management Board of Bank BPH S.A. in charge of Retail Banking.

Since November 30$^{th}$ 2007, he held the position of Vice President of the Management Board of Bank Pekao S.A. with responsibility for the Retail and Business Banking Division and since 2009 he has been responsible for the Retail Banking Division.

Chairman of the Supervisory Board at Centralny Dom Maklerski Pekao S.A. Pekao Bank Hipoteczny S.A. Pioneer Pekao Investment Management S.A.

Member of the Supervisory Board at Biuro Informacji Kredytowej S.A.

Since September 2015, Chairman of the Micro, Small and Medium Entrepreneurs Council at the Polish Bank Association.

**Stefano Santini**, Vice President of the Bank's Management Board.

He graduated from the Faculty of Economics of Bocconi University where he defended his MA dissertation on the "Transformation of Central and East European countries to market economy".

Following a period of involvement in economic research, he embarked on a professional career in banking. In 2000 he joined UniCredit supporting P&C activities for the UniCredit Group and managed project integration in Croatia and Romania. In 2003, as a representative of UniCredit he started supporting P&C, the Project Office of Bank Pekao S.A. In 2005 he joined Bank Pekao S.A. as Deputy Director of the Finance Division. In 2006, after the merger of UniCredit and HVB, he was appointed Project Manager responsible for the spin-off of BPH and merger of Bank BPH and Bank Pekao S.A.

In 2008 he was appointed the Head of the Capital Allocation and ALM Department in Bank Pekao S.A. and the Adviser to the Supervisory Board of UniCredit Bank Ukraine and Member of the Audit Committee.

In April 2010 he became member of the Management Board of UniCredit Bank Hungary Zrt. as CFO responsible for planning and control, accounting, management information, asset and liability management and the tax area, while supervising the operations of the Bank's subsidiary companies. At the same time, he was elected Chairman of the Supervisory Board of UniCredit Jelzálogbank Zrt. (mortgage bank) and Chairman of ALCO.

Since 1 April 2013 he was appointed Vice President of the Management Board of Bank Pekao S.A. supervising the Finance Division.

On March 28$^{th}$ 2013 joined the Supervisory Board of Pekao Leasing and in July 2015 he was appointed Deputy Chairman of the Supervisory Board of Pekao Investment Banking.

**Mr Marian Ważyński**, Vice President of the Management Board.

A graduate of Warsaw University, Faculty of Law and Administration; he also completed postgraduate studies in commercial bank management at the Warsaw School of Economics.

He has been working in the banking sector since 1986. In 1986-1990, Mr Ważyński was Director of the Office of the President of the National Bank of Poland. From 1990 till 1998, he held a number of managerial positions at commercial banks. He was a member of the Management Board of AmerBank and Animex Bank, and a Regional Director of Bank Depozytowo-Kredytowy S.A.

Since he joined Bank Pekao S.A. in 1998, he was Executive Director – Merger Manager responsible for the transaction involving merger of four banks: Bank Depozytowo-Kredytowy S.A. in Lublin, Pomorski Bank Kredytowy S.A. in Szczecin and Powszechny Bank Gospodarczy S.A. in Łódź with Bank Pekao S.A. Then he became Executive Director responsible for the Logistics Division. Since December 15th 2004, he has been member of the Management Board of the Bank. In November 2007, Mr. Ważyński was appointed Vice President of the Management Board; he supervises the Logistics and Procurement Division.

## Powers of the Management Board

The scope of powers of the Management Board is defined by the provisions of applicable laws, including the Commercial Companies Code, the Banking Act and the Bank's Statute.

The Management Board runs the Bank's affairs and represents the Bank. The Management Board's powers include all matters which, pursuant to the provisions of applicable laws or the Bank's Statute, do not fall within the scope of competence of other governing bodies of the Bank.

The Management Board prepares the development strategy for the Bank and is responsible for the implementation of that strategy. Pursuing the principle of efficient and prudent management ofthe Bank, the Management Board is responsible for initiation and implementation of programmes aimed at increasing the Bank's value and rate of return for the shareholders, as well as protection of the employees' long-term interests.

In its decisions, the Bank's Management Board makes every effort to ensure, to the maximum extent possible, the promotion of the interests of the shareholders, customers, employees, as well as other entities and persons cooperating with the Bank in its business activity.

## Functioning of the Management Board

The principles and mode of operation of the Management Board are set forth in the Rules of Procedure of the Management Board of Bank Pekao S.A., approved under Resolution of the Bank's Management Board No. 101/VI/03 of 3 June 2003. With Resolution No. 480/XII/2014 of 22 December 2014 the Bank's Management Board approved new Rules of Procedure of the Management Board. The Rules of Procedure of the Management Board are available on the Bank's website.

The management of the Bank is based on professionalism, reliability and confidentiality. Relations with customers are characterised by reliability and fairness and operations compliant with law. These values are among the principles incorporated in the Code of Conduct and UniCredit Integrity Charter implemented at the Bank.

Each member of the Bank's Management Board is obliged to act in such a way as to further the Bank's interests. According to the Code of Conduct effective at the Bank, each member of the Management Board is expected to be honest and loyal in pursuing the common objectives, and to respect the Bank's resources and use them in a prudent manner.

Moreover members of the Management Board are prohibited from taking any decisions or actions that would lead to conflicts of interests or that would be incompatible with the Bank's interests or their official duties. A Management Board Member is obliged to notify the Management Board of the Bank of any situation in which a conflict of interests might occur or has occurred as well as refrain from participating in discussion and voting on resolution in case of which a conflict of interest has occurred.

The Rules of Procedure of the Management Board specify the issues which require collective consideration by the Management Board. According to the Rules of Procedure, the following issues in particular require collective consideration:
- the Bank's development strategy,
- financial plans, reports on the operations and financial statements of the Bank and its Group,
- proposed distribution of profit (coverage of loss),
- rules for and manner of implementation of: the investment policy, the assets and liabilities management policy, the credit policy, the HR policy, the remuneration policy, the employee benefits policy and the interest rate policy,
- matters relating to purchase, encumbrance and sale of real estate or interests in real estate,
- matters relating to the organisational structure of the Head Office, as well as the establishment and liquidation of the Bank's organisational units,
- adoption of rules for special purpose funds,
- establishment of other companies, joining other companies and disposal of shares (or other equity interests), where a given transaction relates to a long-term strategic investment,
- establishment of associations and foundations and joining associations and foundations,
- matters remitted to the Management Board by the Supervisory Board,

- matters relating to the participation of the Bank's employees in supervisory boards of companies in which the Bank holds equity interests,
- approval and submission of a report on notifications of major abuses to the Supervisory Board.

Furthermore, the Management Board collectively considers all matters which are submitted to the Supervisory Board for consideration, as well as matters submitted by the Bank's Management Board to the General Meeting of Shareholders.

The Management Board is headed by the President, who convenes and presides over its meetings, presents its position to other governing bodies of the Bank and in relations with third parties, in particular with governmental authorities, and issues internal regulations. The President may delegate the authority to issue internal regulations to other persons.

In 2016, the Management Board held 48 meetings and adopted 476 resolutions.

### Management structure

Members of the Management Board coordinate and supervise the Bank's operations in line with the delegation of responsibilities adopted under a resolution of the Management Board and approved by the Supervisory Board. Mr Luigi Lovaglio, President of the Management Board, coordinated the activities of the Members of the Management Board and at the same time supervised the following areas of the Bank's activity: internal audit, compliance risk management and corporate communication, including investor relations.

President of the Management Board, Mr Luigi Lovaglio headed the Management Board, convened and presided over the Board meetings, presented the standpoint of the Board to other governing bodies of the Bank and in relations with third parties, in particular with the state authorities, and issued internal regulations.

Mr Diego Biondo, Vice President of the Management Board, supervised the activity of the Risk Management Division.

Mr Andrzej Kopyrski, Vice President of the Management Board, supervised the activity of the Corporate Banking and MIB Division.

Mr Adam Niewiński, Vice President of the Management Board, supervised the activity of the Private Banking Division.

Mr Grzegorz Piwowar, Vice President of the Management Board, supervised the activity of the Retail Banking Division.

Mr Stefano Santini, Vice President of the Management Board, supervised the activity of the Financial Division.

Mr Marian Ważyński, Vice President of the Management Board, supervised the activity of the Logistics and Procurement Division.

The Management Board ensures that the management system at the Bank is transparent and effective, and runs the Bank's affairs in compliance with applicable laws and the rules of the Code of Best Practice for WSE Listed Companies and the Code of Banking Ethics of the Polish Bank Association.

The Bank's organisational structure is made up of:
- the Head Office,
- operational units of the Head Office,
- Regions,
- Branches,
- other organisational units.

The basic organisational units of the Bank's Head Office (departments, bureaus) may be combined into divisions. Each division may be directly supervised by a member of the Management Board; it may be also managed by an Executive Director / Head of Division. In turn, the divisions and the basic organisational units of Bank's Head Office may be grouped into areas which activities may directly supervised by a member of the Management Board or it may be managed by an Executive Director/Director.

The Bank's Head Office has the following standing Committees:
- Credit Committee of the Bank
- Asset, Liabilities and Risk Committee
- Liquidity and Market Risk Committee
- Operational Risk Committee
- Change Management Committee
- Security Committee
- Internal Business Control Committee
- Committee for Relations with Regulatory and Control Bodies
- Conflicts of Interest Committee
- Data Management and Data Quality Committee
- Model Risk Committee

The tasks, composition and functioning of the Committees are defined by Bank's internal procedures.

## Risk Management System

The risk management system in place at Bank Pekao S.A. is defined in the ICAAP Policy, adopted by the Bank's Management Board and approved by its Supervisory Board.

The ICAAP Policy outlines the key elements of a comprehensive approach to the risks inherent in the Bank's operations and business strategy, both at the level of the Bank and the entire Bank Pekao S.A. Group. It defines the identified risks and the criteria for classifying them as material, sets out the objectives and principles of risk management, the target structure of risk exposure arising from the Bank's operations, as well as the acceptable level and structure of risk, defined within the assumed risk appetite.

# Corporate Governance

Every identified risk is assessed in terms of its materiality and – if found to be material – measured (if classified as measurable), as well as monitored and controlled in line with the methods and procedures defined specifically for each given type of risk. The risk assessment and measurement methodologies are designed to ensure compliance with the applicable legal requirements and the best market practices.

The Bank applies formal limits to mitigate the risks, in compliance with the assumed risk appetite, and defines rules to be followed in the event that the limits are exceeded. The adopted management information system serves as a tool enabling it to monitor the risks. The Bank's organisational structure is adapted to the size and profile of its risk exposure. In managing risks at the Group level, the Bank oversees risk exposures inherent in the operations of its subsidiaries.

Under the risk management system currently in place at the Bank, the Management Board is responsible for: the development, implementation and effective functioning of risk management processes and the process of computing internal capital adapted to the Bank's size and risk profile (risk appetite), taking into account risk exposures of subsidiaries. The Bank's Management Board receives regular updates on the Bank's risk profile, the largest exposures and credit risk concentrations.

The Supervisory Board, supported by the Risk Committee, exercises supervision over the risk management system, assessing its adequacy and effectiveness. Moreover, the Supervisory Board also provides supervision of compliance of the Group's policy with respect to risk management with the strategy and financial plan.

The risk management strategy (inclusive of risk appetite) and the risk management system in place at the Bank are subject to regular reviews and necessary updates to ensure that they remain adequate given the scale and complexity of the Bank's operations.

The risk management system in place at the Bank constitutes an integral part of the Bank's management system. Risk management improves the efficiency of the decision-making process, while ensuring compliance of the Bank's decisions with the best market practice and the applicable regulatory regime.

## Internal Control System

The Internal Control System of the Bank covers all regulations, procedures and organisational structures which – acting together – aim to ensure:

- compliance of the Bank's activities with provisions of law, internal regulations, internal standards and strategy of the Bank,
- effectiveness and efficiency of the Bank,
- protection of assets,
- prevention of losses and errors,
- security, stability and effectiveness of operations,
- reliability and completeness of accounting, management information and reliability of financial reporting,
- compliance of transactions with generally binding provisions of law, supervisory rules and internal policies, plans, regulations and procedures,
- support of the decision-making process,
- compliance with risk management rules in the Bank.

Internal control is a continuous process, carried out at all levels of the Bank. The internal control system involves– in various roles – the statutory bodies of the Bank, organisational units and sections of the Bank, individuals supervising and directing at all levels of management and all employees.

The Internal Control System of the Bank covers:

1. control function with the task of ensuring that the control mechanisms which include positions, groups of people or organisational units responsible for carrying out the tasks assigned to this function are complied with.
2. compliance unit with the task of identification, assessment, control and monitoring of compliance risk of the Bank's operations with law, internal regulations and market standards and submitting reports in that respect,
3. independent internal audit function with the task of testing and evaluating independently and objectively the adequacy and effectiveness of the risk management and internal control system, with the exception of the internal audit unit.

The Supervisory Board is responsible for exercising supervision over the operation of the Internal Control System, which includes evaluation of its adequacy, efficiency and effectiveness. The Supervisory Board is assisted in the performance of its duties by the Audit Committee and the Internal Audit.

The Management Board is responsible for the development, implementation and regular revision of the policies, strategies and procedures of the Internal Control System as well as for the adequacy, efficiency and effectiveness of the Internal Control System, which is adapted to the size and profile of the risk inherent in the Bank's operations. The President of the Management Board issues Internal Control Regulations.

There is an Internal Business Control Committee in the Bank whose tasks include consulting and recommendations supporting the efficiency and effectiveness of the Bank's Internal Control System. The Committee supports the President of the Management Board identifying remedial measures and priorities in their implementation, with a view to providing for the needs of the Bank's organisational units and of Clients, as well as to ensure compliance of the Bank's operations with internal regulations of the Bank and the generally applicable law.

The Internal Control System includes three control levels:

1) Operational management
   Controls carried out under operational management function are divided into line controls and functional controls.
   a) Line control is carried out on an ongoing basis by each employee (self-control) based on existing procedures and based on duty of supervision by managers of the Bank's organizational units (hierarchical control). This control should ensure correctness of operations within the same operational structure in accordance with the applicable procedures.
   b) Functional control is performed in the Bank's units based on control plans prepared by directors of those units, performed by them with respect to their subordinate employees or by delegated employees entrusted with control duties. The purpose of the control is to verify the correctness and the quality of performed activities, in particular with respect to risk assessment and risk monitoring, compliance with the competences assigned to specific positions and checking coherence between authority rights various areas of operations.
2) Control of risk management
   Control of risk management is performed by the Bank's units not involved in business activity, in particular in the areas of security, financial controlling and accounting, risk management and compliance. The purpose of the control is to measure, monitor and strengthen the effectiveness of risk management undertaken by operational units to support risk owners in determining the level of risk exposure and distribution of information regarding the risks in the Bank.
3) Internal Audit (institutional control)
   This control covers audits performed by the Internal Audit Department (IAD) both in organisational units of the Bank and in its subsidiaries. The task of IAD is to review and evaluate independently and objectively, the adequacy, efficiency and effectiveness of the Internal Control System, compliance function and risk management system. IAD activities are aimed to detect and remove any incompliance of actions taken by the Bank's employees with the applicable laws, including compliance with prudential regulations and other external standards as well as the Bank's internal regulations in force.

   Institutional control is exercised through audits performed in accordance with an officially approved audit plan and unplanned ad hoc audits, as well as remote audits. The Internal Audit Department reports directly to the President of the Management Board. The Internal Audit Department also submits its reports to the Audit Committee and the Supervisory Board.

   The Internal Audit Department operates in compliance with the International Standards for the Professional Practice of Internal Auditing, according to an independent quality assessment review performed by PwC in December 2013.

The Bank exercises the control functions at its subsidiary companies by having representatives in the Supervisory Board of each subsidiary. The companies in the Pekao Group apply uniform standards and principles of Internal Audit activity.

## Protection of Inside Information and Prohibition of Trading during Closed Periods

In the sphere of prevention of unlawful use and disclosure of inside information and ensuring that investors have equal access to information, the Bank meets the high standards stipulated in the Act on Trading in Financial Instruments of 29 July 2005, the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies of 29 July 2005, which transposed the provisions of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on Insider Dealing and Market Manipulation (Market Abuse) into Polish law and Regulation (EU) No 596/2014 of the European Parliament and of Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC together with Commission Implementing and delegated regulations.

Pursuant to the provisions of Regulation No 596/2014 on market abuse, the Bank prohibits the use of inside information or attempt to use inside information, the recommending that other persons use inside information or attempt to use inside information, unlawful disclosure of inside information and executing by persons holding managerial responsibilities in the Bank, during the so-called closed period, transactions on their own account or on account of any third party, directly or indirectly, regarding the Bank's stocks or Bank's debt instruments or derivatives or any other related financial instruments, or executing, on their own account or on account of any third party, any other legal activities which lead to or may lead to the disposal of such financial instruments.

Protection of inside information and ensuring that investors have equal access to information are among the basic duties of all the Bank's employees. The manner of performing those duties and detailed procedures in that respect are regulated by orders of the President of the Management Board, pursuant to which the following documents have been introduced:
– The rules for fulfilment of the obligations related to the Bank's Inside Information and notification of transactions made by persons holding managerial responsibilities and persons closely associated with them; and
– Rules for preparing and releasing by Bank Polska Kasa Opieki S.A. of current and periodic information to be published by issuers of securities and other information related to the Bank's shares.

Additionally, the Bank guarantees protection of personal data and protects information embodying its business secrets.

### Protection of Inside Information

In order to prevent unlawful use and disclosure of inside information, the Bank has established an inside information protection system whose main purpose is to secure and protect documents containing inside information, protect systems containing inside information and control the workflow of documents and other information media containing inside information.

The currently applicable also include a prohibition on using or disclosing inside information, or recommending or inducing other persons to acquire or dispose of financial instruments on the basis of the inside information which relates to such instruments.

The above prohibition applies to all persons who hold inside information as a result of performing various functions in the Bank's governing bodies, having access to such information in connection with their employment, practiced profession, or a mandate contract or any other legal relation of a similar nature, and in particular to:

1. members of the Management Board, the Supervisory Board, proxies or attorneys-in-fact of the Bank, its employees, auditors or other persons related to the Bank under a mandate contract or any legal relation of a similar nature (primary insiders),
2. the Bank shareholders,
3. persons employed or holding posts referred to in item 1 in subsidiary companies or the the parent company of the Bank, or bound with such company under a mandate contract or any other legal relation of a similar nature.

The Bank monitors compliance with the above prohibition in accordance with the Rules. The Rules also define the manner of proceeding in the event of a reasonable suspicion of any unlawful use or disclosure of inside information, non-compliance with the disclosure requirements or execution of prohibited transactions during the so-called closed periods.

The Bank keeps a list of all persons having access to inside information and working for the Bank on the basis of employment or on another basis, performing tasks under which they have access to inside information, such as consultants, auditors or rating agencies and immediately updates the list of persons having access to inside information.

### Prohibition of Trading During Closed Periods

Persons holding managerial responsibilities in the Bank, during so-called closed period, are not allowed to execute any transactions on their own account or on account of any third party, directly or indirectly, regarding the Bank's stocks or Bank's debt instruments or derivatives and other financial instruments related thereto, or execute, on their own account or on account of any third party, any other legal activities which lead to or may lead to disposal of such financial instruments.

The closed period is the period of 30 calendar days prior to the date of publication of the quarterly, semi-annual and annual reports of the Bank.

Persons holding managerial responsibilities are persons associated with the Bank who:

a) are members of the Management or Supervisory Board; or
b) perform managerial functions without being members of the management bodies (referred to in point a) but have permanent access to the Bank's Inside Information, directly or indirectly, and are authorised to take management decisions affecting further development and business prospects of the Bank, i.e. persons who are covered with the variable remuneration system for the Management Staff, Executive Director or another Director reporting directly to the Bank's CEO.

Persons holding managerial responsibilities are notified of the opening and closing dates of closed periods related to the publication of the Bank's periodic reports.

The Bank may authorise a person holding managerial responsibilities to execute transactions on their own account or on account of a third party during the closed period: (a) on the basis of individual cases of exceptional circumstances, such as major financial difficulties which require instant sale of stocks; or (b) due to the features of a given transaction carried out within an employee stock ownership plan, savings plans, qualifications for or rights to stocks or transactions in which the benefit related to a given security does not change or features of transactions related to them; and when such person holding managerial responsibilities is able to prove that a given transaction may not be executed at any other moment than during the closed period and also that the execution of the transaction shall not constitute abuse of inside information or attempts to abuse inside information and that the transaction shall not infringe the prohibition to manipulate in the market.

Persons holding managerial responsibilities who undertake investment activity during a closed period are liable to administrative sanctions as well as to criminal sanctions.

### Reporting transactions performed by persons holding managerial responsibilities and persons closely associated with them

Pursuant to the Rules, persons holding managerial responsibilities and persons closely associated with them are required to provide the Polish Financial Supervision Authority and the Bank with information on each and every transaction executed on their own account and related to stocks or debt instruments of the Bank, derivative instruments or other related financial instruments.

The obligation specified above applies to each subsequent transaction upon reaching of the total amount of EUR 5,000 during one calendar year.

Persons closely associated are persons who are:
a) a spouse or partner considered equivalent to a spouse in the light of domestic law,
b) a dependent child, according to domestic law,
c) a family member who on the day of a given transaction has remained in the joint household with the person holding managerial responsibilities for at least a year, or
d) a legal person, a group of enterprises or a partnership in which the managerial function is performed by a person holding managerial responsibilities, or a person closely associated referred to in points a), b) or c) above, that is directly or indirectly controlled by such a person, established to bring benefits to this person or whose business interests are to a large extent convergent with the interests of such a person.

The Bank shall promptly disclose the information it receives simultaneously to the company operating the regulated market (Warsaw Stock Exchange) and to the public in a current report prepared according to a pre-defined format and using the appropriate IT standards.

## Relations with the Statutory Auditor

### Selection of the Auditing Firm to Audit Financial Statements

Pursuant to the Bank's Statute, the auditing firm is selected by the General Meeting of Shareholders. The Supervisory Board's recommendation concerning the selection of the auditing firm is drafted by the Audit Committee. The auditing firm entitled to audit the Bank's financial statements is selected in accordance with the relevant procedures applicable at the Bank, in a way that guarantees the auditor's independence during performance of its responsibilities.

### The Auditor's Independence

According to the applicable legal requirements, the Bank and the Pekao S.A. Group implemented the internal regulations aimed at guaranteeing independence of the auditors and reliability of the financial statements of the Bank and its subsidiaries. In particular, the Audit Committee established by the Supervisory Board, monitors and reviews the auditing firm's independence and impartiality, evaluates the results of the work performed by the auditing firm and examines the status of relations with the auditing firm. The Bank's internal regulations also specify the requirements for the provision of permitted services concluded between the Bank or any of its subsidiary companies and the auditor of financial statements.

## Credit Process for the Management Staff and Entities and Persons Related to the Bank

Pursuant to the provisions of Art. 79a of the Banking Act, credit transactions with members of the Bank's Management Board and Supervisory Board, with persons who hold managerial positions and entities related to them, are entered into on the basis of the relevant Rules adopted by the Bank's Supervisory Board.

The Rules set forth detailed principles of the decision-making process as regards entering into transactions with the above-mentioned persons and entities, and they also specify levels of authority to make relevant decisions, and their authority limits. Specifically, the decision to grant a loan to a member of the Management Board or Supervisory Board or to entities related to them by equity or organisational links, is made by the Management Board and Supervisory Board by way of individual Resolutions if the total exposure to such person or entity exceeds the PLN equivalent of EUR 10,000 translated at the mean exchange rate of the National Bank of Poland.

Members of the Bank's Management and entities related to them by equity or organisational links may use the Bank's credit products in accordance with the terms and conditions normally offered by the Bank. In particular, in relation to such persons and entities the Bank does not apply preferential interest rates; credit risk assessment is made in line with the methodology routinely employed by the Bank, adequately to the given customer segment and type of transaction.

With respect to the entities listed above, the standard credit process is used, while the decisions on entering into transactions are made exclusively by relevant authorities at the level of the Bank's Head Office.

# Corporate Social Responsibility

# Corporate Social Responsibility

## Introduction

Corporate Social Responsibility is the foundation on which the Bank builds its relations with the outside world.

Bank Pekao S.A. also observes Good Banking Practices adopted by the Polish Bank Association and the Canon of Best Practices on the Financial Market, a document endorsed by resolution of the Polish Financial Supervision Authority. The documents set forth the rules of conduct by banks in relations with customers, the rules of mutual relations among banks and of the bank's conduct as an employer towards its employees.

In order to stress the materiality of the issues related to social responsibility, Bank Pekao S.A. has approved an Integrity Charter – an internal set of values that include: respect, trust, equality, freedom (freedom of operation), reciprocity and transparency.

An integral part of consistent activities falling within the scope of the Bank's CSR strategy is social commitment. The Bank favours long-term social commitments based on partnership with selected trustworthy organisations with a view to solving certain clearly identified problems.

## Integrity Charter

The Bank's overarching objective is to build sustainable value by offering customers the best quality of service, introducing simple, easy-to-use solutions, creating a work environment conducive to personal development, ensuring satisfaction with work, reinforcing a sense of pride in being part of the organisation among the employees, and contributing to the betterment of local communities in which the Bank operates. All those aspects are included in the Integrity Charter.

The Charter is a collection of core corporate values. It identifies the values underpinning the relations with each stakeholder group, and indicates the models of conduct to be followed. Adherence to the Charter in relations with employees, customers, shareholders and communities is conducive to sustainable development, as it helps to build value for all stakeholder groups. With the Integrity Charter, the Bank strives to:

- propose ways of conduct that will support the Bank's own conduct in the day-to-day activities which may generate conflicts between morality, business objectives and various cultures,
- create a unity by overcoming conflicts and disputes, contribute to the development of a common sense of perception and experience among staff members.

The System of Values is the practical application of the Integrity Charter by translating its values into real-life situations and workplace relations. The system is based on a network of Ombudsmen for the Integrity Charter whose core task is to restore appropriate relations among employees when corporate values have been breached. The Bank's employees can contact the Ombudsmen for the Integrity Charter if they witness or are affected by a behaviour which is incompliant with the values underlying the Integrity Charter. The role of the Ombudsmen is to help solve problems resulting from non-adherence to those values. When notified, Ombudsmen take steps to reconcile the conflicting parties and restore the relation by using the available array of tools such as a meeting or bringing the problem to the attention of the persons concerned.

## Investing in human capital

### Human Capital as a key asset

The principles of the Bank's policy in the area of Human Resources (HR) development are set by its mission and values considered as a key for the Bank sustainable growth.

The Bank invests in training, professional development of employees (in line with their preferences and abilities), creation of a friendly work environment and conducts questionnaire surveys on employees opinion and satisfaction. Significant area of the Bank's personnel policy is outstanding talents spotting within the organization and investing in development of their skills.

In 2016, these priorities were accompanied by a particular emphasis on promoting preferential values of corporate culture shared across the Bank and UniCredit Group.

### Training and professional development

The Bank creates learning opportunities and provides access to various forms of training for its employees. Key educational activities focus on realization of in-class training programs, on-the-job learning, coaching and Virtual Class system allowing for distance learning in form of Webinars. In 2016, the Bank continued also structured rotation program allowing for direct exchange of professional knowledge between experts.

In 2016, the main training priorities of the Bank were as follows:

- reinforcement of product and sales knowledge of the Bank's personnel,
- professional knowledge development of the Bank's employees,
- education of middle and top managers,
- realization of mandatory training required under internal and external regulations.

**Reinforcement of product and sales knowledge of the Bank's personnel**

The Bank realized training projects supporting personnel in proper distribution of banking products, including products from bancassurance area. In co-operation with the NBP, it was implemented cascade training system for cashiers in scope of new securities of banknotes as well as it was initiated training program for the years 2016 and 2017 on introducing into circulation the new 500 PLN banknote. Training programs were also developed for the staff responsible for acquisition of new customers and personnel dealing with current clients.

**Professional knowledge development of the Bank's employees**

The Bank continued also realization of training projects aimed at reinforcement of risk culture and training regarding introduction of new business strategies. Training activities were concentrated on support of high potential employees and employees servicing SME clients.

In 2016, the Bank delivered (in form of class room and e-learning as well as virtual sessions) more than 375 thousands of training hours, in which attended over 15 thousands of employees (ca. 99% of all employed persons) confirming the Bank's determination in efficient implementation of required regulations and customer care.

## Development programs and initiatives

In 2016, development programs and initiatives were provided for the Bank employees, aimed at providing support in the development of managerial and interpersonal skills.

## Development processes

The priority of development programs in the Bank is identification, review, verification and development of current and future leaders of the Bank.

In order to achieve this goal, the Bank currently operates four main processes:
- Executive Development Plan (EDP) – annual appraisal process of managers as well as planning and realization of development activities. In 2016, 613 persons took part in the EDP,
- Talent Management Review (TMR) – annual process of the professional development, potential and performance assessment, used to manage and develop talents in the Bank and UniCredit Group, which was attended by 137 people, identified as part of the recruitment process, addressed to all employees of the Bank,
- Succession Plans, which are the key outcomes of the EDP and the TMR processes – Succession Plans are crucial for ensuring continuous employment on strategic positions, continuity of long-term projects and minimizing operational risk,
- Annual Employee Appraisal System – process of evaluation of the Bank's employees which comprises appraisal of competencies, potential, personal development planning and business goals appraisal. In 2016, 14,383 employees took part in the process.

Furthermore, the Bank offers the following development:
- Assessment Centre/Development Centre session, survey of individual performance style and communication and 180/360 Feedback – diagnostic tools for identification of strengths and development areas of the employees.
- Mentoring and Coaching – dedicated for selected employees to give them broader business perspectives and an opportunity to gain new experience.
- International development programs realized at the level of UniCredit Group (international training for the higher level managerial staff in the range of Leadership Curriculum Program and Master in CIB).
- Career Navigator tool supporting career development planning of the Bank's employees.

## Internship and trainee programs

One of the annual objectives of the Bank is to obtain a certain number of graduates of the best universities in Poland, offering them career development within the organization: the network of branches and units of the Head Office of the Bank.

The following programs are implemented in order to realize the above mentioned objective:
- UniChallenge – a two year-long internship program, addressed to talented last-year MA students and graduates. The UniChallenge Program is used to spot high-potential candidates for employees.
- The apprenticeship programs addressed to students. The apprenticeship possibility is offered for 2 weeks to 3 months in order to give participants an opportunity to gain experience in different areas of banking, in all of the Bank's units.

## Increasing engagement of employees

In 2016, a number of activities were undertaken in order to increase the employees' satisfaction and engagement. It was launched the Intranet website 'We support diversity' and there was conducted a series of workshops for more than 400 managers and the Bank's employees within the scope of the friendly workplace and effective management of an own energy. Moreover, 'Team's climate' project was continued, which is realized within the teams and is aimed at strengthening the employees' engagement through implementation of the activities that improve the work atmosphere. In 2016, more than 1,000 employees from the 30 Bank's organizational units were covered by this project.

## Compensation policy

On October 11, 2016, as a result of yearly reviews of remuneration rules, the Supervisory Board of Bank Pekao S.A. approved the updated Compensation Policy of the Bank (hereinafter referred to as "the Policy"), reflecting the mission and values of the Bank's approach to remuneration systems, which:
- defines basics of remuneration, structure management, corporate and organizational processes,
- confirms compliance requirements of the adopted remuneration system with generally binding law,
- defines the rules for monitoring of market practices and the approach to remuneration systems, which ensure sustainability of the Bank.

# Corporate Social Responsibility

General framework of the Policy is aimed at providing consistency of components and strategy of remuneration by maintaining compliance with risk management and long-term strategies.

The main principle of the Policy is to guarantee competitive level of remunerations and their efficiency, correctness in scope of acting and achieved results as well as transparency and internal justice.

In 2016, the main elements and assumptions of the Policy were not changed. The Bank's policy implemented in this area takes into account the regulations of the parent company, supplemented by provisions ensuring its compliance with the applicable provisions of the Polish law and the recommendations of regulators and supervisory authorities.

In 2016, in the Policy were included provisions to increase the role of the risk management function in the Bank in designing the compensation policy, incentive system and compensation processes, as well as defining the objectives and evaluating the results, the introduction of those responsible within the Bank's control functions maximum threshold, which the bonus pool of variable remuneration can be gradually reduced and the advantage the share of fixed remuneration in the total remuneration.

The compensation strategy was developed in line with the business standards and values underlying the Bank's mission and reflected in the Policy provisions as well as it constitutes the basis for enhancing and protecting the Bank's reputation and creating long term value for all the stakeholders. Moreover, the Policy presents provisions regarding variable compensation elements of persons in key managerial positions of the Bank. It is aimed at reinforcement of long-term value increase for shareholders and company stability. The conducted internal control concerning implementation of the Policy provisions regarding variable compensation elements confirmed execution of the above assumptions of the Policy at a good level.

Assessment report of functioning of the Policy in the Bank in 2015, according to the provisions of the Supervisory Board of Bank Pekao S.A. Regulation was presented for the General Meeting of Shareholders on June 16, 2016. After considering the report, the General Meeting of Shareholders estimated that the functioning of the Bank's Compensation Policy in 2015 contributed to the development and security of the Bank's activities.

Information regarding remuneration value of each Member of the Management and the Supervisory Board is presented in the section of Remuneration of the Management Board and the Supervisory Board.

**Incentive systems**
In the Bank, there are three main incentive systems: a System based on Management by Objectives (MBO), a System based on provisions of Corporate Collective Labour Agreement, which is based on quarterly bonuses and incentive reward, and Executive Variable Compensation System.

Executive Variable Compensation System is dedicated to people holding managerial positions, who have significant influence on the risk profile of the Bank. The aim of the System is to support the execution of the Bank's operational strategy and to mitigate excessive risk conflicts of interest. Participant covered by the system may receive a variable compensation based on a bonus pool approach providing for a comprehensive performance measurement at individual level, level of his/her organizational unit and results of the entire Bank, as well as verification of the participant's compliant behaviour with respect to law provisions and standards adopted by the Bank. In accordance with the system parameters, for reinforcement of care for long-term welfare of the Bank, at least 50% of variable remuneration is provided in phantom shares based on the value of the Bank shares and at least 40% of the bonus is deferrable and paid after the end of the evaluation period it is payable for. In case of the Management Board Members, deferral refers to 60% of the variable remuneration component. Variable remuneration payable for a particular year, is paid within 6 years by considering economic cycle and the risk resulting from conducted activity.

MBO system covers employees employed under the management contract and refers in particular to the positions in the front-office sales and to the managerial positions, which play a significant role in achieving the Bank's commercial goals. The employees covered by the MBO system receive individual goals resulting from the strategy and activity directions of the Bank approved for a particular year; the annual bonus value is conditioned by completion level of those tasks.

A system based on the provisions of the Corporate Collective Labour Agreement (CCLA) applies to all employees who are subject to it. According to the provisions of the CCLA the basis of the system is a quarterly bonus which is discretionary and depends on evaluation of employee's performance and the level of commitment and an incentive bonus, which is granted for outstanding work achievements and the Bank's results in a given year.

**Retention Plans**
In 2016, the Long-Term Incentive Plans of UniCredit Group (edition 2007 and 2008 within the scope of stock options) addressed to the top management was carried out.

**Additional benefits for employees**
Within the scope of remuneration system, the Bank's employees are offered non-wage benefits allowing fair treatment and consistency of remuneration system.

In 2016, Employee Share Ownership Plan (ESOP) was continued, under which the Bank offers to all employees the opportunity to invest in the shares of UniCredit S.p.A under at favourable conditions by obtaining Free Shares measured on the basis of the Investment Shares purchased by each Participant. Detailed information on Employee Share Ownership Plan is included in the Note 46 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

Moreover, the Bank provides its employees with additional medical care in domestic network of private medical clinic.

### Suitability Assessment Policy

The Bank adopted the Policy of the suitability assessment of the proposed and appointed Members of the Management and the Supervisory Board and Key Function Holders in Bank Pekao S.A. In 2016, the Bank assessed the suitability of the candidates for function of Member of the Supervisory and the Management Board including an assessment of their qualifications, reputation, and additional criteria for management according to mentioned policy. The suitability assessment is performed by the Supervisory Board of the Bank with the support of the Nomination and Remuneration Committee.

### Diversity policy

On February, 4, 2016, the Supervisory Board of Bank Pekao S.A. approved the resolution "Diversity policy in reference to Supervisory Board Members, Management Board Members and Key Function Holders in the Bank", which defines the strategy of the Bank in scope of diversity management, including diversity in reference to appointment, the Supervisory Board Members, the Management Board Members and the Key Function Holders in the Bank.

The purpose of diversity strategy of the Bank is to provide high quality of tasks execution by its governing bodies, through selection of qualified people to hold function in the Supervisory Board, the Management Board and Key Function Holders in the Bank, using as the first objective criteria and taking into account the benefits of diversity in scope of knowledge, skills and work experience, as well as educational background, geographical origin and nationality, gender and age. An integral element of Diversity policy is the Gender Equality Policy of the Bank, which provides the Bank's employees career opportunities, success and performance evaluation based on individual merit, regardless of gender.

### Corporate values

The Bank implements a project "System of Values" which defines the corporate values to be cherished by the Bank's employees in their daily relations at work. The Bank's values defined in the Integrity Charter are: respect, reciprocity, transparency, fairness, confidence, and freedom (to act). These values provide a reference system for routine work and for problem situations which are not always addressed by external and internal regulations.

The foundation of this "System of Values" is the work of Integrity Charter Ombudsmen who are independent, experienced, retired managers to whom the employees may report behaviours which clash with the corporate values. The Ombudsmen use the available tools (meetings, notices) when they undertake measures to restore respect for the corporate values in relations among employees wherever they have been disrupted. Their work directly supports the Bank's internal communication and defines certain standards of conduct and communication patterns for all the employees to follow. In 2016, the Integrity Charter Ombudsmen continue meetings with employees at the Bank in order to familiarize them with the "System of Values" and with the Ombudsmen's service. Furthermore, the Ombudsmen also meet with individual employees and they speak by telephone indicates the ability to solve problems.

### Relations with Trade Union Organisations

In 2016, the co-operation between the Bank and the trade unions in the fields of consultation, negotiation, and agreements was carried out according to the rules and procedures defined by the Labour Law and with respect to the interest of the parties and the principles of social dialogue. There were 14 meetings between the Bank and the Unions in that period.

### Relations with the Works Council

A Works Council of Bank Pekao S.A. Employees operates in the Bank. The Council is a representative of the workforce, authorized to get information and carry out consultation with the employees on matters defined by the Worker Information and Consultation Act of April 7, 2006. In 2016, the discussions with the Employee Council concerned issues covered by the relevant legal regulations and co-operation with the Works Council progressed with respect to the mutual rights of the parties involved. Reports on agreements made with the Employer are published on the Intranet available to the all Bank's employees.

### Workforce in number

As at the end of December 2016, the Group employed 17,757 employees (in the Bank and the companies consolidated under full consolidation method) as compared to 18,327 employees as at the end of 2015.

As at the end of December 2016, the Bank employed 15,882 employees as compared to 16,387 employees as at the end of 2015. The average age of the employees was 46.7 years, 64.7% of the employees are university graduates (64.1% in 2015), women represent 79.3% of the total workforce.

### Quality of cooperation

The Bank continued also in 2016 research regarding the following areas: service quality in branches, cooperation between Bank units and employees' commitment.

To verify service quality, there were nearly 2,000 Mystery Customer visits conducted in branches, supporting additional training initiatives and informational activities for branch employees. At the same time, an in-depth analysis of the results allowed the Bank to select behaviour that is most appreciated by customers and include it in current communications.

# Corporate Social Responsibility

In the Internal Customer Satisfaction Survey, employees have an opportunity to voice their opinions on cooperation with other organisational units and the quality of delivered services, processes and tools. Due to the fact, units have been implementing actions to improve specific processes and increase efficiency according to the expectations of their internal customers. In 2016 opinions were shared by over 10,000 respondents. Since the implementation of the Survey (2010), the TRI*M index for the branch network and the head office has grown by 9 points which means a significant growth in accordance with the applied methodology.

Another valuable source of information is People Survey. It focuses on collecting and analysing opinions on such areas as: commitment, sense of belonging, reputation, leadership, management effectiveness, growth and competence. As many as 81% of employees took part in in the last edition. There are continuous ongoing actions to increase Commitment Index which has gone up by 19 p.p. since the introduction of the survey on a large scale (2009).

The People Survey is complemented with the Pulse Check which is carried out on a quarterly basis and provides ongoing feedback on the level of employees' satisfaction. To further understand employees' opinions and suggestions on specific processes and services as well as to introduce appropriate changes, additional initiatives are taken. One of them is a "Day at the Branch", during which managers and branch employees exchange information on the improvements made and define further priorities for implementation. A number of additional surveys are conducted, dedicated to key projects under way at the Bank, for example a consumer loan survey.

Thanks to the surveys, during 2016 over 15 thousand opinions and comments were collected that have contributed to improvements in the existing procedures and processes and more effective cooperation between the Bank's units.

## Our customers

One of the key elements in building long-term and sustainable value of the Bank is the attention given to the satisfaction and loyalty of our stakeholders, and in particular – customers of the Bank.

In 2016 the Bank continued extensive research of Pekao's customer satisfaction level, which encompassed all business segments. The activities have been systematically used to work on improving the operations of the Bank and to build customers' needs oriented organization culture. More than 40,000 interviews were conducted, gathering feedback from customers of Pekao and competition, using various channels to reach every single respondent, i.e., phone interviews, Internet surveys and ATM surveys.

In 2016 it has been observed that the customer satisfaction positive trend continued for majority of the Bank's customer.

## Protection of Customers' Interests

The focus on the customers' interests is the main principle underlying the Bank's operations.

It is the Bank's objective to ensure that each customer, when purchasing a product or a service, is aware of the related risks and properly understood the value of such product or service. This is particularly important in the context of a substantial growth of risk due to the development of increasingly complex financial instruments. For many years now, the Bank has consistently refrained from granting mortgage loans in foreign currencies, thus effectively protecting its customers against FX risk, which hit many households severely when the złoty exchange rate plummeted.

Further enhancement of the protection for customers against taking excessive risk in their investment decisions resulted from the full implementation of the MiFID Directive in the Bank's Group.

Protecting customers against excessive risk-taking in investment decisions due to the full implementation MiFID in Pekao Group. As a result, customers expect full protection of their interests. On the basis of an adequacy questionnaire filled out by customers, the Bank carries out an assessment of the adequacy of the services related to orders concerning participation units in investment funds and other investment products. The adequacy questionnaire contains a set of questions relating to the customers' knowledge and experience level of investing in financial instruments and other investment products. On the basis of the assessment, customers receive feedback if the proposed service is appropriate and have a possibility to make informed investment decisions.

At the same time, the Bank has implemented management and organisational measures to enhance protection for customers – the conflicts of interests management policy and the customers classification/reclassification policy as well as the principles governing investments of the Bank's employees and a policy of selling investment products.

The Bank always focuses on building proper relations with its Customers and their greater satisfaction with the quality of the offered insurance products. The Bank continues implementing solutions – beneficial from the point of view of the protection of Customers' interests – in the area of the insurance product distribution, compliant with Recommendation U issued by the Polish Financial Supervision Authority, among others such as reliable information policy, and has been supporting customers in the claims reporting process. The Bank analyses bancassurance-related complaints and monitors the performance of insurance contracts by insurance companies.

Additionally, a Financial Survey has been implemented whose aim is to enable the selection of insurance products tailored to the needs of the customer in connection with an intention to conclude contracts related to insurance capital funds.

The Bank protects the interests of its customers, safeguarding their deposits and ensuring the security of transactions in their accounts. Information about customers is protected in line with the applicable security and confidentiality standards.

The protection of the funds entrusted to the Bank by its customers is the Bank's top priority. The solutions offered by the Bank are very modern and secure, convenient and practical.

When developing its state-of-the-art online platforms (Pekao24, PekaoBiznes24 and mobile payment PeoPay), the Bank ensured that they are user-friendly and absolutely secure. Access to accounts is protected by a multi-level security system. Electronic banking systems of Bank Pekao warrant the protection of personal data and the security of the funds in accounts and executed transactions.

In 2010, Bank Pekao was the first bank in Europe to have implemented the innovative biometric method of the authorization of users of its transactional system for corporate customers. The users of PekaoBiznes24 may log into the system and authorize their transactions with their fingerprints. The solution incorporates the best security standard on the market and, at the same time, is practical and convenient for the users.

In Pekao24 system, the Bank's individual customers may take advantage of up-to-date authorization methods: PekaoToken – an application for mobile phones, a hardware token and SMS codes. PekaoToken, the hardware token and SMS codes are very convenient for customers and ensure the highest security level.

The Bank has been constantly improving its procedures and taking necessary measures to respond swiftly to customers' complaints and handle them in a maximum way providing for the customers' equitable interests.

The parties (the customer and the Bank) may also refer any contractual disputes between them to the Arbitration Court of the Polish Bank Association to be resolved. The competence of the Arbitration Court to resolve particular disputes results from a written agreement of the parties indicating the subject of the dispute or the legal relationship which gave or may give rise to the dispute (arbitration clause).

## Business Partners – Suppliers

The Bank respects its business partners and their commercial practices, ensuring good and fair commercial relations.

In the selection process of its suppliers, the Bank applies internal procedures, compliant with the best practices and the applicable Polish laws.

In the procurement procedures, the specification of the procurement is the same for all business partners to guarantee fair competition.

Any company may be invited to participate in a procedure and to submit a business proposal meeting the Bank's requirements. All companies that have submitted their initial proposals are registered in the supplier base and will be taken into account in the development lists of potential supplies. The companies invited to participate in the procedure can make inquiries related to the received specification. Information on the results of a given procedure is sent to all participating bidders.

To ensure an unbiased selection process of suppliers of goods and services the Bank establishes Commissions whose tasks include ensuring transparency of the supplier selection process and preparation of a recommendation of the best proposal.

In accordance with the procurement rules, the Bank is consistently increasing its reliance on negotiations by electronic means, thanks to which the procedure can have a national and international reach. A significant advantage of this solution is enhanced effectiveness and transparency of the negotiation process. The Bank strives towards ensuring high standards in its environmental policies. The suppliers participating in tender processes run by the Bank must complete a Company Social Responsibility form, in which they provide, inter alia, information concerning environmentally conscious management, social responsibility standards and labour-law compliance.

Additionally, as a result of tender procedures, the Bank verifies prospective suppliers with respect to corruption risk and against sanction lists (USA and EU sanction lists) and PFSA's public warnings.

The companies that perform deliveries to the Bank are informed on the existing inconformity process and major provisions of the anti-corruption policy pursued by the Bank.

## Environmental Protection

Bank Pekao S.A. has been involved in actions supporting the natural environment, for instance by providing for ecological aspects in risk analysis processes, financing environmental friendly projects and by financial support to those organisations and institutions that are involved in initiatives related to environmental protection, with particular focus on the Polish bison protection. For years Bank Pekao S.A. has been involved in the "Earth Hour" action when all lights in selected locations are turned off.

### Environmental Risk Associated with Lending Activities

Bank Pekao S.A. has been pursuing a pro-ecological policy which follows from the United Nations Environment Programme Finance Initiative (UNEP FI), providing for ecological aspects in performing credit risk analysis of its transactions and in transaction monitoring processes.

# Corporate Social Responsibility

In its day-to-day activities Bank Pekao S.A. is strongly committed to protection of the environmental risk assessment is one of the crucial factors in evaluating credit transactions executed with businesses. It involves a number of steps: from review of a customer's business profile and preparation of a preliminary environmental risk assessment, to assessment proper, which includes an on-site visit and review of documents relating to the environmental aspects of an undertaking, to management phase, which includes a credit decision and agreement execution, to monitoring of environmental risks.

If a borrower's business profile entails environmental hazards, Bank Pekao S.A. works with the customer on reducing the potential implications of the environmental risks. They cooperate to identify such risks, assess their scale and mitigate their potential impact. Such cooperation, which forms part of credit risk assessment, relies on the methodology and industry guidance developed by the European Bank for Reconstruction and Development.

If the Bank establishes that a customer is unable to minimise its environmental risks, it defines certain environment related conditions to be met during the transaction term, also by including relevant environmental provisions in the loan agreement.

The Bank does not finance certain types of business activities on environmental grounds. Such activities are enumerated in the Environmental Exclusion List drawn up on the basis of international standards, including the Convention on International Trade in Endangered Species (CITES). Furthermore, the Bank refuses to finance trade in goods representing environmental hazards or projects violating health and public safety laws.

The Bank's credit risk policy prohibits it to finance production of military equipment, nuclear power projects and activities which may be a source of major environmental hazards. Any exceptions to that policy require the approval of the Management Board and a positive opinion of the Supervisory Board.

In line with its credit policy, the Bank supports projects with environmental benefits.

### Protection of the Polish Bison

For years Bank Pekao S.A. has been consistently involved in the protection of Polish bison – the unique species threatened with extinction.

In 2016 the Bank continued its long-term cooperation with five leading institutions involved in the protection of the largest European mammal:
- Białowieża National Park (BPN),
- Wildlife Society of the Province of West Pomerania,
- "Panda" Foundation for Warsaw ZOO Development,
- Toruń Zoobotanical Garden,
- Society of Bison Lovers

In 2016 Bank initiated the cooperation with the Agencja Rozwoju i Promocji Ziemi Pszczyńskiej Sp. z o.o.

The donations provided by the Bank are used towards diversification and development of the population, maintenance of the BPN's Bison Breeding Centre, herd care, as well as promoting scientific and educational projects.

### Support to "Earth Hour"

Earth Hour is an international action related to green policies initiated by the ecological organisation *World Wide Fund for Nature* (WWF) whose tasks include generation of reflections over the negative climatic changes. Within the action, WWF encourages people worldwide to switch off all electronic equipment for one hour thus reducing electrical energy consumption.

On 19 March 2016 the 9th edition of the "Earth Hour" was held. Wolf protection was the leading motive of the 2016 edition. Every year, the group of participants has been growing, involving both private individuals and institutions.

Bank Pekao S.A. has been in agreement with the objectives of the action and in 2016 it was participating in it again. During the "Earth Hour", all lights were switched off in the buildings of Bank's Head Office in Warsaw at ul. Żwirki i Wigury 31, ul. Grzybowska 53/57 and ul. Giełdowa 5.

### Pro-ecological activities in the sphere of reduction of electrical energy consumption

Technical solutions implemented in the properties where the Bank's branches are located is a material element of the pro-ecological attitude of Bank Pekao S.A. in their day-to-day operational activity. In 2016 further solutions were being implemented to reduce electrical energy consumption and reduce negative environmental impact, for instance:
- optimisation of energy consumption (reduction of contractual power),
- installation of devices compensating reactive power (eliminating unnecessary energy losses),
- replacement of old UPS devices with new ones with higher maximum efficiency,
- liquidation of unnecessary back-up power supply connections,
- a pilot implementation of LED energy savings lighting technology,
- installation of air conditioning systems with better performance, with special focus on the class of energy efficiency,
- replacement of devices using environmentally harmful refrigerants with devices based on mixtures of ecological gases.

## Bank's Rules of Conduct with Respect to Sponsoring and Charity Activities

The policy pursued by the Bank in the sphere of sponsoring and charity activities is aimed at supporting the Bank's image as an open and modern institution, close to its customers and the communities it operates in.

Selecting various initiatives, the Bank departs from one-off subsidies and reaction to requests for support in favour of long-term social involvement based on partnership with selected organisations. In particular, the Bank has been supporting selected organisations and institutions that are involved in projects in such areas as: high culture, sports, help to children in need, environmental protection, responsible economic development.

Before making a donation or concluding a sponsoring agreement, the Bank assesses the associated risk (due diligence) in compliance with the Bank's internal regulations on counteraction to corruption.

## Charity Activities

Bank Pekao S.A. has been cooperating with leading public benefit organisations to which it has been providing donations supporting their statutory activities. As an actual leader of the financial sector, present directly and indirectly in homes of millions of Poles, the Bank is responsible for the development of the society and the country. Therefore, the Bank has been getting involved in core initiatives, assistance to those in need and development of prosperity of Polish families.

### Dr. Marian Kanton Bank Foundation

The Bank engages in charity work primarily through the Marian Kanton Bank Foundation, established in 1997.

Every year, about a third of the Foundation's resources is applied to finance summer and winter holidays for children from families experiencing financial hardship as well as stays in rehabilitation centres for ill and disabled children and youth. In this way the Foundation is able to improve the quality of life and create equal opportunities.

Additionally, the Foundation provides financial and in-kind assistance to schools and libraries in villages and small towns and supports sports clubs for children and teenagers, usually operating at schools or community culture centres.

In line with the Founder's intention, the Management Board of the Foundation assigns funds for scholarships awarded to talented pupils and students from poor backgrounds.

For years, the Foundation has been offering financial support to children of the Bank employees who require rehabilitation or treatment, covered by the year-round charity initiative ran by the Bank under the name "Let's Help One Another". In 2016, the Foundation assigned PLN 100 thousand for the purpose, directly supporting each of the persons covered with the program.

The regular recipients of assistance provided by the Foundation include state-run and family children's homes, certain organisations and associations (including Caritas, Monar-Markot and Children's Friends Association), village schools and kindergartens, parishes, single mothers' homes, day-care centres, and hospices. It is worth stressing that in many cases, small institutions dedicated to the support of Polish families come to depend on the Foundation's assistance in order to exist.

In 2016 the Bank Pekao Foundation obtained the status of a Public Benefit Organisation (OPP).

A detailed report on the operation of the Foundation is available at the Bank's website:

### Gift Matching Programme

The Gift Matching Programme is a charity initiative of the UniCredit Foundation. The objective is to support charity operations by Employees of the UniCredit Group. Within the Programme, the UniCredit Foundation has been topping up the contributions made by employees to non-profit organisations, selected directly by employees, in line with the guidelines of the Foundation.

In 2016, the Bank's employees registered in the Programme and financially supported 21 projects to which altogether 1580 donations were provided.

The largest project supported by the employees of Pekao was fund collection for the Great Orchestra of Christmas Charity Foundation. Donations offered by the employees were also provided to: Fundacja Pomocy Osobom Niepełnosprawnym oraz Dzieciom i Młodzieży "AUXILIUM", OSP in Lenarty, Stowarzyszenie Piękne Anioły, Fundacja Dzieciom Zdążyć z Pomocą, Fundacja AVALON Bezpośrednia Pomoc, Polska Akcja Humanitarna, Fundacja Sanfilippo, Fundacja Międzynarodowy Ruch na Rzecz Zwierząt Viva! Grupa lokalna Koci Szczecin, Fundacja Ratujmy Ptaki, Fundacja DKMS, Fundacja Serce Dziecka, Fundacja Akademia Piłkarska JUNIOR, Fundacja Sedeka, Stowarzyszenia SOS Wioski Dziecięce in Poland, Fundacja Rycerze i Księżniczki.

### Great Orchestra of Christmas Charity Foundation

Bank Pekao S.A. has been cooperating with the Great Orchestra of Christmas Charity (Wielka Orkeistra Świątecznej Pomocy – WOŚP) since 1999. Since the beginning it has acted as the Charity's banker, providing general assistance, comprehensive financial solutions and supporting projects carried out by the Foundation throughout the year.

The annual WOŚP Finale, held on the second Sunday in January each year, was the largest event held within the cooperation. On 10 January 2016, at the 24th Finale, the Bank played for the 18th time with the Orchestra. The Bank was at places where there were people supporting the extraordinary event – in coordination control, TV studios and at our branches which assisted WOŚP volunteers by collecting and counting the raised funds. Selected branches of the Bank were open to everybody – people could warm up, have a cup of tea; the youngest ones were offered places to play with articles to paint and draw, educational games and books. Over 2,000 Employees from the Bank's branches and head office were involved in the organisation and carrying out the Finale. Additionally, the Bank provided the volunteers with POS terminals to collect contributions to the Finale with credit cards or phones. The Bank donated PLN 2,000,000 to the WOŚP Foundation.

For the third time, the Bank's WOŚP team composed of the Bank's employees and their families participated in the "Fight Diabetes" run held on the day of the Finale. The initiative was of great interest to the employees and their families. Almost 200 representatives of the Bank participated in the "Fight Diabetes" run. By participating in the run, the Bank helps popularise knowledge on diabetes and a programme to fight the sickness and the Bank supports fund-raising to purchase insulin pumps for pregnant women.

The employees of the Bank who make contributions to the Finale fund-raising account generate double payment to the Orchestra's account. Every year the contributions made by the employees of the Bank are doubled by the UniCredit Foundation under the Gift Matching Programme. This way, the Bank promotes and supports social and direct involvement by the Employees. In 2016 the employees of the Bank collected almost PLN 96,268. The amount was doubled by the UniCredit Foundation.

Within its cooperation with the WOŚP Foundation, the Bank also acts as a sponsor of the Woodstock Festival Poland – one of the most extraordinary events on the world musical scene and a Patron of the Academy of Fine Arts (ASP) that is part of the Woodstock Festival Poland. The Bank acts as the main sponsor of the national educational program of the WOŚP Foundation – "We save and we teach to save", one of the largest projects carried out by an NGO in Poland's educational system – from the first primary school grades pupils are getting acquainted with providing first aid and develop appropriate habits.

### "Let's Help One Another" action

The charity actions in which Bank Pekao S.A. is involved has many dimensions. Among the most important internal actions there is the annual "Let's Help One Another" initiative started in 2008 which is organised in two dimensions. The first one is focused on encouraging to donate 1 percent of income tax to chronically sick children of the Bank's employees. The other one is an invitation to make voluntary donations to various external foundations to help support the people they take care of. In 2016 the action covered forty three seriously and chronically sick children of employees of Bank Pekao S.A. The specific dimension of the action is that the participating employees get integrated and help one another.

## Support to culture and art

For years Bank Pekao S.A. has been supporting and promoting art. This approach is an integral part of the Bank's philosophy. In our opinion, culture does not only reflect the world around us but also affects it and contributes to the process of development and exchange of ideas and innovations. It also supports the development of long-term relations with the community based on mutual understanding of needs. Supporting institutions that are important for culture promotion, the Bank relies mainly on long-term agreements and the sponsoring activities of Bank Pekao S.A. is carried out at two levels: national – within which the Bank sponsors strategic events with major impact on Polish culture, and local – supporting initiatives dedicated to local communities.

### POLITYKA Passports

POLITYKA Passports have been awarded since 1993 by the "Polityka" weekly to talented young artists who have had unquestioned impact on Poland's culture in the year. Bank Pekao has been a Partner to the event since 2009.

The prizes in various categories are awarded on the basis of recommendations of critics in six areas: film, theatre, visual arts, literature, classical music, popular music. The special Creator of Culture award is given to outstanding artists for special achievements in popularising Polish culture.

On 12 January 2016, during the ceremonious Gala held in the Grand Theatre – National Opera, the POLITYKA Passports for 2015 were handed over. Among the winners of the prizes there were: Magnus von Horn (film category; a prize for the film "The Here After", the best début of the recent seasons, for discipline and restraint in penetrating the dark side of life. For mature, full of suspense top level psychological cinema), Ewelina Marciniak (theatre category; a prize for diligence, staging imagination and sense of humour, for exploring the subject of women in the men's world of the theatre generating interesting results), Tymek Borowski (visual arts category; a prize for a continuous search for new original ways to communicate with the audience, for witty works well fitting social and cultural discourse), Łukasz Orbitowski (literature category; a prize for the book "Inna dusza" which is an excellent combination of an initiation, psychological and moral novel, a moving and memorable study of evil), Marcin Świątkiewicz (classical music category; a prize for sensitivity and musical erudition, for smart interpretations, for universality so that he can be an outstanding soloist and work as an artist in baroque ensembles in Poland and worldwide) and Kuba Ziołek (popular music category: a prize for exceptional, author's and always recognisable approach to rock, folk or electronic music, for outstanding diligence, consistency and talent in combining various musical environments). The Creator of Culture award was granted to the CD Projekt RED team (prize for the creative adaptation of the protagonist of Andrzej Sapkowski's novel and the creation of "The Witcher" – a great video game brand. For evidencing that a Polish studio may become a great power in the dynamically developing sphere. And finally for its major impact on the development of the entire new cultural sector in Poland).

### Bank Pekao S.A. Project Room at the Centre for Contemporary Art in Warsaw

"Bank Pekao Project Room" is a cultural project initiated in 2012 by the Bank and the Centre for Contemporary Art Ujazdowski Castle (CSW) in Warsaw. It offers an opportunity to present the latest and most interesting trends in art and to create a platform for discussion on contemporary art. With the financial support of the Bank, selected young generation artists may pursue their projects in a special exhibition hall at the Castle. CSW supervises the selection process to ensure the top artistic level of the exhibitions. Since contemporary art in all of its manifestations has been created and exhibited in the Centre for Contemporary Art, the Bank Pekao Project Room has been able to establish itself, drawing in new crowds of art lovers.

In 2016, there were ten exhibitions of young artists in the Bank Pekao Project Room. Since the beginning of the project, Bank Pekao SA has been acquiring the most interesting of the exhibited works. They have been making up a beginning of the Young Art Collection of Bank Pekao S.A.

### 11$^{th}$ Tansman Festival

The "Tansman Festival", organised bi-annually in Łódź, is about innovative ideas and meeting spaces, dialogue and search on the border of tradition and modernity. This is one of most important cultural and artistic events in Poland and the most important events of its kind in the region. In 2016 the Festival celebrated its 20$^{th}$ anniversary. That was also a jubilee of cooperation with Bank Pekao S.A.

The leading motive of the 20$^{th}$ Jubilee of the "Tansman Festival" was: Polish Music – Discoveries and Novelties: unique and spectacular reconstructions of Polish masterpieces of 20$^{th}$-century music, along with première performances and recordings thereof. The aim of the Anniversary Edition was to enrich the cultural heritage and reveal unknown pages of its 20$^{th}$-century history: to propagate and present unknown, forgotten works. The Anniversary Edition showed the creative and original contribution to the world cultural heritage of representatives of Polish music.

The program of the 11th edition of the Festival included outstanding reconstructions of masterpieces of Poland's 20$^{th}$-century music. The "Tansman Festival" was crowned with a world première performance of Aleksander Tansman's opera "The Golden Fleece". That was one of the major sensations of 2016 and as a result the Festival was among the ten most important events of 2016 according to the "Polityka" weekly.

### 20$^{th}$ Shakespearian Festival

The Shakespeare Festival in Gdańsk is one of the largest international events to which the best Shakespeare performances and outstanding theatrical artists from all over the world are invited. The core part of the Festival includes performances from Poland and the world inspired with William Shakespeare's works. It presents modern stagings and most interesting adaptations of Shakespeare's works of the recent years.

The programme of the jubilee 20$^{th}$ edition of the Shakespearian Festival contained great names and outstanding performances, for instance from the United Kingdom, Russia, Italy, Israel or Iran as well as Polish staging of Shakespeare's plays – "Hamlet" directed by Krzysztof Garbaczewski from the National Stary Theatre in Kraków, "The Tempest" directed by Anna Augustynowicz from Teatr Współczesny in Szczecin and "Julius Caesar" directed by Barbara Wysocka from Teatr Powszechny in Warsaw.

Bank Pekao S.A. has supported the Shakespearian Festival since 2000.

### 10$^{th}$ Film and Art Festival Two Riversides

The Film and Art Festival Two Riversides organised in Kazimierz Dolny and Janowiec on the Vistula is an interdisciplinary cultural event presenting interesting Polish and foreign films: première performances, last year's important firms that were of key importance for the development of the world cinematography as well as theatrical performances, exhibitions, concerts and other events.

The film program of the Festival combines proposals of author's cinema, artistic, independent, socially involved cinema, original forms of most recent films and young European cinema. The Festival also opens its programme to the local community and culture – presentations of the achievements of local artists constitute an important element of the Festival. They get an opportunity to present their works to the viewers who come in large numbers from all over Poland to attend the unique Festival.

Bank Pekao S.A. was the Partner of the Film and Art Festival Two Riversides 2016.

### Polski Theatre in Wrocław

The Polski Theatre in Wrocław is one of the most important theatrical stages where outstanding artists stage their performances. As a result of excellent performance, the Polski Theatre in Wrocław has won prestigious prizes in international festivals; its modern and open space is visited by almost 100,000 spectators annually.

Bank Pekao started cooperation with the Polski Theatre in Wrocław in 2015 sponsoring the artistic season of 2015/2016. During the season there were four première performances of which the most successful was the performance of "Dziady" part III by Adam Mickiewicz, directed by Michał Zadara. It is also worth mentioning that "Dziady" was staged in its entirety, without shortening, for the first time in history.

In 2016 the Polski Theatre celebrated its 70th anniversary. The anniversary coincided with cultural events prepared by all cultural institutions in Wrocław – European Capital of Culture 2016 (ECC 2016). Also the Polski Theatre was involved in the activities and it presented its performance to international audience.

In the artistic season 2016/2017, sponsored again by Bank Pekao S.A., the best Polish directors were invited to cooperate, e.g. Radosław Rychcik, Ewelina Marciniak, Michał Borczuch or Barbara Wysocka.

### Poznan Grand Theatre

The Poznan Grand Theatre is one of the most important places of musical and cultural life in Poznań. Its varied repertoire covers works from classical operas to contemporary compositions with special focus on Italian and Polish operas.

In 2016 the Bank sponsored Georges Bizet's "Carmen" directed by Denis Krief – a director, scenographer, theatrical costume and light designer, winner of the prestigious Premio Abbati award, granted by Italian critics, for the performances of "Turandot" (G. Puccini), "Carmen" (G. Bizet) and i „Lucia di Lammermoor" (G. Donizetti).

### Polish PEN Club Awards

The Polish PEN Club is the Polish Centre of the international P.E.N. organisation. The objective of this prestigious and distinguished organisation, active in Poland for 90 years, is to develop cultural exchange and guard the interests of Polish literature worldwide.

Bank Pekao S.A. has been collaborating with the Polish PEN Club since 2006 and the first awards funded by the Bank were granted in 2007. Apart from the Jan Parandowski prize, the Bank has also founded the Juliusz Żuławski Editorial Award for outstanding editorial achievements.

In 2016 Andrzej Wajda was the winner of the Jan Parandowski prize. The editorial prize was awarded to the Editorial Board of the Full Edition of Ringelblum's Archives.

For years Bank Pekao S.A. has been involved in numerous cultural initiatives. Apart from the above, in 2016 the Bank also supported for instance Grape Picking Theatrical Meetings in Zielona Góra, Gorzów Theatrical Meetings, concert by Leszek Możdżer in Lublin Philharmonic, Festival of Polish Composers in Bielska–Biała, Jan Kochanowski Theatre in Opole.

## Support to social initiatives

### "Social Start Up"

In 2016 the second edition of the "Social Start Up" took place – a project aimed at supporting the development of social enterprises, in particular innovative ones with profit invested in resolving social problems. The project is run by Bank Pekao S.A. jointly with the UniCredit Foundation and carried out by the Ashoka Foundation Innovators Pro Publico Bono an NGO specialised in finding and supporting social innovators.

The "Social Start Up" project involves social entrepreneurs and business organisations that have evidenced that their operations or ideas for social enterprises are creative, new and generate specific, visible social changes such as professional activation of people threatened with social exclusion. Entrepreneurs may compete to be involved in the project which will identify the best ideas for developing or reinforcing social enterprises. The objective of the support is to consolidate key skills required in each business such as: financial management, development of sales strategies, market research, planning of promotional activities. As a result of two edition of the programme, 15 social enterprises were incorporated in a social entrepreneurship development incubator.

The best ideas in the second edition were as follows:
- Cuisine of Conflict Foundation which – relying on the potential of refugees or immigrants – has been developing social awareness among Poles with the use of dishes from countries where military conflicts are under way,
- HospiCare – an application improving contacts between doctors, therapists and carers of terminally ill children,
- Fundacja Łąka [Meadow Foundation] which – helping reduce unemployment – develops flowery meadows in cities reducing $CO_2$ emissions and supporting biodiversity.
- Fundacja Mamo Pracuj [Go to Work, Mum] or a portal for women returning to the labour market from maternity leaves and employers,
- Fundacja Teatr 21 which modifies the stereotypic perception of people with the Down syndrome by involving them in real artistic work as actors and playwrights to show their non-typical original perspective.

### Blood donating actions

Employees of Bank Pekao S.A. regularly participate in blood donation actions in cooperation with the Regional Centre for Blood Donation in Warsaw. Since the beginning of the cooperation in 2010, almost 500 employees of the Bank donated about 230 litres of blood. In 2016 there were two blood donation actions – in May and in September. Over 100 volunteered to donate blood of which 83 were qualified and 30 litres of blood were collected. More blood donation actions are planned for 2017.

## Support to Economic Initiatives

### Fifth European Financial Congress

The European Financial Congress (EFC), organised by the Gdańsk Academy of Banking and the Gdańsk Institute of Market Economics is held annually in Sopot. The EFC serves as a forum for the exchange of views on the future safety and stability of the European Union. Its aims to encourage debates whose conclusions will exert impact on the decision-making process of the most important European institutions.

The core subject at EFC 2016 was "21st Century Capital". Bank Pekao S.A. was a partner of four debates:
– "Europe's future? Possible scenarios",
– "Customer experience" (jointly with EY),
– "Why do Polish entrepreneurs not participate in international public procurement?" (in cooperation with the Foreign Ministry),
– "Business internationalisation vs. company development".

The Bank has been a co-organiser of the Congress since its first edition.

### Fifth European Forum for New Ideas

The European Forum for New Ideas (EFNI) is an international gathering for discussion of business circles, devoted to the future of Europe and its economy, against a broad global backdrop. EFNI has been organised since 2011 by the Lewiatan Confederation in cooperation with BUSINESSEUROPE, the City of Sopot and Polish and international companies and institutions. The Bank has been supporting the event as the sole partner of the Opening Gala since 2013.

The motto of the sixth edition was: "The future of work. Realities, dreams and delusions". During three days, the discussions focused primarily on the migration crisis, growing radicalism and unequal income distribution.

### Corporate Banking and Finance Congress

The Corporate Banking and Finance Congress is an initiative of the European Financial Congress focused on discussions on financing and supporting enterprises by private and public financial and development institutions, with special focus on the needs and expectations of enterprises vis-a-vis the financial market.

The objective of the Congress is to develop a permanent place for an international debate and to propose constructive solutions to face challenges in business development financing area in domestic and international markets. The core theme of the Congress in 2016 was: "Foreign expansion in business – opportunities, expectations, support".

Bank Pekao S.A. as a leader of corporate banking co-organised the events and was actively involved; the Bank also hosted two plenary sessions:
– "How to accomplish a common success in foreign expansion? Entrepreneurs, financial institutions, public institutions",
– "Bank as a partner in business internationalisation – new challenges".

### European Congress of Small and Medium-Size Enterprises

From the beginning, Bank Pekao S.A. has been a sponsor of the European Congress of Small and Medium-Size Enterprises held in Katowice. This is the largest business events in Europe devoted solely to SMEs, organised by the Regional Chamber of Commerce in Katowice.

In 2016 the Congress was held for the sixth time.

### Report on the condition of micro and small enterprises

Since 2010, Bank Pekao S.A. has been publishing a "Report on the condition of micro and small enterprises" which is based on interviews with owners with almost seven thousand businesses employing no more than 49 persons each. The results of the research are presented on the national, regional and local levels (66 groups of districts), split by company size (micro, small) and sectors (production, trade, construction, services). The sixth edition of the report published in 2016 was devoted to companies starting business operations. The results of the report were presented at a conference in Warsaw and at sixteen regional conferences organised jointly with Marshall offices.

Bank Pekao S.A. has been actively supporting entrepreneurship in various regions of Poland. It is worth mentioning the Bank's involvement in the South-Eastern Region, particularly in the Provinces of Rzeszów and Lublin where the Bank was a partner of three galas closing competitions at which prizes were awarded to the best entrepreneurs:
– "Lublin Business Club" which is the largest business organisation in Poland; prizes were handed over for specific support to business development in the region of Lublin,
– "Podkarpacie Economic Award" was a competition to promote the best developing enterprises in the Province of Podkarpacie,
– "Fair Play Enterprise". The "Fair Play" competition is an initiative promoting municipalities that offer good investment opportunities for enterprises and companies standing out with their reliability and responsibility in business.

# Corporate Social Responsibility

## Support of sport

### 24nd Pekao Szczecin Open Tennis Tournament

Pekao Szczecin Open (PSO) is the largest and most important male tennis tournament in Poland, with the participation of tennis players from all over the world and a pool of prizes of USD 150 thousand. This is also the most important sports events in the Western Region. The Bank has been the titular sponsor of the Tournament since 1993 or from the very beginning.

For years Pekao Szczecin Open has been a place where talents of Polish tennis were born. Additionally, in 2015 a programme "Way to Pekao Szczecin Open" was initiated within the Tournament. The objective of the programme is to promote sport among children and their parents and thus to identify new tennis talents that may win the challenger in Szczecin in the future.

## RESPECT Index

In 2016 Bank Pekao was included in the portfolio of an index of responsible companies (RESPECT Index) which groups companies managed in a responsible and sustainable manner. The composition of the new portfolio was announced by the Warsaw Stock Exchange (WSE) on 14 December 2016. The index jointly includes 25 companies.

RESPECT Index is a stock index functioning at the Warsaw Stock Exchange since 2009 and it is the first index of this type in Central and East European countries. The index groups companies that have passed a three-stage verification carried out by WSE and the Association of Listed Companies that impeccably comply with disclosure requirements to the market with their current and periodic disclosures and their web sites. The third requirement is socially responsible conduct vis-a-vis the environment, communities and employees which is analysed on the basis of a questionnaire verified by Deloitte which is the auditor of the project.

# Prospects for Development

# Prospects for Development

## Factors which will affect the results of the Group

Bank Pekao S.A. and its subsidiaries operate predominantly on the territory of Poland. Therefore, the Bank's performance will be influenced mainly by the economic events in Poland and international outlooks that have an impact on the Polish economy.

The outlook for economic growth in 2017 is positive, with still dominating private consumption in the structure of the GDP growth, and good chances of acceleration of investments, both public as well as private ones. Consumption is propelled mostly thanks to the improvement in the labor market, which is characterized with increasing demand for labor force amid increasing – due to demographic reasons – shortages of supply. These factors are lowering the unemployment rate, at the same time propelling wages' growth – and these two combined are pushing consumer confidence indicators to record-highs. An additional factors are transfers within the Family 500 plus government program, which should dominate at least in the next one-two years, meaning favorable environment for, among others, banking business. It should be kept in mind, though, that the demographic challenges will intensify in the coming years, posing a challenge for the whole economy.

When it comes to investments, year 2017 should bring the beginning of implementation of investments within the EU financial perspective 2014-2020. However, many factors suggest this will happen in the second half of the year, and a sizeable "jump" in the level of the funds utilized will happen in 2018. Regarding private sector investments, the key factor will be limiting of the regulatory uncertainty, as many other factors (such as: high level of capacity utilization, good current financial results of the enterprises, sizeable accumulated profits, an exchange rate favorable for exporters, high level of amortization of existing productive assets, necessity to substitute labor with capital due to demographic challenges etc.) suggest the need or even necessity to invest by the private sector. It is anticipated gradual improvement with regard to private investments.

The forecast assumes ca. 3.0% of the GDP growth in 2017, after 2.8% in 2016.

In 2017, tax and regulatory environment is still going to have significant influence on banks' business and earnings, including in particular:

– Tax on certain financial institutions in force – this so-called bank levy was introduced in February 2016. In case of banks, the tax base is assets value (net of selected items). According to available information, in 2017 the tax is going to be charged according to the same rules as in previous year,
– growing requirements concerning the level of banks own capital,
– burdens related to the functioning of the BFG. In 2017, certain rules concerning calculation of the contribution are subject to change. As a result the burden for individual banks is going to be, to a higher extent than before, dependent on their risk profile. Moreover, in addition to pre-defined yearly contributions, an ad-hoc need for financing of the BFG may arise, as it did in previous years.

Strict tax and regulatory environment will continue to constrain banks' credit expansion.

It is hard to expect in 2017 a positive one-off event in the type of the one in 2016, when banks' shares in Visa Europe were sold to Visa Inc. It cannot be ruled out, however, that an opposite event may occur, namely an unexpected one-off burden for the sectors' earnings.

In 2017, it should be expected maintaining of the relatively high pace of growth of households' deposits. It is associated with favorable situation on labour market (growing employment and wages), as well as social programs carried out by the government. In case of the enterprises, the fall in deposits' interest rates led to higher attractiveness of other forms of funds placement. In addition, in case of international groups it also caused lower propensity to locate financial surplus in Poland. Such situation may lead to lower growth of corporate deposits in 2017.

As for loans, in 2017 limited growth is to be expected, both in households and corporate portfolio. In case of enterprises, a low propensity to invest is visible (which is connected with uncertainty generated on global and local level). In turn for households, a low growth pace of loans portfolio is being influenced by, among others, growing requirements with regard to a down-payment (from 2017, requirement account for 20%) and growing scale of repayments of principal installments from loans taken out in the past.

In 2017, monetary policy may be among important factors influencing bank results. A rebound of inflation in Poland as at the end of last year with an outlook to maintain such a trend in 2017 greatly decreased the risk of another interest rate cuts. At the same time, if the CPI growth is higher than current expectations, the probability will rise for the Monetary Policy Council to start the cycle of rates hike in the second half of 2017. This would benefit the banks' net interest income.

In the Parliament works are conducted concerning the project of law on returns for some of the loans agreements. It assumes, that in case of FX loans, banks will have to return to the clients the difference between acceptable spread (the difference between the rate of buying and selling of the currency set by the law) and the one actually charged. Estimates point out, that if the law is passed the cost for the banking sector may amount to couple of billions of the złoty. The new law also provided space for introducing supervisory actions that are meant to induce banks to propose to their clients a conversion of FX loans on conditions beneficial to customers. Works are currently being held over specific actions in this case and eventual solutions may have strong, negative impact on banks' financial results in 2017. However, taking into account the relatively minor share of these loans in the total assets of the Bank (almost entirely acquired as a result of the merger of the spun-off part of Bank BPH S.A. in 2007), the Bank assesses that potentially taken solutions should not materially affect the financial standing of the Group.

## Directions of the activities and business priorities

Bank Pekao S.A. is a universal commercial bank focused on conducting business activity on the Polish market. The strategic objective of the Bank is further business development and stable growth thanks to its strong capital and liquidity position while maintaining the highest standards of risk management and further improvement of cost efficiency. The Bank aims to maintain sustainable flow of income and increase its share in the sector income through strengthening its market position in the areas with the largest value creation potential and by effective margin management.

The Bank's philosophy is based on the customer-centric approach, adjusting its products offer and operational model to the changing clients' needs. The Bank aims to build long-term relationships with clients, allowing to ensure sustainable business growth.

The Bank's business model is based on customer segmentation identifying the following groups of customers:

- individual customers – embracing retail, affluent and private banking clients. Segmentation is based on monthly inflows or assets under management. Each segment has its own business model adjusted to the clients' needs,
- small and micro enterprises (SME) – customers are served by dedicated advisors with the support of product specialists. Service is carried out in retail branches as well as in specialized Business Customer Hubs. Customers are offered professional products and services adjusted to individual clients' needs,
- corporate customers – embracing medium and large companies. Segmentation takes into account the turnover value, sector, type of ownership (public/private, domestic/international, etc.). Customers are served by dedicated advisors with the support of product specialists enabling to optimize service level and cost. Customer advisors are focused on providing high-quality and effective service, using the best practices and integrated sales management tools.

The Bank offers competitive products and services on the Polish market, high service quality and nationwide, well-developed and easily accessible network of branches and ATMs as well as professional call center and a competitive Internet and mobile banking platform for individuals, corporate, small and micro enterprises.

Thanks to the scale of operations, strong capital and liquidity structure and balance sheet strength with a high level of solvency ratio and high surplus of deposits in relation to granted loans, the Bank has competitive advantages that allow effectively compete on the market.

### Directions of the activities and business priorities for the year 2017

The Bank's will continue the activities conducted in the previous years. Favourable macroeconomic scenario and strong Bank's fundamentals support the continuation of determined directions, despite still growing regulatory pressure, and introduction of significant additional banking sector financial burdens made last year.

In 2017, the Bank's priority will continue to be further business development and reinforcement of market position in selected areas while maintaining the highest standards of risk management, effective margin management and further operational efficiency improvement, keeping the liquidity and capital position at safe levels, while striving to ensure sustainable and attractive dividends. The Bank will aim to gradual improvement of business profitability by improving the structure and the level of achieved incomes as well as by further cost efficiency enhancement.

It is expected acceleration of high economic growth to the level of 3%, what allow to maintain the demand for loans in the sector at a level of 3%, similar to the level reached in 2016. At the same time a deposit growth at the level of 7% is expected, which will surpass loans dynamics for consecutive year and lead to further lowering loans to deposits ratio in the sector. The Bank, thanks to its competitive advantages, among others, strong capital position aims to continue its strategy of increasing lending activity and strengthening its market position in strategic areas that provide the largest value creation potential.

The Bank's goal is to build the position of the most recognizable bank in Poland thanks to the professionalism of its activities and value creation for the customer. The Bank's activities will be focused on increasing customer satisfaction with provided services through meeting the customer's needs, improvement of service quality and delivering the best on the market solutions that enable clients to reach their financial goals.

In the individual customer segment, the Bank will continue to grant consumer loans and mortgage loans denominated in PLN leveraging on long-term experience in selling these products and proved business model focused on effective and efficient adaptation of the offer to the clients' needs, while maintaining ethical principles in lending and reasonable risk level. In order to adopt best offer to the changing clients' preferences, the Bank will continue to upgrade CRM system and multi-module analytical tools and algorithms while developing sales of products via remote channels and automating and simplifying processes. Thinking about the future of clients, the Bank intends to continue the development of product offer proposing the best and proven savings and insurance solutions, building long-term relationships with the clients.

In the business customer segment, the Bank's focus is to reinforce its leading position in the corporate lending, transactional banking

# Prospects for Development

services as well as organisation and servicing of corporate bonds issuance. The Bank, leveraging on its experience, aims to support the clients in utilizing 2014-2020 EU funds assigned for building a modern and competitive economy. In addition, the Bank will continue the development of cooperation with customers from the agri-food sector.

In order to ensure the highest service quality for corporate as well as small and micro enterprises (SME), the Bank will continue working on the best adoption of its business model to the changing clients' requirements by simplifying business procedures, which should improve client satisfaction, and providing innovative financial solutions.

The Bank will continue acquisition of new clients consistently working on the number of customers increase in all segments. Investments in innovative products and solutions will be one of the elements that increase the attractiveness of the Bank's offer and allow to increase the number of customers served. The Bank will continue the development of remote distribution channels (multichannels / omnichannel), including the Internet and mobile banking exploring innovative solutions available on the market, allowing the customer to use the banking services on multiple devices, among others, computer, mobile/smartphone, tablet. Providing ready-made solutions, tailored to the needs of given customer through the remote channels, without branch visit, making life of the Bank's customers easier, remains one of the Bank's key objectives. The Bank intends to further develop mobile payment system by combining it with banking mobile system in one application, which should enable further dynamic increasing the number of active users and transaction volumes.

The Bank will continue the activities aimed at improving operational efficiency focusing on processes optimisation, gradual adjustment of the distribution channels structure to the evolving customer needs and simplification of the organizational model.

# Representations of the Bank's Management Board

# Representations of the Bank's Management Board

## Representations of the Bank's Management Board

The Management Board of Bank Pekao S.A. declares to the best of its knowledge that:

– Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016 and comparative figures have been prepared in accordance with the binding accounting policies and that they reflect in a true, fair and clear manner Bank Pekao S.A. Group financial position and their results,
– Report on the activities of Bank Pekao S.A. Group for the year 2016 provides the true picture of Bank Pekao S.A. Group development, achievements and situation, including the main threats and risks.

The Management Board of Bank Pekao S.A. declares that the registered audit company performing the review of Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016 has been selected in line with the binding legal regulations. The company and the registered auditors performing the review meet the requirements indispensable for issuing an objective and independent report on the annual consolidated financial statement, in line with the binding provisions of the law and professional standards.

# Statement of Bank Polska Kasa Opieki Spółka Akcyjna on application of Corporate Governance Standards in 2016

# Statement of Bank Polska Kasa Opieki Spółka Akcyjna on application of Corporate Governance Standards in 2016

## Statement of Bank Polska Kasa Opieki Spółka Akcyjna on application of Corporate Governance Standards in 2016

According to the ordinance of Minister of Finance dated February 19, 2009 *on current and periodic information published by issuers of securities and the conditions for recognition as equivalent the information required by the laws of a non-member state*[1], Bank Polska Kasa Opieki Spółka Akcyjna (the "Bank") states that it falls within the following set of corporate governance rules, including standards that issuer applies voluntarily and corporate governance practices used by issuer beyond the requirements of national law.[2]

General corporate governance rules i.e. a system of regulations and procedures defining guidelines for the activities of the Bank's governing bodies, including their relations with entities interested in the Bank's activities (stakeholders) result from laws regulations, especially from the Commercial Companies Code and the Banking Law, capital market regulations, as well as the rules laid down in: Code of Best Practice for WSE Listed Companies 2016, Corporate Governance Rules for the Supervised Institutions issued by the Financial Supervision Authority on July 22, 2014 and Code of Banking Ethics of Polish Bank Association.

In 2016, the Bank applied corporate governance rules laid down in the Code of Best Practice for WSE Listed Companies 2016[3] set by WSE Supervisory Board's Resolution No. 26/1413/2015 of October 13, 2015. Recommendation No. IV.R.2 did not apply to the Bank due to shareholder's structure, lack of notifications regarding shareholders expectations concerning mode of conducting General Meeting with the use of electronic communication means and lack of possibility to ensure technical infrastructure necessary to efficiently conduct General Meeting with the use of electronic communication means and to maintain relevant level of electronic communication security during General Meeting. The Bank ensured General Meeting transmission in real time via Internet.

In 2016, the Bank also applied Corporate Governance Rules for the Supervised Institutions issued by the Polish Financial Supervision Authority on July 22, 2014[4] with the exclusion of:
- chapter 9 of the Rules related to asset management at the client's risk, in view of the fact that the Bank does not pursue any activity in this area,
- § 49 section 4 and § 52 section 2 of the Rules in view of the fact that there is an audit unit and a compliance unit functioning in the Bank,
- § 45 section 2 of the Rules in terms of risk assessment concerning failure to achieve the objectives of the internal control system due to ongoing adjustment works.

Moreover, taking into account the lack of possibility for the Bank to ensure the technical conditions necessary to correctly identify shareholders and to ensure the appropriate level of security of electronic communication during the Ordinary General Meeting of the Bank for 2015, in particular during the process of voting at the General Meeting, the Management Board has resolved not to allow participation in this General Meeting with the use of electronic communication means and hence has decided not to apply § 8 section 4 of Corporate Governance Rules for the Supervised Institutions.

Information about not applying the above mentioned rule was published by the Bank on the website, in accordance with Corporate Governance Rules for the Supervised Institutions.

In the announcement on convening the Ordinary General Meeting of the Bank published in the current report 5/2016 on May 12, 2016 the Bank informed that: "Considering the fact that the Shareholding of the Bank is characterized by a large number of shareholders, geographical and linguistic diversity, which means that for the Bank to meet the requirements necessary to identify the shareholders correctly and to ensure the appropriate level of security of electronic communication it is necessary for the Bank to provide highly advanced technical solutions which currently the Bank is not in possession of, in accordance with Art. 4065 § 2 of the Commercial Companies Code and § 8a sec. 2 of the Statute of the Bank, the Management Board of the Bank resolved not to allow participation with the use of electronic communication means in the Ordinary General Meeting of the Bank for the year 2015".

The Management Board of the Bank defines whether the participation in the General Meeting with the use of electronic communication means is possible if the Bank meets technical conditions necessary to participate in the General Meeting with the use of electronic communication means.

In 2016, the Bank applied corporate governance rules laid down in the Code of Banking Ethics of Polish Bank Association.[5]

Furthermore, the Bank applied corporate governance rules resulting from UniCredit Group Integrity Charter[6] as requirements beyond requirements under national law.

The activities undertaken by the Bank comply with the laws regulations, the Bank's Statute, internal Bank's regulations,

---

[1] Journal of Laws 2014.133 unified text, as amended
[2] Par. 91.5.4.a and b of the ordinance of the Minister of Finance of February 19, 2009
[3] The document is publicly available on the WSE website: http://www.gpw.pl/dobre_praktyki_spolek_regulacje
[4] The document is publicly accessible on the Polish Financial Supervision Authority web site: http://www.knf.gov.pl/regulacje/praktyka/index.html
[5] The document is publicly accessible on the Polish Bank Association web site: http://zbp.pl/dla-bankow/zespoly-rady-i-komitety/dzialania-w-obszarze-legislacyjno-prawnym/komisja-etyki-bankowej
[6] The document is publicly available on Bank Pekao S.A. website: http://www.pekao.com.pl/o_banku/misja/#tab2

supervisory and control bodies recommendations, good practices standards and ethic norms.

Acting in compliance with par. 91.5.4.c–k of above mentioned ordinance of Minister of Finance dated February 19, 2009, the Bank presents following information:

### 1) The description of key features of the Bank's internal control and risk management systems related to the preparation of financial statements and consolidated financial statements[7]

The Management Board of the Bank is responsible for developing and implementing of an adequate, effective and efficient internal control system and risk management system with respect to the preparation of financial statements.

The Supervisory Board oversees the functioning of the internal control system by assessing its adequacy, effectiveness and efficiency through the Audit Committee and the Internal Audit Department.

The internal control system within the process of financial statements preparation is aimed at ensuring reliable, complete and correct disclosure of all commercial transactions executed over a given period.

The accounting policy adopted by the Bank, which is compliant with the International Financial Reporting Standards (IFRS), the chart of accounts and reporting databases take into account the format and the extent of detail of the financial data disclosed in the financial statements, in accordance with the requirements and rules applied by the parent entity. The Bank maintains its accounting books in the form of separate IT resources in its IT systems, in line with the adopted business structure. The IT systems ensure access to intelligible and centralized data, separately for each system, which confirm the accounting records and make it possible to control records continuity and transfer account activity and balances, as well as draw up financial statements.

The accounting books are reconciled against reporting databases.

The responsibility for preparation of financial statements, periodic financial reporting and information management rests with the Financial Division supervised by the Vice President of the Bank's Management Board.

UniCredit S.p.A. as the parent company of the Bank is subject to the provisions of the Italian "Savings Act 262" (law 262/2005). Therefore in the Bank there has been implemented a verification process of its operational and audit procedures applied in the drawing up of the financial statements, in accordance with UniCredit S.p.A. guidelines arising from the above provisions.

### 2) Identification of shareholders owning directly or indirectly a significant block of shares together with identification of number of shares owned by those shareholders, percentage of shareholders share in share capital, number and percentage of votes at the Bank's General Meeting resulting from owned shares[8]

UniCredit S.p.A. has been the Bank's major shareholder since August 1999. As a result of realization block trades in the mode of the accelerated bookbuilding, concluded on July 13, 2016, UniCredit S.p.A. has sold 26,247,003 of the Bank shares. Those transactions were settled on July 15, 2016.

Before the sale UniCredit S.p.A. held 131,497,488 of the Bank shares, which accounted for 50.10% of the Bank share capital and corresponded to the same amount of votes at the Bank General Meeting and the same percentage the total votes at the Bank's General Meeting of Shareholders accordingly.

After the transaction and as at December 31, 2016, UniCredit S.p.A. held 105,250,485 of the Bank shares, which accounted for 40.10% share in the Bank's share capital and the same percentage of the total votes at the Bank's General Meeting of Shareholders. The remaining shareholders held 59.90% share in the Bank's share capital and the same percentage of the total votes at the Bank's General Meeting of Shareholders.

Since none of the remaining shareholders held more than 5% of the total vote at the Bank's General Shareholders Meeting, they were not required to disclose acquisitions of the Bank's shares.

The shareholders of the Bank owning directly or indirectly through their subsidiaries at least 5% of the total number of voting rights at the Bank's General Shareholders Meeting are as follows:

| SHAREHOLDER'S NAME | NUMBER OF SHARES AND VOTES AT THE GENERAL MEETING | SHARE IN SHARE CAPITAL AND TOTAL NUMBER OF VOTES AT THE GENERAL MEETING | NUMBER OF SHARES AND VOTES AT THE GENERAL MEETING | SHARE IN SHARE CAPITAL AND TOTAL NUMBER OF VOTES AT THE GENERAL MEETING |
|---|---|---|---|---|
| | DECEMBER 31, 2016 | | DECEMBER 31, 2015 | |
| UniCredit S.p.A. | 105,250,485 | 40.10% | 131,497,488 | 50.10% |
| Other shareholders (below 5%) | 157,219,549 | 59.90% | 130,972,546 | 49.90% |
| **Total** | **262,470,034** | **100.00%** | **262,470,034** | **100.00%** |

[7] Par. 91.5.4.c of the ordinance of the Minister of Finance of February 19, 2009
[8] Par. 91.5.4.d of the ordinance of the Minister of Finance of February 19, 2009

In the current report No. 30/2016, the Management Board of Bank Pekao S.A. informed that on December 8, 2016 UniCredit S.p.A. announced it has entered into an agreement for the disposal of a 32.8% stake in Bank Pekao S.A. to Powszechny Zakład Ubezpieczeń S.A. (PZU) and Polish Development Fund S.A. (PFR).

The Transaction is subject to the customary regulatory and antitrust approvals and is expected to be completed around mid-2017.

Moreover in the current report No. 31/2016 on December 8, 2016 the Bank informed that it had received communication from UniCredit S.p.A. concerning announcement on sale offer of 1,916 of certificates exchangeable for the Bank shares (equity linked certificates) of total reference value of approx. EUR 500 million, compulsorily settled in the Bank common shares no later than on December 15, 2019. Those certificates shall be used to sell the remaining 7.3% of the Bank shares belonging to UniCredit S.p.A. (after the conclusion of sale agreement mentioned above).

### 3) Identification of holders of any securities with special control rights with description of those rights[9]

According to the Bank's Statute all the existing shares are ordinary bearer shares. There are no special preferences or limitations connected with the shares, or differences in the rights attached to them. The rights and obligations related to the shares are defined by the provisions of the Polish Commercial Companies Code and other applicable laws.

Securities issued by the Bank do not give their holders any special control rights.

### 4) Identification of any restrictions of voting rights, such as restriction of voting rights of holders of given number or percentage of votes, temporary restrictions of voting or provisions according to which, with co-operation of a company, rights resulting from securities are separated from the fact of holding those securities[10]

According to the Bank's Statute there are no restrictions of voting rights.

### 5) Identification of any restrictions of ownership transfer of securities issued by the Bank[11]

According to the Bank's Statute there are no restrictions of ownership transfer of the Bank's shares.

### 6) Description of rules governing appointment and dismissal of Members of managerial bodies and their rights, in particular right to decide whether to issue or repurchase shares[12]

**Management Board**

As stated in the Bank's Statute the Management Board is composed of 5 to 9 Members. Members of the Management Board are appointed by the Supervisory Board for the common term, which shall last three years. The Management Board comprises the President of the Management Board of the Bank, Vice Presidents of the Management Board of the Bank and Members of the Management Board of the Bank. Vice Presidents and Members of the Management Board are appointed and removed on the motion of the President. Appointment of the President of the Management Board and the Member of the Management Board supervising significant risk management or entrusting this function to the appointed Member of the Management Board, is subject to approval by the Financial Supervision Authority. The body which applies to the Financial Supervision Authority for the approval is the Supervisory Board.

At least half of the Members of the Management Board, including its President, should possess a thorough knowledge of the Polish banking market, i.e. they should meet all of the following criteria:

- they have professional experience gained on the Polish market, relevant for the performance of a managerial function at the Bank,
- they are permanently domiciled in Poland,
- they have command of the Polish language.

The Management Board runs the business and represents the Bank. Each Member of the Bank's Management Board is obliged to undertake actions in Bank's interest. Members of the Management Board are prohibited from taking any decisions or actions that would lead to conflicts of interests or that would be incompatible with the Bank's interests or their official duties. A Management Board Member is obliged to notify the Management Board of the Bank of any situation in which a conflict of interests might occur or has occurred as well as refrain from participating in discussion and voting on resolution in case of which a conflict of interest has occurred.

Members of the Management Board shall have rights under the generally applicable law.

According to the Bank's Statute they have no right to decide whether to issue or purchase shares.

[9] Par. 91.5.4.e of the ordinance of the Minister of Finance of February 19, 2009
[10] Par. 91.5.4.f of the ordinance of the Minister of Finance of February 19, 2009
[11] Par. 91.5.4.g of the ordinance of the Minister of Finance of February 19, 2009
[12] Par. 91.5.4.h of the ordinance of the Minister of Finance of February 19, 2009

### 7) Description of rules governing amendment of the Statute of the Bank[13]

Amendment of the Bank's Statute requires adoption by way of resolution of the Bank's General Shareholders Meeting as well as registering the amendment in the National Court Register. Procedure of the General Shareholders Meeting of the Bank[14] defines detailed rules of conducting the Bank's General Shareholders Meetings and adopting resolutions. The Bank's General Shareholders Meetings resolutions concerning the amendments of the Bank's Statute are being adopted by the three-quarter majority, whereas according to the Bank's Status the Bank's General Shareholders Meeting is entitled to adopt resolutions only if at least 50% of shares plus one share is represented. Moreover, as stated in Par. 34.2 of the Banking Act, any amendment of the Statute of the Bank shall require the authorization of the Polish Financial Supervision Authority where such amendment relates to:

- the company name,
- the bank's registered office, objects and scope of activity taking into consideration activities defined in par. 69.2.1-7 of the Act on Trading in Financial Instruments of July 29, 2005 that the bank intends to perform according to Par. 70.2 of this Act,
- the statutory bodies and their competences, including particularly the competences of the members of the management board appointed with acceptance of the Polish Financial Supervision Authority and decision making standards, the basic organizational structure of the bank, the procedures applicable to making legally binding statements regarding property rights and obligations, the procedures for issuing internal regulations and the procedure for making decisions concerning the undertaking of commitments or disposal of assets whose total value with regard to a single entity exceeds 5% of the bank's own funds,
- the principles of functioning of the management system, including internal control system,
- the own funds and financial management principles, and
- voting preference or limitation attached to shares of a bank.

### 8) Functioning of the General Shareholders Meeting and its key powers, as well as description of the rights of shareholders and the manner of exercising these rights, in particular rules resulting from Rules of Procedure for the General Shareholders Meeting, unless these rules result directly from generally applicable law[15]

The operation of the Bank's General Shareholders Meeting is governed by the Rules of Procedure for the Bank's General Shareholders Meeting, adopted by way of Resolution No. 19 of April 8, 2003, amended by way of Resolution No. 41 of May 5, 2009 and Resolution No. 41 of June 1, 2012. The Regulation of Shareholders' Meetings of the Bank was amended by resolution No. 42 dated June 16, 2016 of the Ordinary General Meeting of the Bank which shall enter into force on the day following the next shareholder's General Meeting. The Regulation of Shareholders' Meetings of the Bank defines detailed rules of conducting General Shareholders Meetings and adopting resolutions. The Rules of Procedure are available to the public on the Bank's website[16].

Apart from powers and authorities mentioned in binding laws, in particular in the Code of Commercial Companies and the Banking Law Act, in the Regulators' recommendations and the Bank's Statute, the Bank's General Shareholders Meeting has the following powers and authority:

- to review and approve the report on the Bank's operations and the Bank's financial statements for the previous financial year,
- to adopt a resolution on profit distribution or coverage of loss,
- to review and approve the report on the activities of the Supervisory Board,
- to grant discharge to Members of the Supervisory Board and Management Board in respect of their duties,
- to review and approve the report on the Group's operations and the Group's financial statements,
- to set the dividend record date and dividend payment date,
- to dispose of or lease a business or its organized part, and to encumber it with limited property rights,
- to amend the Bank's Statute and to draft its consolidated text,
- to increase or decrease the Bank's share capital,
- to issue convertible bonds, bonds with pre-emptive rights to acquire shares, and subscription warrants,
- to retire shares and to define the terms of retirement,
- to decide on the Bank's merger, demerger or liquidation,
- to create and release special accounts,
- to appoint and remove from office Members of the Supervisory Board, taking into account assessment of fulfilment of the suitability requirements,
- to define the remuneration rules for Members of the Supervisory Board,
- to conclude an agreement with a subsidiary which provides for the management of the subsidiary or for the transfer of profit by the subsidiary,
- to appoint the entity authorized to examine financial statements and review the financial statements,
- to deal with other matters falling within the scope of the Bank's activities which are submitted to the Bank's General Shareholders Meeting.

The Bank's General Shareholders Meeting is convened via the Bank's website and in a way determined for passing current information according to rules regarding public offer and conditions, under

[13] Par. 91.5.4.i of the ordinance of the Minister of Finance of February 19, 2009
[14] Adopted by virtue of the Resolution of the General Shareholders Meeting No. 19 of April 8, 2003
[15] Par. 91.5.4.j of the ordinance of the Minister of Finance of February 19, 2009
[16] http://www.pekao.com.pl/informacje_dla_inwestorow/walne-zgromadzenia-banku/

# Statement of Bank Polska Kasa Opieki Spółka Akcyjna on application of Corporate Governance Standards in 2016

which the financial instruments are introduced to organized turnover system and to rules regarding public companies. The convocation have to take place at least twenty-six days before the Bank's General Shareholders Meeting.

The Ordinary General Shareholders Meeting should take place once a year, not later than in June. When determining the date of the Bank's General Shareholders Meeting, the Management Board seeks to enable as many shareholders as possible to participate in the Meeting.

The Statute allows the participation in the General Meeting with the use of electronic communication means if the Management Board adopts such decision. Management Board adopts decision mentioned in the previous sentence in the case of fulfilling by the Bank technical conditions necessary for participation in the General Meeting with the use of electronic communication means what covers in particular:

1. real-life broadcast of General Meeting,
2. real-time bilateral communication where shareholders may take the floor during a General Meeting from location other than the General Meeting,
3. exercising the rights to vote during a General Meeting either in person or through a plenipotentiary.

According to the Statute, in each case of convening the General Meeting, the Management Board of the Bank defines whether the participation in the General Meeting with the use of electronic communication means is possible and what are the requirements and limitations necessary to identify of shareholders and to ensure the safety of electronic communication. Detailed conditions of participation in the General Meeting with the use of electronic communication means are specified in regulation adopted by the General Meeting and notice of calling the General Meeting.

The Bank's Supervisory Board can convene Annual General Shareholders Meeting, if the Management Board does not convene it in due time stated in the Statute and the Extraordinary Shareholders Meeting, if necessary.

The full documentation which is to be presented to the Bank's General Meeting, together with the drafts of resolutions and information concerning the Bank's General Meeting are made available to persons entitled to participate in the Bank's General Meeting on the Bank's website and in paper form which is available in the Bank's Headquarters, Warsaw, Żwirki i Wigury Street 31. Information in this respect is covered by announcement about convening the General Meeting, in accordance with Art. $402^2$ of Code of Commercial Companies.

Official copies of the Bank's Management Board on the Bank's operations and financial statements as well as copies of the Supervisory Board's report and external auditor's opinion are issued to shareholders upon request no later than 15 days prior to the Bank's General Meeting date.

The rights of the Bank's shareholders include in particular:

- the right of shareholders holding at least a half of the share capital or at least a half of the votes to convene Extraordinary Meeting of Shareholders. In this case, the shareholders elect the chairman of the Bank's General Meeting,
- the right of shareholders holding at least the twentieth of share capital to demand that specific issues be placed on the agenda of the next Bank's General Shareholders Meeting. The demand should include the justification and the project of resolution's project concerning proposed issue and should be submitted to the Management Board no later than 21 days prior to the Meeting date. The Management Board is obliged to announce changes in the Meeting agenda introduced because of shareholder's demand as fast as possible and no later than 18 days prior to the Meeting date. The Announcement takes place according to the way proper for General Meeting convocation,
- the right of shareholders holding at least the twentieth of share capital to submit via electronic communication media projects of resolutions concerning issues introduced to the Bank's General Meeting agenda or issues, which are supposed to be introduced to the Meeting agenda before the date of holding the Bank's General Meeting. The Bank instantly announces projects of resolutions on the Bank's website,
- the right of every shareholder to submit projects of resolutions concerning issues introduced to the Meeting's agenda,
- the right of shareholders to participate in the Bank's General Shareholders Meeting personally or by proxy,
- the right of shareholders holding a tenth of the share capital represented at the Bank's General Shareholders Meeting to demand that the attendance list of the Bank's General Shareholders Meeting be checked by a committee appointed for that purpose and composed of at least three persons, including one person appointed by the parties making the demand,
- the right according to which the Bank's General Shareholders Meeting is not allowed to adopt a resolution to remove an item from the agenda or not to consider an issue which was placed on the agenda upon request of shareholders unless the shareholders express their consent to the same,
- the right according to which the Bank's General Shareholders Meeting may not be adjourned deliberately to obstruct the exercise of the shareholders rights,
- the right of each individual participant of the Bank's General Shareholders Meeting to nominate one or more candidates for membership on the Bank's Supervisory Board,
- the right of shareholders holding at least a fifth of the share capital to demand block voting on the appointment of the Supervisory Board; a relevant request should be submitted to the Management Board in writing at such time as to enable its placement on the agenda of the Bank's General Shareholders Meeting,
- the right to inspect the book of minutes and to receive copies of resolutions authenticated by the Management Board,
- the right according to which the Chairperson of the Bank's General Shareholders Meeting is obliged to ensure that the rights of minority shareholders are respected,
- the right of shareholders who raise an objection against a resolution to justify the objection in a concise manner.

All issues submitted to the Bank's General Shareholders Meeting have the recommendation of the Supervisory Board. According to Par. 9 of the Bank's Statute, issues submitted to the Bank's General Shareholders Meeting should be submitted to the Supervisory Board for consideration.

The Bank's General Shareholders Meetings are attended by Members of the Management Board and Supervisory Board in makeup that enables providing content-related answers to question in discussion. An auditor is present at the General Shareholders Meeting in particular Ordinary General Shareholders Meeting, if financial matters of the Bank are to be discussed at the Meeting.

The Bank's Management Board, as a body responsible for providing legal service to the Bank's General Shareholders Meeting, exerts every effort to ensure that resolutions are formulated in a clear and unambiguous manner.

The Rules of Procedure for the Bank's General Shareholders Meeting contain provisions (Par. 13.10–17) regarding block voting on the appointment of the Supervisory Board.

Any amendments to the Rules of Procedure for the Bank's General Shareholders Meeting take effect as of the date of the next General Shareholders Meeting.

In the course of performing their responsibilities, the Bank's governing bodies ensure that the interests of majority shareholders are served in such a way as not to prejudice the interests of the minority shareholders. The above principle finds its practical implementation in the proper composition of the Supervisory Board, which comprises representatives of both majority and minority shareholders. Thus, the interests of all shareholder groups are accounted for in carrying out the supervisory function. The principle of the majority rule is reflected in Par. 10.2 of the Bank's Statute, whereby the Bank's General Shareholders Meeting may adopt resolutions if at least 50% of the share capital plus one share is represented at the Meeting. The purpose of this provision is to guarantee that resolutions on matters most important to the Bank and its shareholders are adopted by the Bank's General Shareholders Meeting in the presence of shareholders representing jointly an absolute majority of the share capital. However, if a resolution is not adopted for lack of quorum, as defined above, the resolution may be adopted at the next Meeting with the same agenda, in the presence of shareholders representing at least 20% of the share capital.

The Chairperson of the Bank's General Shareholders Meeting is responsible for the orderly conduct of the meeting and ensures that the rights and interests of all shareholders are respected, that any abuse of rights by the participants is prevented, and that the rights of minority shareholders are observed.

Within the scope of their competence and to the extent necessary to resolve issues placed under discussion of the Bank's General Shareholders Meeting, Members of the Supervisory Board, Members of the Management Board and the auditor provide the participants with the required explanations and information concerning the Bank.

Voting on procedural matters may be carried out only on issues related to the conduct of the Meeting. This voting procedure cannot be applied to resolutions which may have impact on the exercise of the shareholders rights.

Removing an item from the agenda or a decision not to consider an issue placed on the agenda at the request of shareholders requires a resolution of the Bank's General Shareholders Meeting, adopted with a three-quarter majority of the votes, following approval by all the present shareholders who submitted such a request.

### 9) Composition of the Bank's managerial, supervisory or administrative bodies and it's committees, and its changes that occurred during last financial year as well as rules of procedure[17]

**Management Board**

As at January 1, 2016 the Management Board of the Bank was composed of the following persons:

| | |
|---|---|
| Luigi Lovaglio | President of the Management Board, CEO, |
| Diego Biondo | Vice President of the Management Board, |
| Andrzej Kopyrski | Vice President of the Management Board, |
| Adam Niewiński | Vice President of the Management Board, |
| Grzegorz Piwowar | Vice President of the Management Board, |
| Stefano Santini | Vice President of the Management Board, |
| Marian Ważyński | Vice President of the Management Board. |

With the effect from June 16, 2016 the mandates of Management Board Members expired. Therefore, on the meeting of June 6, 2016 the Supervisory Board, taking into account the assessment of fulfilment of the suitability requirements appointed the Management Board Members for three-year joint term, starting on June 17, 2016.

The following persons were appointed as members of the Management Board:

| | |
|---|---|
| Luigi Lovaglio | as the President of the Management Board, CEO, |
| Diego Biondo | as Vice President of the Management Board, supervising material risk management in the Bank's activity, |
| Andrzej Kopyrski | as Vice President of the Management Board, |
| Grzegorz Piwowar | as Vice President of the Management Board, |
| Stefano Santini | as Vice President of the Management Board, |
| Marian Ważyński | as Vice President of the Management Board, |
| Adam Niewiński | as Vice President of the Management Board. |

[17] Par. 91.5.4.k of the ordinance of the Minister of Finance of February 19, 2009

# Statement of Bank Polska Kasa Opieki Spółka Akcyjna on application of Corporate Governance Standards in 2016

As at December 31, 2016 the Management Board was composed of the following persons:

| | |
|---|---|
| Luigi Lovaglio | President of the Management Board, CEO, |
| Diego Biondo | Vice President of the Management Board, supervising material risk management in the Bank's activity, |
| Andrzej Kopyrski | Vice President of the Management Board, |
| Grzegorz Piwowar | Vice President of the Management Board, |
| Stefano Santini | Vice President of the Management Board, |
| Marian Ważyński | Vice President of the Management Board, |
| Adam Niewiński | Vice President of the Management Board. |

The Management Board of the Bank acts according to the Bank's Statute and the Rules of procedure adopted by virtue of its Resolution No. 480/XII/2014 of December 22, 2014. The previously binding Resolution of the Management Board No. 101/VI/03 of June 3, 2003 expired. The Rules of procedure shall in particular define the matters which require joint consideration by the Management Board, as well as the procedure for adopting a resolution in writing. The Rules of Procedure of the Management Board are available on the Bank's website[18]. The Members of the Management Board shall coordinate and supervise the activity of the Bank pursuant to the binding division of competence adopted by the Management Board and approved by the Supervisory Board.

According to the Bank's Statute, the Management Board shall conduct the matters of the Bank and represent the Bank. Issues not reserved by virtue of the provisions of the law or of the Statute to fall within the scope of competence of other Bank's statutory bodies, shall fall within the scope of competence of the Bank's Management Board. The Management Board of the Bank in the framework limited by the rules of the binding Polish law submits all required information and data to UniCredit S.p.A. as the parent company. The Management Board of the Bank, operating through the statutory bodies of the subsidiaries of the Bank, coordinates and affects their activities aimed at ensuring the stability of the Group.

Pursuant to the provisions of the Rules of procedure, the Bank's Management Board prepares the development strategy for the Bank and is responsible for the implementation and execution of that strategy. The Supervisory Board issues its opinions on the Bank's long-term development plans and annual financial plans, prepared by the Management Board. The Management Board ensures that the management system at the Bank is transparent and effective, and runs the Bank's affairs in compliance with applicable laws and Best Practices. The core values underlying the management of the Bank are professionalism, credibility and confidentiality, while customer relations are underpinned by reliability and integrity, as well as compliance with applicable laws, including the provisions on anti-money laundering and financing of terrorism.

Pursuing the principle of efficient and prudent management, the Management Board is responsible for initiation and implementation of programs aimed at increasing the Bank's value and rate of return for the shareholders, as well as protection of the employees' long-term interests. In its decisions, the Bank's Management Board makes every effort to ensure, to the maximum extent possible, the promotion of the interests of the shareholders, creditors, employees, as well as other entities and persons co-operating with the Bank in its business activity.

**Supervisory Board**

As at January 1, 2016 the Supervisory Board of the Bank was composed of the following persons:

| | |
|---|---|
| Jerzy Woźnicki | Chairman of the Supervisory Board, |
| Roberto Nicastro | Deputy Chairman of the Supervisory Board, |
| Leszek Pawłowicz | Deputy Chairman of the Supervisory Board, |
| Alessandro Decio | Secretary of the Supervisory Board, |
| Dariusz Filar | Member of the Supervisory Board, |
| Katarzyna Majchrzak | Member of the Supervisory Board, |
| Laura Stefania Penna | Member of the Supervisory Board, |
| Wioletta Rosołowska | Member of the Supervisory Board, |
| Doris Tomanek | Member of the Supervisory Board. |

The Ordinary General Meeting of Shareholders of the Bank on June 16, 2016 appointed Members of the Supervisory Board of the Bank for three-year joint term starting on June 17, 2016.

The following persons were appointed as Members of the Supervisory Board: Dariusz Filar, Massimiliano Fossati, Katarzyna Majchrzak Giovanni Papa, Leszek Pawłowicz, Laura Stefania Penna, Wioletta Rosołowska, Doris Tomanek, Jerzy Woźnicki,

At the meeting on July 22, 2016 the Supervisory Board appointed:

| | |
|---|---|
| Jerzy Woźnicki | as Chairman of the Supervisory Board, |
| Gianni Papa | as Deputy Chairman of the Supervisory Board, |
| Leszek Pawłowicz | as Deputy Chairman of the Supervisory Board, |
| Massimiliano Fossati | as Secretary of the Supervisory Board, |

As at December 31, 2016 the Supervisory Board of the Bank was composed of the following persons:

| | |
|---|---|
| Jerzy Woźnicki | Chairman of the Supervisory Board, |
| Gianni Papa | Deputy Chairman of the Supervisory Board, |
| Leszek Pawłowicz | Deputy Chairman of the Supervisory Board, |
| Massimiliano Fossati | Secretary of the Supervisory Board, |
| Dariusz Filar | Member of the Supervisory Board, |
| Katarzyna Majchrzak | Member of the Supervisory Board, |
| Laura Stefania Penna | Member of the Supervisory Board, |
| Wioletta Rosołowska | Member of the Supervisory Board, |
| Doris Tomanek | Member of the Supervisory Board. |

Wioletta Rosołowska resigned from the position of the Member of the Supervisory Board as of the end of December 31, 2016.

[18] http://www.pekao.com.pl/o_banku/wladze_Banku/

On January 13, 2017 the Bank Management Board informed in the current report No. 2/2017 that Gianni Papa, Massimiliano Fossati, Laura Stefania Penna and Doris Tomanek resigned from the positions of members of the Supervisory Board of the Bank subject to the condition and with effect as of the date of: (i) the indirect sale by UniCredit S.p.A. of 52,494,007 (fifty-two million four hundred and ninety-four thousand and seven) shares in the Bank to Powszechny Zakład Ubezpieczeń S.A. and (ii) the direct sale by UniCredit S.p.A. of 26,247,003 (twenty-six million, two hundred and forty-seven thousand and three) shares in the Bank to Polski Fundusz Rozwoju S.A.

The Supervisory Board acts on the basis of the Rules of procedure adopted by virtue of its Resolution No. 10/15 of February 6, 2015. amended by the resolution No. 54/15 of the Supervisory Board of December 18, 2015. The Rules of procedure of the Supervisory Board are available on the Bank's website[19].

The role of the Supervisory Board is to exercise a general and permanent supervision over the Bank's activities, taking into consideration the Bank's function of a parent company regarding subsidiaries of the Bank. Apart from the competence defined in law, the Supervisory Board possesses competences stated in the Bank's Statute, the Supervisory Board in particular examines every matter submitted to the Bank's General Shareholders Meeting.

The Supervisory Board Members always act with due regard to the Bank's interests and take all actions necessary to ensure efficient functioning of the Supervisory Board. Moreover, Members of the Supervisory Board of the Bank are prohibited from taking any decisions or actions that would lead to conflicts of interests or that would be not in line with the Bank's best interest. About existing or potential conflict of interests the Member of the Supervisory Board informs the Supervisory Board and restrains from participating in a discussion and voting on resolution regarding issue in the case of which a conflict of interest occurred.

Each year, according to regulations in force, the Supervisory Board prepares and submits to the Bank's General Shareholders Meeting an assessment of the report on the activities of the Bank and the Group prepared by the Bank's Management Board, assessment of the Bank's financial statements and consolidated financial statements of the Group, assessment of motion concerning profit's division or losses coverage, as well as the Supervisory Board activities statements. The assessments prepared by the Supervisory Board are made available to the shareholders before the Bank's General Shareholders Meeting.

The Supervisory Board set up dedicated committees which deal with specific areas of the Bank's operations, including the Audit Committee, the Nomination and Remuneration Committee and the Financial Committee and Risk Committee. Reports of the committees set up by the Supervisory Board are stored at the Bank's Head Office. Annual reports of committees are annexed to and published with the Supervisory Board statement.

**Audit Committee**

As at January 1, 2016 the Audit Committee was composed of the following persons:

| | |
|---|---|
| Dariusz Filar | President of the Committee, |
| Alessandro Decio | Member of the Committee, |
| Leszek Pawłowicz | Member of the Committee, |
| Laura Stefania Penna | Member of the Committee, |
| Jerzy Woźnicki | Member of the Committee. |

Due to appointing a new composition of the Supervisory Board, the composition of the Audit Committee has changed.

Since July 22, 2016 Audit Committee is composed of the following persons:

| | |
|---|---|
| Dariusz Filar | President of the Committee, |
| Massimiliano Fossati | Member of the Committee, |
| Leszek Pawłowicz | Member of the Committee, |
| Laura Stefania Penna | Member of the Committee, |
| Jerzy Woźnicki | Member of the Committee. |

and until December 31, 2016 it did not change.

The scope of the Audit Committee's competence has been determined by the Supervisory Board's Resolution No. 41/14 of December 12, 2014. Previously in force Supervisory Board's Resolution No. 9/12 of March 8, 2012 expired.

The Audit Committee supports the Supervisory Board in the performance of its duties, therein related to the adequacy and effectiveness of the Bank's internal control mechanisms, including identification, measurement and management of risk, compliance with applicable laws and procedures governing the Bank's operations, correct application of accounting rules in the process of drawing up financial statements, and ensuring independence of external auditors and the resources of the Internal Audit Department.

The Audit Committee is composed of five persons selected from among the Members of the Supervisory Board, and includes at least three independent Members. The Chairman of the Audit Committee is an independent Member of the Supervisory Board.

Meetings of the Audit Committee are held as need of Committee arises, but not less frequently than four times a year, and dates of these meetings coincide with key dates in the Bank's quarterly reporting cycle and the review of the annual audit plan presented by the Director of the Internal Audit Department.

[19] http://www.pekao.com.pl/o_banku/wladze_Banku/#tab2

# Statement of Bank Polska Kasa Opieki Spółka Akcyjna on application of Corporate Governance Standards in 2016

**Nomination and Remuneration Committee**
As at January 1, 2016, in the Bank operated the Remuneration Committee, which was composed of the following persons:
Roberto Nicastro,
Wioletta Rosołowska,
Doris Tomanek,
Jerzy Woźnicki.

As a result of appointing new composition of the Supervisory Board, the composition of the Nomination and Remuneration Committee has changed.

Since July 22, 2016 Nomination and Remuneration Committee is composed of the following persons:
Dariusz Filar,
Gianni Papa,
Wioletta Rosołowska – until December 31, 2016.
Doris Tomanek,
Jerzy Woźnicki
and until December 31, 2016 it did not change.

The Committee operates on the basis of the Rules of Procedure of the Supervisory Board of the Bank which was adopted on April 27, 2015, amended by the resolution No. 75/16 dated October 11, 2016.

The aim of the Committee is to support the Supervisory Board in performing its duties by, among others:

a) submission of recommendations regarding conditions of agreements that regulate employment relationship or other legal relationship between Members of the Management Board and the Bank, including the amount of remuneration to be paid to Members of the Management Board, and regarding approval of the policy on variable components of the remuneration for persons holding managerial positions in the Bank according to separate regulations and in order to submit recommendations to the General Shareholders Meeting regarding the remuneration to be paid to Members of the Supervisory Board,
b) preparation of recommendations regarding fulfillment of suitability requirements for the purpose of appointment of Members of the Management Board and the Supervisory Board,
c) Preparation of report for the General Shareholders Meeting regarding assessment of functioning of the remuneration policy in the Bank.

**Financial Committee**
As at January 1, 2016, the Financial Committee was composed of the following persons:
Alessandro Decio,
Roberto Nicastro,
Laura Stefania Penna.

As a result of appointing new composition of the Supervisory Board, the composition of the Financial Committee has changed.

Since July 22, 2016 Financial Committee is composed of the following persons:
Massimiliano Fossati,
Gianni Papa,
Laura Stefania Penna
and until December 31, 2016 it did not change.

The Financial Committee operates on the basis of the Supervisory Board's resolution. Its role is to exercise supervision over the implementation of the Bank's financial objectives. Members of the Committee have the right to use services of advisers.

**Risk Committee**
Since July 22, 2016 Risk Committee was composed of the following persons:
Massimiliano Fossati,
Katarzyna Majchrzak
Leszek Pawłowicz
and until December 31, 2016 it did not change.

Risk Committee operates on the basis of "Rules of Procedure of the Risk Committee" set up by the Supervisory Board. Mission of the Committee is to support the Supervisory Board in fulfillment of its obligations concerning supervision over risk management system and assessment of the adequacy and effectiveness of the said system.

## 10. Description of the Bank's diversity Policy applied to governing, managing and supervising bodies with respect to such factors as age, gender or education and professional experience, aims of the diversity policy, manner of its realisation and results in the given reporting period[20]

On December 22, 2015 Management Board of the Bank adopted by resolution and on February 4, 2016 Supervisory Board of the Bank accepted by resolution "Diversity policy in reference to Supervisory Board members, Management Board members and Key Function Holders in Bank Polska Kasa Opieki Spółka Akcyjna" (hereinafter referred to as "the Policy").

This Policy defines the strategy of the Bank in scope of diversity management, including diversity in reference to appointment the Supervisory Board members, Management Board members and Key Function Holders in the Bank.

The purpose of diversity strategy of the Bank is to provide high quality of tasks execution by its governing bodies, through selection of qualified people to hold function in the Supervisory Board, the Management Board and Key Function Holders in the Bank, using as the first objective criteria and taking into account the benefits of diversity.

[20] § 91, item 5, pt 4 l of the ordinance of the Minister of Finance of February 19, 2009

The diversity strategy includes and uses to achieve the best outcome differences, which in addition to knowledge, skills and work experience result from educational background, geographical origin and nationality, gender and age. The diversity strategy is also conducted in the processes of selection, suitability assessment and succession.

Application of diversity strategy is accomplished also by the Gender Equality Policy of the Bank, which assumes striving to provide representatives of both genders in the following processes referring to Management Board members and Key Functions in the Bank: external selection, internal appointment, succession planning, taking into account provisions on equal treatment in the field of establishing an employment relationship.

In 2014-2016 the share of men and women the Management of the Bank was following.

| | DECEMBER 31, 2014 | | DECEMBER 31, 2015 | | DECEMBER 31, 2016 | |
|---|---|---|---|---|---|---|
| | NO. OF PERSONS | % | NO. OF PERSONS | % | NO. OF PERSONS | % |
| Women | | 0% | | 0% | | 0% |
| Men | 6 | 100% | 7 | 100% | 7 | 100% |
| Sum | 6 | 100% | 7 | 100% | 7 | 100% |

In 2014-2016 the share of men and women the Supervisory Board of the Bank was following.

| | DECEMBER 31, 2014 | | DECEMBER 31, 2015 | | DECEMBER 31, 2016 | |
|---|---|---|---|---|---|---|
| | NO. OF PERSONS | % | NO. OF PERSONS | % | NO. OF PERSONS | % |
| Women | 4 | 44% | 4 | 44% | 4 | 44% |
| Men | 5 | 56% | 5 | 56% | 5 | 56% |
| Sum | 9 | 100% | 9 | 100% | 9 | 100% |

# Auditor’s Opinion

# Auditor's Opinion

*To the Shareholders and Supervisory Board*
*of Bank Polska Kasa Opieki S.A.*

Auditor's report
We have audited the attached consolidated financial statements of the Bank Polska Kasa Opieki S.A. Capital Group ("Capital Group"), for which Bank Polska Kasa Opieki S.A. ("Bank") with its registered office in Warsaw, at Grzybowska 53/57 is the Parent Company. Those consolidated financial statements include: consolidated income statement and consolidated statement of comprehensive income for the financial year from 1 January 2016 to 31 December 2016, consolidated statement of financial position prepared as of 31 December 2016, consolidated statement of changes in equity, consolidated cash flow statement for the financial year from 1 January 2016 to 31 December 2016 and notes comprising a summary of significant accounting policies and other explanatory information.

*Responsibility of the Bank's manager and persons supervising the preparation of the financial statements*
The Management Board of the Bank is responsible for the preparation of the financial statements, based on properly kept accounting records, and their fair presentation in accordance with the International Accounting Standards, International Financial Reporting Standards, related interpretations published as European Commission regulations and applicable laws. It is also obliged to ensure internal control as it determines necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Under the Accounting Act of 29 September 1994 (Journal of Laws of 2016 item 1047 as amended), hereinafter referred to as the "Accounting Act" the Management Board of the Bank and members of its Supervisory Board are obliged to ensure that the financial statements meet the requirements of the Accounting Act.

*Auditor's responsibility*
Our responsibility is to express an opinion on these financial statements based on our audit works.

We conducted our audit in accordance with Section 7 of the Accounting Act and the National Auditing Standards in line with the wording of the International Standards on Auditing adopted by Resolution No. 2783/52/2015 of the National Council of Statutory Auditors of 10 February 2015 as amended. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Management Board of the Bank, evaluating if accounting books based on which financial statements are prepared, are properly kept, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion on the consolidated financial statements*
In our opinion, the attached consolidated financial statements:
– give a true and fair view of the economic and financial position of the Bank Polska Kasa Opieki S.A. Capital Group as at 31 December 2016 and its financial performance for the financial year from 1 January 2016 to 31 December 2016 in accordance with the International Accounting Standards, International Financial Reporting Standards, related interpretations published as European Commission regulations and the adopted accounting principles (policies),
– comply, with respect to their form and content, with the applicable provisions of law applicable to the Capital Group and the articles of association of the Bank.

Report on other legal and regulatory requirements
*Opinion on the report on the activities*
We do not express an opinion on the report on the activities.

It is the responsibility of the Management Board of the Bank to prepare the report on the activities of the Capital Group in accordance with the Accounting Act and other applicable laws. Moreover, the Management Board of the Bank and members of the Supervisory Board are obliged to ensure that the financial statements and the report on the activities of the Capital Group meet the requirements of the Accounting Act.

When auditing the consolidated financial statements we were obliged to examine the report on the activities of the Capital Group and indicate whether the information contained therein complies with Article 49 of the Accounting Act and the Ordinance of the Minister of Finance of 19 February 2009 on current and periodic information published by issuers of securities and the rules of equal treatment of the information required by the laws of non-member states (Journal of Laws of 2014 item 133 as amended) and is consistent with underlying information disclosed in the attached consolidated financial statements. Additionally, according to the Article 111a paragraph 3 of the Banking Law (Journal of Laws of 2016 item 1988 as amended, "Banking Law") our responsibility was to audit financial information presented in paragraph 8 of the Report on the activities of the Capital Group. The audit was performed in accordance with the scope presented in the paragraph Auditor's responsibility. Additionally, it was our responsibility to indicate whether we have detected any material misstatement in the report on the activities of the Capital Group based on our knowledge of the Capital Group and its business environment obtained in the course of the audit.

In our opinion, the information contained in the report on the activities of the Capital Group complies with Article 49 of the Accounting Act and the Ordinance of the Minister of Finance of 19 February 2009 on current and periodic information published by issuers of securities and the rules of equal treatment of the information required by the laws of non-member states (Journal of Laws of 2014 item 133 as amended) and is consistent with underlying information disclosed in the attached consolidated financial statements. Moreover, based on our knowledge of the Capital Group and its business environment obtained in the course of the audit, we have not detected any material misstatements in the report on the activities. Additionally, information presented in the paragraph 8 of the Report on the activities of the Capital Group are compliant with the requirements of the Article 111a, paragraph 1 and 2 of the Banking Law.

*Statement of compliance with corporate governance principles*
In relation to our audit of the consolidated financial statements, it was our responsibility to examine the Bank's statement of compliance with corporate governance principles, which constitutes a separate part of the report on the activities of the Capital Group. In our opinion, the Bank's statement provides all information required by the secondary legislation issued under Article 60.2 of the Act on public offering, conditions governing the introduction of financial instruments to organized trading, and public companies of 29 July 2005 (Journal of Laws of 2016 item 1639 as amended) and regulations issued under Article 61 thereof. The information is compliant with the applicable laws and information presented in the financial statements.

Dorota Snarska-Kuman
Key certified auditor
conducting the audit
No. 9667

On behalf of Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. – entity authorized to audit financial statements entered under number 73 on the list kept by the National Council of Statutory Auditors:

Dorota Snarska-Kuman
– Vice-President of the Management Board of Deloitte Polska Sp. z o.o.
– which is the General Partner of Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k.

Warsaw, 9 February 2017

*The above audit opinion together with audit report is a translation from the original Polish version. In case of any discrepancies between the Polish and English version, the Polish version shall prevail.*

# Employee Commitment

**Each of us is motivated and committed to the success of Bank Pekao S.A.**

"It's easier to win as a team."

# Consolidated Financial Statements of Bank Pekao S.A. Group

for the period ended on 31 December 2016

(in PLN thousand)

# Consolidated income statement

(in PLN thousand)

| | NOTE | 2016 | 2015 |
|---|---|---|---|
| Interest income | 10 | 5,448,490 | 5,456,369 |
| Interest expense | 10 | (1,066,485) | (1,289,799) |
| **Net interest income** | | **4,382,005** | **4,166,570** |
| Fee and commission income | 11 | 2,252,085 | 2,388,523 |
| Fee and commission expense | 11 | (293,121) | (382,997) |
| **Net fee and commission income** | | **1,958,964** | **2,005,526** |
| **Dividend income** | **12** | **16,798** | **13,635** |
| **Result on financial assets and liabilities held for trading** | **13** | **485,409** | **428,048** |
| **Result on fair value hedge accounting** | **30** | **1,313** | **5,547** |
| **Gains (losses) on disposal of:** | **14** | **435,903** | **229,601** |
| loans and other financial receivables | | 159,493 | 534 |
| available for sale financial assets and held to maturity investments | | 276,493 | 229,551 |
| financial liabilities | | (83) | (484) |
| **Operating income** | | **7,280,392** | **6,848,927** |
| **Net impairment losses on financial assets and off-balance sheet commitments:** | **18** | **(500,629)** | **(517,558)** |
| loans and other financial receivables | | (401,409) | (500,355) |
| off-balance sheet commitments | | (99,220) | (17,203) |
| **Net result on financial activity** | | **6,779,763** | **6,331,369** |
| **Administrative expenses** | **15** | **(3,602,324)** | **(3,426,592)** |
| personnel expenses | | (1,896,836) | (1,908,519) |
| other administrative expenses | | (1,705,488) | (1,518,073) |
| **Depreciation and amortization** | **16** | **(340,866)** | **(331,465)** |
| **Net result on other provisions** | | **(14,475)** | **(28,766)** |
| **Net other operating income and expenses** | **17** | **30,528** | **160,996** |
| **Operating costs** | | **(3,927,137)** | **(3,625,827)** |
| **Gains (losses) on subsidiaries and associates** | **19** | **38,561** | **113,203** |
| **Gains (losses) on disposal of property, plant and equipment and intangible assets** | **20** | **5,359** | **12,373** |
| **Profit before income tax** | | **2,896,546** | **2,831,118** |
| **Income tax expense** | **21** | **(616,782)** | **(537,640)** |
| **Net profit for the period** | | **2,279,764** | **2,293,478** |
| 1. Attributable to equity holders of the Bank | | 2,279,275 | 2,292,459 |
| 2. Attributable to non-controlling interests | 51 | 489 | 1,019 |
| **Earnings per share (in PLN per share)** | | | |
| basic for the period | 22 | 8.68 | 8.73 |
| diluted for the period | 22 | 8.68 | 8.73 |

Notes to the financial statements presented on pages 150-277 constitute an integral part of the consolidated financial statements.

# Consolidated statement of comprehensive income

(in PLN thousand)

| | NOTE | 2016 | 2015 |
|---|---|---|---|
| **Net profit** | | **2,279,764** | **2,293,478** |
| 1. Attributable to equity holders of the Bank | | 2,279,275 | 2,292,459 |
| 2. Attributable to non-controlling interests | 51 | 489 | 1,019 |
| OTHER COMPREHENSIVE INCOME | | | |
| **Item that are or may be reclassified subsequently to profit or loss:** | | | |
| Foreign currency translation differences | | – | (1,169) |
| Change in fair value of available-for-sale financial assets | | (608,819) | (237,124) |
| Change in fair value of cash flow hedges | 30 | (5,557) | (93,341) |
| Tax on items that are or may be reclassified subsequently to profit or loss | 21 | 116,731 | 62,789 |
| **Items that will never be reclassified to profit or loss:** | | | |
| Remeasurements of the defined benefit liabilities | 45 | (11,560) | 12,900 |
| Share in remeasurements of the defined benefit liabilities of associates | | 18 | 18 |
| Tax on items that will never be reclassified to profit or loss | 21 | 2,196 | (2,451) |
| **Other comprehensive income (net of tax)** | | **(506,991)** | **(258,378)** |
| **Total comprehensive income** | | **1,772,773** | **2,035,100** |
| 1. Attributable to equity holders of the Bank | | 1,772,284 | 2,034,081 |
| 2. Attributable to non-controlling interests | 51 | 489 | 1,019 |

Notes to the financial statements presented on pages 150-277 constitute an integral part of the consolidated financial statements.

# Consolidated statement of financial position

(in PLN thousand)

| | NOTE | 31.12.2016 | 31.12.2015 |
|---|---|---|---|
| ASSETS | | | |
| Cash and due from Central Bank | 24 | 5,872,911 | 7,881,607 |
| Bill of exchange eligible for rediscounting at Central Bank | | – | 70 |
| Loans and advances to banks | 25 | 3,257,829 | 7,314,724 |
| Financial assets held for trading | 26 | 732,469 | 1,126,792 |
| Derivative financial instruments (held for trading) | 27 | 1,913,429 | 3,206,447 |
| Loans and advances to customers | 28 | 118,689,267 | 118,555,199 |
| Receivables from finance leases | 29 | 3,974,643 | 3,503,979 |
| Hedging instruments | 30 | 289,752 | 421,640 |
| Investments (placement) securities | 31 | 35,120,619 | 21,181,723 |
| 1. Available for sale | | 32,101,634 | 17,813,299 |
| 2. Held to maturity | | 3,018,985 | 3,368,424 |
| Assets held for sale | 33 | 48,277 | 45,302 |
| Investments in associates | 34 | 136,221 | 148,965 |
| Intangible assets | 35 | 596,181 | 636,717 |
| Property, plant and equipment | 36 | 1,422,930 | 1,460,652 |
| Investment properties | 37 | 24,874 | 30,221 |
| Income tax assets | | 1,104,343 | 991,804 |
| 1. Current tax assets | | 100,992 | 76,600 |
| 2. Deferred tax assets | 21 | 1,003,351 | 915,204 |
| Other assets | 38 | 1,031,198 | 2,279,725 |
| **TOTAL ASSETS** | | **174,214,943** | **168,785,567** |
| LIABILITIES AND EQUITY | | | |
| **Liabilities** | | | |
| Amounts due to Central Bank | 24 | 6,091 | 914 |
| Amounts due to other banks | 40 | 4,823,440 | 5,958,449 |
| Financial liabilities held for trading | 26 | 673,165 | 611,442 |
| Derivative financial instruments (held for trading) | 27 | 1,952,674 | 3,204,328 |
| Amounts due to customers | 41 | 137,815,926 | 128,867,691 |
| Hedging instruments | 30 | 1,638,718 | 1,702,759 |
| Debt securities issued | 42 | 1,522,963 | 2,903,233 |
| Income tax liabilities | | 11,579 | 6,649 |
| 1. Current tax liabilities | | 6,694 | 1,713 |
| 2. Deferred tax liabilities | 21 | 4,885 | 4,936 |
| Provisions | 43 | 560,392 | 425,374 |
| Other liabilities | 44 | 2,298,052 | 1,680,535 |
| **TOTAL LIABILITIES** | | 151,303,000 | 145,361,374 |
| **Equity** | | | |
| Share capital | 49 | **262,470** | **262,470** |
| Other capital and reserves | 50 | 20,375,527 | 20,869,976 |
| Retained earnings and profit for the period | 50 | 2,259,022 | 2,275,783 |
| **Total equity attributable to equity holders of the Bank** | | 22,897,019 | 23,408,229 |
| Non – controlling interests | 51 | **14,924** | **15,964** |
| **TOTAL EQUITY** | | 22,911,943 | 23,424,193 |
| **TOTAL LIABILITIES AND EQUITY** | | **174,214,943** | **168,785,567** |

Notes to the financial statements presented on pages 150-277 constitute an integral part of the consolidated financial statements.

# Consolidated statement of changes in equity

(in PLN thousand)

| | EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | OTHER CAPITAL AND RESERVES | | | | | | | | | | |
| | SHARE CAPITAL | TOTAL OTHER CAPITAL AND RESERVES | SHARE PREMIUM | GENERAL BANKING RISK FUND | OTHER RESERVE CAPITAL | REVALUATION RESERVES | FOREIGN CURRENCY TRANSLATION DIFFERENCES | OTHER | RETAINED EARNINGS AND PROFIT FOR THE PERIOD | TOTAL EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK | NON – CONTROLLING INTERESTS | TOTAL EQUITY |
| Note | 49 | 50 | | | | | | | 50 | | 51 | |
| **Equity as at 1.01.2016** | **262,470** | **20,869,976** | **9,137,221** | **1,975,415** | **9,092,740** | **283,597** | **–** | **381,003** | **2,275,783** | **23,408,229** | **15,964** | **23,424,193** |
| **Management options** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** |
| Options exercised (share issue) | – | – | – | – | – | – | – | – | – | – | – | – |
| Revaluation of management share options | – | – | – | – | – | – | – | – | – | – | – | – |
| **Comprehensive income** | **–** | **(506,991)** | **–** | **–** | **–** | **(506,991)** | **–** | **–** | **2,279,275** | **1,772,284** | **489** | **1,772,773** |
| Remeasurements of the defined benefit liabilities (net of tax) | – | (9,346) | – | – | – | (9,346) | – | – | – | (9,346) | – | (9,346) |
| Revaluation of available-for-sale investments (net of tax) | – | (493,144) | – | – | – | (493,144) | – | – | – | (493,144) | – | (493,144) |
| Revaluation of hedging financial instruments (net of tax) | – | (4,501) | – | – | – | (4,501) | – | – | – | (4,501) | – | (4,501) |
| Foreign currency translation differences | – | – | – | – | – | – | – | – | – | – | – | – |
| Net profit for the period | – | – | – | – | – | – | – | – | 2,279,275 | 2,279,275 | 489 | 2,279,764 |
| **Appropriation of retained earnings** | **–** | **12,547** | **–** | **6,909** | **–** | **–** | **–** | **5,638** | **(2,296,036)** | **(2,283,489)** | **(1,529)** | **(2,285,018)** |
| Dividend paid | – | – | – | – | – | – | – | – | (2,283,489) | (2,283,489) | (1,529) | (2,285,018) |
| Profit appropriation to other reserves including consolidation adjustments | – | 12,547 | – | 6,909 | – | – | – | 5,638 | (12,547) | – | – | – |
| **Other** | **–** | **(5)** | **–** | **–** | **(5)** | **–** | **–** | **–** | **–** | **(5)** | **–** | **(5)** |
| Other | – | (5) | – | – | (5) | – | – | – | – | (5) | – | (5) |
| **Equity as at 31.12.2016** | **262,470** | **20,375,527** | **9,137,221** | **1,982,324** | **9,092,735** | **(223,394)** | **–** | **386,641** | **2,259,022** | **22,897,019** | **14,924** | **22,911,943** |

Notes to the financial statements presented on pages 150-277 constitute an integral part of the consolidated financial statements.

# Consolidated statement of changes in equity

(in PLN thousand)

| | EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | OTHER CAPITAL AND RESERVES | | | | | | | | | | |
| | SHARE CAPITAL | TOTAL OTHER CAPITAL AND RESERVES | SHARE PREMIUM | GENERAL BANKING RISK FUND | OTHER RESERVE CAPITAL | REVALUATION RESERVES | FOREIGN CURRENCY TRANSLATION DIFFERENCES | OTHER | RETAINED EARNINGS AND PROFIT FOR THE PERIOD | TOTAL EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK | NON – CONTROLLING INTERESTS | TOTAL EQUITY |
| Note | 49 | 50 | | | | | | | 50 | | 51 | |
| **Equity as at 1.01.2015** | **262,470** | **20,990,344** | **9,137,221** | **1,937,850** | **9,002,629** | **540,806** | **1,169** | **370,669** | **2,764,875** | **24,017,689** | **28,043** | **24,045,732** |
| **Management options** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** |
| Options exercised (share issue) | – | – | – | – | – | – | – | – | – | – | – | – |
| Revaluation of management share options | – | – | – | – | – | – | – | – | – | – | – | – |
| **Comprehensive income** | **–** | **(258,378)** | **–** | **–** | **–** | **(257,209)** | **(1,169)** | **–** | **2,292,459** | **2,034,081** | **1,019** | **2,035,100** |
| Remeasurements of the defined benefit liabilities (net of tax) | – | 10,467 | – | – | – | 10,467 | – | – | – | 10,467 | – | 10,467 |
| Revaluation of available-for-sale investments (net of tax) | – | (192,070) | – | – | – | (192,070) | – | – | – | (192,070) | – | (192,070) |
| Revaluation of hedging financial instruments (net of tax) | – | (75,606) | – | – | – | (75,606) | – | – | – | (75,606) | – | (75,606) |
| Foreign currency translation differences | – | (1,169) | – | – | – | – | (1,169) | – | – | (1,169) | – | (1,169) |
| Net profit for the period | – | – | – | – | – | – | – | – | 2,292,459 | 2,292,459 | 1,019 | 2,293,478 |
| **Appropriation of retained earnings** | **–** | **161,860** | **–** | **37,565** | **113,961** | **–** | **–** | **10,334** | **(2,781,551)** | **(2,619,691)** | **(13,098)** | **(2,632,789)** |
| Dividend paid | – | – | – | – | – | – | – | – | (2,624,701) | (2,624,701) | (8,088) | (2,632,789) |
| Profit appropriation to other reserves including consolidation adjustments | – | 161,860 | – | 37,565 | 113,961 | – | – | 10,334 | (156,850) | 5,010 | (5,010) | – |
| **Other** | **–** | **(23,850)** | **–** | **–** | **(23,850)** | **–** | **–** | **–** | **–** | **(23,850)** | **–** | **(23,850)** |
| Acquisition of Pekao Investment Banking S.A. | – | (23,850) | – | – | (23,850) | – | – | – | – | (23,850) | – | (23,850) |
| **Equity as at 31.12.2015** | **262,470** | **20,869,976** | **9,137,221** | **1,975,415** | **9,092,740** | **283,597** | **–** | **381,003** | **2,275,783** | **23,408,229** | **15,964** | **23,424,193** |

Notes to the financial statements presented on pages 150-277 constitute an integral part of the consolidated financial statements.

# Consolidated cash flow statement

(in PLN thousand)

| | NOTE | 2016 | 2015 |
|---|---|---|---|
| CASH FLOW FROM OPERATING ACTIVITIES – INDIRECT METHOD | | | |
| **Net profit for the period** | | **2,279,275** | **2,292,459** |
| **Adjustments for:** | | **9,051,905** | **(3,592,611)** |
| Depreciation and amortization | 16 | 340,866 | 331,465 |
| Share of profit (loss) of associates | | (38,561) | (52,146) |
| (Gains) losses on investing activities | | (280,761) | (241,559) |
| Net interest income | 10 | (4,382,005) | (4,166,570) |
| Dividend income | 12 | (16,798) | (13,635) |
| Interests received | | 5,347,032 | 5,228,593 |
| Interests paid | | (1,104,545) | (1,266,247) |
| Income tax | | 800,763 | 550,623 |
| Income tax paid | | (613,243) | (607,365) |
| Change in loans and advances to banks | | 214,246 | 174,433 |
| Change in financial assets held for trading | | 393,623 | (677,498) |
| Change in derivative financial instruments (assets) | | 1,293,018 | 1,241,528 |
| Change in loans and advances to customers and bill of exchange eligible for rediscounting at Central Bank | | (42,858) | (6,507,423) |
| Change in receivables from finance leases | | (470,664) | (391,931) |
| Change in investment (placement) securities | | (928,421) | (830,115) |
| Change in other assets | | 1,228,207 | 819,733 |
| Change in amounts due to banks | | (1,128,745) | 615,159 |
| Change in financial liabilities held for trading | | 61,723 | 20,131 |
| Change in derivative financial instruments (liabilities) | | (1,251,654) | (1,213,378) |
| Change in amounts due to customers | | 8,969,426 | 3,229,320 |
| Change in debt securities issued | | 11,832 | 91,981 |
| Change in provisions | | 135,018 | (17,082) |
| Change in other liabilities | | 514,406 | 89,372 |
| **NET CASH FLOWS FROM OPERATING ACTIVITIES** | | **11,331,180** | **(1,300,152)** |
| **Cash flow from investing activities** | | | |
| **Investing activity inflows** | | **83,089,908** | **269,003,982** |
| Sale of shares in associates | | – | 75,000 |
| Sale of investment securities | | 82,248,380 | 268,281,039 |
| Sale of intangible assets and property, plant and equipment | | 14,190 | 17,120 |
| Dividend received | 12 | 16,798 | 13,635 |
| Other investing inflows | | 810,540 | 617,188 |
| **Investing activity outflows** | | **(96,608,585)** | **(265,080,477)** |
| Acquisition of shares in subsidiary, net of cash acquired | | – | (274,329) |
| Acquisition of investment securities | | (96,335,321) | (264,510,542) |
| Acquisition of intangible assets and property, plant and equipment | 35, 36 | (273,264) | (295,606) |
| **Net cash flows from investing activities** | | **(13,518,677)** | **3,923,505** |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| **Financing activity inflows** | | **1,129,733** | **3,966,098** |
| Issue of debt securities | 42 | 1,129,733 | 3,966,098 |
| **Financing activity outflows** | | **(4,789,541)** | **(7,632,240)** |
| Redemption of debt securities | 42 | (2,506,052) | (5,007,539) |
| Dividends and other payments to shareholders | | (2,283,489) | (2,624,701) |
| **Net cash flows from financing activities** | | **(3,659,808)** | **(3,666,142)** |
| **Total net cash flows** | | **(5,847,305)** | **(1,042,789)** |
| including: effect of exchange rate fluctuations on cash and cash equivalents held | | 96,157 | 151,702 |
| **Net change in cash and cash equivalents** | | **(5,847,305)** | **(1,042,789)** |
| **Cash and cash equivalents at the beginning of the period** | | **14,513,395** | **15,556,184** |
| **Cash and cash equivalents at the end of the period** | **52** | **8,666,090** | **14,513,395** |

Notes to the financial statements presented on pages 150-277 constitute an integral part of the consolidated financial statements.

# Notes to financial statements

(in PLN thousand)

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

## 1. General information

The parent company of the Bank Pekao S.A. Group (the 'Group') is Bank Pekao S.A. (hereinafter referred to the 'the Parent Company', 'the Bank'), with Head Office in Warsaw, at 53/57 Grzybowska Street, 00-950 Warsaw. Bank Pekao S.A. was incorporated on 29 October 1929 in the Commercial Register of the District Court in Warsaw and has been continuously in operation since its incorporation.

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

The Bank's statistical REGON number is 000010205.

Both the Parent Company and the consolidating entities constituting the Capital Group has been estabilished for an indefinite period of time.

Bank Pekao S.A. Capital Group ('Group' or 'Bank Pekao S.A. Group') is part of the UniCredit S.p.A. Group with its seat in Roma, Italy.

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

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

### Changes in share ownership structure of the Bank

In the current report No. 17/2016, the Management Board of Bank Pekao S.A. informed that on 18 July 2016 it received the notification from UniCredit S.p.A. according to which, UniCredit S.p.A. sold 26 247 003 shares of the Bank as a result of the execution on 13 July 2016 of the block trades concluded as a result of the accelerated book-building process. The transactions were settled on 15 July 2016.

In the current report No. 30/2016, the Management Board of Bank Pekao S.A. informed that on 8 December 2016 UniCredit S.p.A. announced it has entered into an agreement for the disposal of a 32.8% stake in Bank Pekao S.A. to Powszechny Zakład Ubezpieczeń S.A. ('PZU') and Polish Development Fund S.A. ('PFR').

The Transaction is subject to the customary regulatory and antitrust approvals and is expected to be completed around mid-2017.

Moreover in the current report No. 31/2016 on 8 December 2016 the Bank informed that it had received communication from UniCredit S.p.A. concerning announcement on sale offer of 1 916 of certificates exchangeable for the Bank shares of total reference value of approx. EUR 500 million, compulsorily settled in the Bank common shares no later than on 15 December 2019. Those certificates shall be used to sell the remaining 7.3% of the Bank shares belonging to UniCredit S.p.A. (after the conclusion of sale agreement mentioned above).

(in PLN thousand)

# 2. Group structure

The Group consists of Bank Pekao S.A. as the parent entity and the following subsidiaries

| NAME OF ENTITY | LOCATION | CORE ACTIVITY | PERCENTAGE OF THE GROUP'S OWNERSHIP RIGHTS IN SHARE CAPITAL/ VOTING | |
|---|---|---|---|---|
| | | | 31.12.2016 | 31.12.2015 |
| Pekao Bank Hipoteczny S.A. | Warsaw | Banking | 100.00 | 100.00 |
| Centralny Dom Maklerski Pekao S.A. | Warsaw | Brokerage | 100.00 | 100.00 |
| Pekao Leasing Sp. z o.o. | Warsaw | Leasing services | 100.00 | 36.49 |
| Pekao Investment Banking S.A. | Warsaw | Brokerage | 100.00 | 100.00 |
| Pekao Leasing Holding S.A. (in liquidation), including: | Warsaw | Deleted from the registry | – | 100.00 |
| *Pekao Leasing Sp. z o.o.* | *Warsaw* | *Leasing services* | – | *63.51* |
| Pekao Faktoring Sp. z o.o. | Lublin | Factoring services | 100.00 | 100.00 |
| Pekao Pioneer Powszechne Towarzystwo Emerytalne S.A. | Warsaw | Pension fund management | 65.00 | 65.00 |
| Centrum Kart S.A. | Warsaw | Financial support | 100.00 | 100.00 |
| Pekao Financial Services Sp. z o.o. | Warsaw | Transferable agent | 100.00 | 100.00 |
| Centrum Bankowości Bezpośredniej Sp. z o.o. | Cracow | Call-center services | 100.00 | 100.00 |
| Pekao Property S.A., including: | Warsaw | Real estate development | 100.00 | 100.00 |
| *FPB – Media Sp. z o.o.* | *Warsaw* | *Real estate development* | *100.00* | *100.00* |
| Pekao Fundusz Kapitałowy Sp. z o.o. (in liquidation) | Warsaw | Business consulting | 100.00 | 100.00 |

As at 31 December 2016, all of the subsidiaries have been consolidated.

### Associates

Bank Pekao S.A. Capital Group has an interest in the following associates

| NAME OF ENTITY | LOCATION | CORE ACTIVITY | PERCENTAGE OF THE GROUP'S OWNERSHIP RIGHTS IN SHARE CAPITAL/ VOTING | |
|---|---|---|---|---|
| | | | 31.12.2016 | 31.12.2015 |
| Dom Inwestycyjny Xelion Sp. z o.o. (*) | Warsaw | Financial intermediary | 50.00 | 50.00 |
| Pioneer Pekao Investment Management S.A. | Warsaw | Asset management | 49.00 | 49.00 |
| *Pioneer Pekao TFI S.A.* | *Warsaw* | *Asset management* | *49.00* | *49.00* |
| CPF Management | Tortola, British Virgin Islands | Financial brokerage – not operating | 40.00 | 40.00 |
| Polish Banking System S.A. (in liquidation) | Warsaw | Deleted from the registry | – | 48.90 |
| PPU Budpress Sp. z o.o. (in liquidation) | Żyrardów | Deleted from the registry | – | 36.20 |

(*)The Group has no control over the entity due to provisions in the Company's Articles of Association.

As at 31 December 2016, the Group held no shares in entities under joint control.

### Changes in Group structure

***The deletion of Polish Banking System S.A. (in liquidation) and PPU Budpress Sp. z o.o. (in liquidation) from the Registry***

On 1 January 2016 Polish Banking System S.A. (in liquidation) and PPU Budpress Sp. z o.o. (in liquidation) were deleted from the Registry.

***The deletion of Pekao Leasing Holding S.A. (in liquidation) from the Registry***

On 20 September 2016 Pekao Leasing Holding S.A. (in liquidation) was deleted from the Registry. In the course of the liquidation process of the Company, the transfer of ownership of 69 746 shares in Pekao Leasing Sp. z o.o. to Bank Pekao S.A. has been made. The Bank now holds 100% shares in the share capital and in the votes in the General Meeting of Pekao Leasing Sp. z o.o.

# 3. Business combination

In the year of 2016 there were no business combinations in the Group. In 2015 the Bank acquired 100% of the share capital of UniCredit CAIB Poland S.A. (presently Pekao Investment Banking S.A.). The transaction was detailed in the consolidated financial statements of Bank Pekao S.A. Group for the period ended on 31 December 2015.

# 4. Statement of compliance

The annual consolidated financial statements ('financial statements') of the Bank Pekao S.A. Group have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union, and in respect to matters that are not regulated by the above standards, in accordance with the requirements of the Accounting Act dated 29 September 1994 (Official Journal from 2016, item 1047 with further amendments) and respective operating regulations, and in accordance with the requirements for issuers of securities admitted or sought to be admitted to trading on an official stock exchange listing market.

These Consolidated Financial Statements were approved for publication by the Bank's Management Board on 9 February 2017.

# 5.Significant accounting policies

## 5.1 Basis of preparation of Consolidated Financial Statements

**General information**

These Consolidated Financial Statements of the Group, which have been prepared for the period from 1 January to 31 December 2016, contain the financial results of the Bank and of its subsidiaries, comprising the 'Group', as well as the results of associated entities, measured using the equity method.

The financial statements have been prepared in Polish zloty, and all data in the financial statements are presented in PLN thousand (PLN '000), unless indicated otherwise.

The financial statements have been prepared on a going concern basis on the assumption that the Group will continue its business operations substantially unchanged in scope for a period of at least one year from the balance sheet date.

The accounting principles as described below have been consistently applied for all the reporting periods. The principles have been applied consistently by all the Group entities.

Consolidated Financial Statements of the Group have been prepared based on the following valuation methods:

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

The consolidated financial statements include the requirements of all the International Financial Reporting Standards and International Accounting Standards approved by the European Union and related interpretations. Changes in published standards and interpretations, which became effective on or after 1 January 2016, had no material impact on the Group's financial statements (Note 5.10).

The financial statements does not take into consideration interpretations and amendments to Standards, pending approval by the European Union or approved by the European Union but came into force or shall come into force after the balance sheet date (Note 5.11 and Note 5.12).

In the Group's opinion, amendments to Standards and interpretations will not have a significant influence on the consolidated financial statements of the Group, with the exception of IFRS 9 'Financial Instruments'.

### IFRS 9 'Financial Instruments'

In November 2016 the European Commission has adopted International Financial Reporting Standard no. 9 'Financial Instruments' that will replace IAS 39 'Financial Instruments: Recognition and Measurement'.

IFRS 9 will be mandatorily effective for annual periods beginning on or after 1 January 2018.

The new standard will introduce a revised model for classification and measurement of financial asserts, an impairment model for credit allowances based on 'expected loss' and a reformed approach to hedge accounting.

#### *Classification and measurement*

According to IFRS 9, classification of financial assets at initial recognition will be based upon:
- the entity's business model for managing the financial assets,
- the contractual cash flow characteristics of the financial asset (i.e. whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding, hereinafter 'SPPI').

Depending on the entity's business model, financial assets may be classified as:
- 'held to collect' contractual cash flows (measured at amortized cost, if SPPI criteria are met, and subject to the expected loss impairment),
- 'held to collect or sale' (measured at fair value through other comprehensive income, if SPPI criteria are met, and subject to the expected loss impairment), or
- 'held for trading' or other (measured at fair value through profit or loss).

Financial assets may be reclassified when, and only when, the Bank changes its business model for managing financial assets. In such a case the Bank shall reclassify all financial assets affected by the change of business model.

IFRS 9 allows an entity at initial recognition to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument that is not held for trading. Dividends from such an investment shall be recognized in profit or loss.

The Bank has performed an analysis of business models used for managing the particular categories of financial assets as well as characteristics of the cash flows and concluded that:
- loans and advances to banks, loans and advances to customers and debt securities which, in accordance with IAS 39 are classified as loans and receivables and are held to collect contractual cash flows will be mostly measured at amortized cost under IFRS 9,
- debt securities, which according to IAS 39 are classified as held to maturity, are held to collect contractual cash flows and will be measured at amortized cost under IFRS 9,
- the majority of the debt securities which in accordance with IAS 39 are classified as available for sale, are held to collect contractual cash flows or for sale and will be still measured at fair value through other comprehensive income in accordance with IFRS 9,
- financial assets and liabilities held for trading, including assets and liabilities arising from derivative financial instruments, will continue to be measured at fair value through profit or loss,
- investments in equity instruments classified as available for sale according to IAS 39, will be measured at fair value through profit or loss in accordance with IFRS 9. The Bank has not yet made a final decision regarding the possibility of making an irrevocable election regarding recognition of changes in fair value of the equity instrument in other comprehensive income.

The Bank assesses that the implementation of the new standard will have no impact on the accounting treatment of financial liabilities, as IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities.

#### *Impairment of financial assets*

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model. Because of the aforementioned change the Bank will be obliged to calculate loss allowances based on the expected credit loss, taking into consideration forecasts of future economic conditions with regard to the measurement of the credit risk of an exposure, which is unacceptable under IAS 39.

The new impairment model will be applied to financial instruments measured, in accordance with IFRS 9, at amortized cost or at fair value through other comprehensive income, except for equity instruments.

# Notes to the financial statements

(in PLN thousand)

Replacing the concept of 'incurred loss' with the concept of 'expected credit loss' will influence significantly the way of modelling credit risk parameters and the final amount of loss allowances. The currently applied loss identification period will not be used anymore, therefore the IBNR (incurred but not reported) category of loss allowance will be eliminated. In accordance with IFRS 9, the loss allowances will be calculated in the following categories (instead of the IBNR loss allowances and the loss allowances for non-performing exposures):

1. Stage 1 – 12-month expected credit losses – the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date,
2. Stage 2 and 3 – lifetime expected credit losses – the expected credit losses that result from all possible default events over the expected life of a financial instrument.

The measurement of lifetime expected credit losses will be applied to all exposures for which during the period between the initial recognition and the reporting date the Bank has identified a significant increase in credit risk (Stage 2) or has identified impairment (Stage 3). The measurement of 12-month expected credit losses (Stage 1) will be applied to all exposures for which the Bank has not identified a significant increase in credit risk or impairment during the period between the initial recognition and the reporting date.

The new approach to calculating the impairment of the financial assets will also have an impact on the interest income recognition. In particular, interest income on financial assets allocated to Stages 1 and 2 will be calculated based on the gross carrying amount of the exposure, whereas interest income on financial assets allocated to Stage 3 will be calculated based on the net carrying amount of the exposure (similarly to impaired financial assets under the requirements of IAS 39).

The Bank assumes that the implementation of the new impairment model based on the concept of ECL will have an impact on the level of the Bank's loss allowances, particularly with regard to exposures allocated to Stage 2. Contrary to IAS 39, IFRS 9 does not require the entities to identify the impairment triggers in order to estimate lifetime credit losses in Stage 2. Instead, the Bank is obliged to constantly estimate the level of credit losses since the initial recognition of a given asset until its derecognition. In the event of significant increase in credit risk since the initial recognition of the asset, the Bank will be obliged to calculate lifetime expected credit losses – Stage 2. Such an approach will result in the earlier recognition of credit losses which will cause an increase in loss allowances and therefore it will also affect profit or loss.

Within the scope of the IFRS 9 implementation project, the Bank is working on implementing a new methodology of loss allowances calculation as well as on implementing appropriate modifications in IT systems and processes used by the Bank, in particular on the foundations of the impairment model, acquiring appropriate data as well as designing the processes and tools and performing a detailed estimation of the impact of IFRS 9 on the level of loss allowances. Methodological tasks are focused on both development of currently applied solutions as well as implementation of the brand new solutions. In terms of the development of existing solutions, the Bank is currently adjusting PD, RR, EAD and CCF models so that they may be used to estimate expected credit losses.

The development of credit risk models is focused on estimating the life time credit risk parameters adjusted to take into account forward looking information in respect of Bank's expectations regarding future macroeconomic outlook. Modelling of the future exposure on the date of default will leverage on available payment schedules as well as information regarding prepayments. For the exposures without defined payment schedules the Bank is developing methodology aimed at modelling limit utilization at the date of default. In respect of transfer between Stage 1 and Stage 2 the Bank develops statistical transfer logic models utilizing probability of default parameter and other characteristics of the exposure such as product type, rating class or time to maturity, supplemented by additional qualitative transfer triggers.

In terms of new solutions, the works mainly include the development of criteria for the transfer between the stages, as well as taking into account the economic forecasts in the estimation of expected credit losses.

In the Bank's opinion, the implementation of the new Standard requires the application of more complex credit risk models of greater predictive abilities which require a significantly broader set of source data than the currently applied models.

***Hedge accounting***

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

Therefore, in the case of hedge accounting, the entry into force of IFRS 9 will have no impact on the financial position of the Bank.

*Disclosures and comparatives*
The Bank expects that new requirements of IFRS 9 will significantly change the presentation and extent of the disclosures on financial instruments, particularly in the year of the adoption of the new standard.

The Bank plans to take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 generally will be recognized in retained earnings as at 1 January 2018.

*Implementation schedule*
The Bank has launched a dedicated project of IFRS 9 implementation in 2015. The project is organized into two main streams: (1) C&M (classification and measurement including hedge accounting) and (2) LLP (impairment) which are managed by the key management persons of Finance and Risk Division respectively. Additionally the Bank has appointed the Steering Committee responsible for supervision over the project. The key members of Steering Committee are CFO, CRO and COO. Main objectives of Steering Committee are setting and monitoring key milestones and budget and taking major decisions concerning methodology and the operating model. The project involves also employees of Finance Division, Risk Division, as well as the main Business functions, Organization and Information Technology departments.

Currently, the Bank is in the process of designing and building the necessary solutions for particular requirements based on the results of the analysis gaps and defined methodological assumptions. The Bank plans to gradually finish the design work till the end of third quarter of 2017.

In parallel with the work on the methodology, the Bank develops architecture of IT systems in order to allow both the implementation of the new standard in the framework of impairment calculations and determining the risk parameters used.

*Potential impact of IFRS 9 on the financial situation and the own funds*
Quantitative assessment of the impact of changes on the financial statements upon adoption of the standard is not yet available primarily due to ongoing methodological works regarding adjustments of credit risk models to IFRS 9 requirements which are still in progress as well as from the lack of uniform market practice. From the legislative standpoint, the supervisory and regulatory authorities are working on updating prudential requirements which will be binding for the Bank. However, it needs to be noted that these works are not advanced enough to enable Bank to unambiguously determine the impact of the IFRS 9 on the financial position and capital adequacy indicators.

In the Bank's opinion, disclosing quantitative data that would not reflect the potential impact of all aspects of IFRS 9 on the Bank's financial situation and own funds could have a negative impact on the informative value of the financial statements for its users. Therefore, the Bank has chosen to disclose solely qualitative information on the Bank's approach to the IFRS 9 implementation, which in the Bank's opinion will enable the users of the financial statements to understand the impact of IFRS 9 on the financial situation and capital management of the Bank.

In the Bank's view the implementation of the new standard, and especially the introduction of the new impairment model based on the ECL concept, will increase the value of impairment allowances, especially in terms of exposures to Stage 2. The Bank does not anticipate a significant impact on the level or volatility of P&L/OCI, as expected changes in classification and measurement methods will be limited to a minor part of financial assets. The final result will depend on the structure of assets at the date of initial application of IFRS 9. Any changes in the carrying value of financial instruments due to the adoption of IFRS 9 will be recognized in the Bank's equity as of 1 January 2018.

The most significant impact on the Bank's own funds will have the above-mentioned increase in the value of allowances for credit losses and the change in the classification and valuation of equity securities which in accordance with IAS 39 are classified to available-for-sale portfolio and measured at fair value recognized through other comprehensive income (provided that the Bank does not exercise the OCI option in accordance with IFRS 9).

Moreover, in connection to the changes resulting from implementation of IFRS 9 in the accounting regulations and lack at present of the information on the direction of the changes in the tax regulations, according to Bank's judgment there is a significant uncertainty concerning the future shape of the tax regulations, which will have to be amended to reflect the new standard and which can have an impact on the value of the deferred tax asset of the Bank created on the cost of allowances for credit losses.

## 5.2 Consolidation

### Consolidation principles

The consolidated financial statements of Bank Pekao S.A. Group include the financial data of Bank Pekao S.A. and its subsidiaries as at 31 December 2016. The financial statements of the subsidiaries are prepared at the same reporting date as those of the parent entity, using consistent accounting policies within the Group in all important aspects.

All intra-group balances and transactions, including unrealized gains, have been eliminated. Unrealized losses are also eliminated, unless there is an objective evidence of impairment, which should be recognized in the consolidated financial statements.

### Investments in subsidiaries

Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group has power over an entity, is exposed to or has rights to variable returns from its involvement with the entity and has the ability to affect these returns through its power over the entity. The subsidiaries are consolidated from the date of obtaining control by the Group until the date when the control ceases.

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group. Identifiable assets acquired and liabilities assumed are measured at their fair values at the acquisition date. The Group measures any non-controlling interests in the acquire at fair value or at the present ownership instruments' proportionate share in the recognized amounts of the acquire's identifiable net assets. Acquisition-related costs are expenses as incurred (in the income statement under 'Administrative expenses').

If the business combination is achieved in stages, the acquirer remeasures its previously held equity interests in the acquiree at fair value at the acquisition date (date of obtaining control) and recognizes the resulting gain or loss in the income statement.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If the total of consideration transferred, non-controlling interest recognized and previously held interest measured is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognized directly in the income statement.

The above policy does not apply to the business combinations under common control.

The changes in a parent entity's ownership interest in a subsidiary that do not result in the parent entity losing control of the subsidiary are accounted for as equity transactions (i.e. transactions with owners of parent entity). The Group recognizes directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attributes it to the owners of the parent entity.

When the Group ceases to have control over the subsidiary, any retained interest in that subsidiary is remeasured to its fair value at the date when control is lost, with the change in carrying amount recognized in the income statement.

### Recognition of business combinations under common control at book value

Business combinations under common control are excluded from the scope of IFRS. As a consequence, following the recommendation included in IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', in the absence of any specific guidance within IFRS, Bank Pekao S.A. has adopted the accounting policy consistently applied in all business combinations under common control within the UniCredit Group, of which the Bank is a member, which recognizes those transactions using book value.

The acquirer recognizes the assets and liabilities of the acquired entity at their current book value adjusted exclusively for the purpose of aligning the accounting principles. Neither goodwill, nor badwill is recognized.

Any difference between the book value of the net assets acquired and the fair value of the consideration paid is recognized in the Group's equity. In applying this book value method, the comparative periods are not restated.

If the transaction results in the acquisition of non-controlling interests, the acquisition of any non-controlling interest is accounted for separately.

There is no guidance in IFRS how to determine the percentage of non-controlling interests acquired from the perspective of a subsidiary. Accordingly Bank Pekao S.A. uses the same principles as the ultimate parent for estimating the value of non-controlling interests acquired.

### Investments in Associates

An associate is an entity over which the Group has significant influence, and that is neither a subsidiary nor a joint venture. The Group usually holds from 20% to 50% of the voting rights in an associate. The equity method is calculated using the financial statements of the associates. The balance sheet dates of the Group and its associates are the same.

On acquisition of the investment, any difference between the cost of the investment and the Group's share in the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:

- goodwill relating to an associate is included in the carrying amount of the investment,
- any excess of the Group's share in the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the Group's share in the associate's profit or loss in the period in which the investment is acquired.

The Group recognizes the investments in associates applying the equity method. The investment in associates is initially recognized at cost and the carrying amount is increased or decreased to recognize the Group's share in net assets of the associate after the date of acquisition, net of any impairment allowances. The Group's share of post-acquisition profit or loss is recognized in the income statement, and its share of post-acquisition movements in other comprehensive income is recognized in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. Distributions received from an associate reduce the carrying amount of the investment.

If the Group's share in the losses of an associate equals or exceeds the Group's share in the associate, the Group ceases to recognize further losses, unless it assumed obligations or made a payment on behalf of the associate.

Unrealized profits or losses from transactions between the Group and associates are eliminated pro rata to the Group's share in the associates.

## 5.3 Accounting estimates

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

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

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

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

### Impairment of loans and advances to customers

At each balance sheet date the Group assesses whether there is any objective evidence ('trigger') that loan exposures are impaired. Impairment losses are incurred if, and only if at least one impairment trigger is identified and the event implicating the impairment trigger has a negative impact on the estimated future cash flows of the loan exposure. Whilst the identification of loan exposures impairment the Group does not consider future events, irrespective of probability of its occurrence.

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

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

(in PLN thousand)

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

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

For all individually insignificant exposures, which are impaired as at balance sheet date, the Group measures the impairment allowance (impairment loss) as part of collective assessment. Each exposure assessed collectively is grouped based on similar credit risk characteristics (on the basis of the borrower's type, the product's type, past-due status or other relevant factors impacting on the debtor's ability to pay all amounts due according to the contractual terms). The future cash flows are estimated on the basis of historical data of cash flows and historical loss experience for exposures with credit risk characteristics similar to those in the group. Historical data, when necessary, are adjusted on the basis of current data to remove the effects of conditions in the historical period that do not exist currently. The recovery rates and the methodology and assumptions used for estimating future cash flows for particular groups of loan exposures are reviewed regularly.

For all loan exposures, for which no impairment triggers have been identified, the Group measures the allowance for losses incurred, but not reported ('IBNR').

The following table presents the impact on the net impairment losses as part of collective assessment and IBNR of a change in the estimated recovery rates (RR) and estimated probability of default (PD) by 10%.

| | NET IMPAIRMENT LOSSES ON FINANCIAL ASSETS AND OFF-BALANCE SHEET COMMITMENTS | |
|---|---|---|
| 31.12.2016 | 10% INCREASE | 10% DECREASE |
| Recovery rates (RR) | 98,821 | (99,182) |
| Probability of default (PD) | (32,689) | 32,956 |

| | NET IMPAIRMENT LOSSES ON FINANCIAL ASSETS AND OFF-BALANCE SHEET COMMITMENTS | |
|---|---|---|
| 31.12.2015 | 10% INCREASE | 10% DECREASE |
| Recovery rates (RR) | 110,990 | (112,736) |
| Probability of default (PD) | (43,102) | 43,219 |

### Impairment of non-current assets

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

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

### Measurement of derivatives and unquoted debt securities available for sale

The fair value of non-option derivatives and debt securities available for sale that do not have a quoted market price on an active market is measured using valuation models based on discounted cash flows. Options are valued using option valuation models. Variables used for valuation purposes include, where possible, the data from observable markets. However, the Group also adopts assumptions concerning counterparty's credit risks which affect the valuation of instruments. The adoption of other measurement assumptions may affect the valuation of these financial instruments. The assumptions used for fair value measurement are described in detail in Note 6.7 'Fair value of financial assets and liabilities'.

### Provisions for defined benefit plans

The principal actuarial assumptions applied to estimation of provisions for defined benefit plans, as well as the sensitivity analysis were presented in Note 45.

### Goodwill

The Group performs an impairment test of goodwill on a yearly basis or more often if impairment triggers occur. The assessment of goodwill impairment requires an estimate of value in use of all cash-generating units to which the goodwill relates. The principal assumptions applied to an impairment test of goodwill were presented in Note 35.

## 5.4 Foreign currencies

- Functional and presentation currency
  The financial statements of individual Group entities, including the Bank's Branch in Paris, are presented in their functional currencies, i.e. in the currency of the primary economic environment in which the entity operates. The Consolidated Financial Statements are presented in Polish zloty. Polish zloty is the functional currency and the presentation currency of the Bank. The Group applies as the closing rate the average the National Bank of Poland ('NBP') exchange rate, valid as at the balance sheet date.

- Transactions and balances
  Foreign currency transactions are calculated into the functional currency using the spot exchange rate from the date of the transaction. Gains and losses from foreign currency translation differences resulting from settlements of such transactions and from the statement of financial position valuation of monetary assets and liabilities expressed in foreign currencies are recognized in the income statement.

- Foreign currency translation differences arising from non-monetary items, such as equity instruments classified as financial assets measured at fair value through the profit or loss are recognized together with the changes in the fair value of that item in the income statement.
  Foreign currency translation differences arising from non-monetary items such as equity instruments classified as available for sale financial assets are recognized in the revaluation reserves.

- Companies of the Group
  The consolidation of assets and liabilities of foreign business entities are translated into Polish currency i.e. to the presentation currency as per the closing exchange rate for the balance sheet date. Revenues and expenses are translated at the average exchange rates calculated on the basis of the exchange rates of the reporting period except for situations where exchange rates fluctuate significantly such that the average exchange rate is not an acceptable approximation of the exchange rate from the transaction date. In such situations revenue and expenses are translated on the basis of the exchange rate from the date of the transaction.

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

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

## 5.5 Income statement

### Interest income and expense

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

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

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

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

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

### Fee and commission income and expense

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

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

### Income and expense from bancassurance

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

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

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

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

In 2016 the Bank recognized upfront 11% of bancassurance revenue associated with cash loans and 16% of bancassurance revenue associated with mortgage loans. The remaining portion of bancassurance revenue is amortized over the life of the associated loans as part of effective interest rate.

### Result on financial assets and liabilities held for trading

Result on financial assets and liabilities held for trading include:

- Foreign exchange result
  The foreign exchange gains (losses) are calculated taking into account the positive and negative foreign currency translation differences, whether realized or unrealized from the daily valuation of assets and liabilities denominated in foreign currencies. The revaluation is perform using the average exchange announced by the NBP on the balance sheet date.
  The foreign exchange result includes the trade margins on foreign exchange transactions with the Group's clients, as well as swap points from derivative transactions, entered into by the Group for the purpose of managing the Group's liquidity in foreign currencies.
  Income from foreign exchange positions includes also foreign currency translation differences from valuation of investments in foreign operations arising on disposal thereof. Until the disposal, foreign currency translation differences from valuation of assets in foreign operations are recognized in 'Other capital and reserves'.

- Income from derivatives and securities held for trading
  The income referred to above includes gains and losses realized on a sale or a change in the fair value of assets and liabilities held for trading.
  The accrued interest and unwinding of a discount or a premium on securities held for trading is presented in the net interest income.

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

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

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

### Other operating income/expense

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

## 5.6 Valuation of financial assets and liabilities, derivative financial instruments

### Financial assets

Financial assets are classified into the following categories:

- Financial assets measured at fair value through profit or loss
  This category comprises two sub-categories: financial assets held for trading and financial assets designated at initial recognition as financial assets measured at fair value through profit or loss.
  Financial assets held for trading include: debt and equity securities, loans and receivables purchased or classified into this category for the purpose of disposal thereof on a short-term basis. The classification also includes derivative instruments (not used as hedging instruments).
  Financial assets classified at the moment of original recognition as financial assets measured at fair value through profit or loss include debt securities acquired by the Group for the purpose of elimination or considerable reduction of inconsistencies in the valuation between these securities and the derivatives, which are economically hedging the interest rate risk of such securities. Otherwise, such securities would have been classified into the available for sale portfolio, with the effect of valuation recognized in revaluation reserves, and valuation of derivatives economically hedging such securities reported in the income statement.

- Held to maturity
  These are non-derivative financial assets with fixed or determinable payments and fixed maturity, for which the entity has an intent and ability to hold to maturity, other than:
  a) those that the entity upon initial recognition designates as at fair value through profit or loss,
  b) those that the entity designates as available for sale, and
  c) those that meet the definition of loans and receivables.
  Financial assets classified into this category are measured at amortized cost using the effective interest rate method. The recognition of amortized cost with the use of effective interest rate is recognized in interest income.

- Loans and receivables
  Loans and receivables are non-derivative financial assets, with fixed or determinable payments, not quoted on active markets, other than:
  a) those that the entity intends to sell immediately or in the near term which are classified as held for trading and those that the entity designates as at fair value through profit or loss upon initial recognition,
  b) those that the Group upon initial recognition designates as available for sale, or
  c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which are classified as available for sale.
  This category also contains debt securities, purchased from the issuer, for which there is no active market, as well as credits, loans, receivables from reverse repo transactions and other receivables acquired and granted. Loans and receivables are measured at amortized cost using the effective interest rate method and with consideration of impairment.

- Available for sale
  This includes financial assets with an undefined holding period. The portfolio includes: debt and equity securities, as well as loans and receivables not classified into other categories. Interest on assets available for sale is calculated using the effective interest rate method, and recognized in the income statement.
  Available for sale financial assets are measured at fair value, whereas gains and losses resulting from changes in fair value against amortized cost are recognized in the revaluation reserves. Amounts in the revaluation reserves are recognized in the income statement either on the sale of an asset, or its impairment. In case of impairment of an asset, previous increases from revaluation to fair value will decrease the 'Revaluation

reserves'. Should the amount of previously recognized increases be insufficient to cover the impairment, the difference will be recorded in the income statement as 'Net impairment losses on financial assets and off-balance sheet commitments'.

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

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

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

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

Derivative instruments are recognized or derecognized on transaction dates.

### Reclassification of financial assets

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

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

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

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

### Impairment of financial assets

***Assets measured at amortized cost – loans and advances***

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

The Group splits the loan exposures into individually significant exposures and individually insignificant exposures.

In respect to exposures assessed individually the Group applies the following list of impairment triggers:

- overdue in repayment of principal, interest or credit fees more than 90 days and more than 2 working days in case of exposure towards banks including credit transactions and reverse repo/sell-buy-backs,
- significant financial difficulties of borrower (including loss of job or other events that could impact on ability to repayment in case of individuals). Significant financial difficulties of economic entity mean financial standing that could threaten timely repayment of liabilities towards the Group, especially when incurred losses have consumed equity in 50%, excluding projects where losses have been assumed or where external financial support exists (in form of injections to the equity, granting a loan, warranty/guarantee by related company or other third party, conversion of loan into equity, issuance of shares/bonds),
- restructuring, if it is related with granting an advantage, due to economic or legal reasons resulted from financial difficulties of the borrower, that in other circumstances the Group would not give. The advantage leads to reduction of the Group's loan exposure, and may include: reduction of the interest rate, temporary interest accruing holidays, cancelling a part or total of the exposures, in this interest or principal,
- lowering by the well-known and accepted rating agency a borrower's rating or country's rating – country of domicile or rating of debt securities issued by the borrower by at least 4 notches including modifiers within one year. Decrease in credit rating alone is not an evidence of impairment trigger but could be confirmation of impairment if it is analyzed together with other available information,

(in PLN thousand)

- significant worsening of rating or scoring analysis results. It means the decrease in rating by 4 notches in the scale and at the same time move to non-performing category based only on rating criterion, excluding situations of rating deterioration resulted from seasonality of activity and excluding impact of classification in RMT ('Risk Management Tool') on rating. Decrease in rating alone is not an evidence of impairment trigger but could be confirmation of impairment if it is analyzed together with other available information,
- the Group has started an execution process or has been informed about execution towards borrower,
- the debt/loan is questioned by the borrower including commencement of legal proceedings,
- the debt/loan has been due as the credit agreement has been terminated,
- the motion for borrower's bankruptcy has been filled in the court or legal proceedings has been instituted,
- disappearance of active market for given credit exposure resulted from financial difficulties of debtor. This impairment trigger could refer to financial instruments listed on stock exchanges, when due to significant deterioration in financial standing of issuer (eventually bankruptcy), the liquidity of assets trading is so low that reliable price fixing is not possible,
- receivership has been established or debtor has stopped/suspended its activity,
- unknown place of stay and not disclosed assets of the borrower.

In respect to exposures assessed collectively the Group applies the following list of impairment triggers:
- overdue in repayment of principal, interest or credit fees greater or equal to 90 days,
- significant financial difficulties of debtor, including loss of job or other events that could impact on ability to repayment,
- unknown place of stay and not disclosed assets of the retail debtor or sole trader.

The Group classifies the exposure as past due in case the borrower has failed to make payment on the principal and/or interest in the contractual maturity date. The Group presents the whole amount of exposure as past due, regardless of whether the delay of payment affects the whole exposure, or only part of it (installment). The number of days past due for receivables paid by installments is assumed as the period from the date of maturity of the earliest installment, when the repayment is delayed.

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

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

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

For all individually insignificant exposures, which are impaired as at balance sheet date, the Group measures the impairment allowance (impairment loss) as part of collective assessment. Each exposure assessed collectively is grouped based on similar credit risk characteristics on the basis of the borrower's type, the product's type, past-due status or other relevant factors impacting on the debtor's ability to pay all amounts due according to the contractual terms. The future cash flows are estimated on the basis of historical data of cash flows and historical loss experience for exposures with credit risk characteristics similar to those in the group (for example, the value of the real estate taken as the collateral for the mortgage). Historical data, when necessary, are adjusted on the basis of current data to remove the effects of conditions in the historical period that do not exist currently. The recovery rates ('RR') and the methodology and assumptions used for estimating future cash flows for particular groups of loan exposures are reviewed regularly.

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

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

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

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

***Financial assets available for sale***

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

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

## Off-balance sheet commitments

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

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

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

## Repo and reverse-repo agreements

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

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

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

## Derivative financial instruments and hedge accounting

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

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

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

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

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

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

The Group designates some of its derivative instruments as hedging items in applying hedge accounting. The Group implemented fair value hedge accounting as well as cash flow hedge accounting, under the condition of meeting the criteria of IAS 39 'Financial Instruments: Recognition and Measurement'.

***Fair value hedge accounting principles***

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

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

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

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

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

***Cash flow hedge accounting principles***

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

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

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

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

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

### Financial liabilities

The Group's financial liabilities are classified to the following categories:

- financial liabilities held for trading, valued at fair value,
- financial liabilities not held for trading, valued at amounts payable, measured at amortized cost using the effective interest rate method.

Financial liabilities not held for trading consist of amounts due to banks and customers, loans from other banks, and own debt securities issued.

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

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

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

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

## 5.7 Valuation of other items in the Group's consolidated statement of financial position

### Intangible assets

*Goodwill*

Goodwill is defined as a surplus of the purchasing price over the fair value of the assets, liabilities and contingent liabilities of the acquired subsidiary, associate or a unit under joint control. Goodwill at initial recognition is carried at purchase price reduced by any accumulated impairment losses. Impairment is determined by estimating the recoverable value of the cash generating unit, to which given goodwill pertains. If the recoverable value of the cash generating unit is lower than the carrying amount an impairment charge is made. Impairment identified in the course of such tests is not subject to subsequent adjustments.

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

*Other intangible assets*

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

These assets include:

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

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

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

(in PLN thousand)

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

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

### Property, plant and equipment

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

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

Each component of property, plant and equipment, the purchase price or production cost of which is significant compared to the purchase price or production cost of the entire item is a subject to separate depreciation. The Group separates the initial value of property, plant and equipment into its significant parts.

Subsequent expenditures relating to property plant and equipment are capitalized only when it is probable that such expenditures will result in future economic benefits to the Group, and the cost of such expenses can be reliably measured.

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

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

### Depreciation and amortization

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

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

a) depreciation rates applied for non-current assets

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

b) amortization rates for intangible assets

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

c) depreciation rates for investment properties

| | |
|---|---|
| Buildings and structures | 1.5% –,10.0% |

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

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

## Investment properties

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

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

## Non-current assets held for sale and discontinued operations

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

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

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

## Leases

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

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

### *Operating leases*

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

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

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

### *Finance leases*

The Group as lessor

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

Lease payments from agreements, which do not meet the conditions of finance lease agreements are recognized as revenues in the income statement using the straight-line method over the life of the lease.

The Group as lessee

For lease agreements in which in principle all risks and benefits relating to ownership of the leased assets are transferred to the Group, the leased asset is recognized as a non-current asset and simultaneously a liability is recognized in the amount equal to the present value of minimum lease payments as at the date of commencement of the lease. Lease payments are split into costs of lease charges and a reduction of liabilities in order to maintain a fixed interest rate on the outstanding liability. Financial costs are recognized directly in the income statement.

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

Lease charges from agreements that do not fulfill the criteria for finance lease agreements are recognized as costs in the income statement on a straight line basis over the lease period.

### Provisions

The provisions are recognized when the Group has a present obligation (legal or constructive) resulting from the past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, the amount of a provision is established by discounting forecasted future cash flows to the present value, using the discount rate reflecting current market estimates of the time value of money and the possible risk associated with the obligation.

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

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

### Deferred income and accrued expenses (liabilities)

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

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

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

### Government grants

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

### Equity of the Group

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

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

The Group equity consists of the following:

a) share capital – applies only to the capital of the Bank as the parent entity and is presented at nominal value specified in the Articles of Association and in the entry in the Enterprises Registry,
b) 'issue premium' – surplus generated during share issues over the nominal value of such issues, remaining after the issue costs are covered. Moreover, this item also includes a change in the value of minority shares, ensuing from an increase of the share of the Parent entity in Bank's share capital. This accounting principle is in accordance with the accounting principles applied by UniCredit Group,
c) the general banking risk fund is established at Bank Pekao S.A. in keeping with the Banking Act dated 29 August 1997 from profit after tax,
d) other reserve capital utilized for the purposes defined in the Statute is created from appropriations of profits,

e) revaluation reserve includes the impact of valuation of financial instruments available for sale, effects of valuation of derivative instruments hedging cash flows, remeasurements of the defined benefit liabilities and the value of deferred tax for items classified as temporary differences, recognized as valuation allowance. In the statement of financial position, the valuation allowance is presented as net value,
f) exchange rate differences include differences arising from valuation of net assets in foreign entities and from the recalculation of the result of a foreign branch at the weighted average exchange rate at the balance sheet date in relation to the average NBP exchange rate,
g) other capital:
- other supplementary capital, established in keeping with provisions under the Articles of Association of companies from profit appropriations,
- capital components:
  - bonds convertible to shares – includes the fair value of financial instruments issued as part of transactions settled in equity instruments,
  - provision for purchase of parent entity stocks,
- brokerage activity fund for stock broking operations, carried out by Bank Pekao S.A.,
- retained earnings from prior periods includes undistributed profit and uncovered losses generated/incurred in prior periods by subsidiaries consolidated full method,
- net profit/loss which constitutes profit/loss presented in the income statement for the relevant period. Net profit is after accounting for income tax.

### Non – controlling interests

Non – controlling interests are defined as the equity in a subsidiary not attributable, directly or indirectly, to the Bank.

### Share-based payments

Employee participation programs are established by the Group under which key management staff is granted pre-emptive rights to buy shares of the Bank, including phantom shares, and shares of UniCredit S.p.A. (Note 46).

#### *Bank's Pekao S.A. phantom shares-settled share-based payment transaction*

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

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

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

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

#### *Stock options and stock of the UniCredit S.p.A.*

The Group entities joined the UniCredit-wide long term incentive program. The aim of the program is to offer to selected key Group's employees share options and shares of UniCredit S.p.A.

The fair value of the instruments granted to the Group employees was established following the UCI Group-wide applied Hull and White model.

The expenses related to the rights granted are recognized in 'Personnel expenses' and respective increase is recognized as liabilities presented in 'Other liabilities'.

The Group is obliged to pay to UniCredit S.p.A. the fair value of the instruments vested at the time the instruments are exercised.

## 5.8 Income tax

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

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

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

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

## 5.9 Other

### Contingent liabilities and commitments

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

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

The issuer of the financial guarantee contract recognizes it at the higher of:

- the amount determined in accordance with IAS 37 'Provisions, contingent liabilities and contingent assets',or
- the amount initially recognized less, when appropriate, cumulative amortization charges recognized in accordance with IAS 18 'Revenue'.

### Cash and cash equivalents

Cash and cash equivalents in the consolidated cash flow statement include 'Cash and due from Central Bank' and loans and receivables from banks with maturities up to three months.

(in PLN thousand)

## 5.10 New standards, interpretations and amendments to published standards that have been approved and published by the European Union and are effective on or after 1 January 2016

| STANDARD/INTERPRETATION | DESCRIPTION | IMPACT ASSESSMENT |
|---|---|---|
| **Amendments to IFRS 10** 'Consolidated Financial Statements', **IFRS 12** 'Disclosure of interests in other entities' and **IAS 28** 'Investments in Associates and Joint Ventures' | The amendments clarify the application of the consolidation exception for investment entities and their subsidiaries.<br>Date of application: the first financial year beginning on or after 1 January 2016. | The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application. |
| **IFRS 11 (amendment)** 'Joint Arrangements' | The amendments add new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business. The amendments specify the appropriate accounting treatment for such acquisitions.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the standard's amendment will not have a material impact on its financial statements in the period of its first application. |
| **IAS 1 (amendment)** 'Presentation of the financial statements' | The amendments clarify that among others an entity should not reduce understandability by aggregating or disaggregating information in a manner that obscures useful information.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the standard's amendment will not have a material impact on its financial statements in the period of its first application. |
| **IAS 16 (amendment)** 'Property, Plant and Equipment' and **IAS 38 (amendment)** 'Intangible Assets' | The IASB has clarified that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset.<br>The IASB also clarified that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset.<br>This presumption, however, can be rebutted in certain limited circumstances.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the standards amendments will not have a material impact on its financial statements in the period of its first application. |
| **IAS 16 (amendment)** 'Property, Plant and Equipment' and **IAS 41 (amendment)** 'Agriculture' | IAS 41 'Agriculture' currently requires all biological assets related to agricultural activity to be measured at fair value less costs to sell. This is based on the principle that the biological transformation that these assets undergo during their lifespan is best reflected by fair value measurement. However, there is a subset of biological assets, known as bearer plants, which are used solely to grow produce over several periods. At the end of their productive lives they are usually scrapped. Once a bearer plant is mature, apart from bearing produce, its biological transformation is no longer significant in generating future economic benefits.<br>The IASB decided that bearer plants should be accounted for in the same way as property, plant and equipment in IAS 16 'Property, Plant and Equipment', because their operation is similar to that of manufacturing.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application. |
| **IAS 19 (amendment)** 'Employee benefits' | The amendment applies to contributions from employees or third parties to defined benefit plans. The aim of the amendments is to simplify the accounting for contributions that are independent of the number of years of employee service, for example, employee contributions that are calculated according to a fixed percentage of remuneration. Date of application: the first financial year beginning on or after 1 February 2015. | The Group claims that the standard's amendment did not have a material impact on its financial statements in the period of its first application. |
| **IAS 27 (amendment)** 'Separate Financial Statements' | The amendments to IAS 27 will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application. |
| **Improvements to IFRS 2010-2012** | The annual improvements to IFRS 2010-2012 principally aim to solve inconsistencies and specify vocabulary. Date of application: the first financial year beginning on or after 1 February 2015. | The Group claims that the improvements did not have a material impact on its financial statements in the period of its first application. |
| **Improvements to IFRS 2012-2014** | The annual improvements to IFRS 2012-2014 principally aim to solve inconsistencies and specify vocabulary.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the improvements will not have a material impact on its financial statements in the period of its first application. |

(in PLN thousand)

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

| STANDARD/INTERPRETATION | DESCRIPTION | IMPACT ASSESSMENT |
|---|---|---|
| **IFRS 9**<br>'Financial Instruments' | New regulations constitute a part of changes designed to replace IAS 39 'Financial Instruments: Recognition and Measurement'. The main changes, introduced by the new standard, are as follows:<br>• new categorisation of financial assets,<br>• new criteria of assets classification to the group of financial assets measured at amortized cost,<br>• new impairment model – expected credit losses model,<br>• new principles for recognition of changes in fair value measurement of capital investment in financial instruments,<br>• elimination of the necessity to separate embedded derivatives from financial assets.<br>The major part of IAS 39 requirements relating to financial liabilities classification and valuation were transferred to IFRS 9 unchanged.<br>Date of application: the first financial year beginning after 1 January 2018. | The impact assessment of the new standard implementation on Group's financial statements is described in note 5.1 Basis of preparation of Consolidated Financial Statements. |
| **IFRS 15**<br>'Revenue from Contracts with Customers' | The Standard will improve the financial reporting of revenue and improve comparability of the top line in financial statements globally.<br>The core principle of the new Standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. In accordance with new IFRS 15, the revenue is recognized when the control over the goods or services is transferred to the customer.<br>Date of application: the first financial year beginning after 1 January 2018. | The Group is currently assessing the impact of the IFRS 15 application on its financial statements. |

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

| STANDARD/INTERPRETATION | DESCRIPTION | IMPACT ASSESSMENT |
|---|---|---|
| **IFRS 14**<br>'Regulatory deferral accounts' | The aim of this standard is to enhance the comparability of financial reporting by entities that are engaged in rate-regulated activities.<br>Date of application: the first financial year beginning after 1 January 2016. the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard. | The Group claims that the new standard will not have a material impact on its financial statements in the period of its first application. |
| **IFRS 16**<br>'Leases' | Under IFRS 16 a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate. As with IFRS 16's predecessor, IAS 17, lessors classify leases as operating or finance in nature. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease. For finance leases a lessor recognises finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis.<br>Date of application: annual periods beginning on or after 1 January 2019. | The Group is currently assessing the impact of the IFRS 15 application on its financial statements. |
| **IFRS 10 (amendment)** 'Consolidated Financial Statements' and **IAS 28 (amendment)** 'Investments in Associates and Joint Ventures' | The amendments concern the sale or contribution of assets between the investor and the associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognized when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application. |

# Notes to the financial statements

(in PLN thousand)

| STANDARD/INTERPRETATION | DESCRIPTION | IMPACT ASSESSMENT |
|---|---|---|
| **IAS 7 (amendment)** 'Statement of Cash Flows' – Disclosure Initiative | The amendments are intended to clarify IAS 7 to improve information provided to users of financial statements about an entity's financing activities. The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.<br>Date of application: annual periods beginning on or after 1 January 2017. | The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application. |
| **IAS 12 (amendment)** 'Income Taxes' | The amendments to IAS 12 clarify how to account for deferred tax assets related to debt instruments measured at fair value.<br>Date of application: annual periods beginning on or after 1 January 2017. | The Group is currently analyzing the impact of those changes on the financial statements. |
| **IFRS 2 (amendment)** 'Share-based Payment' | The amendments provide requirements on the accounting for<br>(a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments,<br>(b) share-based payment transactions with a net settlement feature for withholding tax obligations, and<br>(c) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.<br>Date of application: annual periods beginning on or after 1 January 2018. | The Group is currently analyzing the impact of those changes on the financial statements. |
| **IFRS 4 (amendment)** 'Insurance Contracts' | The amendments address concerns arising from implementing the new financial instruments standard, IFRS 9, before implementing the replacement standard that the Board is developing for IFRS 4.<br>Date of application: effective for annual periods beginning on or after 1 January 2018 or when IFRS 9 'Financial Instruments' is applied first time. | The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application. |
| **IAS 40 (amendment)** 'Investment Property' | Amendments to IAS 40 'Investment Property' – Transfers of Investment Property state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use. Amendments also state that the list of evidence in paragraph 57 was designated as non-exhaustive list of examples instead of the previous exhaustive list.<br>Date of application: annual periods beginning on or after 1 January 2018. | The Group is currently analyzing the impact of those changes on the financial statements. |
| **Improvements to IFRS 2014-2016** | Amendments result from the annual improvement project of IFRS. Amendments relate to IFRS 1, IFRS 12 and IAS 28 and were introduced primarily with a view to removing inconsistencies and clarifying wording.<br>Date of application: amendments to IFRS 12 are to be applied for annual periods beginning on or after 1 January 2017 and amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018. | The Group is currently analyzing the impact of those changes on the financial statements. |
| **IFRIC 22** 'Foreign Currency Transactions and Advance Consideration' | Interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt.<br>Date of application: annual periods beginning on or after 1 January 2018. | The Group is currently analyzing the impact of those changes on the financial statements. |

# 6. Risk management

The risk management policy of the Group has a goal of optimizing the structure of the statement of financial position and off-balance sheet positions under the consideration of all risks in relation to income and other risk that the Group encounters in conducting its daily activity. Risks are monitored and controlled with reference to profitability and equity coverage and are regularly reported in accordance with rules briefly presented below.

All important risk types, occurring in the course of the Group's operations are described as follows.

## 6.1 Organizational structure of risk management

**Supervisory Board**
The Supervisory Board provides supervision over the risk management control system, assessing the adequacy and effectiveness. Moreover, the Supervisory Board also provides supervision of the compliance with Group policy with respect to risk management as it relates to the Group's strategy and financial planning.

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

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

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

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

**Committees**
In performing these tasks, in terms of risk management, the Management Board is supported by committees:
- Assets, Liabilities and Risk Management Committee (ALCO) – in terms of market risk management, liquidity and capital adequacy,
- Liquidity and Market Risk Committee (LMRC) – in terms of liquidity and market risk management, acting as support for Assets, Liabilities and Risk Management Committee,
- Operational Risk Committee – in operational risk management,
- Credit Committee – in making credit decisions within the powers and in the case of the largest transactions in preparing recommendations for the Board of Directors,
- Change Management Committee – in the implementation of new or modification of existing products and processes in business and outside business,
- Safety Committee – in the field of security and business continuity management,
- Model Risk Committee – in terms of model risk management.

## 6.2 Credit risk

Credit risk is one of the basic risks associated with activities of the Group. The percentage share of credits and loans in the Group's statement of financial position makes the maintenance of this risk at safe level essential to the Group's performance. The process of credit risk management is centralized and managed mainly by Risk Management Division units, situated at the Bank Head Office or in local units. The integration of various risks in the Risk Management Division, where apart from credit risk, market and operational risk are dealt with, facilitates effective management of all credit-related risks. This process covers all credit functions – credit analysis, making credit decisions, monitoring and loan administration, as well as restructuring and collection. These functions are conducted in compliance with the Bank's credit policy, adopted by the Bank's Management Board and the Bank's Supervisory Board for a given year and its related guidelines. The effectiveness and efficiency of credit functions are achieved using diverse credit methods and methodologies, supported by advanced IT tools, integrated into the Bank's general IT system. The Bank's procedures facilitate credit risk mitigation. In particular those related to transaction risk evaluation, establishing collateral, setting authorization limits for granting loans and limiting of exposure to some areas of business activity in line with current client's segmentation scheme in the Bank.

The Bank's lending activity is limited by the restrictions of the Banking Act as well as internal limits in order to increase safety. These restrictions refer in particular to concentration limits for specific sectors of the economy, share of large exposures in the loan portfolio of the Bank and exposure limits for particular foreign countries, foreign banks and domestic financial institutions. Credit granting limits, concentration limits for specific business activities as well as internal and external prudential standards include not only credits, loans and guarantees, but also derivatives transactions and debt securities.

The Bank established the following portfolio limits:
- share of large exposures in the loan portfolio of the Bank – approved by the Management Board and the Supervisory Board of the Bank,
- customer segment limits – established in the Bank's credit policy,
- product limits (mortgage loans given to private individuals, financing commercial real estate) – established in the Bank's credit policy,
- concentration limits for specific sectors of the economy – approved by the Credit Committee of the Bank.

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

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

### Rating models utilized in the credit risk management process

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

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

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

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

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

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

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

(in PLN thousand)

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

For internal purposes, within the Bank the following rating models are used, developed in accordance with provisions of Regulation (EU) no 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms:

1. For the private individuals, the Bank uses two separate models applicable for:
   - mortgage loans,
   - consumer loans.
2. For the corporate clients, the Bank uses rating models dividing clients for:
   - clients with income not exceeding EUR 500 million,
   - corporate clients assessed by central model with income exceeding EUR 500 million,
   - specialized lending.

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

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

## Rating scale

The rating scale is determined by the client segment and the exposure type.

The proceeds of assigning a client or an exposure to a given rating class depends on its probability of default (PD parameter).

The tables below present the loan portfolio quality for exposures encompassed by internal rating models.

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

| RATING CLASS | RANGE OF PD | 31.12.2016 CARRYING AMOUNT | 31.12.2016 %PORTFOLIO | 31.12.2015 CARRYING AMOUNT | 31.12.2015 %PORTFOLIO |
|---|---|---|---|---|---|
| 1 | 0.00% <= PD < 0.06% | 11,544,215 | 26.2% | 10,532,502 | 25.9% |
| 2 | 0.06% <= PD < 0.19% | 6,794,533 | 15.4% | 5,936,116 | 14.6% |
| 3 | 0.19% <= PD < 0.35% | 17,482,613 | 39.7% | 16,303,771 | 40.1% |
| 4 | 0.35% <= PD < 0.73% | 5,463,689 | 12.4% | 5,213,593 | 12.8% |
| 5 | 0.73% <= PD < 3.50% | 1,435,604 | 3.3% | 1,393,240 | 3.4% |
| 6 | 3.50% <= PD < 14.00% | 638,891 | 1.5% | 651,234 | 1.6% |
| 7 | 14.00% <= PD < 100.00% | 671,745 | 1.5% | 652,160 | 1.6% |
| **Total** | | **44,031,290** | **100.0%** | **40,682,616** | **100.0%** |

(in PLN thousand)

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

| RATING CLASS | RANGE OF PD | 31.12.2016 CARRYING AMOUNT | 31.12.2016 %PORTFOLIO | 31.12.2015 CARRYING AMOUNT | 31.12.2015 %PORTFOLIO |
|---|---|---|---|---|---|
| 1 | 0.00% <= PD < 0.34% | 687,697 | 7.9% | 573,469 | 7.4% |
| 2 | 0.34% <= PD < 0.80% | 948,701 | 10.8% | 805,937 | 10.3% |
| 3 | 0.80% <= PD < 1.34% | 1,506,160 | 17.2% | 1,390,763 | 17.8% |
| 4 | 1.34% <= PD < 2.40% | 2,669,352 | 30.5% | 2,393,959 | 30.6% |
| 5 | 2.40% <= PD < 4.75% | 1,815,307 | 20.7% | 1,594,636 | 20.4% |
| 6 | 4.75% <= PD < 14.50% | 756,550 | 8.7% | 673,978 | 8.6% |
| 7 | 14.50% <= PD < 31.00% | 186,915 | 2.1% | 187,224 | 2.4% |
| 8 | 31.00% <= PD < 100.00% | 186,336 | 2.1% | 194,052 | 2.5% |
| **Total** | | **8,757,018** | **100.0%** | **7,814,018** | **100.0%** |

**The distribution of rated portfolio for corporate client segment (excluding impaired loans) – clients with income not exceeding EUR 500 million**

| RATING CLASS | RANGE OF PD | 31.12.2016 CARRYING AMOUNT | 31.12.2016 %PORTFOLIO | 31.12.2015 CARRYING AMOUNT | 31.12.2015 %PORTFOLIO |
|---|---|---|---|---|---|
| 1 | 0.00% <= PD < 0.15% | 515,756 | 3.5% | 357,910 | 2.4% |
| 2 | 0.15% <= PD < 0.27% | 2,188,032 | 14.8% | 1,887,596 | 12.5% |
| 3 | 0.27% <= PD < 0.45% | 1,984,785 | 13.5% | 2,348,388 | 15.6% |
| 4 | 0.45% <= PD < 0.75% | 2,105,131 | 14.3% | 2,304,203 | 15.3% |
| 5 | 0.75% <= PD < 1.27% | 2,131,155 | 14.5% | 3,136,094 | 20.8% |
| 6 | 1.27% <= PD < 2.25% | 2,269,874 | 15.4% | 1,935,237 | 12.8% |
| 7 | 2.25% <= PD < 4.00% | 1,266,801 | 8.6% | 1,043,523 | 6.9% |
| 8 | 4.00% <= PD < 8.50% | 1,948,049 | 13.2% | 1,898,162 | 12.6% |
| 9 | 8.50% <= PD < 100.00% | 319,268 | 2.2% | 165,709 | 1.1% |
| **Total** | | **14,728,851** | **100.0%** | **15,076,822** | **100.0%** |

(in PLN thousand)

**The distribution of rated portfolio for corporate client segment (excluding impaired loans) – clients assessed by central model with income exceeding EUR 500 million**

| RATING CLASS | RANGE OF PD | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|---|
| | | CARRYING AMOUNT | %PORTFOLIO | CARRYING AMOUNT | %PORTFOLIO |
| 1 | 0.0000% <= PD < 0.0011% | – | 0.0% | – | 0.0% |
| 2 | 0.0011% <= PD < 0.0031% | – | 0.0% | – | 0.0% |
| 3 | 0.0031% <= PD < 0.0069% | – | 0.0% | – | 0.0% |
| 4 | 0.0069% <= PD < 0.0124% | – | 0.0% | – | 0.0% |
| 5 | 0.0124% <= PD < 0.0223% | 1 | 0.0% | – | 0.0% |
| 6 | 0.0223% <= PD < 0.0395% | – | 0.0% | – | 0.0% |
| 7 | 0.0395% <= PD < 0.0691% | 5 | 0.0% | 1,243,315 | 24.2% |
| 8 | 0.0691% <= PD < 0.1208% | 430,448 | 8.0% | 645,108 | 12.6% |
| 9 | 0.1208% <= PD < 0.2091% | 1,029,404 | 19.1% | 629,490 | 12.3% |
| 10 | 0.2091% <= PD < 0.3581% | 255,864 | 4.8% | 375,435 | 7.3% |
| 11 | 0.3581% <= PD < 0.6132% | 2,486,615 | 46.2% | 81,377 | 1.6% |
| 12 | 0.6132% <= PD < 1.0807% | – | 0.0% | 93,303 | 1.8% |
| 13 | 1.0807% <= PD < 1.9599% | 847,569 | 15.7% | – | 0.0% |
| 14 | 1.9599% <= PD < 3.5545% | 331,740 | 6.2% | 2,063,695 | 40.2 |
| 15 | 3.5545% <= PD < 7.6705% | 11 | 0.0% | – | 0.0% |
| 16 | 7.6705% <= PD < 19.6959% | – | 0.0% | 16 | 0.0% |
| 17 | 19.6959% <= PD < 100.0000% | – | 0.0% | – | 0.0% |
| **Total** | | **5,381,657** | **100.0%** | **5,131,739** | **100.0%** |

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

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

| SUPERVISORY CATHEGORY | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|
| | CARRYING AMOUNT | %PORTFOLIO | CARRYING AMOUNT | %PORTFOLIO |
| High | 3,470,755 | 42.6% | 1,647,122 | 25.0% |
| Good | 3,623,153 | 44.5% | 4,185,156 | 63.4% |
| Satisfactory | 1,010,603 | 12.4% | 720,513 | 10.9% |
| Low | 44,728 | 0.5% | 43,078 | 0.7% |
| **Total** | **8,149,239** | **100.0%** | **6,595,869** | **100.0%** |

(in PLN thousand)

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

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Loans with no impairment:** | **120,112,554** | **119,349,516** |
| **Loans to individuals:** | **55,863,932** | **51,611,229** |
| Covered by internal rating model: | 52,788,308 | 48,496,634 |
| Mortgage loans | 44,031,290 | 40,682,616 |
| Consumer loans | 8,757,018 | 7,814,018 |
| Other, not covered by internal rating model | 3,075,624 | 3,114,595 |
| **Loans to corporates:** | **64,248,622** | **67,738,287** |
| Covered by internal rating model: | 20,110,508 | 20,208,561 |
| Clients with income not exceeding EUR 500 million | 14,728,851 | 15,076,822 |
| Clients assessed by central model with income exceeding EUR 500 million | 5,381,657 | 5,131,739 |
| Specialized lending exposures | 8,149,239 | 6,595,869 |
| Debt securities, not covered by internal rating model | 12,352,160 | 12,330,221 |
| Repo transactions, not covered by internal rating model | – | 4,755,472 |
| Other, not covered by internal rating model | 23,636,715 | 23,848,164 |
| **Impaired loans** | **2,550,658** | **2,705,410** |
| **Total loans and advances to customers (*)** | **122,663,212** | **122,054,926** |

(*) Loans and advances to customers include receivables from financial leases and bills of exchange eligible for rediscounting at Central Bank.

### Client/transaction rating and credit risk decision-making level

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

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

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

### Validation of rating models

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

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

(in PLN thousand)

### Group's exposure to credit risk

*The maximum credit risk exposure*

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

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Due from Central Bank | 3,233,379 | 4,930,181 |
| Loans and advances from banks and from customers (*) | 121,947,096 | 125,869,993 |
| Receivables from finance leases | 3,974,643 | 3,503,979 |
| Financial assets held for trading | 732,469 | 1,126,792 |
| Derivative financial instruments (held for trading) | 1,913,429 | 3,206,447 |
| Hedging instruments | 289,752 | 421,640 |
| Investment securities | 35,120,619 | 21,181,723 |
| Other assets (**) | 1,020,482 | 2,300,995 |
| **Balance sheet exposure (***)** | **168,231,869** | **162,541,750** |
| Obligations to grant loans | 32,126,475 | 30,825,051 |
| Other contingent liabilities | 11,473,757 | 15,130,027 |
| **Off-balance sheet exposure** | **43,600,232** | **45,955,078** |
| **Total** | **211,832,101** | **208,496,828** |

(*) Loans and advances to customers include bills of exchange eligible for rediscounting at Central Bank.
(**) Includes the following items of the statement of financial position: 'Investments in associates' and part of 'Other assets' (Accrued income, Interbank and interbranch settlements, Other debtors and Card settlements).
(***) Balance sheet exposure is equal to the carrying amount presented in the statement of financial position.

*Credit risk mitigation methods*

Bank Pekao S.A. Group has established specific policies with regard to collateral accepted to secure loans and guarantees. This policy is reflected under internal rules and regulations, which are based on supervision rules, specified in Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.

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

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

The financial effect of pledged collaterals for exposure portfolio with recognized impairment defined individually amounts to PLN 1 496 661 thousand as at the 31 December 2016 (1 465 933 thousand as of the 31 December 2015). The level of required impairment allowances for the portfolio would increase by this amount, if the discounted cash flows from collateral were not taken into account during estimation.

### *Offsetting financial assets and financial liabilities*

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

The netting agreements concluded by the Group are:
- ISDA agreements and similar master netting agreements on derivatives,
- GMRA agreements on repo and reverse-repo transactions.

The netting agreements do not meet the criteria for offsetting in the statement of financial position. This is because they create for the parties to the agreement a right of set-off of recognized amounts that is enforceable only following an event of default, insolvency or bankruptcy of the one of the counterparty. In addition, the Group and its counterparties do not intend to settle on a net basis or to realize the assets and settle the liabilities simultaneously.

The Group receives and gives collateral in the form of cash and marketable securities in respect of the following transactions:
- derivatives,
- repo and reverse-repo transactions.

(in PLN thousand)

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

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

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

| 31.12.2016 | CARRYING AMOUNT OF FINANCIAL ASSETS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION | AMOUNT OF POTENTIAL OFFSETTING | | NET AMOUNT |
|---|---|---|---|---|
| | | FINANCIAL INSTRUMENTS (INCLUDING RECEIVED COLLATERAL IN THE FORM OF SECURITIES) | CASH COLLATERAL RECEIVED | |
| **FINANCIAL ASSETS** | | | | |
| Derivatives | 1,848,236 | (1,434,265) | (182,765) | 231,206 |
| **TOTAL** | **1,848,236** | **(1,434,265)** | **(182,765)** | **231,206** |

| 31.12.2016 | CARRYING AMOUNT OF FINANCIAL LIABILITIES PRESENTED IN THE STATEMENT OF FINANCIAL POSITION | AMOUNT OF POTENTIAL OFFSETTING | | NET AMOUNT |
|---|---|---|---|---|
| | | FINANCIAL INSTRUMENTS (INCLUDING PLEDGED COLLATERAL IN THE FORM OF SECURITIES) | CASH COLLATERAL PLEDGED | |
| **FINANCIAL LIABILITIES** | | | | |
| Derivatives | 3,254,372 | (1,434,265) | (1,651,984) | 168,123 |
| **RAZEM** | **3,254,372** | **(1,434,265)** | **(1,651,984)** | **168,123** |

| 31.12.2015 | CARRYING AMOUNT OF FINANCIAL ASSETS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION | AMOUNT OF POTENTIAL OFFSETTING | | NET AMOUNT |
|---|---|---|---|---|
| | | FINANCIAL INSTRUMENTS (INCLUDING RECEIVED COLLATERAL IN THE FORM OF SECURITIES) | CASH COLLATERAL RECEIVED | |
| **FINANCIAL ASSETS** | | | | |
| Derivatives | 3,628,087 | (3,012,327) | (295,762) | 319,998 |
| **TOTAL** | **3,628,087** | **(3,012,327)** | **(295,762)** | **319,998** |

| 31.12.2015 | CARRYING AMOUNT OF FINANCIAL LIABILITIES PRESENTED IN THE STATEMENT OF FINANCIAL POSITION | AMOUNT OF POTENTIAL OFFSETTING | | NET AMOUNT |
|---|---|---|---|---|
| | | FINANCIAL INSTRUMENTS (INCLUDING PLEDGED COLLATERAL IN THE FORM OF SECURITIES) | CASH COLLATERAL PLEDGED | |
| **FINANCIAL LIABILITIES** | | | | |
| Derivatives | 4,907,087 | (3,012,327) | (1,339,417) | 555,343 |
| Repo transactions | 963,829 | (962,346) | – | 1,483 |
| **TOTAL** | **5,870,916** | **(3,974,673)** | **(1,339,417)** | **556,826** |

# Notes to the financial statements

(in PLN thousand)

The carrying amount of financial assets and financial liabilities disclosed in the above tables have been measured in the statement of financial position on the following bases:
- derivatives – fair value,
- assets and liabilities resulting from repo and reverse-repo transactions – amortized cost.

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

| 31.12.2016 | NET CARRYING AMOUNT | ITEM IN STATEMENT OF FINANCIAL POSITION | CARRYING AMOUNT IN STATEMENT OF FINANCIAL POSITION | CARRYING AMOUNT OF TRANSACTIONS NOT IN SCOPE OF OFFSETTING DISCLOSURES | NOTE |
|---|---|---|---|---|---|
| **FINANCIAL ASSETS** | | | | | |
| Derivatives | 1,791,677 | Derivative financial instruments (held for trading) | 1,913,429 | 121,752 | 27 |
| | 56,559 | Hedging instruments | 289,752 | 233,193 | 30 |
| **FINANCIAL LIABILITIES** | | | | | |
| Derivatives | 1,618,110 | Derivative financial instruments (held for trading) | 1,952,674 | 334,564 | 27 |
| | 1,636,262 | Hedging instruments | 1,638,718 | 2,456 | 30 |

| 31.12.2015 | NET CARRYING AMOUNT | ITEM IN STATEMENT OF FINANCIAL POSITION | CARRYING AMOUNT IN STATEMENT OF FINANCIAL POSITION | CARRYING AMOUNT OF TRANSACTIONS NOT IN SCOPE OF OFFSETTING DISCLOSURES | NOTE |
|---|---|---|---|---|---|
| **FINANCIAL ASSETS** | | | | | |
| Derivatives | 3,134,367 | Derivative financial instruments (held for trading) | 3,206,447 | 72,080 | 27 |
| | 421,640 | Hedging instruments | 421,640 | – | 30 |
| **FINANCIAL LIABILITIES** | | | | | |
| Derivatives | 3,106,943 | Derivative financial instruments (held for trading) | 3,204,328 | 97,385 | 27 |
| | 1,702,759 | Hedging instruments | 1,702,759 | – | 30 |
| Repo transactions | 963,829 | Amounts due to other banks | 5,958,449 | 4,994,620 | 40 |

(in PLN thousand)

*Overall characteristics of monitoring process*

The monitoring process is oriented at the identification of symptoms and threats, affecting the client, undertaking actions preventing the deterioration of credit portfolio quality for the purpose of maximizing the probability of recovery of assets made available to the client.

In particular, the monitoring of credit risk includes the control of timely debt service, analysis of client's financial standing, verification of meeting the terms of credit agreement and reviewing the collaterals.

Loans for large corporate clients are monitored using the rating system and data from both internal and external sources of information. In case of small and medium-size clients, the monitoring process is carried out using an internal tool, embedded into the statistical behavioral model. Process efficiency is further enhanced by regular reviews of the credit portfolio, carried out by representatives of the Risk Management Division and other Business Divisions for the purpose of determining the actual quality of individual exposures and of the entire credit portfolio.

The monitoring of individual clients is carried by IT systems and is based on the results of behavioral scoring.

*Overall characteristics of provisioning model*

The Group establishes loan loss provisions ('LLP') in line with International Financial Reporting Standards ('IFRS'). LLP reflects the loan impairment and whether the Group recognizes objective impairment triggers. Impairment of loans is recognized under an individual and collective approach.

The process of identifying impaired exposures covered by individual valuation is carried out with the use of an internal tool and consists of the following stages:

- identification, whether the impairment trigger for given a credit exposure has been recognized and, upon such identification, determination of the type of such trigger and assignment of default status to the exposure,
- assessment of future cash flows, discounted using the effective interest rate, generated both from collateral and client operations,
- calculation and registration of loan loss provision in the IT system.

Exposures covered by the collective approach valuation are classified into the default class for overdue amounts exceeding 90 days. For such exposures, the loan loss provision is calculated using a statistical model.

If an impairment trigger is not recognized, the Group establishes provisions for incurred but not reported losses (IBNR) applying a statistical model of expected loss.

The applied statistical models are based on historical data for homogenous groups of exposure.

Both the models and parameters applied in the establishment of loan loss provision are subject to regular validation.

(in PLN thousand)

*The quality analysis of the Group's financial assets*

**The Group exposures to credit risk with impairment recognized, broken down by delays in repayment**

| | LOANS AND ADVANCES TO BANKS (*) | | LOANS AND ADVANCES TO CUSTOMERS (*) | |
|---|---|---|---|---|
| | 31.12.2016 | 31.12.2015 | 31.12.2016 | 31.12.2015 |
| GROSS CARRYING AMOUNT OF EXPOSURE INDIVIDUALLY IMPAIRED | | | | |
| – not past due | – | – | 642,927 | 564,430 |
| – up to 1 month | – | – | 106,904 | 37,283 |
| – between 1 month and 3 months | – | – | 31,323 | 22,868 |
| – between 3 months and 1 year | – | – | 228,925 | 158,487 |
| – between 1 year and 5 years | 8,192 | 9,927 | 2,565,907 | 3,079,109 |
| – above 5 years | – | – | 1,498,788 | 1,429,845 |
| **Total gross carrying amount** | **8,192** | **9,927** | **5,074,774** | **5,292,022** |
| ALLOWANCE FOR IMPAIRMENT | | | | |
| – not past due | – | – | (292,907) | (238,852) |
| – up to 1 month | – | – | (30,285) | (7,530) |
| – between 1 month and 3 months | – | – | (7,077) | (5,206) |
| – between 3 months and 1 year | – | – | (121,057) | (52,140) |
| – between 1 year and 5 years | (8,192) | (9,927) | (1,563,402) | (1,738,572) |
| – above 5 years | – | – | (1,170,559) | (1,198,995) |
| **Total allowance for impairment** | **(8,192)** | **(9,927)** | **(3,185,287)** | **(3,241,295)** |
| **Net carrying amount of exposure individually impaired** | **–** | **–** | **1,889,487** | **2,050,727** |
| GROSS CARRYING AMOUNT OF EXPOSURE COLLECTIVELY IMPAIRED | | | | |
| – not past due | – | – | 166,121 | 120,069 |
| – up to 1 month | – | – | 69,664 | 42,559 |
| – between 1 month and 3 months | – | – | 56,545 | 47,688 |
| – between 3 months and 1 year | – | – | 286,856 | 303,072 |
| – between 1 year and 5 years | – | – | 1,297,813 | 1,359,720 |
| – above 5 years | 9,800 | 9,800 | 914,748 | 956,361 |
| **Total gross carrying amount** | **9,800** | **9,800** | **2,791,747** | **2,829,469** |
| ALLOWANCE FOR IMPAIRMENT | | | | |
| – not past due | – | – | (54,371) | (46,047) |
| – up to 1 month | – | – | (21,678) | (10,980) |
| – between 1 month and 3 months | – | – | (20,975) | (17,089) |
| – between 3 months and 1 year | – | – | (152,797) | (156,199) |
| – between 1 year and 5 years | – | – | (1,038,042) | (1,047,727) |
| – above 5 years | (9,800) | (9,800) | (842,713) | (896,744) |
| **Total allowance for impairment** | **(9,800)** | **(9,800)** | **(2,130,576)** | **(2,174,786)** |
| **Net carrying amount of exposure collectively impaired** | **–** | **–** | **661,171** | **654,683** |

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

(in PLN thousand)

### The Group exposures to credit risk with no impairment recognized, broken down by delays in repayment

| | LOANS AND ADVANCES TO BANKS (*) | | LOANS AND ADVANCES TO CUSTOMERS (*) | | | |
|---|---|---|---|---|---|---|
| | | | CORPORATE | | RETAIL | |
| | 31.12.2016 | 31.12.2015 | 31.12.2016 | 31.12.2015 | 31.12.2016 | 31.12.2015 |
| GROSS CARRYING AMOUNT OF EXPOSURE WITH NO IMPAIRMENT | | | | | | |
| – not past due | 3,258,534 | 7,319,104 | 64,156,501 | 67,677,272 | 54,316,545 | 50,112,528 |
| – up to 30 days | – | – | 240,713 | 214,225 | 1,314,340 | 1,269,204 |
| – between 30 days and 60 days | – | – | 27,468 | 34,541 | 177,909 | 183,623 |
| – above 60 days | – | – | 88,700 | 89,848 | 184,075 | 194,520 |
| **Total gross carrying amount** | **3,258,534** | **7,319,104** | **64,513,382** | **68,015,886** | **55,992,869** | **51,759,875** |
| IBNR PROVISION | | | | | | |
| – not past due | (8) | (58) | (256,869) | (273,574) | (80,772) | (90,586) |
| – up to 30 days | – | – | (5,106) | (2,652) | (30,818) | (37,046) |
| – between 30 days and 60 days | – | – | (1,425) | (686) | (9,873) | (11,615) |
| – above 60 days | – | – | (1,360) | (687) | (7,474) | (9,399) |
| **Total IBNR provision** | **(8)** | **(58)** | **(264,760)** | **(277,599)** | **(128,937)** | **(148,646)** |
| **Net carrying amount of exposure with no impairment** | **3,258,526** | **7,319,046** | **64,248,622** | **67,738,287** | **55,863,932** | **51,611,229** |

(*) Loans and advances to banks and loans and advances to customers include receivables from financial leases and bills of exchange eligible for rediscounting at Central Bank.

### The Group exposures to credit risk, broken down by impairment triggers criteria

| | LOANS AND ADVANCES TO BANKS (*) | | LOANS AND ADVANCES TO CUSTOMERS (*) | |
|---|---|---|---|---|
| | 31.12.2016 | 31.12.2015 | 31.12.2016 | 31.12.2015 |
| IMPAIRED EXPOSURE | | | | |
| Gross carrying amount | 17,992 | 19,727 | 7,866,521 | 8,121,491 |
| Allowance for impairment | (17,992) | (19,727) | (5,315,863) | (5,416,081) |
| **Total net carrying amount** | **–** | **–** | **2,550,658** | **2,705,410** |
| EXPOSURES WITH IMPAIRMENT TRIGGERS FOR WHICH NO IMPAIRMENT HAS BEEN IDENTIFIED | | | | |
| Gross carrying amount, in this: | – | – | 100,560 | 78,166 |
| *Exposure with collateral value included in expected discounted cash flow, in this* | – | – | *100,560* | *78,166* |
| *Past due exposures* | – | – | *35,382* | *31,741* |
| IBNR provision | – | – | (2,610) | (1,362) |
| **Total net carrying amount** | **–** | **–** | **97,950** | **76,804** |
| EXPOSURES WITH NO IMPAIRMENT TRIGGERS | | | | |
| Gross carrying amount | 3,258,534 | 7,319,104 | 120,405,691 | 119,697,595 |
| IBNR provision | (8) | (58) | (391,087) | (424,883) |
| **Total net carrying amount** | **3,258,526** | **7,319,046** | **120,014,604** | **119,272,712** |

(*) Loans and advances to banks and loans and advances to customers include receivables from financial leases and bills of exchange eligible for rediscounting at Central Bank.

# Notes to the financial statements

(in PLN thousand)

## Classification of exposures to debt securities according to Standard & Poor's ratings as at 31 December 2016

| RATING | DEBT SECURITIES HELD FOR TRADING | AVAILABLE FOR SALE | HELD TO MATURITY | REPO TRANSACTIONS (***) | TOTAL |
|---|---|---|---|---|---|
| AA+ to AA- | – | 327,613 | – | – | 327,613 |
| A+ to A- | 654,918 | 24,719,097 | 2,998,379 | 700,960 | 29,073,354 |
| BBB+ to BBB- | 9,719 | – | – | – | 9,719 |
| no rating | 66,113 | 6,903,060 (*) | 20,606 (**) | – | 6,989,779 |
| **Total** | **730,750** | **31,949,770** | **3,018,985** | **700,960** | **36,400,465** |

(*) Including NBP bills in an amount of PLN 5 978 629 thousand.
(**) Including NBP bills in an amount of PLN 20 606 thousand.
(***) Fair value of debt securities purchased in the reverse repo transactions.

## Classification of exposures to debt securities according to Standard & Poor's ratings as at 31 December 2015

| RATING | DEBT SECURITIES HELD FOR TRADING | AVAILABLE FOR SALE | HELD TO MATURITY | REPO TRANSACTIONS(***) | TOTAL |
|---|---|---|---|---|---|
| A+ to A- | 1,003,007 | 15,954,349 | 2,497,324 | 6,520,122 | 25,974,802 |
| BBB+ to BBB- | 7,724 | 251,367 | – | – | 259,091 |
| no rating | 113,986 | 1,312,168 (*) | 871,100 (**) | – | 2,297,254 |
| **Total** | **1,124,717** | **17,517,884** | **3,368,424** | **6,520,122** | **28,531,147** |

(*) Including NBP bills in an amount of PLN 628 454 thousand.
(**) Including NBP bills in an amount of PLN 871 100 thousand.
(***) Fair value of debt securities purchased in the reverse repo transactions.

## Classification of exposures to derivative financial instruments according to Standard & Poor's ratings as at 31 December 2016

| | DERIVATIVES | | | | | | |
|---|---|---|---|---|---|---|---|
| | TRADING DERIVATIVES | | | DERIVATIVE HEDGING INSTRUMENTS | | | |
| RATING | BANKS | OTHER FINANCIAL INSTITUTIONS | NON-FINANCIAL ENTITIES | BANKS | OTHER FINANCIAL INSTITUTIONS | NON-FINANCIAL ENTITIES | TOTAL |
| AAA | 143 | – | – | – | – | – | 143 |
| AA+ to AA- | 75,047 | – | – | 1,044 | – | – | 76,091 |
| A+ to A- | 581,997 | 179,546 | – | 22,224 | – | – | 783,767 |
| BBB+ to BBB- | 379,748 | – | – | 4,414 | – | – | 384,162 |
| no rating | 303,021 | 69,325 | 324,602 | 26,868 | 235,202 | – | 959,018 |
| **Total** | **1,339,956** | **248,871** | **324,602** | **54,550** | **235,202** | **–** | **2,203,181** |

## Classification of exposures to derivative financial instruments according to Standard & Poor's ratings as at 31 December 2015

| | DERIVATIVES | | | | | | |
|---|---|---|---|---|---|---|---|
| | TRADING DERIVATIVES | | | DERIVATIVE HEDGING INSTRUMENTS | | | |
| RATING | BANKS | OTHER FINANCIAL INSTITUTIONS | NON-FINANCIAL ENTITIES | BANKS | OTHER FINANCIAL INSTITUTIONS | NON-FINANCIAL ENTITIES | TOTAL |
| AAA | 90 | – | – | – | – | – | 90 |
| AA+ to AA- | 126,730 | – | – | 3,032 | – | – | 129,762 |
| A+ to A- | 1,044,437 | 272,974 | – | 64,698 | – | 749 | 1,382,858 |
| BBB+ to BBB- | 1,003,930 | – | 503 | 319,425 | – | – | 1,323,858 |
| BB+ to BB- | – | – | 1,454 | – | – | – | 1,454 |
| no rating | 464,159 | 52,220 | 239,950 | 29,798 | 3,938 | – | 790,065 |
| **Total** | **2,639,346** | **325,194** | **241,907** | **416,953** | **3,938** | **749** | **3,628,087** |

(in PLN thousand)

## Forbearance measures

With reference to European Securities and Markets Authority (ESMA) document 2012/853 and instructions issued by European Banking Authority in terms of disclosure as far as forborne exposures, the Group in cooperation with its mother company has implemented a process of classification of this type of exposures.

Forborne exposures are debt contracts in respect of which forbearance measures have been extended. Forbearance measures occur in situations in which the borrower is considered to be unable to meet the terms and conditions of the contract due to financial difficulties. Based on these difficulties, the Group decides to modify the terms and conditions of the contract to allow the borrower sufficient ability to service the debt or refinance the contract, either totally or partially. Modification of the terms and conditions of the contract may include i.e. the reduction of the interest rate, principal, accrued interest or the rescheduling of the dates of payment of principal and/or interests.

In particular, the Group assumes that the forbearance has taken place when:

- the modified contract was classified as impaired and the modifications were made within restructuring activities,
- the modified contract was totally or partially past-due by more than 30 days (without being impaired) at least once during the three months prior to its modification or would be more than 30 days past-due, totally or partially, without modification,
- simultaneously with or close in time to the concession of additional debt by the Group, the debtor made payments of principal or interest on another contract with the Group that was totally or partially 30 days past due at least once during the three months prior to its refinancing.

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

- the contract is considered as exposure without impairment triggers,
- a minimum 2 year probation period has passed from the date the forborne exposure was considered as exposure without impairment triggers,
- regular payments of more than an insignificant amount of principal or interest have been made,
- none of the exposures to the debtor is more than 30 days past-due at the end of the probation period of forborne exposure.

If a decision is made to extend a concession, modify the contractual terms or refinance, which is not related to the financial difficulties of the borrower, then forbearance has not occurred.

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

When the exposure is classified as forborne and at each balance sheet date the Group assesses whether there is any objective evidence that the exposure is impaired. The accounting policies in respect to the evaluation and the provisioning of the forborne exposures generally follow the principles in line with the provisions of IAS 39, i.e. whether there are objective evidences that it has incurred a loss for impairment of loans valued at amortized cost, the amount of the loss is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not yet incurred) discounted at the original effective interest rate of the loan.

When the forbearance measures lead to derecognition of the original loan, the Group recognizes the new loan at its fair value. The difference between the carrying amount of the original loan and the fair value of the new loan is recognised in income statement.

The Group also performs an in-depth analysis of the credit risk characteristics of assets for which forbearance measures have been applied, when assessing for specific as well as collective impairment.

### Share of forborne exposures in the Group's loan portfolio

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| LOANS AND ADVANCES TO CUSTOMERS | | |
| **Exposures with no impairment, of which:** | **120,112,554** | **119,349,516** |
| forborne exposures | 574,117 | 422,649 |
| **Impaired exposures, of which:** | **2,550,658** | **2,705,410** |
| forborne exposures | 1,476,521 | 1,537,735 |
| **Total net carrying amount, of which:** | **122,663,212** | **122,054,926** |
| forborne exposures | 2,050,638 | 1,960,384 |

# Notes to the financial statements

(in PLN thousand)

## The quality analysis of forborne exposures

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Exposures with no impairment** | | |
| Gross carrying amount | 587,347 | 437,459 |
| IBNR provisions | (13,230) | (14,810) |
| **Net carrying amount** | **574,117** | **422,649** |
| **Impaired exposures** | | |
| Gross carrying amount, of which: | 3,152,110 | 2,957,036 |
| exposures individually impaired | 2,816,470 | 2,745,545 |
| exposures collectively impaired | 335,640 | 211,491 |
| Allowances for impairment, of which: | (1,675,589) | (1,419,301) |
| exposures individually impaired | (1,524,510) | (1,323,802) |
| exposures collectively impaired | (151,079) | (95,499) |
| **Net carrying amount** | **1,476,521** | **1,537,735** |
| **Total net carrying amount** | **2,050,638** | **1,960,384** |

The Group holds the collaterals for forborne exposures amounting to PLN 1 023 631 thousand as at 31 December 2016 (PLN 881 711 thousand at 31 December 2015).

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

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Gross carrying amount of exposures with no impairment, of which:** | **587,347** | **437,459** |
| – not past due | 483,434 | 285,368 |
| – up to 30 days | 73,519 | 95,039 |
| – between 30 days and 60 days | 19,513 | 27,860 |
| – above 60 days | 10,881 | 29,192 |
| **IBNR provisions for exposures with no impairment, of which:** | **(13,230)** | **(14,810)** |
| – not past due | (8,476) | (5,807) |
| – up to 30 days | (3,051) | (5,673) |
| – between 30 days and 60 days | (1,037) | (1,533) |
| – above 60 days | (666) | (1,797) |
| **Gross carrying amount of impaired exposures, of which:** | **3,152,110** | **2,957,036** |
| – not past due | 627,945 | 571,632 |
| – up to 1 month | 150,815 | 46,871 |
| – between 1 month and 3 months | 46,077 | 32,999 |
| – between 3 months and 1 year | 214,022 | 131,902 |
| – between 1 year and 5 years | 2,026,748 | 2,124,721 |
| – above 5 years | 86,503 | 48,911 |
| **Allowances for impairment, of which:** | **(1,675,589)** | **(1,419,301)** |
| – not past due | (270,904) | (198,882) |
| – up to 1 month | (44,380) | (11,312) |
| – between 1 month and 3 months | (13,893) | (7,510) |
| – between 3 months and 1 year | (116,608) | (42,355) |
| – between 1 year and 5 years | (1,168,335) | (1,120,572) |
| – above 5 years | (61,469) | (38,670) |
| **Total net carrying amount** | **2,050,638** | **1,960,384** |

(in PLN thousand)

## Changes in net carrying amount of forborne exposures

| | 2016 | 2015 |
|---|---|---|
| **Net carrying amount at the beginning** | **1,960,384** | **2,168,125** |
| Amount of exposures recognized in the period | 569,808 | 229,336 |
| Amount of exposures derecognized in the period | (218,057) | (152,818) |
| Changes in impairment allowances | (118,306) | (217,882) |
| Other changes | (143,191) | (66,377) |
| **Net carrying amount at the end** | **2,050,638** | **1,960,384** |
| Interest income | 139,522 | 168,659 |

## Forborne exposures by type of forbearance activity

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Modification of terms and conditions | 3,546,182 | 3,199,428 |
| Refinancing | 193,275 | 195,067 |
| **Total gross carrying amount** | **3,739,457** | **3,394,495** |
| Impairment allowances | (1,688,819) | (1,434,111) |
| **Total net carrying amount** | **2,050,638** | **1,960,384** |

## Forborne exposures by product type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Mortgage loans | 1,293,194 | 979,328 |
| Current accounts | 264,371 | 301,434 |
| Operating loans | 966,079 | 879,129 |
| Investment loans | 844,813 | 935,210 |
| Cash loans | 221,506 | 206,771 |
| Other loans and advances | 149,494 | 92,623 |
| **Total gross carrying amount** | **3,739,457** | **3,394,495** |
| Impairment allowances | (1,688,819) | (1,434,111) |
| **Total net carrying amount** | **2,050,638** | **1,960,384** |

## Forborne exposures by industrial sectors

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Corporations: | 3,122,618 | 2,818,427 |
| Manufacturing | 770,470 | 718,779 |
| Construction | 770,424 | 604,287 |
| Real estate activities | 481,286 | 468,815 |
| Professional, scientific and technical activities | 554,119 | 523,922 |
| Accommodation and food service activities | 230,080 | 212,819 |
| Wholesale and retail trade | 155,655 | 128,840 |
| Mining and quarrying | 58,100 | 77,734 |
| Transportation and storage | 60,215 | 63,613 |
| Agriculture, forestry and fishing | 14,495 | 2,816 |
| Other sectors | 27,774 | 16,802 |
| Individuals | 616,839 | 576,068 |
| **Total gross carrying amount** | **3,739,457** | **3,394,495** |
| Impairment allowances | (1,688,819) | (1,434,111) |
| **Total net carrying amount** | **2,050,638** | **1,960,384** |

(in PLN thousand)

**Forborne exposures by geographical structure**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Poland | 3,391,584 | 3,082,046 |
| Ukraine | 319,396 | 292,314 |
| Cyprus | 26,874 | 18,503 |
| Other countries | 1,603 | 1,632 |
| **Total gross carrying amount** | **3,739,457** | **3,394,495** |
| Impairment allowances | (1,688,819) | (1,434,111) |
| **Total net carrying amount** | **2,050,638** | **1,960,384** |

## Credit risk concentration

According to the current legislation the total exposure of the Group to the risks associated with the single borrower or a group of borrowers in which entities are related by capital or management may not exceed 25% of the Group's equity. In 2016 the maximum exposure limits were not exceeded.

a) Breakdown by individual entities:

As at 31 December 2016

| EXPOSURE TO 10 LARGEST CLIENTS OF THE GROUP | % SHARE OF PORTFOLIO |
|---|---|
| Client 1 | 1.5% |
| Client 2 | 1.3% |
| Client 3 | 1.1% |
| Client 4 | 0.9% |
| Client 5 | 0.9% |
| Client 6 | 0.8% |
| Client 7 | 0.7% |
| Client 8 | 0.7% |
| Client 9 | 0.6% |
| Client 10 | 0.5% |
| **Total** | **9.0%** |

b) Concentration by capital groups:

As at 31 December 2016

| EXPOSURE TO 5 LARGEST CAPITAL GROUPS SERVICED BY THE GROUP | % SHARE OF PORTFOLIO |
|---|---|
| Group 1 | 1.7% |
| Group 2 | 1.4% |
| Group 3 | 1.3% |
| Group 4 | 1.3% |
| Group 5 | 1.2% |
| **Total** | **6.9%** |

(in PLN thousand)

c) Breakdown by industrial sectors:

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

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

**The table below presents the structure of exposures by industrial sectors**

| SECTOR DESCRIPTION | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Wholesale and retail trade; repair of motor vehicles | 15.4% | 15.2% |
| Real estate activities | 12.4% | 10.5% |
| Public administration and defence | 10.3% | 10.9% |
| Electricity, gas, steam | 7.3% | 8.6% |
| Construction | 6.8% | 6.3% |
| Transportation and storage | 6.4% | 7.2% |
| Manufacture of metals, metal products and machinery | 5.0% | 4.0% |
| Manufacture of coke, rafined petroleum products, chemicals and pharmaceutical products | 4.5% | 2.9% |
| Manufacture of beverages and food products | 4.4% | 3.8% |
| Financial and insurance activities | 4.1% | 7.8% |
| Mining and quarrying | 3.2% | 4.4% |
| Other manufacturing | 7.6% | 7.3% |
| Other sectors | 12.6% | 11.1% |
| **Total** | **100.0%** | **100.0%** |

(in PLN thousand)

### CHF loans to individuals

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

A few concepts of restructuring of CHF mortgage loans for individuals have been proposed recently, including the President's draft of the act on the restoration of the equality of parties of certain loan agreements. The proposed solutions are under discussion and may change significantly. Therefore, at the moment, the Group is not able to reliably estimate the impact of the proposed solutions on the financial statements. However, taking into account the relatively minor share of these loans in the total assets and limited market share, the Group assesses that potentially taken solutions should not materially affect the financial standing of the Group.

The tables below present the structure and quality of CHF loans for individuals.

**Gross and net amount of CHF loans to individuals**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Gross carrying amount, of which:** | **4,492,086** | **4,761,295** |
| – denominated in CHF | 4,461,077 | 4,719,657 |
| – indexed to CHF | 31,009 | 41,638 |
| **Impairment allowances, of which:** | **(91,931)** | **(78,963)** |
| – denominated in CHF | (91,604) | (78,616) |
| – indexed to CHF | (327) | (347) |
| **Net carrying amount, of which:** | **4,400,155** | **4,682,332** |
| – denominated in CHF | 4,369,473 | 4,641,041 |
| – indexed to CHF | 30,682 | 41,291 |

**Quality of CHF loans to individuals**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Gross carrying amount of exposures with no impairment, of which:** | **4,302,638** | **4,599,473** |
| – not past due | 3,956,983 | 4,251,469 |
| – up to 30 days | 280,365 | 277,566 |
| – between 30 days and 60 days | 47,308 | 41,226 |
| – above 60 days | 17,982 | 29,212 |
| **IBNR provisions for exposures with no impairment, of which:** | **(11,261)** | **(13,479)** |
| – not past due | (4,183) | (5,144) |
| – up to 30 days | (4,464) | (4,898) |
| – between 30 days and 60 days | (1,755) | (1,542) |
| – above 60 days | (859) | (1,895) |
| **Gross carrying amount of impaired exposures, of which:** | **189,448** | **161,822** |
| – not past due | 31,997 | 25,499 |
| – up to 1 month | 18,589 | 12,076 |
| – between 1 month and 3 months | 12,590 | 9,211 |
| – between 3 months and 1 year | 32,948 | 30,569 |
| – between 1 year and 5 years | 55,254 | 53,721 |
| – above 5 years | 38,070 | 30,746 |
| **Allowances for impairment, of which:** | **(80,670)** | **(65,484)** |
| – not past due | (6,020) | (4,356) |
| – up to 1 month | (2,867) | (1,507) |
| – between 1 month and 3 months | (2,720) | (1,764) |
| – between 3 months and 1 year | (9,379) | (6,250) |
| – between 1 year and 5 years | (31,609) | (27,927) |
| – above 5 years | (28,075) | (23,680) |
| **Total net carrying amount** | **4,400,155** | **4,682,332** |

(in PLN thousand)

As of 31 December 2016 the average LTV for CHF loans to individuals granted by the Group amounted to 56.3% (56.5% as at 31 December 2015), with an average LTV for the whole portfolio of 66.0% (66.4% as at 31 December 2015).

### Credit exposures towards Ukraine

In 2016 Group exposure towards Ukraine in the form of interbank placements were repaid in full.

As at 31 December 2016, the net balance sheet value of remaining exposures towards Ukraine amounted to PLN 111 million (which constitutes 0.1% of total Group exposures), less by PLN 481 million in comparison to the end of December 2015.

**The below table presents the Group's exposure towards the Ukrainian entities**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Balance sheet exposure** | | |
| Loans and advances to banks | – | 402,630 |
| Loans and advances to customers | 321,048 | 300,551 |
| **Total gross carrying amount** | **321,048** | **703,181** |
| IBNR / Impairment allowances | (209,687) | (110,605) |
| **Total net carrying amount** | **111,361** | **592,576** |
| **Off-balance sheet exposure** | | |
| Credit lines granted | 428 | 4,049 |
| **Total gross carrying amount** | **428** | **4,049** |
| IBNR | – | (27) |
| **Total net carrying amount** | **428** | **4,022** |

## 6.3 Market risk

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

Market risk is the risk of deteriorating financial result or capital of the Group resulting from market changes. The main factors of market risk are as follows:
- interest rates,
- foreign exchange rates,
- stock prices,
- commodity prices.

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

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

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

(in PLN thousand)

## Market risk of the trading book

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

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

The model is subject to continuous, statistical verification by comparing the VaR values to actual and revaluated performance figures. Results of analyses carried out in 2016 and 2015 confirmed the adequacy of the model applied.

The tables below presents the market risk exposure of the trading portfolio of the Group measured by Value at Risk in 2016 and 2015

| | 31.12.2016 | MINIMUM VALUE | AVERAGE VALUE | MAXIMUM VALUE |
|---|---|---|---|---|
| foreign exchange risk | 60 | 14 | 275 | 1,958 |
| interest rate risk | 819 | 804 | 1,106 | 1,677 |
| Trading portfolio | 791 | 791 | 1,187 | 2,174 |

| | 31.12.2015 | MINIMUM VALUE | AVERAGE VALUE | MAXIMUM VALUE |
|---|---|---|---|---|
| foreign exchange risk | 54 | 15 | 203 | 1,674 |
| interest rate risk | 1,176 | 676 | 1,175 | 2,103 |
| Trading portfolio | 1,282 | 854 | 1,179 | 1,880 |

## Interest rate risk of the banking book

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

The table below presents the sensitivity levels of the contractual interest income (NII) to the interest rate change by 100 b.p. and of economic value of the Group's equity (EVE) to the interest rate change by 200 b.p. for the end of December 2016 and December 2015. Both analyses assume instant change of market rates. Interest rates of banking products change according to contractual notations, nevertheless in case of contractual NII, for retail deposits the drop of interest rates is limited by 0. In case of EVE sensitivity for current deposits in PLN, the deposit model is applied, which adjusts deposits revaluation profile.

| SENSITIVITY IN % | 31.12.2016 | 31.12.2015 |
|---|---|---|
| NII | (8.03) | (5.97) |
| EVE | (0.76) | (0.77) |

## Currency risk

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

The table below presents the Group's foreign currency risk profile measured at Value at Risk

| CURRENCY | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Currencies total (*) | 208 | 1,538 |

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

(in PLN thousand)

**Foreign currency position of the Group**

| 31.12.2016 | BALANCE SHEET OPERATIONS | | OFF-BALANCE SHEET OPERATIONS– DERIVATIVES | | NET POSITION |
|---|---|---|---|---|---|
| | ASSETS | LIABILITIES | LONG POSITION | SHORT POSITION | |
| EUR | 21,197,815 | 17,067,038 | 12,655,773 | 16,763,013 | 23,537 |
| USD | 5,210,025 | 7,710,838 | 6,409,305 | 3,980,769 | (72,277) |
| CHF | 4,722,131 | 1,049,133 | 3,606,673 | 7,285,284 | (5,613) |
| GBP | 212,581 | 869,553 | 687,217 | 29,324 | 921 |
| CZK | 34,786 | 529,413 | 602,343 | 107,358 | 358 |
| Other currencies | 262,357 | 164,008 | 208,033 | 304,055 | 2,327 |
| **TOTAL** | **31,639,695** | **27,389,983** | **24,169,344** | **28,469,803** | **(50,747)** |

| 31.12.2015 | BALANCE SHEET OPERATIONS | | OFF-BALANCE SHEET OPERATIONS– DERIVATIVES | | NET POSITION |
|---|---|---|---|---|---|
| | ASSETS | LIABILITIES | LONG POSITION | SHORT POSITION | |
| EUR | 18,890,563 | 17,929,313 | 11,066,799 | 11,841,800 | 186,249 |
| USD | 6,294,671 | 8,290,240 | 7,077,654 | 5,116,063 | (33,978) |
| CHF | 4,700,851 | 606,176 | 3,221,543 | 7,319,753 | (3,535) |
| GBP | 318,067 | 708,529 | 622,872 | 232,423 | (13) |
| CZK | 37,732 | 16,591 | 183,225 | 204,259 | 107 |
| Other currencies | 273,984 | 161,448 | 73,793 | 183,113 | 3,216 |
| **TOTAL** | **30,515,868** | **27,712,297** | **22,245,886** | **24,897,411** | **152,046** |

The amount of the net long position in EUR (equivalent of PLN 186 249 thousand) as at 31 December 2015 mainly resulted from the recognition of the fair value valuation of shares in Visa Europe (Note 31) in the amount of EUR 40 866 611 (equivalent of PLN 174 153 thousand). The foreign currency position from the valuation of shares in Visa Europe was closed on January 2016.

## 6.4 Liquidity risk

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

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

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

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

# Notes to the financial statements

(in PLN thousand)

Scenario-based stress analyses, conducted on a monthly basis, constitute an integral part of the Group's liquidity monitoring process. Within the scope of these analyses the Group's liquidity is assessed under the conditions of crisis which is caused by financial markets or is caused by internal factors, specific to the Group. In 2016 the Bank widened the scope of applied tests without making significant changes in their logic.

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

In order to define the principles of contingency liquidity management, Bank introduced, approved by the Management Board, 'Contingency Liquidity Policy', which defines the contingency procedures in the event of crisis situations. This policy involves daily monitoring of the system and specific early-warning indicators for the Bank and the Group as well as three levels of liquidity risk states depending on the level of early-warning indicators, the Bank's, the Group's and market situation. It also defines the sources for covering the expected outflows from the Group. This document sets the procedures for monitoring the liquidity states, emergency action procedures, task forces dedicated for restoring the Group's liquidity and the Management's responsibilities for taking necessary decisions to restore the required liquidity level. In 2016, the Policy was updated in order to be adjusted to the Recovery Plan that is in force in the Bank.

Below are presented basic quantitative information concerning the Group's liquidity at the end of 2016 year in comparison to the end of 2015. They cover the structure of financial liabilities by contractual maturity, adjusted liquidity gap and financial flows from derivative transactions.

### Structure of financial liabilities by contractual maturities

| 31.12.2016 | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| BALANCE SHEET LIABILITIES | | | | | | |
| Amounts due to banks (*) | 1,568,626 | 7,866 | 62,274 | 1,490,498 | 1,775,910 | 4,905,174 |
| Amounts due to customers | 107,386,695 | 11,705,237 | 18,590,217 | 529,562 | 81,291 | 138,293,002 |
| Debt securities issued | 28,936 | 194,369 | 171,915 | 1,056,438 | 206,332 | 1,657,990 |
| Financial liabilities held for trading | 102,076 | – | 131,194 | 263,435 | 176,460 | 673,165 |
| **Total** | **109,086,333** | **11,907,472** | **18,955,600** | **3,339,933** | **2,239,993** | **145,529,331** |
| OFF-BALANCE SHEET COMMITMENTS (**) | | | | | | |
| Financial liabilities granted | 32,304,313 | – | – | – | – | 32,304,313 |
| Guarantees issued | 11,259,832 | – | – | – | – | 11,259,832 |
| **Total** | **43,564,145** | **–** | **–** | **–** | **–** | **43,564,145** |

| 31.12.2015 | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| BALANCE SHEET LIABILITIES) | | | | | | |
| Amounts due to banks (*) | 1,606,000 | 1,066,155 | 108,638 | 1,204,022 | 2,124,172 | 6,108,987 |
| Amounts due to customers | 96,357,303 | 12,213,137 | 17,987,883 | 2,777,981 | 55,721 | 129,392,025 |
| Debt securities issued | 336,500 | 1,034,304 | 409,535 | 616,862 | 661,531 | 3,058,732 |
| Financial liabilities held for trading | – | – | 170,729 | 382,663 | 58,050 | 611,442 |
| **Total** | **98,299,803** | **14,313,596** | **18,676,785** | **4,981,528** | **2,899,474** | **139,171,186** |
| OFF-BALANCE SHEET COMMITMENTS (**) | | | | | | |
| Financial liabilities granted | 30,935,860 | – | – | – | – | 30,935,860 |
| Guarantees issued | 14,072,827 | – | – | – | – | 14,072,827 |
| **Total** | **45,008,687** | **–** | **–** | **–** | **–** | **45,008,687** |

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

(in PLN thousand)

## Adjusted liquidity gap

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

### Adjusted liquidity gap

| 31.12.2016 | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| Balance sheet assets | 42,255,570 | 4,225,036 | 24,539,554 | 50,597,089 | 52,597,694 | 174,214,943 |
| Balance sheet liabilities | 19,300,857 | 6,459,100 | 18,513,533 | 20,417,900 | 109,523,553 | 174,214,943 |
| Off-balance sheet assets/liabilities (net) | (4,956,771) | (16,411) | 862,106 | 1,309,640 | 1,496,475 | (1,304,961) |
| **Periodic gap** | **17,997,942** | **(2,250,475)** | **6,888,127** | **31,488,829** | **(55,429,384)** | **(1,304,961)** |
| **Cumulated gap** | **–** | **15,747,467** | **22,635,594** | **54,124,423** | **(1,304,961)** | **–** |

| 31.12.2015 | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| Balance sheet assets | 39,156,141 | 7,110,676 | 24,968,630 | 50,455,851 | 47,094,269 | 168,785,567 |
| Balance sheet liabilities | 16,049,305 | 8,827,295 | 18,770,564 | 19,999,689 | 105,138,714 | 168,785,567 |
| Off-balance sheet assets/liabilities (net) | (6,717,006) | 568,926 | 1,240,893 | 2,489,137 | 1,254,323 | (1,163,727) |
| **Periodic gap** | **16,389,830** | **(1,147,693)** | **7,438,959** | **32,945,299** | **(56,790,122)** | **(1,163,727)** |
| **Cumulated gap** | **–** | **15,242,137** | **22,681,096** | **55,626,395** | **(1,163,727)** | **–** |

## Off-balance derivative transactions

The tables below show the financial flows relating to derivative off balance transactions.

According to Group's policy, off-balance derivative transactions settled in net amounts include:
- Interest Rate Swaps (IRS),
- Forward Rate Agreements (FRA),
- Foreign currency options and for gold,
- Interest rate options (Cap/Floor),
- Transactions based on equity securities and stock indexes,
- Transactions based on commodities and precious metals.

Off-balance derivative transactions settled by the Group in gross amounts include:
- Cross-Currency Interest Rate Swaps (CIRS),
- Foreign currency forward contracts,
- Foreign currency swaps (FX-Swap),
- Forward contracts based on securities.

(in PLN thousand)

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

| | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| **31.12.2016** | 26,757 | 51,903 | 131,715 | 1,219,802 | 449,921 | **1,880,098** |
| **31.12.2015** | 70,648 | 104,854 | 151,485 | 2,007,425 | 889,219 | **3,223,631** |

**Cash flows related to off-balance derivative transactions settled in gross amounts**

| | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| **31.12.2016** | | | | | | |
| inflows | 20,805,957 | 6,032,490 | 7,701,296 | 8,030,511 | 2,915,201 | **45,485,455** |
| outflows | 20,827,342 | 6,055,624 | 7,823,747 | 8,745,485 | 3,322,026 | **46,774,224** |
| **31.12.2015** | | | | | | |
| inflows | 16,745,976 | 6,290,357 | 7,529,685 | 8,415,940 | 2,830,603 | **41,812,561** |
| outflows | 16,750,719 | 6,249,486 | 7,612,854 | 9,216,680 | 3,152,969 | **42,982,708** |

## 6.5 Operational risk

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

Operational risk management is based on internal procedures that are consistent with the law requirements, resolutions, recommendations and guidelines of the supervisor, and the standards of UniCredit Group. Operational risk management includes identification, assessment, monitoring, preventing and reporting. Identification and assessment of operational risk is based on an analysis of internal factors and external factors that may have a significant impact on the achievement of the objectives of the Group. The main tools used in identifying and assessing operational risk are: internal operational events, external operational events, key risk indicators, scenario analysis and self-assessment of operational risk. Monitoring activities are conducted on three levels of control: operational control (all employees), risk management control (Financial and Operational Risk Management Department) and internal audit (Internal Audit Department). Preventing operational risk includes definition of operational risk limits and the obligation to initiate mitigation actions in case they are exceeded, the system of internal control, business continuity plans and insurance coverage. Operational risk reporting system enables the assessment of the Group's exposure to operational risk and the effective management of this risk, and also plays a fundamental role in the process of informing the Supervisory Board, the Management Board and executives of the Group's exposure to operational risk. It is based in particular on the quarterly reports on operational risk control that include, among others: profile of operational risk, loss limit utilization, analysis of trends in the relevant categories of operational risk, potential losses, information on key indicators of operational risk and operational risk capital requirement.

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

Operational risk management system is subject to internal validation at least once a year. Validation aims at verification of compliance with regulatory requirements and standards of the UniCredit Group.

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

- internal frauds – losses resulting from acts of intended fraud, misappropriation of property, circumvention of regulations, the laws and internal policies of a company, excluding losses resulting from diversity or discrimination of employees, which concern at least one internal party,
- external frauds – losses being a consequence of acts of defraud, misappropriation of property or circumvention of regulations performed by a third party,
- employment practices and workplace safety – losses due to acts inconsistent with regulations or employment agreements, workplace health and safety agreements, payments from personal injuries claims or losses from discrimination and unequal employee treatment,

(in PLN thousand)

- clients, products and business practices – losses arising from failures of meeting professional obligations towards clients due to unintended or negligent acts (including custody requirements and appropriate behavior) or concerning specific features or a design of a product,
- damages to physical assets – losses due to damage or loss of tangible assets resulting from natural disasters or other events,
- business disruption and system failures – losses stemming from business or system failures,
- execution, delivery and process management – losses resulting from failed transaction settlements or process management and losses from relations with cooperating parties and vendors.

| OPERATING EVENTS BY CATEGORIES | 2016 | 2015 |
|---|---|---|
| Internal frauds | 10.62% | 20.50% |
| External frauds | 18.08% | 4.70% |
| Employment practices and workplace safety | 14.26% | 1.12% |
| Clients, products and business practices | 7.35% | 59.15% |
| Damages to physical assets | 32.00% | 4.70% |
| Business disruption and system failures | 0.40% | 0.71% |
| Execution, delivery and process management | 17.29% | 9.12% |
| **Total** | **100.00%** | **100.00%** |

## 6.6 Capital management

The capital management process applied by the Group has been adopted for the following purposes:
- assurance of safe operating by maintaining the balance between the capacity to undertake risk (limited by own funds), and the risk levels generated,
- maintenance of capital for covering risk above the minimum stated levels in order to assure further business operations, taking into consideration the possible, future changes in capital requirements and to safeguarding the interests of shareholders,
- maintenance of the optimal capital structure in order to maintain the desired quality of risk coverage capital,
- creation of value to shareholders by the best possible utilization of the Group funds.

The Bank Pekao S.A. has put in place a formalized process of capital management and monitoring, established within the scope of ICAAP process. The Finance Division under the Chief Financial Officer is responsible for functioning of the capital management process in the Bank. The ultimate responsibility for capital management is allocated to the Management Board of the Bank, supported by the Assets, Liabilities and Risk Management Committee, which approves the capital management process. The Bank has also implemented the Capital Contingency Policy which establishes rules and obligations in the event of crisis appearance or further development that would significantly reduce capitalization level of the Bank or Group. The policy defines the principles of supervision including split of responsibilities for the purpose of early and consistent management in case of crisis situation development.

The Capital Management Strategy defines the objectives and general rules of the management and monitoring of the Group's capital adequacy, such as the guidelines concerning risk coverage sources, preferred structure of capital for risk coverage, long-term capital targets, capital limits system and sources of additional capital under contingency.

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

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

(in PLN thousand)

### Regulatory capital requirements

Calculations of the regulatory capital requirements were done based on Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, with further amendments as well as Commission Implementing and Delegated Regulations (EU) (hereinafter: 'Regulation 575/2013').

Capital ratios are the basic measures applied for the measurement of capital adequacy. Minimum capital ratios required by law equal 10.0% for TCR and 8.0% for CET1 which are the sum of minimum value defined in Regulation 575/2013 (8.0% for TCR and 6.0% for T1) and the combined buffer requirement defined in Act on macroprudential supervision (total of 2.0% in line with Chapter 2). According to the recommendation of the Polish Financial Supervision Authority (KNF) total capital ratio of the Pekao Group, taking into account of Other Systemically Important Institution buffer of 0.75%, must be not lower than 14.0% and Tier I capital ratio not lower than 11.0%.

As at 31 December 2016 total capital ratio of the Group amounted at 17.64% (as at 31 December 2015 – 17.66%).

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **CAPITAL REQUIREMENTS** | | |
| Credit and counterparty risk including CVA | 8,511,165 | 8,527,666 |
| Market risk | 44,022 | 63,578 |
| Operational risk | 493,557 | 564,787 |
| **Total capital requirement** | **9,048,744** | **9,156,031** |
| **OWN FUNDS** | | |
| Common Equity Tier 1 capital | 19,954,579 | 20,209,595 |
| **Own funds for total capital ratio** | **19,954,579** | **20,209,595** |
| **OWN FUNDS REQUIREMENTS** | | |
| **Common Equity Tier 1 capital ratio (%)** | **17.64%** | **17.66%** |
| **Total capital ratio (%)** | **17.64%** | **17.66%** |

Total capital ratio at the end of 2016 compared with the end of 2015 decreased by 0.02 p.p. due to decrease of own funds by 1.3% despite decrease of total capital requirement by 1.2%.

Total capital requirement decreased in 2016 as a result of decrease of capital requirements for all risks.

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

(in PLN thousand)

## Own funds

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

The Group's own funds consist only of Common Equity Tier 1 capital. Additional Tier 1 capital and Tier 2 capital are not identified in the Group.

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **OWN FUNDS** | | |
| **Capital** | **22,911,943** | **23,424,193** |
| **Different scope of consolidation** | **16,361** | **15,826** |
| **Component of the capital not included into own funds, in which:** | **(2,279,275)** | **(2,292,459)** |
| Current year net profit | (2,279,275) | (2,292,459) |
| **Regulatory adjustments, in which:** | **(694,450)** | **(937,965)** |
| Intangible assets | (531,041) | (570,309) |
| Capital from revaluation | (32,177) | (36,678) |
| Unrealised loss from debt and capital instruments available for sale | – | – |
| Unrealised gain from debt and capital instruments available for sale | (51,593) | (267,136) |
| Deferred tax assets that rely on future profitability | (18,876) | (16,490) |
| Additional value adjustments due to prudent calculation | (45,839) | (31,388) |
| Minority interests | (14,924) | (15,964) |
| **Common Equity Tier 1 capital** | **19,954,579** | **20,209,595** |
| **Own funds for total capital ratio** | **19,954,579** | **20,209,595** |

Components of capital not included into own funds:
- Current year net profit – net profit of current reporting period, verified by statutory auditor responsible for auditing of the Group's accounts reduced by all foreseeable charge and dividend, can be included into Common Equity Tier 1 capital only with the permission of KNF. As at 31 of December 2016, current profit of the Group was not included into Common Equity Tier 1 capital.

Regulatory adjustments:
- intangible assets (after deduction of related deferred tax liabilities) decrease Common Equity Tier 1 capital, according to Article 36 of Regulation No 575/2013,
- capital from revaluation reflects fair value of cash flow hedges is not included in any element of own funds, according to Article 33 of Regulation No 575/2013,
- unrealised losses from debt and capital instruments classified as available for sale according to Article 467 of Regulation No 575/2013 using national options defined in Article 171a. Banking Act, decrease Common Equity Tier 1 capital in 100%,
- unrealised gains from debt and capital instruments classified as available for sale according to Article 468 of Regulation No 575/2013 using national options defined in Article 171a. Banking Act are included in 60% to Common Equity Tier 1 capital,
- deferred tax assets based on future profitability decrease Common Equity Tier 1 capital according to Article 36 of Regulation No 575/2013 only in 60% (Article 469 of Regulation No 575/2013 using national options defined in Article 171a Banking Act),
- additional value adjustments due to prudent valuation are created for every asset measured at fair value, according to Article 34 of Regulation No 575/2013,
- minority interests are deducted from Group's capital because requirements laid down in Regulation No 575/2013 are not meet.

## Internal capital adequacy assessment

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

The Group takes the following risk types into consideration:
- credit risk,
- operational risk,
- market risk,
- liquidity risk,
- real estate risk,

- macroeconomic risk,
- business risk (including strategic risk),
- compliance risk,
- reputational risk,
- model risk,
- excessive leverage risk,
- bancassurance risk,
- financial investment risk.

For each risk deemed material, the Group develops and applies adequate risk assessment and measurement methods. The Group applies the following risk assessment methods:
- qualitative assessment – applied in case of risks which are difficult to measure or for which capital is not a sufficient mean to cover losses (compliance, reputational and bancassurance risks) with potencial capital coverage in other risks areas,
- assessment by estimation of capital buffer, for risks that are not easily quantifiable however some aggregate assessment of their impact is possible (model risk and macroeconomic risk),
- quantitative assessment – applied for risks which can be measured with the use of economic capital (other risk types apart from liquidity risk and excessive leverage risk) or based on other risk-specific measures (liquidity risk and excessive leverage risk).

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

Also, a consistent methodology for estimating the buffer for macroeconomic changes and model risks has been developed. The macroeconomic changes risk capital buffer is determined on the basis of the impact of the economic slowdown scenario on economic capital in the forecast horizon.

Model risk is assessed with scenario analyses making it possible to evaluate the impact of potential model inconsistencies on its output. Based on the aggregated output, the model risk capital buffer is determined.

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

## 6.7 Fair value of financial assets and liabilities

**Financial instruments that are measured at fair value in the consolidated statement of financial position of the Group**

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

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

As of 31 December 2016 and 31 December 2015, the Group classified the financial assets and liabilities measured at fair value into the following hierarchy of three categories based on the valuation method:
- Level 1: mark-to-market, applies to securities quoted on active markets,
- Level 2: mark-to-model valuation with model parameterization, based on quotations from active markets for given type of instrument, applies to illiquid government, municipal, corporate and central bank debt securities, linear and non-linear derivative instruments of interest rate markets (including forward transactions on debt securities), equity, commodity and foreign currency exchange markets, except for those cases that meet the criteria of Level 3,

(in PLN thousand)

- Level 3: mark-to-model valuation with partial model parameterization, based on estimated risk factors, applicable to corporate and municipal debt securities and for linear and non-linear derivative instruments of interest rate, equity, commodity and foreign currency exchange markets for which unobservable parameters (e.g. credit risk factors) are recognized as significant.

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

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

| 31.12.2016 | LEVEL 1 | LEVEL 2 | LEVEL 3 | TOTAL |
|---|---|---|---|---|
| **Assets:** | **20,944,182** | **13,685,790** | **407,312** | **35,037,284** |
| Financial assets held for trading | 636,385 | 29,971 | 66,113 | 732,469 |
| Derivative financial instruments, including: | 1 | 1,913,428 | – | 1,913,429 |
| – Banks | – | 1,339,956 | – | 1,339,956 |
| – Customers | 1 | 573,472 | – | 573,473 |
| Hedging instruments, including: | – | 289,752 | – | 289,752 |
| – Banks | – | 54,550 | – | 54,550 |
| – Customers | – | 235,202 | – | 235,202 |
| Securities available for sale | 20,307,796 | 11,452,639 | 341,199 | 32,101,634 |
| **Liabilities:** | **527,840** | **3,736,717** | **–** | **4,264,557** |
| Financial liabilities held for trading | 527,836 | 145,329 | – | 673,165 |
| Derivative financial instruments, including: | 4 | 1,952,670 | – | 1,952,674 |
| – Banks | – | 1,349,082 | – | 1,349,082 |
| – Customers | 4 | 603,588 | – | 603,592 |
| Hedging instruments, including: | – | 1,638,718 | – | 1,638,718 |
| – Banks | – | 1,636,262 | – | 1,636,262 |
| – Customers | – | 2,456 | – | 2,456 |

| 31.12.2015 | LEVEL 1 | LEVEL 2 | LEVEL 3 | TOTAL |
|---|---|---|---|---|
| **Assets:** | **15,929,590** | **6,134,087** | **504,501** | **22,568,178** |
| Financial assets held for trading | 936,763 | 142,640 | 47,389 | 1,126,792 |
| Derivative financial instruments, including: | 28 | 3,205,476 | 943 | 3,206,447 |
| – Banks | – | 2,639,346 | – | 2,639,346 |
| – Customers | 28 | 566,130 | 943 | 567,101 |
| Hedging instruments, including: | – | 421,640 | – | 421,640 |
| – Banks | – | 416,953 | – | 416,953 |
| – Customers | – | 4,687 | – | 4,687 |
| Securities available for sale | 14,992,799 | 2,364,331 | 456,169 | 17,813,299 |
| **Liabilities:** | **611,443** | **4,907,086** | **–** | **5,518,529** |
| Financial liabilities held for trading | 611,442 | – | – | 611,442 |
| Derivative financial instruments, including: | 1 | 3,204,327 | – | 3,204,328 |
| – Banks | – | 2,747,772 | – | 2,747,772 |
| – Customers | 1 | 456,555 | – | 456,556 |
| Hedging instruments, including: | – | 1,702,759 | – | 1,702,759 |
| – Banks | – | 1,702,759 | – | 1,702,759 |
| – Customers | – | – | – | – |

(in PLN thousand)

**Change in fair value of financial instruments measured at fair value according to Level 3 by the Group**

| 2016 | FINANCIAL ASSETS HELD FOR TRADING | DERIVATIVE FINANCIAL INSTRUMENTS (ASSETS) | SECURITIES AVAILABLE FOR SALE |
|---|---|---|---|
| **Opening balance** | **47,389** | **943** | **456,169** |
| Increases, including: | 188,786 | – | 68,170 |
| Reclassification | – | – | – |
| Acquisition | 187,298 | – | 58,952 |
| Settlement | – | – | – |
| Gains on financial instruments | 1,488 | – | 9,218 |
| recognized in the income statement | 1,488 | – | 7,598 |
| recognized in revaluation reserves | – | – | 1,620 |
| Decreases, including: | (170,062) | (943) | (183,140) |
| Reclassification | – | (943) | – |
| Settlement / Redemption | (23,454) | – | (181,678) |
| Sale | (146,585) | – | – |
| Loss on financial instruments | (23) | – | (1,462) |
| recognized in the income statement | (23) | – | (4) |
| recognized in revaluation reserves | – | – | (1,458) |
| **Closing balance** | **66,113** | **–** | **341,199** |
| **Unrealized income from financial instruments held in portfolio until end of period, recognized in:** | **25** | **–** | **(1,187)** |
| Income statement: | 25 | – | 271 |
| net interest income | 41 | – | 271 |
| result on financial assets and liabilities held for trading | (16) | – | – |
| Other components income | – | – | (1,458) |

| 2015 | FINANCIAL ASSETS HELD FOR TRADING | DERIVATIVE FINANCIAL INSTRUMENTS (ASSETS) | SECURITIES AVAILABLE FOR SALE |
|---|---|---|---|
| **Opening balance** | **99,784** | **2,967** | **263,815** |
| Increases, including: | 10,663,874 | 1,942 | 200,231 |
| Reclassification | – | 1,942 | 313 |
| Acquisition | 10,661,018 | – | – |
| Settlement | – | – | – |
| Gains on financial instruments | 2,856 | – | 199,918 |
| recognized in the income statement | 2,856 | – | 11,077 |
| recognized in revaluation reserves | – | – | 188,841 |
| Decreases, including: | (10,716,269) | (3,966) | (7,877) |
| Reclassification | (55,052) | (2,967) | – |
| Settlement / Redemption | (435,186) | (891) | (7,877) |
| Sale | (10,225,856) | – | – |
| Loss on financial instruments | (175) | (108) | – |
| recognized in the income statement | (175) | (108) | – |
| **Closing balance** | **47,389** | **943** | **456,169** |
| **Unrealized income from financial instruments held in portfolio until end of period, recognized in:** | **(63)** | **(108)** | **2,674** |
| Income statement: | 108 | (108) | 268 |
| net interest income | 108 | – | 268 |
| result on financial assets and liabilities held for trading | – | (108) | – |
| Other components income | (171) | – | 2,406 |

(in PLN thousand)

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

In the period from 1 January to 31 December 2016 the following transfers between fair value hierarchy levels were performed:
- Government bonds in foreign currencies were transferred from Level 1 to Level 2 due to a change in the availability of active market quotations,
- Interest rate derivatives and commodity derivatives (concluded within the year) were transferred from Level 3 to Level 2 due to the decrease of impact on the fair value of credit parameters and correlation parameter respectively.

In the period from 1 January to 31 December 2016 there were no other transfers between fair value hierarchy levels.

The impact of estimated parameters on measurement of financial instruments for which the Group applies fair value valuation according to Level 3 as at 31 December 2016 and 31 December 2015 is as follows

| FINANCIAL ASSET/ LIABILITY | FAIR VALUE AS AT 31.12.2016 | VALUATION TECHNIQUE | UNOBSERVABLE FACTOR | ALTERNATIVE FACTOR RANGE (WEIGHTED AVERAGE) | IMPACT ON FAIR VALUE AS AT 31.12.2016 | |
|---|---|---|---|---|---|---|
| | | | | | POSITIVE SCENARIO | NEGATIVE SCENARIO |
| Corporate debt securities | 316,025 | Discounted cash flow | Credit spread | 0.32%-1.13% | 613 | (627) |

| FINANCIAL ASSET/ LIABILITY | FAIR VALUE AS AT 31.12.2015 | VALUATION TECHNIQUE | UNOBSERVABLE FACTOR | ALTERNATIVE FACTOR RANGE (WEIGHTED AVERAGE) | IMPACT ON FAIR VALUE AS AT 31.12.2015 | |
|---|---|---|---|---|---|---|
| | | | | | POSITIVE SCENARIO | NEGATIVE SCENARIO |
| Corporate debt securities | 298,756 | Discounted cash flow | Credit spread | 0.54%-1% | 526 | (1,427) |
| Interest rate derivatives | 943 | Discounted cash flow | PD | 2.1%-5.4% | 39 | (44) |
| | | | LGD | 40.1%-54.1% | 16 | (16) |

## Financial instruments that are not measured at fair value in the consolidated statement of financial position of the Group

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

As of 31 December 2016 and on 31 December 2015, the Group classified the financial assets and liabilities not measured at fair value in the consolidated statement of financial position into the following three categories based on the valuation level:
- Level 1: mark-to-market, applies to government securities quoted on the liquid market and cash,
- Level 2: mark-to-model valuation with model parameterization, based on quotations from active markets for given type of instrument, applies to interbank deposits, own issues, illiquid government, municipal, corporate and central bank debt securities,
- Level 3: mark-to-model valuation with partial model parameterization, based on estimated risk factors is applicable to corporate and municipal debt securities and loans and deposits for which the applied credit risk factor (an unobservable parameter) is recognized significant.

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

In the case of loans for which no quoted market values are available, the fair values presented are generally estimated using valuation techniques taking into consideration the assumption, that at the moment when the loan is granted its fair value is equal to its carrying amount. Fair value of non-impaired loans is equal to the sum of future expected cash flows, discounted at the balance sheet date. The discount rate is defined as the appropriate market risk-free rate plus the credit risk margin and current sales margin for the given loan products group. The margin is computed on loans granted during last three months broken down by loan product groups and maturity. For the purpose of the fair value of foreign currency loans estimation, the margin on PLN loans adjusted by the cross-currency basis swap quotes is used. The fair value of impaired loans is defined as equal to the sum of expected recoveries, discounted with the use of effective interest rate, since the average expected recovery values take the element of credit risk fully into consideration. In case of loans without repayment schedule (loans in current account, overdrafts and credit cards), the fair value was assumed as equal to the carrying amount.

(in PLN thousand)

For the Group's capital exposure, for which no active market prices are available and market values are unattainable, the Group does not measure their fair value. Such exposures include companies from financial sector, associated with the use of the financial and banking infrastructure and payment card services and companies taken-over as a result of debt restructuring.

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

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

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

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

| | | | OF WHICH: | | |
|---|---|---|---|---|---|
| 31.12.2016 | CARRYING AMOUNT | FAIR VALUE | LEVEL 1 | LEVEL 2 | LEVEL 3 |
| **Assets** | | | | | |
| Cash and due from Central Bank | 5,872,911 | 5,872,802 | 2,639,531 | 3,233,271 | – |
| Loans and advance to banks | 3,257,829 | 3,257,936 | – | 1,089,488 | 2,168,448 |
| Loans and advances to customers | 118,689,267 | 117,912,278 | – | 5,789,241 | 112,123,037 |
| Receivables from financial leases | 3,974,643 | 4,038,178 | – | – | 4,038,178 |
| Debt securities held to maturity | 3,018,985 | 3,033,397 | 3,012,791 | 20,606 | – |
| **Total assets** | **134,813,635** | **134,114,591** | **5,652,322** | **10,132,606** | **118,329,663** |
| **Liabilities** | | | | | |
| Amounts due to Central Bank | 6,091 | 6,185 | – | – | 6,185 |
| Amounts due to other banks | 4,823,440 | 4,870,778 | – | 482,375 | 4,388,403 |
| Amounts due to customers | 137,815,926 | 137,494,049 | – | 1,436,240 | 136,057,809 |
| Debt securities issued | 1,522,963 | 1,565,925 | – | 1,565,925 | – |
| **Total liabilities** | **144,168,420** | **143,936,937** | **–** | **3,484,540** | **140,452,397** |

(in PLN thousand)

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

| 31.12.2015 | CARRYING AMOUNT | FAIR VALUE | OF WHICH: LEVEL 1 | LEVEL 2 | LEVEL 3 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and due from Central Bank | 7,881,607 | 7,881,607 | 2,951,414 | 4,930,193 | – |
| Loans and advance to banks | 7,314,724 | 7,311,058 | – | 5,301,176 | 2,009,882 |
| Loans and advances to customers (*) | 118,555,269 | 117,717,427 | – | 7,140,550 | 110,576,877 |
| Receivables from financial leases | 3,503,979 | 3,568,200 | – | – | 3,568,200 |
| Debt securities held to maturity | 3,368,424 | 3,380,400 | 2,509,227 | 871,173 | – |
| **Total assets** | **140,624,003** | **139,858,692** | **5,460,641** | **18,243,092** | **116,154,959** |
| **Liabilities** | | | | | |
| Amounts due to Central Bank | 914 | 928 | – | – | 928 |
| Amounts due to other banks | 5,958,449 | 6,002,687 | – | 1,182,111 | 4,820,576 |
| Amounts due to customers | 128,867,691 | 128,479,792 | – | 4,468,820 | 124,010,972 |
| Debt securities issued | 2,903,233 | 2,959,349 | – | 2,959,349 | – |
| **Total liabilities** | **137,730,287** | **137,442,756** | **–** | **8,610,280** | **128,832,476** |

(*) Including bills of exchange eligible for rediscounting at Central Bank.

# 7. Custody activity

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

As at 31 December 2016 the Bank maintained 12 333 securities accounts (in comparison to 12 077 securities accounts as at 31 December 2015).

# 8. Brokerage activity

The Group offers a wide range of capital market products and services via specialized Bank's organizational unit – Dom Maklerski Pekao (DM) and by the agency of Centralny Dom Maklerski Pekao S.A. (CDM) and Pekao Investment Banking S.A. (Pekao IB) a subsidiaries of the Bank Pekao S.A.

### Dom Maklerski Pekao and Centralny Dom Maklerski Pekao S.A.

Dom Maklerski Pekao is a specialized organizational unit of the Bank designed to sell capital market products. The objective of the entity is to provide the highest quality brokerage services. The comprehensive offer enables investors, especially the individual clients of the Bank to invest in financial instruments traded on the regulated market and on the alternative trading platform organized by the Warsaw Stock Exchange (GPW S.A.) and by the BondSpot S.A. (i.e. shares, treasury and corporate bonds, derivatives – futures and options, ETF, certificates, warrants) as well as the instruments traded on the particular foreign markets using any service channel (mobile application, Internet, mobile service, phone, direct contact in the Brokerage Services Spots) after activation of the service. Dom Maklerski Pekao intermediates also in sales of the Structured Certificates of Deposit issued by Bank Pekao S.A., enables investors to acquire instruments in the IPO's and makes the transactions on the non-public market. The service for the clients is provided in more than 390 Brokerage Services Spots located in the Bank branches throughout Poland and via remote channels of Pekao24Makler (Internet, mobile service, phone, mobile application) fully integrated with the Bank's electronic banking platform Pekao24.

Centralny Dom Maklerski Pekao S.A. (CDM) is the largest and oldest brokerage firm on the Polish capital market. The aim of CDM is to service investment accounts. The offering enables Clients to invest in inter alia shares, Treasury bonds, corporate bonds, certificates, funds' units, ETF, structured products, insurance and pension programs. CDM grants to clients access to invest on derivatives markets, foreign markets and OTC markets. Clients are served in 48 Consumer Service Spots located mainly in Bank branches throughout Poland and additionally in 12 points dedicated to service for strategic clients and through remote service channels of CDM24 (CDMInternet, TeleCDM, CDM Mobile) enabling connection to electronic banking platform Pekao24.

# Notes to the financial statements

(in PLN thousand)

The tight cooperation of Dom Maklerski Pekao and CDM on the realization of the projects conducted on the primary market and in the other areas of market activities of both entities ensures professional and comprehensive brokerage services.

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

Both entities conform to the Good Practices Code of Brokerage Firms guaranteeing comprehensive services in accordance with highest ethics standards. Both DM and CDM actively participate in capital market development in Poland.

### Pekao Investment Banking S.A.

Pekao Investment Banking S.A. operates as a brokerage house supervised by the Financial Supervision Commission, focusing on the service of institutional and corporate clients. The scope of services provided by Pekao IB comprises in particular acceptance and transfer of orders for purchase or sale of financial instruments, execution of these orders on account of the person or entity placing the order, offering of financial instruments, advisory services for enterprises on capital structure, corporate strategy or other matters related to such structure or strategy as well as advisory services and other services relating to mergers, divisions and acquisitions of companies. Pekao IB also performs the market maker's function both on the capital market and on the derivatives market, being one of the most active market makers.

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

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

| | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|
| | QUANTITY (PCS) | VALUE | QUANTITY (PCS) | VALUE |
| **CLIENTS' FINANCIAL INSTRUMENTS** | | | | |
| Held on securities accounts | 3,556,221,597 | 24,707,398 | 4,085,831,592 | 28,594,389 |
| Equity securities and rights to such financial assets | 3,550,120,296 | 23,236,537 | 4,075,825,419 | 27,191,398 |
| Debt instruments and rights to such financial assets | 6,101,301 | 1,470,861 | 10,006,173 | 1,402,991 |
| Stored in a form of document | 2,623,762,193 | 6,291,869 | 3,767,973,072 | 16,232,127 |
| Equity securities and rights to such financial assets | 2,623,762,193 | 6,291,869 | 3,763,773,072 | 16,074,480 |
| Debt instruments and rights to such financial assets | – | – | 4,200,000 | 157,647 |

#### Customers' cash on brokerage accounts

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Deposited on cash accounts in brokerage house and paid for securities bought in IPO or on the primary market | 1,100,623 | 857,944 |
| Other customers' cash | 40,955 | 45,571 |
| **Total** | **1,141,578** | **903,515** |

#### Settlements due to unsettled transactions

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Receivables from executed transactions | 32,061 | – |
| Liabilities from executed transactions | – | 13,201 |

(in PLN thousand)

**Settlements with National Depository of Securities (KDPW), KDPW_CCP and other stock exchange clearing houses**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Receivables from clearing fund | 24,817 | 18,727 |
| Receivables from margin deposits | 32,391 | 29,866 |
| Other receivables | 1,252 | 231 |
| **Total receivables** | **58,460** | **48,824** |
| Amounts due on margin deposits | 921 | 4,421 |
| Other liabilities | 317 | 331 |
| **Total liabilities** | **1,238** | **4,752** |

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

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Receivables from compensation fund | 11,432 | 10,914 |
| Prepaid expenses – system maintenance fees | 1,764 | 1,456 |
| Deferred income – benefits from system | (13,411) | (12,549) |
| **Total net balance sheet items concerning participation in the compensation fund** | **(215)** | **(179)** |

**Settlement with entities running regulated securities markets and commodity exchanges**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Amounts due to Warsaw Stock Exchange | 527 | 638 |
| **Total liabilities** | **527** | **638** |

# 9. Operating segments

Data reported in the section steem from the application of the management model (‘Model’) in which the main criterion for segmentation is the classification of customers based on their profile and service model.

Reporting and monitoring of results, for managerial purposes, includes all components of the income statement up to the gross profit level. Therefore, the income from the segment’s activities as well as operating costs related to those activities (including direct and allocated costs in line with the allocation model applied) and other components of income statement are attached to each segment.

The Group settles transactions between segments on an arm’s length basis by applying current market prices. Fund transfers between retail, private, corporate and investment banking segments, and the assets and liabilities management and other area are based on market prices applicable to the funds’ currency and maturity, including liquidity margins.

### Operating segments

The operating segments of the Group are as follows:

- Retail banking – all banking activites related to retail customers (excluding private banking customers), small and micro companies with annual turnover not exceeding PLN 20 million, as well as results of the subsidiaries, and shares in net profit of associates accounted for using the equity method, that are assigned to the retail banking activity,
- Private banking – all banking activites related to the most affluent individual customers,
- Corporate and Investment banking – all banking activites related to the medium and large companies, interbank market, debt securities and other instruments, and results of the of the subsidiaries that are assigned to the Corporate and Investment banking activity,
- assets and liabilities management and other – supervision and monitoring of fund transfers, other activities centrally managded as well as the results of subsidiaries and share in net profit of associated accounted for using equity method that are not assigned to other reported segments.

# Notes to the financial statements

(in PLN thousand)

**Operating segments reporting for the period from 1 January to 31 December 2016**

| | RETAIL BANKING | PRIVATE BANKING | CORPORATE AND INVESTMENT BANKING | ASSETS AND LIABILITIES MANAGEMENT AND OTHER | TOTAL |
|---|---|---|---|---|---|
| **Total net interest income** | **2,406,728** | **47,529** | **1,634,037** | **349,089** | **4,437,383** |
| **Non-interest income** | **1,523,051** | **30,608** | **925,353** | **430,823** | **2,909,835** |
| **Operating income** | **3,929,779** | **78,137** | **2,559,390** | **779,912** | **7,347,218** |
| Personnel expenses | (1,111,686) | (25,335) | (261,344) | (498,471) | (1,896,836) |
| Other administrative expenses | (1,250,524) | (25,125) | (336,035) | 637,480 | (974,204) |
| Depreciation and amortisation | (177,566) | (1,714) | (22,642) | (138,944) | (340,866) |
| **Operating costs** | **(2,539,776)** | **(52,174)** | **(620,021)** | **65** | **(3,211,906)** |
| **Gross operating profit** | **1,390,003** | **25,963** | **1,939,369** | **779,977** | **4,135,312** |
| Net impairment losses on loans and off-balance sheet commitments | (250,042) | (133) | (252,807) | 2,353 | (500,629) |
| **Net operating profit** | **1,139,961** | **25,830** | **1,686,562** | **782,330** | **3,634,683** |
| Net result on other provisions | (651) | (514) | 1,259 | (14,569) | (14,475) |
| Guarantee funds charges | (99,618) | (632) | (154,296) | (24,922) | (279,468) |
| Tax on certain financial institutions | – | – | – | (449,533) | (449,533) |
| Net result on investment activities | (170) | – | 498 | 5,011 | 5,339 |
| **Profit before tax** | **1,039,522** | **24,684** | **1,534,023** | **298,317** | **2,896,546** |
| Income tax expense | | | | | (616,782) |
| **Net profit for the period** | | | | | **2,279,764** |
| Attributable to equity holders of the Bank | | | | | 2,279,275 |
| Attributable to non-controling interests | | | | | 489 |
| Allocated assets | 63,640,992 | 261,932 | 105,098,620 | (3,929,788) | 165,071,756 |
| Unallocated assets | | | | | 9,143,187 |
| **Total assets** | | | | | **174,214,943** |
| Allocated liabilities | 79,287,145 | 8,304,002 | 63,233,403 | (5,142,417) | 145,682,133 |
| Unallocated liabilities | | | | | 28,532,810 |
| **Total liabilities** | | | | | **174,214,943** |

(in PLN thousand)

**Operating segments reporting for the period from 1 January to 31 December 2015**

| | RETAIL BANKING | PRIVATE BANKING | CORPORATE AND INVESTMENT BANKING | ASSETS AND LIABILITIES MANAGEMENT AND OTHER | TOTAL |
|---|---|---|---|---|---|
| **Total net interest income** | **2,306,368** | **25,162** | **1,603,118** | **297,648** | **4,232,296** |
| **Non-interest income** | **1,537,516** | **33,061** | **1,122,692** | **133,017** | **2,826,286** |
| **Operating income** | **3,843,884** | **58,223** | **2,725,810** | **430,665** | **7,058,582** |
| Personnel expenses | (1,132,086) | (23,226) | (261,916) | (491,291) | (1,908,519) |
| Other administrative expenses | (1,236,547) | (25,573) | (342,781) | 625,213 | (979,688) |
| Depreciation and amortisation | (170,218) | (1,571) | (23,181) | (136,495) | (331,465) |
| **Operating costs** | **(2,538,851)** | **(50,370)** | **(627,878)** | **(2,573)** | **(3,219,672)** |
| **Gross operating profit** | **1,305,033** | **7,853** | **2,097,932** | **428,092** | **3,838,910** |
| Net impairment losses on loans and off-balance sheet commitments | (185,573) | (1,066) | (352,613) | 21,694 | (517,558) |
| **Net operating profit** | **1,119,460** | **6,787** | **1,745,319** | **449,786** | **3,321,352** |
| Net result on other provisions | (283) | (388) | 15 | (28,110) | (28,766) |
| Guarantee funds charges | (106,880) | (796) | (171,233) | (256,044) | (534,953) |
| Tax on certain financial institutions | – | – | – | – | – |
| Net result on investment activities | (122) | – | 386 | 73,221 | 73,485 |
| **Profit before tax** | **1,012,175** | **5,603** | **1,574,487** | **238,853** | **2,831,118** |
| Income tax expense | | | | | (537,640) |
| **Net profit for the period** | | | | | **2,293,478** |
| Attributable to equity holders of the Bank | | | | | 2,292,459 |
| Attributable to non-controling interests | | | | | 1,019 |
| Allocated assets | 59,276,412 | 299,794 | 97,664,414 | (283,705) | 156,956,915 |
| Unallocated assets | | | | | 11,828,652 |
| **Total assets** | | | | | **168,785,567** |
| Allocated liabilities | 71,778,919 | 8,353,642 | 64,094,425 | (4,755,682) | 139,471,304 |
| Unallocated liabilities | | | | | 29,314,263 |
| **Total liabilities** | | | | | **168,785,567** |

**Reconciliation of operating income for reportable segments**

| | 2016 | 2015 |
|---|---|---|
| **Total operating income for reportable segments** | **7,347,218** | **7,058,582** |
| Share in gains (losses) from associates | (38,580) | (52,091) |
| Net other operating income and expenses | (30,528) | (160,996) |
| Refunding of administrative expenses | 2,282 | 3,432 |
| **Operating income** | **7,280,392** | **6,848,927** |

## Geographical segment

The operating activity of Bank Pekao S.A. Group is concentrated in Poland through the network of branches and the subsidiaries.

(in PLN thousand)

# 10. Interest income and expense

## Interest income

| | 2016 | 2015 |
|---|---|---|
| Loans and other receivables from customers | 4,431,535 | 4,410,834 |
| Interbank placements | 79,776 | 103,034 |
| Reverse repo transactions | 50,078 | 77,626 |
| Investment securities | 736,789 | 699,863 |
| Hedging derivatives | 138,866 | 150,934 |
| Financial assets held for trading | 11,446 | 14,078 |
| **Total** | **5,448,490** | **5,456,369** |

Interest income for 2016 includes income from impaired financial assets in the amount of PLN 243 131 thousand (in 2015 PLN 301 340 thousand).

Total amount of interest income for 2016 measured at amortized cost using the effective interest rate method, which applies to financial assets not measured at fair value through profit or loss, amounted to PLN 3 797 006 thousand (in 2015 PLN 3 730 968 thousand).

## Interest expense

| | 2016 | 2015 |
|---|---|---|
| Deposits from customers | (941,996) | (1,097,030) |
| Interbank deposits | (24,257) | (23,156) |
| Repo transactions | (44,045) | (59,001) |
| Loans and advances received | (10,817) | (19,940) |
| Debt securities issued | (45,370) | (90,672) |
| **Total** | **(1,066,485)** | **(1,289,799)** |

Total amount of interest expense for 2016, measured at amortized cost using the effective interest rate method with reference to financial liabilities, which are not valued at fair value through profit or loss amounted to PLN 868 315 thousand (in 2015 PLN 1 094 924 thousand).

(in PLN thousand)

# 11. Fee and commission income and expense

### Fee and commission income

| | 2016 | 2015 |
|---|---|---|
| Accounts maintenance, payment orders and cash transactions | 636,652 | 651,507 |
| Payment cards | 598,246 | 693,067 |
| Loans and advances | 460,543 | 432,269 |
| Investment products sales intermediation | 248,716 | 294,648 |
| Securities operations | 91,198 | 96,794 |
| Custody activity | 62,842 | 69,519 |
| Pension and investment funds service fees | 48,920 | 50,246 |
| Guarantees, letters of credit and similar transactions | 54,774 | 51,050 |
| Other | 50,194 | 49,423 |
| **Total** | **2,252,085** | **2,388,523** |

### Fee and commission expense

| | 2016 | 2015 |
|---|---|---|
| Payment cards | (218,109) | (322,424) |
| Money orders and transfers | (20,077) | (21,708) |
| Securities and derivatives operations | (28,578) | (13,840) |
| Accounts maintenance | (5,236) | (4,275) |
| Custody activity | (14,378) | (13,388) |
| Pension funds management charges | (856) | (868) |
| Acquisition services | (3,968) | (3,404) |
| Other | (1,919) | (3,090) |
| **Total** | **(293,121)** | **(382,997)** |

# 12. Dividend income

| | 2016 | 2015 |
|---|---|---|
| Issuers of securities held for trading | 89 | 530 |
| Issuers of securities available for sale | 16,709 | 13,105 |
| **Total** | **16,798** | **13,635** |

# 13. Result on financial assets and liabilities held for trading

| | 2016 | 2015 |
|---|---|---|
| Foreign currency exchange result | 416,031 | 367,908 |
| Gains (losses) on derivatives | 45,994 | 64,206 |
| Gains (losses) on securities | 23,384 | (4,066) |
| **Total** | **485,409** | **428,048** |

In 2016, the total change in the fair value of financial instruments valued at fair value through profit or loss, determined with the use of valuation techniques (when no published quotations from active markets are available) amounted to PLN 53 902 thousand (in 2015 PLN 64 586 thousand).

(in PLN thousand)

# 14. Gains (losses) on disposal

### Realized gains

| | 2016 | 2015 |
|---|---|---|
| Loans and other financial receivables (*) | 159,495 | 534 |
| Available for sale financial assets – debt instruments | 14,531 | 229,592 |
| Available for sale financial assets – equity instruments (**) | 262,826 | – |
| Debt securities issued | 1 | 6 |
| **Total** | **436,853** | **230,132** |

(*) In 2016 the Bank sold loans with a total debt of PLN 1 863 million. The realized gross result on the transaction was PLN 149.9 million.
(**) In 2016 the Bank has received information about the closing of the acquisition of Visa Europe Limited by Visa Inc. The details of the transactions are presented in the Note 31.

### Realized losses

| | 2016 | 2015 |
|---|---|---|
| Loans and other financial receivables | (2) | – |
| Available for sale financial assets – debt instruments | (864) | (41) |
| Debt securities issued | (84) | (490) |
| **Total** | **(950)** | **(531)** |

| | | |
|---|---|---|
| **Net realized profit** | **435,903** | **229,601** |

The change in fair value of financial assets available for sale transferred in 2016 directly to equity amounted to PLN 332 328 thousand (decrease), in 2015 PLN 7 573 thousand (decrease).

The change in fair value of financial assets, transferred in 2016 from equity to financial income amounted to PLN 276 493 thousand (profit), in 2015 PLN 229 551 thousand (profit).

# 15. Administrative expenses

### Personnel expenses

| | 2016 | 2015 |
|---|---|---|
| Wages and salaries | (1,600,420) | (1,609,253) |
| Insurance and other charges related to employees | (286,844) | (291,849) |
| Share-based payments expenses | (9,572) | (7,417) |
| **Total** | **(1,896,836)** | **(1,908,519)** |

### Other administrative expenses

| | 2016 | 2015 |
|---|---|---|
| General expenses | (924,479) | (916,571) |
| Taxes and charges (*) | (40,874) | (74,850) |
| Bank Guarantee Fund fee (**) | (278,929) | (509,127) |
| Financial supervision authority fee (KNF) | (11,673) | (17,525) |
| Tax on certain financial institutions (***) | (449,533) | – |
| **Total** | **(1,705,488)** | **(1,518,073)** |

| | | |
|---|---|---|
| **Total administrative expenses** | **(3,602,324)** | **(3,426,592)** |

(*) In 2015 this item includes the amount of PLN 26 469 thousand representing the cost of provision for the contribution to the Borrowers Support Fund.
(**) In 2016 this item includes the amount of PLN 16 604 thousand contributed by the Group to BFG for the purpose of payments of the funds guaranteed to the depositors of Bank Spółdzielczy in Nadarzyn, respectively in 2015 the amount of PLN 234 081 thousand concerns Spółdzielczy Bank Rzemiosła i Rolnictwa in Wołomin.
(***) On 1 February 2016 tax on certain financial institutions was introduced under the Act on tax on certain financial institutions.

(in PLN thousand)

# 16. Depreciation and amortization

| | 2016 | 2015 |
|---|---|---|
| Property, plant and equipment | (168,077) | (180,457) |
| Investment property | (1,183) | (1,654) |
| Intangible assets | (171,606) | (149,354) |
| **Total** | **(340,866)** | **(331,465)** |

# 17. Net other operating income and expenses

## Other operating income

| | 2016 | 2015 |
|---|---|---|
| Rental income | 21,259 | 22,096 |
| Miscellaneous income | 17,608 | 15,504 |
| Recovery of debt collection costs | 13,539 | 16,369 |
| Revenues from sale of products, goods and services | 16,442 | 5,778 |
| Excess payments, repayments | 9,692 | 9,152 |
| Compensation, penalty fees and fines received (including received compensations from damages in relation to fixed assets) | 5,885 | 116,510 |
| Revenues from leasing activity | 2,615 | 15,559 |
| Refunding of administrative expenses | 2,282 | 3,432 |
| Income from written off liabilities | 3,512 | 4,624 |
| Releases of impairment allowances for litigation and other assets | 1,021 | 3,093 |
| Gains on sale of leasing assets for third person and other assets | 883 | 764 |
| Other | 4,967 | 7,555 |
| **Total** | **99,705** | **220,436** |

## Other operating expenses

| | 2016 | 2015 |
|---|---|---|
| Costs related to leasing activity | (2,262) | (2,443) |
| Credit insurance expenses | (11,163) | (10,101) |
| Sundry expenses | (15,501) | (14,541) |
| Reimbursement and deficiencies | (2,877) | (4,021) |
| Costs from sale of products, goods and services | (13,119) | (2,358) |
| Customers complaints expenses | (1,734) | (2,311) |
| Impairment allowance for litigations and other assets | (4,418) | (9,167) |
| Costs of litigation and claims | (1,394) | (2,130) |
| Compensation, penalty fees and fines paid | (1,682) | (644) |
| Losses on disposal of leasing assets for third person and other assets | (466) | (604) |
| Other | (14,561) | (11,120) |
| **Total** | **(69,177)** | **(59,440)** |

| | | |
|---|---|---|
| **Net other operating income and expenses** | **30,528** | **160,996** |

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

(in PLN thousand)

| 2016 | OPENING BALANCE | INCREASES: IMPARIMENT CHARGES | INCREASES: OTHER (*) | DECREASES: WRITE-OFFS OF ASSETS FROM THE BALANCE SHEET | DECREASES: RELEASE OF IMPARIMENT CHARGES | DECREASES: OTHER (*) | CLOSING BALANCE | IMPACT ON INCOME STATEMENT(**) |
|---|---|---|---|---|---|---|---|---|
| **Impairment of financial assets and off-balance sheet commitments** | | | | | | | | |
| Loans and advances to banks valued at amortized cost | 19,774 | 590 | 1,451 | – | (2,933) | (889) | 17,993 | 2,343 |
| Loans and advances to customers valued at amortized cost | 5,678,633 | 1,021,762 | 167,086 | (583,975) | (602,645) | (138,242) | 5,542,619 | (419,117) |
| Receivables from financial leases | 163,704 | 17,112 | 3 | (86) | (13,244) | (542) | 166,947 | (3,868) |
| Financial assets available for sale | 122 | – | – | – | – | (122) | – | – |
| Off-balance sheet commitments | 120,771 | 160,561 | 992 | – | (61,341) | – | 220,983 | (99,220) |
| **Total financial assets and off-balance sheet commitments** | **5,983,004** | **1,200,025** | **169,532** | **(584,061)** | **(680,163)** | **(139,795)** | **5,948,542** | **(519,862)** |
| **Impairment of other assets** | | | | | | | | |
| Investments in associates | 60 | – | – | – | – | (60) | – | – |
| Intangible assets | 10,961 | – | – | (10,961) | – | – | – | – |
| Property, plant and equipment | 8,451 | – | – | (693) | – | – | 7,758 | – |
| Investment properties | 8,682 | – | – | (926) | – | (725) | 7,031 | – |
| Other | 77,736 | 4,418 | 1,369 | (2,230) | (1,021) | (6) | 80,266 | (3,397) |
| **Total impairment of other assets** | **105,890** | **4,418** | **1,369** | **(14,810)** | **(1,021)** | **(791)** | **95,055** | **(3,397)** |
| **Total** | **6,088,894** | **1,204,443** | **170,901** | **(598,871)** | **(681,184)** | **(140,586)** | **6,043,597** | **(523,259)** |

(*) Including foreign exchange differences and transfers between positions.
(**) 'Impairment of financial assets and off-balance sheet commitments' includes net impairment in the amount of PLN minus 519 862 thousand and proceeds from recovered bad debt in the amount of PLN 19 233 thousand, the total is PLN minus 500 629 thousand.

(in PLN thousand)

| 2015 | OPENING BALANCE | INCREASES: IMPARIMENT CHARGES | INCREASES: OTHER (*) | DECREASES: WRITE-OFFS OF ASSETS FROM THE BALANCE SHEET | DECREASES: RELEASE OF IMPARIMENT CHARGES | DECREASES: OTHER (*) | CLOSING BALANCE | IMPACT ON INCOME STATEMENT(**) |
|---|---|---|---|---|---|---|---|---|
| **Impairment of financial assets and off-balance sheet commitments** | | | | | | | | |
| Loans and advances to banks valued at amortized cost | 19,360 | 684 | 1,541 | – | (870) | (941) | 19,774 | 186 |
| Loans and advances to customers valued at amortized cost | 5,582,478 | 1,156,227 | 100,138 | (445,826) | (646,377) | (68,007) | 5,678,633 | (509,850) |
| Receivables from financial leases | 187,901 | 23,834 | – | (139) | (19,101) | (28,791) | 163,704 | (4,733) |
| Financial assets available for sale | 122 | – | – | – | – | – | 122 | – |
| Off-balance sheet commitments | 102,386 | 71,614 | 1,182 | – | (54,411) | – | 120,771 | (17,203) |
| **Total financial assets and off-balance sheet commitments** | **5,892,247** | **1,252,359** | **102,861** | **(445,965)** | **(720,759)** | **(97,739)** | **5,983,004** | **(531,600)** |
| **Impairment of other assets** | | | | | | | | |
| Investments in associates | 60 | – | – | – | – | – | 60 | – |
| Intangible assets | 10,961 | – | – | – | – | – | 10,961 | – |
| Property, plant and equipment | 6,667 | 610 | 1,569 | (152) | – | (243) | 8,451 | (610) |
| Investment properties | 8,682 | – | – | – | – | – | 8,682 | – |
| Other | 76,532 | 9,167 | 626 | (3,592) | (3,093) | (1,904) | 77,736 | (6,074) |
| **Total impairment of other assets** | **102,902** | **9,777** | **2,195** | **(3,744)** | **(3,093)** | **(2,147)** | **105,890** | **(6,684)** |
| **Total** | **5,995,149** | **1,262,136** | **105,056** | **(449,709)** | **(723,852)** | **(99,886)** | **6,088,894** | **(538,284)** |

(*) Including foreign exchange differences and transfers between positions.
(**) 'Impairment of financial assets and off-balance sheet commitments' includes net impairment in the amount of PLN minus 531 600 thousand and proceeds from recovered bad debt in the amount of PLN 14 042 thousand, the total is PLN minus 517 558 thousand.

(in PLN thousand)

# 19. Gains (losses) on subsidiaries and associates

**Share of profit (losses) from associates**

| | 2016 | 2015 |
|---|---|---|
| **Share in gains (losses) from associates** | | |
| Dom Inwestycyjny Xelion Sp. z o.o. | 2,179 | 1,965 |
| Pioneer Pekao Investment Management S.A. | 36,401 | 44,649 |
| Krajowa Izba Rozliczeniowa S.A. | – | 5,477 |
| **Total share in gains (losses) from associates** | **38,580** | **52,091** |
| **Gains (losses) on liquidation of subsidiaries** | **(19)** | **55** |
| **Gains (losses) on disposal of associates** | **–** | **61,057** |
| **Total gains (losses) from subsidiaries and associates** | **38,561** | **113,203** |

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

| | 2016 | 2015 |
|---|---|---|
| Gains (losses) on disposal of property, plant and equipment classified as assets held for sale | 1,029 | – |
| Gains (losses) on de-recognition of property, plant and equipment and intangible assets other than classified as assets held for sale | 4,330 | 12,373 |
| **Total gains (losses) on disposal of property, plant and equipment and intangible assets** | **5,359** | **12,373** |

# 21. Income tax

The below additional information notes present the Group gross profit's.

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

| | 2016 | 2015 |
|---|---|---|
| **Profit before income tax** | **2,896,546** | **2,831,118** |
| **Tax charge according to applicable tax rate** | **550,344** | **537,912** |
| **Permanent differences:** | **66,438** | **(272)** |
| Non taxable income | (35,001) | (28,950) |
| Non tax deductible costs | 105,720 | 29,252 |
| Impact of other tax rates applied under a different tax jurisdiction | – | – |
| Impact of utilized tax losses | – | – |
| Tax relieves not included in the income statement | 80 | 185 |
| Other | (4,361) | (759) |
| **Effective income tax charge on gross profit** | **616,782** | **537,640** |

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

(in PLN thousand)

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

| | 2016 | 2015 |
|---|---|---|
| INCOME STATEMENT | | |
| **Current tax** | **(586,052)** | **(469,589)** |
| Current tax charge in the income statement | (585,499) | (489,233) |
| Adjustments related to the current tax from previous years | 207 | 22,393 |
| Other taxes (e.g. withholding tax, income tax relating to foreign branch) | (760) | (2,749) |
| **Deferred tax** | **(30,730)** | **(68,051)** |
| Occurrence and reversal of temporary differences | (30,730) | (68,051) |
| **Tax charge in the consolidated income statement** | **(616,782)** | **(537,640)** |
| EQUITY | | |
| **Deferred tax** | **118,927** | **60,338** |
| Income and costs disclosed in other comprehensive income: | | |
| revaluation of financial instruments – cash flows hedges | 1,056 | 17,735 |
| revaluation of available for sale financial assets – debt securities | 77,187 | 84,422 |
| revaluation of available for sale financial assets – equity securities | 38,488 | (39,368) |
| **Tax on items that are or may be reclassified subsequently to profit or loss** | **116,731** | **62,789** |
| **Tax charge on items that will never be reclassified to profit or loss** | **2,196** | **(2,451)** |
| revaluation of the defined benefit liabilities | 2,196 | (2,451) |
| **Total charge** | **(497,855)** | **(477,302)** |

(in PLN thousand)

| | CHANGES IN TEMPORARY DIFFERENCES IN 2016 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | OPENING BALANCE | CHANGES RECOGNIZED IN | | | | CLOSING BALANCE | | |
| | TOTAL DEFERRED TAX | RECOGNIZED IN THE INCOME STATEMENT | IN EQUITY | THE INCOME STATEMENT | IN EQUITY | TOTAL DEFERRED TAX | THE INCOME STATEMENT | IN EQUITY |
| DEFFERED TAX LIABILITY | | | | | | | | |
| Accrued income – securities | – | – | – | 46,320 | – | 46,320 | 46,320 | – |
| Accrued income – loans | 128,540 | 128,540 | – | 15,592 | – | 144,132 | 144,132 | – |
| Change in revaluation of financial assets | 102,790 | 19,661 | 83,129 | (14,955) | (75,267) | 12,568 | 4,706 | 7,862 |
| Accelerated depreciation | 123,326 | 123,326 | – | (7,422) | – | 115,904 | 115,904 | – |
| Investment relief | 5,724 | 5,724 | – | (407) | – | 5,317 | 5,317 | – |
| Other | 90,118 | 90,118 | – | 14,219 | – | 104,337 | 104,337 | – |
| **Gross deferred tax liability** | **450,498** | **367,369** | **83,129** | **53,347** | **(75,267)** | **428,578** | **420,716** | **7,862** |
| DEFFERED TAX ASSET | | | | | | | | |
| Accrued expenses – securities | 23,366 | 23,366 | – | (21,853) | – | 1,513 | 1,513 | – |
| Accrued expenses – deposits and loans | 45,339 | 45,339 | – | (7,388) | – | 37,951 | 37,951 | – |
| Downward revaluation of financial assets | 256,958 | 256,958 | – | 4,114 | 41,465 | 302,537 | 261,072 | 41,465 |
| Income received to be amortized over time from loans and current accounts | 174,097 | 174,097 | – | 3,313 | – | 177,410 | 177,410 | – |
| Loan provisions charges | 493,328 | 493,328 | – | 47,379 | – | 540,707 | 540,707 | – |
| Personnel related provisions | 114,657 | 98,174 | 16,483 | 1,435 | 2,196 | 118,288 | 99,609 | 18,679 |
| Accruals | 19,517 | 19,517 | – | (1,847) | – | 17,670 | 17,670 | – |
| Previous year losses | 10,033 | 10,033 | – | 21,427 | – | 31,460 | 31,460 | – |
| Other | 223,471 | 223,471 | – | (23,963) | – | 199,508 | 199,508 | – |
| **Gross deferred tax asset** | **1,360,766** | **1,344,283** | **16,483** | **22,617** | **43,661** | **1,427,044** | **1,366,900** | **60,144** |
| **Deferred tax charge** | **x** | **x** | **x** | **(30,730)** | **118,928** | **x** | **x** | **x** |
| **Net deferred tax assets** | **915,204** | **981,850** | **(66,646)** | **x** | **x** | **1,003,351** | **951,069** | **52,282** |
| **Net deferred tax provision** | **4,936** | **4,936** | **–** | **x** | **x** | **4,885** | **4,885** | **–** |

(in PLN thousand)

| | CHANGES IN TEMPORARY DIFFERENCES IN 2015 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | OPENING BALANCE | | | CHANGES RECOGNIZED | | CHANGES RESULTING FROM CHANGES IN THE SCOPE OF CONSOLIDATION AND OTHER | | CLOSING BALANCE | | |
| | TOTAL DEFERRED TAX | RECOGNIZED IN THE INCOME STATEMENT | IN EQUITY | IN THE INCOME STATEMENT | IN EQUITY | RECOGNIZED IN THE INCOME STATEMENT | IN EQUITY | TOTAL DEFERRED TAX | RECOGNIZED IN THE INCOME STATEMENTS | IN EQUITY |
| DEFFERED TAX LIABILITY | | | | | | | | | | |
| Accrued income – securities | – | – | – | – | – | – | – | – | – | – |
| Accrued income – loans | 104,485 | 104,485 | – | 24,055 | – | – | – | 128,540 | 128,540 | – |
| Change in revaluation of financial assets | 258,875 | 113,075 | 145,800 | (93,473) | (62,789) | 59 | 118 | 102,790 | 19,661 | 83,129 |
| Accelerated depreciation | 125,491 | 125,491 | – | (2,165) | – | – | – | 123,326 | 123,326 | – |
| Investment relief | 6,459 | 6,459 | – | (735) | – | – | – | 5,724 | 5,724 | – |
| Other | 90,351 | 90,351 | – | (233) | – | – | – | 90,118 | 90,118 | – |
| **Gross deferred tax liability** | **585,661** | **439,861** | **145,800** | **(72,551)** | **(62,789)** | **59** | **118** | **450,498** | **367,369** | **83,129** |
| DEFFERED TAX ASSET | | | | | | | | | | |
| Accrued expenses – securities | 97,700 | 97,700 | – | (74,334) | – | – | – | 23,366 | 23,366 | – |
| Accrued expenses – loans and deposits | 40,482 | 40,482 | – | 4,857 | – | – | – | 45,339 | 45,339 | – |
| Downward revaluation of financial assets | 298,354 | 298,354 | – | (44,155) | – | 2,759 | – | 256,958 | 256,958 | – |
| Income received to be amortized over time from loans and current accounts | 156,639 | 156,639 | – | 17,458 | – | – | – | 174,097 | 174,097 | – |
| Loan provision expenses | 524,936 | 524,936 | – | (31,608) | – | – | – | 493,328 | 493,328 | – |
| Personnel related provisions | 105,139 | 86,205 | 18,934 | 9,942 | (2,451) | 2,027 | – | 114,657 | 98,174 | 16,483 |
| Accruals | 25,331 | 25,331 | – | (5,814) | – | – | – | 19,517 | 19,517 | – |
| Previous year loss | – | – | – | (1,412) | – | 11,445 | – | 10,033 | 10,033 | – |
| Other | 212,406 | 212,406 | – | (15,536) | – | 26,601 | – | 223,471 | 223,471 | – |
| **Gross deferred tax asset** | **1,460,987** | **1,442,053** | **18,934** | **(140,602)** | **(2,451)** | **42,832** | **–** | **1,360,766** | **1,344,283** | **16,483** |
| **Deferred tax expenses** | **x** | **x** | **x** | **(68,051)** | **60,338** | **42,773** | **(118)** | **x** | **x** | **x** |
| **Net deferred tax assets** | **877,419** | **1,004,285** | **(126,866)** | **x** | **x** | **x** | **x** | **915,204** | **981,850** | **(66,646)** |
| **Net deferred tax provision** | **2,093** | **2,093** | **–** | **x** | **x** | **x** | **x** | **4,936** | **4,936** | **–** |

(in PLN thousand)

In the opinion of the Group the deferred tax asset in the amount of PLN 1 003 351 thousand reported as at 31 December 2016 is sustainable in total amount. The analysis was performed based on the past results of the Group's companies and assumed results in the future periods. The analysis assumed the five years' time horizon.

As at 31 December 2016 and 31 December 2015, there were temporary differences related to investments in subsidiaries and associates, for which deferred tax liability was not created as a result of meeting the conditions of controlling the terms of temporary differences' reversing and being probable that these differences will not reverse in foreseeable future.

The table below presents the amount of negative temporary differences, unrecognized tax losses, unutilized tax reliefs, in relation to which deferred tax asset was not recognized in the statement of financial position as well as the expiration date of temporary differences.

| EXPIRATION YEAR OF TEMPORARY DIFFERENCES | AMOUNT OF DIFFERENCES AS AT 31.12.2016 | AMOUNT OF DIFFERENCES AS AT 31.12.2015 |
|---|---|---|
| 2016 | – | 20,753 |
| 2017 | 13,242 | 13,193 |
| 2018 | 14,165 | 10,150 |
| 2019 | 7,730 | 8,801 |
| 2020 | 313 | 888 |
| 2021 | – | – |
| No time limits | 32,043 | 26,448 |
| **Total** | **67,493** | **80,233** |

# 22. Earnings per share

### Basic earnings per share

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

| | 2016 | 2015 |
|---|---|---|
| Net profit | 2,279,275 | 2,292,459 |
| Weighted average number of ordinary shares in the period | 262,470,034 | 262,470,034 |
| Earnings per share (in PLN per share) | 8.68 | 8.73 |

### Diluted earnings per share

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

As at 31 December 2016 there no diluting instruments in the form of convertible bonds in the Group.

| | 2016 | 2015 |
|---|---|---|
| Net profit | 2,279,275 | 2,292,459 |
| Weighted average number of ordinary shares in the period | 262,470,034 | 262,470,034 |
| Weighted average number of ordinary shares for the purpose of calculation of diluted earnings per share | 262,470,034 | 262,470,034 |
| Diluted earnings per share (in PLN per share) | 8.68 | 8.73 |

(in PLN thousand)

# 23. Dividend proposal

The Management Board of the Bank has decided to propose to the Ordinary General Meeting of Shareholders a dividend payment for 2016 in the amount of PLN 8.68 per share. Total dividend proposed to be paid amounts to 2 278 240 thousand. The dividend has not been recognized as liabilities and there are no tax consequences for the Bank.

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

# 24. Cash and balances with Central Bank

| CASH AND DUE FROM CENTRAL BANK | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Cash | 2,639,532 | 2,951,414 |
| Current account at Central Bank | 1,718,775 | 4,930,181 |
| Other | 1,514,604 | 12 |
| **Total** | **5,872,911** | **7,881,607** |

| AMOUNTS DUE TO CENTRAL BANK | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Term deposits | 6,091 | 914 |
| **Total** | **6,091** | **914** |

### Cash and balances with Central Bank by currencies

| 31.12.2016 | ASSETS | LIABILITIES |
|---|---|---|
| PLN | 4,944,326 | 6,091 |
| EUR | 443,480 | – |
| USD | 260,015 | – |
| CHF | 59,727 | – |
| Other currencies | 165,363 | – |
| **Total** | **5,872,911** | **6,091** |

| 31.12.2015 | ASSETS | LIABILITIES |
|---|---|---|
| PLN | 6,900,383 | 914 |
| EUR | 513,012 | – |
| USD | 247,073 | – |
| CHF | 64,635 | – |
| Other currencies | 156,504 | – |
| **Total** | **7,881,607** | **914** |

During the day, the Bank may use funds from the mandatory reserve account for ongoing payments pursuant to an instruction, submitted to the National Bank of Poland. It must, however, ensure that the average monthly balance on such accounts comply with the requirements described in the mandatory reserve declaration.

As at 31 December 2016 the interest rate of funds held on the mandatory reserve account is at 1.35% (0.9 of NBP reference rate).
As at 31 December 2015 the interest rate was at 1.35% (0.9 of rediscount rate for bills of exchange).

(in PLN thousand)

# 25. Loans and advances to banks

### Loans and advances to banks by product type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Current accounts | 118,142 | 89,553 |
| Interbank placements | 267,828 | 3,461,155 |
| Loans and advances | 34,517 | 59,224 |
| Cash collateral | 1,771,842 | 1,675,589 |
| Reverse repo transactions | 703,635 | 1,757,063 |
| Cash in transit | 379,858 | 291,914 |
| **Total gross amount** | **3,275,822** | **7,334,498** |
| Impairment allowances | (17,993) | (19,774) |
| **Total net amount** | **3,257,829** | **7,314,724** |

### Loans and advances to banks by quality

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Loans and advances to banks, including: | | |
| non impaired (gross) | 3,257,830 | 7,314,771 |
| impaired (gross) | 17,992 | 19,727 |
| individual impairment allowances | (8,192) | (9,927) |
| collective impairment allowances (*) | (9,801) | (9,847) |
| **Total** | **3,257,829** | **7,314,724** |

(*) Including estimated impairment allowances for losses incurred but not reported (IBNR).

### Loans and advances to banks by contractual maturities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Loans and advances to banks, including: | | |
| up to 1 month | 3,178,259 | 6,919,511 |
| between 1 and 3 months | 345 | 11,481 |
| between 3 months and 1 year | 69,684 | 21,852 |
| between 1 and 5 years | 47 | 351,334 |
| over 5 years | 2 | 2 |
| past due | 27,485 | 30,318 |
| **Total gross amount** | **3,275,822** | **7,334,498** |
| Impairment allowances | (17,993) | (19,774) |
| **Total net amount** | **3,257,829** | **7,314,724** |

### Loans and advances to banks by currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 1,012,264 | 2,758,456 |
| CHF | 19,462 | 30,586 |
| EUR | 2,010,070 | 1,959,303 |
| USD | 68,792 | 2,214,880 |
| Other currencies | 147,241 | 351,499 |
| **Total** | **3,257,829** | **7,314,724** |

Changes in the level of impairment allowances in 2016 and 2015 are presented in the Note 18.

(in PLN thousand)

# 26. Financial assets and liabilities held for trading

### Financial assets and liabilities held for trading by product type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **FINANCIAL ASSETS** | | |
| Debt securities | 730,750 | 1,124,717 |
| Equity securities | 1,719 | 2,075 |
| **Total financial assets** | **732,469** | **1,126,792** |
| **FINANCIAL LIABILITIES** | | |
| Debt securities | 673,165 | 611,442 |
| **Total financial liabilities** | **673,165** | **611,442** |

### Debt securities held for trading

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **FINANCIAL ASSETS** | | |
| Debt securities issued by State Treasury | 654,918 | 1,003,007 |
| T- bills | – | – |
| T- bonds | 654,918 | 1,003,007 |
| Debt securities issued by banks | 9,719 | 45,590 |
| Debt securities issued by business entities | 66,113 | 76,120 |
| Debt securities issued by local governments | – | – |
| **Total financial assets** | **730,750** | **1,124,717** |
| **FINANCIAL LIABILITIES** | | |
| Debt securities issued by State Treasury | 673,165 | 611,442 |
| T- bonds | 673,165 | 611,442 |
| **Total financial liabilities** | **673,165** | **611,442** |

### Equity securities held for trading

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Shares | 1,719 | 2,075 |
| **Total** | **1,719** | **2,075** |

### Debt securities held for trading by maturity

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **FINANCIAL ASSETS** | | |
| Debt securities, including: | | |
| up to 1 month | – | 39,222 |
| between 1 and 3 months | 239 | 23,294 |
| between 3 months and 1 year | 117,804 | 358,297 |
| between 1 and 5 years | 324,868 | 163,737 |
| over 5 years | 278,120 | 532,443 |
| unspecified term | 9,719 | 7,724 |
| **Total financial assets** | **730,750** | **1,124,717** |
| **FINANCIAL LIABILITIES** | | |
| Debt securities, including: | | |
| up to 1 month | 102,076 | – |
| between 1 and 3 months | – | – |
| between 3 months and 1 year | 131,194 | 170,729 |
| between 1 and 5 years | 263,435 | 382,663 |
| over 5 years | 176,460 | 58,050 |
| **Total financial liabilities** | **673,165** | **611,442** |

(in PLN thousand)

**Debt securities held for trading by currency**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **FINANCIAL ASSETS** | | |
| PLN | 710,575 | 1,110,529 |
| EUR | 5,629 | 10,072 |
| USD | 14,546 | 4,116 |
| **Total financial assets** | **730,750** | **1,124,717** |
| **FINANCIAL LIABILITIES** | | |
| PLN | 673,165 | 611,442 |
| **Total financial liabilities** | **673,165** | **611,442** |

# 27. Derivative financial instruments (held for trading)

### Derivative financial instruments at the Group

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

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

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

Foreign exchange options with delivery are defined as contracts, where one of the parties, i.e. the option buyer, purchases from the other party, referred to as the option writer, at a so-called premium price the right without the obligation to buy (call option) or to sell (put option), at a specified point of time in the future or during a specified time range a foreign currency amount specified in the contract at the exchange rate set during the conclusion of the option agreement.

In case of options settled in net amounts, upon acquisition of the rights, the buyer receives an amount of money equal to the product of notional and difference between spot ad strike price.

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

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

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

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

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

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

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

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

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

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

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

### Derivative financial instruments embedded in other instruments

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

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

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

All embedded options are immediately closed back-to-back on the interbank market.

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

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

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

(in PLN thousand)

### Risk involved in financial derivatives

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

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

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

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

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

#### Fair value of trading derivatives

| 31.12.2016 | ASSETS | LIABILITIES |
|---|---|---|
| Interest rate transactions | | |
| Interest Rate Swaps (IRS) | 1,517,526 | 1,503,394 |
| Forward Rate Agreements (FRA) | 347 | 155 |
| Options | 1,837 | 1,710 |
| Other | 426 | 618 |
| Foreign currency and gold transactions | | |
| Cross-Currency Interest Rate Swaps (CIRS) | 49,978 | 161,421 |
| Currency Forward Agreements | 183,636 | 84,759 |
| Currency Swaps (FX–Swap) | 62,207 | 93,089 |
| Options for currency and for gold | 52,971 | 53,605 |
| Transactions based on equity securities and stock indexes | | |
| Options | 5,403 | 5,422 |
| Other | 1 | 9,723 |
| Transactions based on commodities and precious metals | | |
| Options | 2,113 | 1,971 |
| Other | 36,984 | 36,807 |
| **Total** | **1,913,429** | **1,952,674** |

(in PLN thousand)

### Fair value of trading derivatives

| 31.12.2015 | ASSETS | LIABILITIES |
|---|---|---|
| Interest rate transactions | | |
| Interest Rate Swaps (IRS) | 2,866,458 | 2,857,159 |
| Forward Rate Agreements (FRA) | 960 | 906 |
| Options | 10,129 | 10,046 |
| Other | 3,515 | 3,278 |
| Foreign currency and gold transactions | | |
| Cross-Currency Interest Rate Swaps (CIRS) | 28,626 | 99,948 |
| Currency Forward Agreements | 80,894 | 76,309 |
| Currency Swaps (FX-Swap) | 134,707 | 70,979 |
| Options for currency and gold | 44,658 | 41,557 |
| Transactions based on equity securities and stock indexes | | |
| Options | 8,366 | 8,366 |
| Other | 28 | 7,725 |
| Transactions based on commodities and precious metals | | |
| Options | 12,120 | 12,182 |
| Other | 15,986 | 15,873 |
| **Total** | **3,206,447** | **3,204,328** |

### Nominal value of trading derivatives

| | CONTRACTUAL MATURITY | | | | | |
|---|---|---|---|---|---|---|
| 31.12.2016 | UP TO 1MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
| Interest rate transactions | | | | | | |
| Interest Rate Swaps (IRS) | 2,064,679 | 2,846,675 | 11,640,203 | 51,529,159 | 12,317,504 | 80,398,220 |
| Forward Rate Agreements (FRA) | 275,000 | 750,000 | 300,000 | – | – | 1,325,000 |
| Options | 700,000 | 604,917 | 857,351 | 3,907,471 | 165,096 | 6,234,835 |
| Other | 458,475 | – | – | – | – | 458,475 |
| Foreign currency and gold transactions | | | | | | |
| Cross-Currency Interest Rate Swaps (CIRS) – currency bought | – | 413,339 | 652,407 | 1,959,424 | 1,071,214 | 4,096,384 |
| Cross-Currency Interest Rate Swaps (CIRS) – currency sold | – | 427,850 | 665,328 | 2,022,765 | 1,086,332 | 4,202,275 |
| Currency Forward Agreements – currency bought | 6,765,791 | 2,525,196 | 3,177,714 | 1,337,691 | – | 13,806,392 |
| Currency Forward Agreements – currency sold | 6,791,531 | 2,541,317 | 3,101,465 | 1,346,657 | – | 13,780,970 |
| Currency Swaps (FX-Swap) – currency bought | 13,380,696 | 2,643,905 | 2,799,405 | 115,108 | – | 18,939,114 |
| Currency Swaps (FX-Swap) – currency sold | 13,369,780 | 2,644,057 | 2,797,880 | 110,600 | – | 18,922,317 |
| Options bought | 463,120 | 540,425 | 2,526,286 | 186,400 | – | 3,716,231 |
| Options sold | 465,995 | 545,333 | 2,538,592 | 186,400 | – | 3,736,320 |
| Transactions based on equity securities and stock indexes | | | | | | |
| Options | – | – | – | 73,865 | – | 73,865 |
| Other | – | 863 | 1,037 | – | 21,000 | 22,900 |
| Transactions based on commodities and precious metals | | | | | | |
| Options | 8,693 | 13,039 | 80,418 | – | – | 102,150 |
| Other | 61,558 | 78,176 | 218,647 | 272,791 | – | 631,172 |
| **Total** | **44,805,318** | **16,575,092** | **31,356,733** | **63,048,331** | **14,661,146** | **170,446,620** |

(in PLN thousand)

**Nominal value of trading derivatives**

| 31.12.2015 | CONTRACTUAL MATURITY UP TO 1MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| Interest rate transactions | | | | | | |
| Interest Rate Swaps (IRS) | 5,430,113 | 7,313,716 | 11,740,420 | 71,051,076 | 16,922,760 | 112,458,085 |
| Forward Rate Agreements (FRA) | 2,710,000 | 1,715,000 | 2,600,000 | – | – | 7,025,000 |
| Options | – | – | 449,753 | 4,067,896 | – | 4,517,649 |
| Other | 2,151,319 | – | – | – | – | 2,151,319 |
| Foreign currency and gold transactions | | | | | | |
| Cross-Currency Interest Rate Swaps (CIRS) – currency bought | – | – | 190,050 | 1,767,090 | 738,117 | 2,695,257 |
| Cross-Currency Interest Rate Swaps (CIRS) – currency sold | – | – | 191,768 | 1,824,407 | 738,117 | 2,754,292 |
| Currency Forward Agreements – currency bought | 5,449,992 | 1,556,316 | 2,378,828 | 1,490,042 | – | 10,875,178 |
| Currency Forward Agreements – currency sold | 5,466,131 | 1,564,270 | 2,392,129 | 1,489,816 | – | 10,912,346 |
| Currency Swaps (FX-Swap) – currency bought | 9,712,492 | 4,346,841 | 3,556,983 | 44,767 | – | 17,661,083 |
| Currency Swaps (FX-Swap) – currency sold | 9,724,187 | 4,295,106 | 3,510,929 | 43,527 | – | 17,573,749 |
| Options bought | 449,287 | 437,335 | 2,339,376 | 1,921,686 | – | 5,147,684 |
| Options sold | 448,167 | 437,504 | 2,335,255 | 1,921,686 | – | 5,142,612 |
| Transactions based on equity securities and stock indexes | | | | | | |
| Options | 83,326 | 81,857 | – | – | – | 165,183 |
| Other | – | 941 | 684 | – | 21,000 | 22,625 |
| Transactions based on commodities and precious metals | | | | | | |
| Options | 55,650 | 38,465 | 180,543 | 23,048 | – | 297,706 |
| Other | 647 | 3,652 | 143,299 | 20,985 | – | 168,583 |
| **Total** | **41,681,311** | **21,791,003** | **32,010,017** | **85,666,026** | **18,419,994** | **199,568,351** |

# 28. Loans and advances to customers

**Loans and advances to customers by product type**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Mortgage loans | 54,713,809 | 49,231,194 |
| Current accounts | 10,599,898 | 11,230,205 |
| Operating loans | 13,897,871 | 15,070,467 |
| Investment loans | 16,810,632 | 17,071,901 |
| Cash loans | 10,211,931 | 9,087,671 |
| Payment cards receivables | 970,673 | 873,287 |
| Factoring | 2,890,930 | 2,610,926 |
| Other loans and advances | 1,595,088 | 1,855,173 |
| Debt securities | 12,451,372 | 12,376,949 |
| Reverse repo transactions | – | 4,755,472 |
| Cash in transit | 89,682 | 70,587 |
| **Total gross amount** | **124,231,886** | **124,233,832** |
| Impairment allowances | (5,542,619) | (5,678,633) |
| **Total net amount** | **118,689,267** | **118,555,199** |

(in PLN thousand)

### Loans and advances to customers by customer type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Corporate | 55,257,059 | 58,541,698 |
| Individuals | 58,379,647 | 54,155,797 |
| Budget entities | 10,595,180 | 11,536,337 |
| **Total gross amount** | **124,231,886** | **124,233,832** |
| Impairment allowances | (5,542,619) | (5,678,633) |
| **Total net amount** | **118,689,267** | **118,555,199** |

### Loans and advances to customers by quality

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Loans and advances to customers, including: | | |
| non impaired (gross) | 116,571,271 | 116,339,786 |
| impaired (gross) | 7,660,615 | 7,894,046 |
| individual impairment allowances | (3,189,149) | (3,248,513) |
| collective impairment allowances (*) | (2,353,470) | (2,430,120) |
| **Total** | **118,689,267** | **118,555,199** |

(*) Including estimated impairment allowances for losses incurred but not reported (IBNR).

### Loans and advances to customers by contractual maturities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Loans and advances to customers, including: | | |
| up to 1 month | 15,184,650 | 17,494,117 |
| between 1 and 3 months | 3,050,503 | 4,172,392 |
| between 3 months and 1 year | 12,393,167 | 12,542,056 |
| between 1 and 5 years | 37,323,318 | 37,537,504 |
| over 5 years | 50,359,575 | 46,398,538 |
| past due | 5,920,673 | 6,089,225 |
| **Total gross amount** | **124,231,886** | **124,233,832** |
| Impairment allowances | (5,542,619) | (5,678,633) |
| **Total net amount** | **118,689,267** | **118,555,199** |

### Loans and advances to customers by currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 96,647,980 | 98,406,507 |
| CHF | 4,640,419 | 4,975,796 |
| EUR | 13,934,872 | 11,871,781 |
| USD | 3,289,584 | 3,198,687 |
| Other currencies | 176,412 | 102,428 |
| **Total** | **118,689,267** | **118,555,199** |

Changes in impairment allowances in 2016 and 2015 are presented in the Note 18.

(in PLN thousand)

# 29. Receivables from finance leases

The Group conducts leasing operations through its subsidiary Pekao Leasing Sp. z o.o.

**The value of gross lease investments and minimum lease payments are follows as**

| 31.12.2016 | GROSS LEASING INVESTMENT | PRESENT VALUE OF MINIMUM LEASING PAYMENTS |
|---|---|---|
| Up to 1 year | 1,632,601 | 1,492,018 |
| Between 1 and 5 years | 2,520,358 | 2,353,845 |
| Over 5 years | 322,590 | 295,727 |
| **Total** | **4,475,549** | **4,141,590** |
| Unrealized financial income | (333,959) | |
| **Net leasing investment** | **4,141,590** | |
| Unguaranteed residual values accruing to the benefit of the lessor | – | |
| Present value of minimum lease payments | 4,141,590 | |
| Impairment allowances | (166,947) | |
| **Balance sheet value** | **3,974,643** | |

| 31.12.2015 | GROSS LEASING INVESTMENT | PRESENT VALUE OF MINIMUM LEASING PAYMENTS |
|---|---|---|
| Up to 1 year | 1,464,287 | 1,355,346 |
| Between 1 and 5 years | 2,156,562 | 2,037,787 |
| Over 5 years | 284,717 | 274,550 |
| **Total** | **3,905,566** | **3,667,683** |
| Unrealized financial income | (237,883) | |
| **Net leasing investment** | **3,667,683** | |
| Unguaranteed residual values accruing to the benefit of the lessor | – | |
| Present value of minimum lease payments | 3,667,683 | |
| Impairment allowances | (163,704) | |
| **Balance sheet value** | **3,503,979** | |

The Group is acting as a lessor in finance leases mainly for transport vehicles, machines and equipment.

Moreover, when the Group is a lessee in a finance lease contract among the Group entities, the inter-company transactions relating to the finance lease are eliminated in the consolidated financial statements.

**Lease financing receivables from banks by quality**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Receivables from financial leases from banks, including: | | |
| non impaired (gross) | 704 | 4,334 |
| impaired (gross) | – | – |
| individual impairment allowances | – | – |
| collective impairment allowances (*) | (6) | (11) |
| **Total** | **698** | **4,323** |

(*) Including estimated impairment allowances for losses, incurred but not reported (IBNR).

(in PLN thousand)

**Lease financing receivables from customers by quality**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Receivables from financial leases from customers, including: | | |
| non impaired (gross) | 3,934,980 | 3,435,904 |
| impaired (gross) | 205,906 | 227,445 |
| individual impairment allowances | (30,047) | (31,556) |
| collective impairment allowances (*) | (136,894) | (132,137) |
| **Total** | **3,973,945** | **3,499,656** |

(*) Including estimated impairment allowances for losses, incurred but not reported (IBNR).

**Receivables from finance leases by currencies**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 2,450,665 | 2,227,320 |
| CHF | 1,416 | 2,390 |
| EUR | 1,522,242 | 1,270,687 |
| USD | 320 | 3,582 |
| **Total** | **3,974,643** | **3,503,979** |

Changes in impairment allowances in 2016 and 2015 are presented in the Note 18.

# 30. Hedge accounting

As at 31 December 2016 the Group applies fair value hedge accounting and cash flow hedge accounting.

In the period from 1 January to 31 December 2016 the Group continued to apply the following hedge accounting:
- fair value hedge accounting for fixed coupon debt securities classified as available-for-sale (AFS) hedged with interest rate swap (IRS) transactions – described in point 1 of the table with details of hedging relationships,
- cash flow hedge accounting for floating-rate financial assets and liabilities hedged with cross-currency interest rate swap (CIRS) transactions – described in point 2 of the table with details of hedging relationships,
- cash flow hedge accounting for floating-rate financial assets hedged with interest rate swap (IRS) transactions – described in point 3 of the table with details of hedging relationships,
- cash flow hedge accounting for variable portfolio of loans in EUR and USD hedged with FX-Swap instruments – described in point 4 of the table with details of hedging relationships,
- fair value hedge accounting for fixed coupon debt securities classified as loans and receivables hedged with interest rate swaps (IRS) – described in point 5 of the table with details of hedging relationships.

In the period from 1 January to 31 December 2016 the Group designated to the hedge accounting the hedging relationship and terminated the relationship – cash flow hedge accounting for highly probable cash flow denominated in EUR (long position in EUR for the Group) hedged with foreign exchange forward transactions (a series of FX-Spot and FX-Swap transactions) – described in point 6 of the table with details of hedging relationships. Termination of the relationship resulted from settlement of transactions included in the hedging relationship. Last cash flows from hedged items occurred on 27 June 2016.

(in PLN thousand)

**The table below presents the fair values of hedging derivatives**

| 31.12.2016 | ASSETS | LIABILITIES |
|---|---|---|
| Fair value hedge accounting | | |
| Interest rate swaps (IRS) | 14,683 | 267,311 |
| Cross-currency interest rate swaps (CIRS) | – | – |
| Cash flow hedge accounting | | |
| Interest rate swaps (IRS) | 263,752 | – |
| Cross-currency interest rate swaps (CIRS) | – | 1,370,905 |
| Currency Swaps (FX–Swap) | 11,317 | 502 |
| **Total** | **289,752** | **1,638,718** |

| 31.12.2015 | ASSETS | LIABILITIES |
|---|---|---|
| Fair value hedge accounting | | |
| Interest rate swaps (IRS) | 5,737 | 269,817 |
| Cross-currency interest rate swaps (CIRS) | – | – |
| Cash flow hedge accounting | | |
| Interest rate swaps (IRS) | 355,731 | – |
| Cross-currency interest rate swaps (CIRS) | 56,840 | 1,431,956 |
| Currency Swaps (FX–Swap) | 3,332 | 986 |
| **Total** | **421,640** | **1,702,759** |

**The table below presents nominal values of hedging derivatives**

| | CONTRACTS ACCORDING TO MATURITIES | | | | | |
|---|---|---|---|---|---|---|
| 31.12.2016 | UP TO 1MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
| Fair value hedge accounting | | | | | | |
| Interest rate swaps (IRS) | – | 553,000 | – | 1,627,612 | 2,113,964 | 4,294,576 |
| Cross-currency interest rate swaps (CIRS) | – | – | – | – | – | – |
| Cash flow hedge accounting | | | | | | |
| Interest rate swaps (IRS) | – | 25,000 | 150,000 | 3,600,000 | – | 3,775,000 |
| Cross-currency interest rate swaps (CIRS) | 867,025 | – | 1,033,820 | 9,883,752 | 4,079,680 | 15,864,277 |
| Currency Swaps (FX–Swap) | – | 892,450 | 1,297,025 | – | – | 2,189,475 |
| **Total** | **867,025** | **1,470,450** | **2,480,845** | **15,111,364** | **6,193,644** | **26,123,328** |

| | CONTRACTS ACCORDING TO MATURITIES | | | | | |
|---|---|---|---|---|---|---|
| 31.12.2015 | UP TO 1MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
| Fair value hedge accounting | | | | | | |
| Interest rate swaps (IRS) | – | – | – | 1,511,172 | 1,451,033 | 2,962,205 |
| Cross-currency interest rate swaps (CIRS) | – | – | – | – | – | – |
| Cash flow hedge accounting | | | | | | |
| Interest rate swaps (IRS) | – | – | 215,000 | 3,775,000 | – | 3,990,000 |
| Cross-currency interest rate swaps (CIRS) | – | – | 2,708,866 | 10,972,969 | 4,507,339 | 18,189,174 |
| Currency Swaps (FX–Swap) | 992,573 | 777,310 | 212,988 | – | – | 1,982,871 |
| **Total** | **992,573** | **777,310** | **3,136,854** | **16,259,141** | **5,958,372** | **27,124,250** |

(in PLN thousand)

**The table below presents the amounts recognized in the income statement and in the revaluation reserves due to cash flow hedge accounting**

| | 2016 | 2015 |
|---|---|---|
| Revaluation reserves (deferral of fair value changes of hedging instruments related to the portion recognized as effective hedge – gross value) | 39,724 | 45,280 |
| Net interest income on hedging derivatives | 212,587 | 208,571 |
| Ineffective portion in changes in fair value of hedging transactions recognized in income statement | (756) | 795 |

**The table below presents changes in the revaluation reserves during the period due to cash flow hedge accounting**

| | 2016 | 2015 |
|---|---|---|
| **Opening balance** | **45,280** | **138,621** |
| Deferral of fair value changes of hedging instruments related to the portion recognized as effective hedge | (5,451) | (93,277) |
| Amount of the deferral of fair value changes of hedging instruments of the effective hedge removed from revaluation reserves and presented in net profit or loss | (105) | (64) |
| **Closing balance** | **39,724** | **45,280** |

**The table below presents the amounts recognized in the income statement due to the fair value hedge accounting**

| TYPE OF GAINS/LOSSES | 2016 | 2015 |
|---|---|---|
| Gains/losses from revaluation of hedging instruments to fair value | 26,502 | 40,167 |
| Gains/losses from revaluation of hedged item associated with hedged risk to fair value | (25,189) | (34,620) |
| **Result on fair value hedge accounting** | **1,313** | **5,547** |
| Net interest income of hedging derivatives | (73,721) | (57,637) |

# Notes to the financial statements

(in PLN thousand)

**Detailed description of hedging relationships applied by the Group during the period from 1 January to 31 December 2016**

| DESCRIPTION OF THE HEDGING RELATIONSHIP | HEDGED ITEM | HEDGING DERIVATIVES | FINANCIAL STATEMENTS PRESENTATION | PERIOD IN WHICH THE CASH FLOWS RELATED TO THE HEDGED ITEMS ARE EXPECTED TO OCCUR |
|---|---|---|---|---|
| **1. Fair value hedge of fixed-coupon debt securities** | | | | |
| The Group hedges a portion of the interest rate risk resulting from the fair value changes of the hedged item related to the volatility of market swap curves with the designated IRS transactions. | The hedged items are fixed coupon debt securities classified as AFS, denominated in PLN, EUR and USD. | The hedging derivatives consist of IRS transactions in PLN, EUR and USD (short position in fixed-rate) for which the Group receives floating-rate payments, and pays fixed-rate. | The result of the change in the hedged items' fair value that relates to the hedged risk is presented in the income statement line item 'Result on fair value hedge accounting'. The remaining portion of the change in the hedged items' fair value (resulting from spread between swap yield curve and bond yield curve) is recognized in accordance with the accounting principles applicable to AFS (i.e. in the revaluation reserve in equity). Interest accrued on AFS bonds is presented in the net interest income. Changes in the fair value of hedging derivatives under the fair value hedge accounting are presented in the income statement line item 'Result on fair value hedge accounting'. Interest accrued on the hedging derivatives under the fair value hedge accounting is presented in the net interest income. | It is expected that the cash flows related to the hedged items will occur until 18 January 2036. |
| **2. Cash flow hedge of floating-rate loans and floating-rate deposits** | | | | |
| The Group hedges a portion of the interest rate risk and the foreign currency risk resulting from the volatility of cash flows from floating-rate assets and liabilities with the designated CIRS transactions (basis swap). | Hedged item consists of two separate components, which are cash flows arising from floating-rate assets portfolio and floating-rate liabilities portfolio. | Hedging derivatives consist of a portfolio of CIRS transactions (basis swap), where the Group pays floating-rate currency cash flows, and receives floating-rate PLN/currency cash-flows. CIRS transactions are decomposed into the part hedging the assets portfolio and the part hedging the liabilities portfolio. | The effective portion of the change in fair value of hedging derivatives' is recognized in the revaluation reserve in equity. The ineffective portion of the change in fair value of hedging derivatives is recognized in the result on financial assets and liabilities held for trading. The interest on CIRS transactions and hedged items is presented in the net interest income. | It is expected that the cash flows related to the hedged items will occur until 15 May 2029. |
| **3. Cash flow hedge of floating-rate loans** | | | | |
| The Group hedges a portion of the interest rate risk related to the volatility of cash flows on floating-rate assets with the designated IRS transactions. | The hedged items consist of the cash flows from floating-rate assets. | The hedging derivatives consist of portfolio of IRS transactions (short position in floating rate – the Group receives fixed payments and pays floating-rate). | The effective portion of the change in fair value of hedging derivatives is recognized in the revaluation reserve in equity. The ineffective portion of change in fair value hedging derivatives is recognized in the result on financial assets and liabilities held for trading. The interest on IRS transactions and hedged items is presented in the net interest income. | It is expected that the cash flows related to the hedged items will occur until 29 April 2020. |

(in PLN thousand)

| DESCRIPTION OF THE HEDGING RELATIONSHIP | HEDGED ITEM | HEDGING DERIVATIVES | FINANCIAL STATEMENTS PRESENTATION | PERIOD IN WHICH THE CASH FLOWS RELATED TO THE HEDGED ITEMS ARE EXPECTED TO OCCUR |
|---|---|---|---|---|
| **4. Cash flow hedge of floating-rate currency assets hedged with FX-Swap transactions against the exchange and interest rate risk** | | | | |
| The Group hedges volatility of cash flows constituting floating-rate financial assets (loans in EUR and USD) with FX-Swap transactions. The currency and interest rate risk is hedged. | Loans with variable interest rate risk, denominated in EUR and USD constitute hedged items. | FX-Swap transaction portfolio constitutes the hedging position. | The effective portion of the change in fair value of hedging derivatives is recognized in the revaluation reserve in equity. The ineffective portion of the change in fair value of hedging derivatives is recognized in the result on financial assets and liabilities held for trading. Settled part of the swap points on the hedging instrument is transferred from the revaluation reserve in equity and recognized in interest income. Currency revaluation regarding the first capital exchange on the hedging instrument is transferred from the revaluation reserve in equity and recognized in the foreign currency exchange result. | It is expected that the cash flows related to the hedged items will occur until 18 April 2017. |
| **5. Fair value hedge of fixed-coupon debt securities** | | | | |
| The Group hedges a portion of the interest rate risk resulting from the fair value changes of the hedged item related to the volatility of market swap curves with the designated IRS transactions. | The hedged items are fixed coupon debt securities classified as loans and receivables, denominated in PLN. | The hedging derivatives consist of IRS transactions in PLN (short position in fixed-rate) for which the Group receives floating-rate payments, and pays fixed-rate. | The result of the change in the hedged items' fair value that relates to the hedged risk is presented in the income statement line item 'Result on fair value hedge accounting'. Interest accrued on bonds is presented in the net interest income. Changes in the fair value of hedging derivatives under the fair value hedge accounting are presented in the income statement line item 'Result on fair value hedge accounting'. Interest accrued on the hedging derivatives under the fair value hedge accounting is presented in the net interest income. | It is expected that the cash flows related to the hedged items will occur until 22 December 2026. |
| **6. Cash flow hedge of expected future inflows in foreign currency – relationship completed** | | | | |
| The Group hedged the volatility of cash flows denominated in EUR constituting the projected inflows from expected sales with the designated FX-Forward transactions. The currency risk was being hedged. Discontinuation of the hedge accounting resulted from settlement of transactions included in the hedging relationship. | Projected inflows dependent on EUR and Polish zloty exchange rates were the hedged item. | The hedging derivatives consisted of a portfolio of FX-Forward transactions (FX-Spot and series of FX-Swap), in which the Group sold EUR currency in exchange for PLN currency on 27 June 2016 at an agreed exchange rate. | The amount of the settlement of hedging transactions adjusted the settlement of the hedged item.net interest income. | – |

(in PLN thousand)

# 31. Investment (placement) securities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Debt securities available for sale (AFS) | 31,949,770 | 17,517,884 |
| Equity securities available for sale (AFS) | 151,864 | 295,415 |
| Debt securities held to maturity (HTM) | 3,018,985 | 3,368,424 |
| **Total** | **35,120,619** | **21,181,723** |

### Debt securities available for sale (AFS)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Securities issued by State Treasury | 25,046,710 | 15,954,349 |
| T-bills | – | – |
| T-bonds | 25,046,710 | 15,954,349 |
| Securities issued by Central Banks | 5,978,629 | 628,454 |
| Securities issued by business entities | 249,912 | 251,367 |
| Securities issued by local governments | 674,519 | 683,714 |
| **Total** | **31,949,770** | **17,517,884** |
| including impairment of assets | – | – |

### Equity securities available for sale (AFS)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Shares | 151,864 | 295,415 |
| **Total** | **151,864** | **295,415** |
| including impairment of assets | – | (122) |

In June 2016 the Bank has received information about the closing of the acquisition of Visa Europe Limited by Visa Inc. As a result of the settlement of this transaction the Bank has recognized in the financial statements for 2016:

- the cash received in the amount of EUR 43.6 million, equivalent to PLN 191.4 million at the average NBP exchange rate as of 21 June 2016,
- 15 818 preferred shares of Visa Inc. Series C, whose value has been estimated by the Bank at EUR 12.7 million, which is equivalent to PLN 55.8 million according to the average NBP exchange rate as of 21 June 2016. The shares have been classified to the available for sale portfolio of securities. Preferred shares of Visa Inc. Series C will be converted into ordinary shares of Visa Inc. Conversion of all preferred shares will take place no later than 2028. Until then, the transfer of shares by the Bank is subject to restrictions. The current conversion of preferred shares into ordinary shares may be decreased until 2028, which depends on the compensation paid by Visa during this period,
- receivables from deferred payments in cash in the amount of EUR 3.8 million (ie. 16.5 million at the average NBP exchange rate as of 21 June 2016). This amount will be paid on the third anniversary of the closing date, ie. in the second quarter of 2019.

On the same time the Bank derecognised the share in Visa Europe, together with its valuation. The carrying value of the share amounted to EUR 40.9 million (PLN 179.5 million as of 21 June 2016).

As a result of the settlement, the Bank has recognized the gain of PLN 263.7 million (before tax) in the Income Statement.

(in PLN thousand)

### Debt securities held to maturity (HTM)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Securities issued by State Treasury | 2,998,379 | 2,497,324 |
| T- bills | – | – |
| T- bonds | 2,998,379 | 2,497,324 |
| Securities issued by Central Banks | 20,606 | 871,100 |
| **Total** | **3,018,985** | **3,368,424** |
| including impairment of assets | – | – |

### Investment debt securities according to contractual maturities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Debt securities, including: | | |
| up to 1 month | 7,424,354 | 1,499,554 |
| between 1 and 3 months | 573,661 | 443,644 |
| between 3 months and 1 year | 6,072,130 | 2,696,342 |
| between 1 and 5 years | 12,109,707 | 10,646,471 |
| over 5 years | 8,788,903 | 5,600,297 |
| **Total** | **34,968,755** | **20,886,308** |

### Investment debt securities according to currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 30,844,812 | 17,835,368 |
| EUR | 2,790,183 | 2,635,034 |
| USD | 1,333,760 | 415,906 |
| **Total** | **34,968,755** | **20,886,308** |

### Changes in investment (placement) securities

| | 2016 | 2015 |
|---|---|---|
| SECURITIES AVAILABLE FOR SALE (AFS) | | |
| **Opening balance** | **17,813,299** | **23,111,208** |
| Increases (purchase) | 89,733,305 | 217,273,604 |
| Decreases (sale and redemption) | (75,816,126) | (222,978,862) |
| Changes in fair value | (460,735) | (257,139) |
| Exchange rate differences | 170,926 | 179,036 |
| Accrued interest | 705,443 | 618,156 |
| Other changes | (44,478) | (132,704) |
| **Closing balance** | **32,101,634** | **17,813,299** |
| DEBT SECURITIES HELD UNTIL MATURITY (HTM) | | |
| **Opening balance** | **3,368,424** | **1,601,568** |
| Increases (purchase) | 6,660,966 | 47,236,297 |
| Decreases (sale and redemption) | (7,069,725) | (45,530,013) |
| Accrued interest | 28,096 | 21,238 |
| Other changes | 31,224 | 39,334 |
| **Closing balance** | **3,018,985** | **3,368,424** |
| **Net total investment (placement) securities** | **35,120,619** | **21,181,723** |

(in PLN thousand)

# 32. Reclassification of securities

IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 7 'Financial Instruments: Disclosures' provide, under certain conditions, the possibility for reclassification of financial instruments into other categories.

In 2016 and 2015, the Group did not reclassify any financial instruments into other categories.

On 1 October 2008, however, due to the exceptional situation related to the financial crisis, the Group made use of the possibility for reclassification of its financial instruments.

**The tables below present the information on the reclassified financial assets**

| | | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|---|
| | AMOUNT OF RECLASSIFICATION | CARRYING AMOUNT | FAIR VALUE | CARRYING AMOUNT | FAIR VALUE |
| Financial assets reclassified from Available for Sale assets to Loans and advances to customers | 1,331,580 | 64,381 | 61,109 | 68,974 | 65,191 |
| Financial assets reclassified from Held for Trading assets to Held to Maturity assets | 602,507 | 217,365 | 219,258 | 666,725 | 673,607 |
| **Total** | **1,934,087** | **281,746** | **280,367** | **735,699** | **738,798** |

**If the Group failed to perform the reclassification, the income and revaluation equity would have changed as follows**

| 31.12.2016 | NET INCOME FROM FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE | REVALUATION RESERVE |
|---|---|---|
| Financial assets reclassified from Available for Sale assets to Loans and advances to customers | – | 263 |
| Financial assets reclassified from Held for Trading assets to Held to Maturity assets | (5,633) | – |
| **Total** | **(5,633)** | **263** |

| 31.12.2015 | NET INCOME FROM FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE | REVALUATION RESERVE |
|---|---|---|
| Financial assets reclassified from Available for Sale assets to Loans and advances to customers | – | 127 |
| Financial assets reclassified from Held for Trading assets to Held to Maturity assets | (6,713) | – |
| **Total** | **(6,713** | **127** |

**Net interest income on reclassified financial assets**

| | 2016 | 2015 |
|---|---|---|
| Financial assets reclassified from Available for Sale assets to Loans and advances to customers | 1,580 | 1,998 |
| Financial assets reclassified from Held for Trading assets to Held to Maturity assets | 10,625 | 12,770 |
| **Total** | **12,205** | **14,768** |

(in PLN thousand)

# 33. Assets and liabilities held for sale

According to IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', the Group identified non-current assets meeting requirements of IFRS 5 (concerning classification of non-current assets as held for sale) from the item 'Assets held for sale'.

As at 31 December 2016, non-current assets classified as held for sale are as follows:
- real estate,
- other property, plant and equipment.

**Assets held for sale and liabilities associated with assets held for sale are presented below**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| ASSETS HELD FOR SALE | | |
| Property, plant and equipment | 25,703 | 22,787 |
| Other assets | 22,574 | 22,515 |
| **Total assets** | **48,277** | **45,302** |

**The changes in the balance of assets held for sale and liabilities associated with assets held for sale are presented in the table below**

| ASSETS HELD FOR SALE | 2016 | 2015 |
|---|---|---|
| **Opening balance** | **45,302** | **37,102** |
| Increases including: | 11,541 | 51,929 |
| transfer from property, plant and equipment | 3,113 | 27,008 |
| transfer from investment properties | 8,295 | – |
| transfer from investments in associates | – | 24,119 |
| other changes | 133 | 802 |
| Decreases including: | (8,566) | (43,729) |
| transfer from property, plant and equipment | (1,250) | (13,460) |
| transfer from investment properties | (4,466) | – |
| sale of shares in associate | – | (24,119) |
| disposal | (2,820) | (5,879) |
| other changes | (30) | (271) |
| **Closing balance** | **48,277** | **45,302** |

**The effect of disposal of property, plant and equipment and other assets is as follows**

| | 2016 | 2015 |
|---|---|---|
| Sales revenues | 3,849 | 5,150 |
| Net carrying amount of disposed assets (including costs to sell) | (2,820) | (5,150) |
| **Profit/loss on sale before income tax** | **1,029** | **–** |

(in PLN thousand)

# 34. Investments in associates

### The below tables present the information about associates that are material to the Group

| NAME OF ASSOCIATE | COUNTRY OF INCORPORATION AND PLACE OF BUSINESS | PERCENTAGE OF THE GROUP'S OWNERSHIP RIGHTS IN SHARE CAPITAL/VOTING | | MEASUREMENT METHOD | NATURE OF THE RELATIONSHIP |
|---|---|---|---|---|---|
| | | 31.12.2016 | 31.12.2015 | | |
| Dom Inwestycyjny Xelion Sp. z o.o. | Poland | 50.00 | 50.00 | Equity method | The strategic Entity providing affluent customers with services of assets management. |
| Pioneer Pekao Investment Management S.A. | Poland | 49.00 | 49.00 | Equity method | The Entity deals with management of investment funds assets and is of strategic importance for the Group that distributes and supporting such products. |

The summarized financial information of the associates are presented below. The information derives from the financial statements, which are in the process of auditing by the entities authorizing to audit financial statements. The audit opinions on those financial statements will be expressed after the release date of the consolidated financial statements of Bank Pekao S.A. Group.

| | DOM INWESTYCYJNY XELION SP. Z O.O. | | PIONEER PEKAO INVESTMENT MANAGEMENT S.A. | |
|---|---|---|---|---|
| | 31.12.2016 | 31.12.2015 | 31.12.2016 | 31.12.2015 |
| Current assets | 53,997 | 48,090 | 281,275 | 313,553 |
| Non-current assets | 2,175 | 3,269 | 8,605 | 9,295 |
| **TOTAL ASSETS** | **56,172** | **51,359** | **289,880** | **322,848** |
| Current liabilities | 26,380 | 26,361 | 33,299 | 35,284 |
| Non-current liabilities | 4,348 | 3,913 | 4,541 | 5,070 |
| **TOTAL LIABILITIES** | **30,728** | **30,274** | **37,840** | **40,354** |
| **NET ASSETS** | **25,444** | **21,085** | **252,040** | **282,494** |

| | DOM INWESTYCYJNY XELION SP. Z O.O. | | PIONEER PEKAO INVESTMENT MANAGEMENT S.A. | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Revenue | 57,129 | 56,331 | 324,839 | 383,019 |
| Net profit (loss) for the period from continuing operations | 4,359 | 3,930 | 74,437 | 91,284 |
| Other comprehensive income | – | – | 37 | 36 |
| **Total comprehensive income** | **4,359** | **3,930** | **74,474** | **91,320** |

### Reconciliation of the summarized financial information to the carrying amount of the interests in associates

| | DOM INWESTYCYJNY XELION SP. Z O.O. | | PIONEER PEKAO INVESTMENT MANAGEMENT S.A. | | TOTAL | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Group's interest in net assets at beginning of the year | 10,542 | 8,577 | 138,423 | 141,985 | 148,965 | 150,562 |
| Group's interest in net profit (loss) for the period (*) | 2,179 | 1,965 | 36,401 | 44,649 | 38,580 | 46,614 |
| Group's interest in other comprehensive income | – | – | 18 | 18 | 18 | 18 |
| Dividend received from associates | – | – | (51,342) | (48,229) | (51,342) | (48,229) |
| Group's interest in net assets at beginning of the year | 12,721 | 10,542 | 123,500 | 138,423 | 136,221 | 148,965 |
| **Carrying amount of the interests** | **12,721** | **10,542** | **123,500** | **138,423** | **136,221** | **148,965** |

(*) Group's interest includes the changes in net profit (loss) for the previous period, that arose after the release date of financial statements of Bank Pekao S.A. Group and before the approval date of financial statements of particular associates.

(in PLN thousand)

# 35. Intangible assets

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Intangible assets, including: | 540,661 | 581,197 |
| research and development expenditures | 3,024 | 7,948 |
| licenses and patents | 455,647 | 446,987 |
| other | 7,688 | 11,183 |
| assets under construction | 74,302 | 115,079 |
| Goodwill | 55,520 | 55,520 |
| **Total** | **596,181** | **636,717** |

The goodwill was transferred to Bank Pekao S.A. on integration with Bank BPH S.A. It represents the goodwill recognized upon acquisition of Pierwszy Komercyjny Bank S.A. in Lublin ('PKBL') by Bank BPH S.A. and relates to those branches of the PKBL which were transferred to Bank Pekao S.A. as a result of integration with Bank BPH S.A. It is determined the smallest identifiable cash-generating units ('CGU'), to which the goodwill has been allocated in the amount of PLN 51 675 thousand.

Moreover in the line 'Goodwill' are presented:
- goodwill recognized upon acquisition of Spółdzielcza Kasa Oszczędnościowo – Kredytowa im. Mikołaja Kopernika by Bank Pekao S.A. It is determined the smallest identifiable cash-generating units ('CGU'), to which the goodwill has been allocated in the amount of PLN 960 thousand,
- goodwill recognized upon acquisition of Pekao Leasing i Finanse S.A. (formerly BPH Leasing S.A.) by Pekao Leasing Holding S.A. (ex. BPH PBK Leasing S.A.). It is determined the smallest identifiable cash-generating units ('CGU'), to which the goodwill has been allocated in the amount of PLN 2 885 thousand.

In respect to the goodwill, the impairment test is performed annually, irrespective of whether there is any indication that it may be impaired.

The impairment test is performed by comparing the carrying amount of the CGU, including the goodwill, with the recoverable amount of the CGU. The recoverable amount is estimated on the basis of value in use of the CGU. The value in use is the present, estimated value of the future cash flows for the period of 5 years, taking into account the residual value of the CGU. The residual value of the CGU is calculated based on an extrapolation of cash flows projections beyond the forecast period using the growth rate of 2.5%. The forecasts of the future cash flows are based on the assumptions included the Bank's budget for 2017 and financial plan for 2018-2021. To discount the future cash flows, it is applied the discount rate of 8.38%, which includes the risk-free rate and the risk premium.

The impairment test performed as at 31 December 2016 showed the surplus of the recoverable amount over the carrying amount of the CGU, and therefore no CGU impairment was recognized.

# Notes to the financial statements

(in PLN thousand)

### Changes in 'Intangibles assets' in the course of the reporting period

| 2016 | RESEARCH AND DEVELOPMENT COSTS | LICENSES AND PATENTS | OTHER | ASSETS UNDER CONSTRUCTION | TOTAL |
|---|---|---|---|---|---|
| GROSS VALUE | | | | | |
| **Opening balance** | **90,174** | **2,279,571** | **51,326** | **115,079** | **2,536,150** |
| Increases including: | – | 171,830 | 312 | 125,093 | 297,235 |
| acquisitions | – | 5,089 | – | 125,093 | 130,182 |
| other | – | 183 | – | – | 183 |
| transfer from investments outlays | – | 166,558 | 312 | – | 166,870 |
| Decreases, including: | – | (20,889) | (16,445) | (165,870) | (203,204) |
| liquidation | – | (20,621) | (16,445) | – | (37,066) |
| other | – | (268) | – | – | (268) |
| transfer from investments outlays | – | – | – | (165,870) | (165,870) |
| **Closing balance** | **90,174** | **2,430,512** | **35,193** | **74,302** | **2,630,181** |
| ACCUMULATED AMORTIZATION | | | | | |
| **Opening balance** | **82,226** | **1,832,584** | **29,182** | **–** | **1,943,992** |
| Amortization | 4,924 | 163,345 | 3,337 | – | 171,606 |
| Liquidation | – | (21,064) | (5,014) | – | (26,078) |
| Other | – | – | – | – | – |
| **Closing balance** | **87,150** | **1,974,865** | **27,505** | **–** | **2,089,520** |
| IMPAIRMENT | | | | | |
| **Opening balance** | **–** | **–** | **10,961** | **–** | **10,961** |
| Increases | – | – | – | – | – |
| Decreases | – | – | (10,961) | – | (10,961) |
| **Closing balance** | **–** | **–** | **–** | **–** | **–** |
| NET VALUE | | | | | |
| **Opening balance** | **7,948** | **446,987** | **11,183** | **115,079** | **581,197** |
| **Closing balance** | **3,024** | **455,647** | **7,688** | **74,302** | **540,661** |

(in PLN thousand)

**Changes in 'Intangibles assets' in the course of the reporting period**

| 2015 | RESEARCH AND DEVELOPMENT COSTS | LICENSES AND PATENTS | OTHER | ASSETS UNDER CONSTRUCTION | TOTAL |
|---|---|---|---|---|---|
| GROSS VALUE | | | | | |
| **Opening balance** | **89,362** | **2,132,059** | **49,663** | **113,316** | **2,384,400** |
| Increases including: | 812 | 157,708 | 1,677 | 154,937 | 315,134 |
| acquisitions | – | 2,826 | – | 154,937 | 157,763 |
| other | – | 36,741 | – | – | 36,741 |
| transfer from investments outlays | 812 | 118,141 | 1,677 | – | 120,630 |
| Decreases, including: | – | (10,196) | (14) | (153,174) | (163,384) |
| liquidation | – | (7,319) | – | – | (7,319) |
| other | – | (2,877) | (14) | (32,544) | (35,435) |
| transfer from investments outlays | – | – | – | (120,630) | (120,630) |
| **Closing balance** | **90,174** | **2,279,571** | **51,326** | **115,079** | **2,536,150** |
| ACCUMULATED AMORTIZATION | | | | | |
| **Opening balance** | **78,950** | **1,695,120** | **27,857** | **–** | **1,801,927** |
| Amortization | 3,276 | 144,738 | 1,340 | – | 149,354 |
| Liquidation | – | (7,228) | (15) | – | (7,243) |
| Other | – | (46) | – | – | (46) |
| **Closing balance** | **82,226** | **1,832,584** | **29,182** | **–** | **1,943,992** |
| IMPAIRMENT | | | | | |
| **Opening balance** | **–** | **–** | **10,961** | **–** | **10,961** |
| **Closing balance** | **–** | **–** | **10,961** | **–** | **10,961** |
| NET VALUE | | | | | |
| **Opening balance** | **10,412** | **436,939** | **10,845** | **113,316** | **571,512** |
| **Closing balance** | **7,948** | **446,987** | **11,183** | **115,079** | **581,197** |

In the period from 1 January to 31 December 2016, the Group acquired intangible assets in the amount of PLN 130 182 thousand (in 2015 – PLN 157 763 thousand).

In the period from 1 January to 31 December 2016 and in 2015 there have been no intangible assets whose title is restricted and pledged as security for liabilities.

## Contractual commitments

As at 31 December 2016 the contractual commitments for the acquisition of intangible assets amounted to PLN 43 930 thousand, whereas as at 31 December 2015 – PLN 49 487 thousand.

(in PLN thousand)

# 36. Property, plant and equipment

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Non-current assets, including: | 1,308,234 | 1,376,409 |
| land and buildings | 1,000,882 | 1,055,147 |
| machinery and equipment | 245,479 | 245,717 |
| transport vehicles | 24,026 | 34,170 |
| other | 37,847 | 41,375 |
| Non-current assets under construction and prepayments | 114,696 | 84,243 |
| **Total** | **1,422,930** | **1,460,652** |

**Changes in 'Property, plant and equipment' in the course of the reporting period**

| 2016 | LANDS AND BUILDINGS | MACHINERY AND EQUIPMENT | MEANS OF TRANSPORTATION | OTHER | NON-CURRENT ASSETS UNDER CONSTRUCTION AND PREPAYMENTS | TOTAL |
|---|---|---|---|---|---|---|
| GROSS VALUE | | | | | | |
| **Opening balance** | **2,278,125** | **1,452,658** | **83,169** | **326,314** | **84,826** | **4,225,092** |
| Increases, including: | 21,640 | 81,249 | 4,882 | 4,996 | 133,837 | 246,604 |
| acquisitions | 1,969 | 5,233 | 1,412 | 630 | 133,837 | 143,081 |
| other | 2 | 610 | 3,470 | 48 | – | 4,130 |
| transfer from non-current assets under construction | 19,669 | 75,406 | – | 4,318 | – | 99,393 |
| Decreases, including: | (35,556) | (64,734) | (7,291) | (10,486) | (103,967) | (222,034) |
| liquidation and sale | (32,398) | (64,257) | (7,291) | (8,837) | – | (112,783) |
| transfer to non-current assets held for sale | (2,886) | (149) | – | (78) | – | (3,113) |
| other | (272) | (328) | – | (1,571) | (4,574) | (6,745) |
| transfer from non-current assets under construction | – | – | – | – | (99,393) | (99,393) |
| **Closing balance** | **2,264,209** | **1,469,173** | **80,760** | **320,824** | **114,696** | **4,249,662** |
| ACCUMULATED DEPRECIATION | | | | | | |
| **Opening balance** | **1,219,079** | **1,203,090** | **48,999** | **284,821** | **–** | **2,755,989** |
| Increases, including: | 66,805 | 80,631 | 12,575 | 8,371 | – | 168,382 |
| depreciation | 66,805 | 80,326 | 12,575 | 8,371 | – | 168,077 |
| other | – | 305 | – | – | – | 305 |
| Decreases, including: | (26,410) | (63,814) | (4,840) | (10,333) | – | (105,397) |
| liquidation and sale | (25,385) | (63,376) | (4,783) | (10,255) | – | (103,799) |
| transfer to non-current assets held for sale | (1,025) | (147) | – | (78) | – | (1,250) |
| other | – | (291) | (57) | – | – | (348) |
| **Closing balance** | **1,259,474** | **1,219,907** | **56,734** | **282,859** | **–** | **2,818,974** |
| IMPAIRMENT | | | | | | |
| **Opening balance** | **3,899** | **3,851** | **–** | **118** | **583** | **8,451** |
| Increases | – | – | – | – | – | – |
| Decreases | (46) | (64) | – | – | (583) | (693) |
| **Closing balance** | **3,853** | **3,787** | **–** | **118** | **–** | **7,758** |
| NET VALUE | | | | | | |
| **Opening balance** | **1,055,147** | **245,717** | **34,170** | **41,375** | **84,243** | **1,460,652** |
| **Closing balance** | **1,000,882** | **245,479** | **24,026** | **37,847** | **114,696** | **1,422,930** |

(in PLN thousand)

**Changes in 'Property, plant and equipment' in the course of the reporting period**

| 2015 | LANDS AND BUILDINGS | MACHINERY AND EQUIPMENT | MEANS OF TRANSPORTATION | OTHER | NON-CURRENT ASSETS UNDER CONSTRUCTION AND PREPAYMENTS | TOTAL |
|---|---|---|---|---|---|---|
| GROSS VALUE | | | | | | |
| **Opening balance** | **2,303,114** | **1,495,518** | **94,510** | **344,297** | **86,054** | **4,323,493** |
| Increases, including: | 49,589 | 79,072 | 7,718 | 7,385 | 110,597 | 254,361 |
| acquisitions | 9,541 | 12,235 | 4,324 | 1,611 | 110,132 | 137,843 |
| other | 2,228 | 1,053 | 3,360 | 77 | 465 | 7,183 |
| transfer from non-current assets under construction | 37,820 | 65,784 | 34 | 5,697 | – | 109,335 |
| Decreases, including: | (74,578) | (121,932) | (19,059) | (25,368) | (111,825) | (352,762) |
| liquidation and sale | (29,005) | (121,719) | (11,692) | (25,335) | (53) | (187,804) |
| transfer to non-current assets held for sale | (26,956) | (52) | – | – | – | (27,008) |
| other | (18,617) | (161) | (7,367) | (33) | (2,437) | (28,615) |
| transfer from non-current assets under construction | – | – | – | – | (109,335) | (109,335) |
| **Closing balance** | **2,278,125** | **1,452,658** | **83,169** | **326,314** | **84,826** | **4,225,092** |
| ACCUMULATED DEPRECIATION | | | | | | |
| **Opening balance** | **1,196,576** | **1,230,481** | **47,209** | **298,421** | **–** | **2,772,687** |
| Increases, including: | 76,894 | 93,557 | 15,331 | 11,297 | – | 197,079 |
| depreciation | 69,957 | 84,941 | 14,923 | 10,026 | – | 179,847 |
| other | 6,937 | 8,616 | 408 | 1,271 | – | 17,232 |
| Decreases, including: | (54,391) | (120,948) | (13,541) | (24,897) | – | (213,777) |
| liquidation and sale | (33,002) | (120,742) | (13,533) | (24,883) | – | (192,160) |
| transfer to non-current assets held for sale | (13,414) | (47) | – | – | – | (13,461) |
| other | (7,975) | (159) | (8) | (14) | – | (8,156) |
| **Closing balance** | **1,219,079** | **1,203,090** | **48,999** | **284,821** | **–** | **2,755,989** |
| IMPAIRMENT | | | | | | |
| **Opening balance** | **2,565** | **3,961** | **–** | **141** | **–** | **6,667** |
| Increases | 1,560 | 35 | – | 1 | 583 | 2,179 |
| Decreases | (226) | (145) | – | (24) | – | (395) |
| **Closing balance** | **3,899** | **3,851** | **–** | **118** | **583** | **8,451** |
| NET VALUE | | | | | | |
| **Opening balance** | **1,103,973** | **261,076** | **47,301** | **45,735** | **86,054** | **1,544,139** |
| **Closing balance** | **1,055,147** | **245,717** | **34,170** | **41,375** | **84,243** | **1,460,652** |

In the period from 1 January to 31 December 2016 the Group acquired property, plant and equipment in the amount of PLN 143 081 thousand (in 2015 – PLN 137 843 thousand), while the value of property, plant and equipment sold amounted to PLN 8 150 thousand (in 2015 – PLN 7 717 thousand).

The amount of compensations received from third parties for impairment of loss of property, plant and equipment items recognized in the income statement for 2016 stood at PLN 3 551 thousand (in 2015 – PLN 1 995 thousand).

In 2016 and 2015 there have been no restrictions to legal titles to property, plant and equipment, nor pledges in place as security for liabilities.

## Contractual commitments

As at 31 December 2016 the contractual commitments for the acquisition of property, plant and equipment amounted to PLN 17 525 thousand, whereas as at 31 December 2015 – PLN 57 012 thousand.

(in PLN thousand)

# 37. Investment property

The Group values investment property using the historical cost model.

The rights to sell the investment property and the rights to transfer related revenues and profits are not a subject to limitations.

**Changes in 'Investment property' in the course of the reporting period**

| | 2016 | 2015 |
|---|---|---|
| GROSS VALUE | | |
| **Opening balance** | **66,253** | **71,461** |
| Increases, including: | 431 | 10,341 |
| acquisitions | 431 | 324 |
| transfer from property plant and equipment | – | 10,017 |
| transfer from non-current assets held for sale | – | – |
| Decreases, including: | (11,120) | (15,549) |
| sale of real estate | (2,777) | (15,437) |
| transfer to non-current assets held for sale | (8,295) | – |
| other | (48) | (112) |
| **Closing balance** | **55,564** | **66,253** |
| ACCUMULATED DEPRECIATION | | |
| **Opening balance** | **27,350** | **27,484** |
| Increases, including: | 1,183 | 9,628 |
| depreciation for the period | 1,183 | 1,654 |
| transfer from property plant and equipment | – | 7,974 |
| other | – | – |
| Decreases, including: | (4,874) | (9,762) |
| sale of real estate | (1,133) | (9,650) |
| transfer from non-current assets held for sale | (3,741) | – |
| other | – | (112) |
| **Closing balance** | **23,659** | **27,350** |
| IMPAIRMENT | | |
| **Opening balance** | **8,682** | **8,682** |
| Increases, including: | – | – |
| impairment charges | – | – |
| Decreases, including: | (1,651) | – |
| sale of real estate | (926) | – |
| transfer from non-current assets held for sale | (725) | – |
| **Closing balance** | **7,031** | **8,682** |
| NET VALUE | | |
| **Opening balance** | **30,221** | **35,295** |
| **Closing balance** | **24,874** | **30,221** |

The fair value of investment property as at 31 December 2016 stood at PLN 14 599 thousand (PLN 43 889 thousand as at 31 December 2015). The fair value of investment property are categorized in Level 3 of the fair value hierarchy. The fair value was measured based on valuations of the property appraisers, having appropriate professional qualifications and recent experience in the location of the properties being valued. The valuations of investment property are based on investment method or profits method, taking into account such unobservable input data as expected rental growth rate, void periods, occupancy rate, discount rate.

(in PLN thousand)

**The following amounts of revenues and costs associated with investment properties have been recognized in the income statement**

| | 2016 | 2015 |
|---|---|---|
| Rental revenues from investment properties | 4,069 | 4,319 |
| Direct operating expenses associated with investment properties (including repair and maintenance costs) which generated rental revenues during the reporting period | (1,568) | (1,485) |
| Direct operating expenses associated with investment properties (including repair and maintenance costs) which did not generate rental revenues during the reporting period | – | (371) |

# 38. Other assets

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Prepaid expenses | 132,063 | 112,514 |
| Perpetual usufruct rights | 14,876 | 15,181 |
| Accrued income | 78,756 | 52,595 |
| Interbank and interbranch settlements | 156 | 1,770 |
| Other debtors | 325,351 | 289,515 |
| Card settlements | 479,996 | 1,808,150 |
| **Total** | **1,031,198** | **2,279,725** |

Prepaid expenses represent expenditures, which will be amortized against income statement in the forthcoming reporting periods.

The item ‘Other debtors’ includes assets for sale in the amount of PLN 90 thousand as at 31 December 2016 (PLN 90 thousand as at 31 December 2015). Assets for sale represent assets taken over for debts. They are presented in a debt value reduced by impairment charge, calculated as a difference between the amount of debt and fair value of taken over assets (if lower than the amount of debt). In case of surplus between the fair value of taken over asset and the amount of debt, the difference is recognized as a liability to debtor.

The Group disposes of the assets for sale taken over for debts. The period in which the assets should be disposed is 5 years for real estate and 3 years for other assets for sale (the period starts from the date of assets’ taken over). When the period expires, the Group reclassifies the carrying value of unsold assets for sales into appropriate category of property, plant and equipment used by the Group.

(in PLN thousand)

# 39. Assets pledged as collateral

**As at 31 December 2016 the Group held the following financial assets pledged as security for liabilities**

| TYPE OF TRANSACTION | SECURITY | CARRYING VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES | NOMINAL VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES | VALUE OF LIABILITIES SUBJECT TO SECURITY |
|---|---|---|---|---|
| Repo transaction | bonds | 1,774,747 | 1,678,677 | 1,775,808 |
| Coverage of Fund for protection of guaranteed assets to the benefit of the Bank Guarantee Fund | bonds | 750,701 | 720,200 | – |
| Lombard and technical loan | bonds | 4,808,629 | 4,515,159 | – |
| Other loans | bonds | 357,614 | 353,900 | 297,497 |
| Issue of mortgage bonds | receivables backed by mortgage, bonds | 1,678,258 | 1,679,057 | 1,222,018 |
| Coverage of the Gurantee Fund for the Settlement of Stock Exchange Transactions to Central Securities Depository (KDPW) | bonds, cash deposit | 51,155 | 50,890 | – |
| Derivatives | bonds | 60,792 | 65,302 | 31,987 |

**As at 31 December 2015 the Group held the following financial assets pledged as security for liabilities**

| TYPE OF TRANSACTION | SECURITY | CARRYING VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES | NOMINAL VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES | VALUE OF LIABILITIES SUBJECT TO SECURITY |
|---|---|---|---|---|
| Repo transaction | bonds | 3,394,183 | 3,152,162 | 3,388,421 |
| Coverage of Fund for protection of guaranteed assets to the benefit of the Bank Guarantee Fund | bonds | 703,818 | 680,200 | – |
| Lombard and technical loan | bonds | 4,750,392 | 4,504,675 | – |
| Other loans | bonds | 490,285 | 481,200 | 328,076 |
| Issue of mortgage bonds | receivables backed by mortgage, bonds | 1,679,460 | 1,683,864 | 1,234,528 |
| Coverage of the Gurantee Fund for the Settlement of Stock Exchange Transactions to Central Securities Depository (KDPW) | bonds, cash deposit | 39,296 | 38,802 | – |
| Derivatives | bonds | 45,708 | 47,163 | 24,771 |

The freeze on securities is a consequence of:
- in case of Repo and Sell-buy-back transactions – binding money market standards for such transactions,
- in case of freeze to the benefit of BFG – binding provisions of the Law on Banking Guaranty Fund BFG,
- in case of lombard and technical loans – policy and standards, applied by the National Bank of Poland NBP,
- in case of other loans, deposits and derivatives – terms and conditions of the agreement, entered between Bank Pekao S.A. and its clients,
- in case of issue of mortgage bonds – binding provisions of the Law on Mortgage Bonds and Mortgage Banks,
- in case of freeze to the benefit of KDPW – with the status of the clearing member for brokerage transactions.

(in PLN thousand)

# 40. Amounts due to other banks

### Amounts due to other banks by product type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Current accounts | 902,856 | 1,121,885 |
| Interbank deposits and other liabilities | 309,837 | 581,301 |
| Loans and advances received | 3,249,417 | 3,263,303 |
| Repo transactions | 339,568 | 963,830 |
| Cash in transit | 21,762 | 28,130 |
| **Total** | **4,823,440** | **5,958,449** |

### Amounts due to other banks by currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 1,442,611 | 1,379,402 |
| CHF | 731,657 | 744,746 |
| EUR | 2,592,591 | 3,774,189 |
| USD | 48,467 | 50,277 |
| Other currencies | 8,114 | 9,835 |
| **Total** | **4,823,440** | **5,958,449** |

# 41. Amounts due to customers

### Amounts due to customers by product type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Amounts due to corporate, including: | 57,989,927 | 55,167,425 |
| current accounts | 33,946,882 | 29,048,523 |
| term deposits and other liabilities | 24,043,045 | 26,118,902 |
| Amounts due to budget entities, including: | 7,809,235 | 5,610,623 |
| current accounts | 5,461,224 | 4,689,452 |
| term deposits and other liabilities | 2,348,011 | 921,171 |
| Amounts due to individuals, including: | 70,347,039 | 63,434,250 |
| current accounts | 39,682,587 | 33,827,209 |
| term deposits and other liabilities | 30,664,452 | 29,607,041 |
| Repo transactions | 1,436,241 | 4,468,820 |
| Cash in transit | 233,484 | 186,573 |
| **Total** | **137,815,926** | **128,867,691** |

### Amounts due to customers by currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 115,090,198 | 106,548,096 |
| CHF | 315,787 | 234,011 |
| EUR | 13,400,735 | 13,215,198 |
| USD | 7,476,067 | 8,013,651 |
| Other currencies | 1,533,139 | 856,735 |
| **Total** | **137,815,926** | **128,867,691** |

(in PLN thousand)

# 42. Debt securities issued

### Debt securities issued by type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Certificates of deposit | 300,945 | 1,668,706 |
| Mortgage bonds | 1,222,018 | 1,234,527 |
| **Total** | **1,522,963** | **2,903,233** |

The Group redeems its own debt securities issued on a timely basis.

### Debt securities issued by currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 1,200,548 | 2,592,848 |
| EUR | 322,415 | 310,385 |
| USD | – | – |
| **Total** | **1,522,963** | **2,903,233** |

### Changes in debt securities issued

| | 2016 | 2015 |
|---|---|---|
| **Opening balance** | **2,903,233** | **3,857,043** |
| Increase (issuance) | 1,129,733 | 3,966,098 |
| Decrease (redemption) | (2,467,807) | (4,999,636) |
| Decrease (partial redemption) | (38,245) | (7,903) |
| Foreign currency exchange differences | 11,885 | (1,053) |
| Purchase | – | (33) |
| Sale | – | 90,989 |
| Other | (15,836) | (2,272) |
| **Closing balance** | **1,522,963** | **2,903,233** |

# 43. Provisions

### Change in provisions in the reporting period

| 2016 | PROVISIONS FOR LITIGATION AND CLAIMS | PROVISIONS FOR DEFINED BENEFIT PLANS | PROVISIONS FOR UNDRAWN CREDIT FACILITIES AND GUARANTEES ISSUED | OTHER PROVISIONS | TOTAL |
|---|---|---|---|---|---|
| **Opening balance** | **10,608** | **268,858** | **120,771** | **25,137** | **425,374** |
| Provision charges/revaluation | 4,092 | 26,635 | 160,561 | 23,386 | 214,674 |
| Provision utilization | (3,405) | (13,020) | – | (11,207) | (27,632) |
| Provision releases | (3,202) | (19) | (61,341) | (442) | (65,004) |
| Foreign currency exchange differences | – | – | 992 | – | 992 |
| Other changes | 458 | 11,560 | – | (30) | 11,988 |
| **Closing balance** | **8,551** | **294,014** | **220,983** | **36,844** | **560,392** |
| Short term | 3,214 | 47,435 | 67,159 | 14,201 | 132,009 |
| Long term | 5,337 | 246,579 | 153,824 | 22,643 | 428,383 |

(in PLN thousand)

**Change in provisions in the reporting period**

| 2015 | PROVISIONS FOR LITIGATION AND CLAIMS | PROVISIONS FOR DEFINED BENEFIT PLANS | PROVISIONS FOR UNDRAWN CREDIT FACILITIES AND GUARANTEES ISSUED | OTHER PROVISIONS | TOTAL |
|---|---|---|---|---|---|
| **Opening balance** | **37,873** | **267,991** | **102,386** | **34,206** | **442,456** |
| Provision charges/revaluation | 31,147 | 23,655 | 71,614 | 5,814 | 132,230 |
| Provision utilization | (56,417) | (10,246) | – | (14,435) | (81,098) |
| Provision releases | (2,310) | (84) | (54,411) | (76) | (56,881) |
| Foreign currency exchange differences | – | – | 1,182 | – | 1,182 |
| Other changes | 315 | (12,458) | – | (372) | (12,515) |
| **Closing balance** | **10,608** | **268,858** | **120,771** | **25,137** | **425,374** |
| Short term | 4,113 | 21,180 | 67,527 | 145 | 92,965 |
| Long term | 6,495 | 247,678 | 53,244 | 24,992 | 332,409 |

### Provisions for litigation and claims

Provisions for litigation and claims include court, administrative and other legal proceedings. The provisions were estimated in the amount of expected outflow of resources embodying econimic benefits.

### Provisions for defined benefit plans

Detailed information in respect to provisions for defined benefit plans were presented in Note 45.

### Other provisions

Other provisions include in particular provisions for other employee benefits.

## 44. Other liabilities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Deferred income | 115,137 | 120,308 |
| Provisions for holiday leave | 56,924 | 56,983 |
| Provisions for other employee-related liabilities | 251,582 | 255,274 |
| Provisions for administrative costs | 90,461 | 103,348 |
| Other costs to be paid (*) | 111,239 | 162,048 |
| Other creditors | 338,335 | 274,565 |
| Interbank and interbranch settlements | 1,029,899 | 515,533 |
| Card settlements | 304,475 | 192,476 |
| **Total** | **2,298,052** | **1,680,535** |

(*) in this as at 31 December 2016 is PLN 95 346 thousand of provision for future refunds of the part of the remuneration for sale of insurance products linked to loans (PLN 104 122 as at 31 December 2015).

## 45. Defined benefit plans

Based on internal regulations in respect to remuneration, the employees of the Group or their families are entitled to defined benefits other than remuneration:
a) retirement benefits,
b) death-in-service benefits.

The present value of such obligations is measured by an independent actuary using the projected unit credit method.

The amount of the retirement benefits and death-in-service benefits is dependent on length of service and amount of remuneration. The expected amount of the benefits is discounted actuarially, taking into account the financial discount rate and the probability of an individual get to the retirement age or die while working respectively. The financial discount rate is determined by reference to market yields at the end of reporting period on government bonds. The probability of an individual get to the retirement age or die while working is determined using the multiple decrement model, taking into consideration the following risks: possibility of dismissal from service, risk of total disability to work and risk of death.

(in PLN thousand)

These defined benefit plans expose the Group to actuarial risk, such as:
- interest rate risk – the decrease in market yields on government bonds would increase the defined benefit plans obligations,
- remuneration risk – the increase in remuneration of the Group's employees would increase the defined benefit plans obligations,
- longevity risk – the increase in life expectancy of the Group's employees would increase the defined benefit plans obligations.

The principal actuarial assumptions as at 31 December 2016 are as follows:
- the discount rate at the level of 3.50% (2.90 % as at 31 December 2015),
- the future salary growth rate at the level of 2.50% (2.50 % as at 31 December 2015),
- the probable number of leaving employees calculated on the basis of historical data concerning personnel rotation in the Group,
- the mortality adopted in accordance with Life Expectancy Tables for men and women, published the Central Statistical Office, adequately adjusted on the basis of historical data of the Group.

### Reconciliation of the present value of defined benefit plans obligations

**The following table presents a reconciliation from the opening balances to closing balances for the present value of defined benefit plans obligations.**

| | 2016 | 2015 |
|---|---|---|
| **Opening balance** | **268,858** | **267,991** |
| Current service cost | 18,845 | 16,594 |
| Interest expense | 7,771 | 6,978 |
| Remeasurements of the defined benefit obligations: | 11,560 | (12,900) |
| actuarial gains and losses arising from changes in demographic assumptions | 33,812 | (134) |
| actuarial gains and losses arising from changes in financial assumptions | (16,128) | (9,611) |
| actuarial gains and losses arising from experience adjustments | (6,124) | (3,155) |
| Contributions paid by the employer | (13,020) | (10,247) |
| Business combination | – | 442 |
| **Closing balance** | **294,014** | **268,858** |

### Sensitivity analysis

**The following table presents how the impact on the defined benefits obligations would have increased (decreased) as a result of a change in the respective actuarial assumptions by one percent.**

| | DEFINED BENEFIT PLANS OBLIGATIONS | |
|---|---|---|
| 31.12.2016 | 1 PERCENT INCREASE | 1 PERCENT DECREASE |
| Discount rate | (23,580) | 27,509 |
| Future salary growth rate | 26,278 | (23,033) |

| | DEFINED BENEFIT PLANS OBLIGATIONS | |
|---|---|---|
| 31.12.2015 | 1 PERCENT INCREASE | 1 PERCENT DECREASE |
| Discount rate | (28,208) | 34,057 |
| Future salary growth rate | 34,158 | (28,801) |

### Maturity of defined benefit plans obligations

**The following table presents the maturity profile of the defined benefit plans obligations**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| The weighted average duration of the defined benefit plans obligations (in years) | 8.8 | 11.7 |

(in PLN thousand)

# 46. Share-based payments

**The UniCredit Group incentive program**

In the current and comparative reporting periods the following incentive programs granted to employees of the Bank Pekao Group by the UniCredit Group existed:

- The long-term UniCredit Group Incentive Program 2007 in respect to share options. The rights to exercise the option were acquired in 2011. Strike price is EUR 7.094. The option will expire in 2017,
- The long-term UniCredit Group Incentive Program 2008 in respect to share options. The rights to exercise the option were acquired in 2012. Strike price is EUR 4.185. The option will expire in 2018,
- Employee Share Ownership Plan that offers to eligible UniCredit Group employees the possibility to buy UniCredit ordinary shares with the following advantages: obtaining Free Shares ('Free Shares') granted free of charge based on the number of the Investment shares purchased by each participant. The granting of free ordinary shares depends on the vesting conditions stated in the rules of the Plan.

The above mentioned share-based payments are recognized as cash-settled transactions.

The fair value of share options and shares of UniCredit S.p.A. was established based on the Hull and White model.

**The tables below present changes in the number of stock options and performance shares of UniCredit S.p.A., as well as the weighted average exercise prices**

| | STOCK OPTIONS | | PERFORMANCE SHARES | |
|---|---|---|---|---|
| 2016 | NUMBER | WEIGHTED AVERAGE EXECUTION PRICE (*) | NUMBER | WEIGHTED AVERAGE EXECUTION PRICE |
| Opening balance | 2,289,715 | 17.83/30.23 | – | – |
| Granted during the year | – | – | – | – |
| Redeemed during the year | (24,167) | – | – | – |
| Exercised during the year | – | – | – | – |
| Terminated during the year | – | – | – | – |
| Existing at the period-end | 2,265,548 | 17.83/30.23 | – | – |
| Executable at the period-end | 2,265,548 | 17.83/30.23 | – | – |

(*)The value of PLN 17.83 relates to the stock options program 2008, whereas the value of PLN 30.23 relates to the stock options program 2007.

| | STOCK OPTIONS | | PERFORMANCE SHARES | |
|---|---|---|---|---|
| 2015 | NUMBER | WEIGHTED AVERAGE EXECUTION PRICE (*) | NUMBER | WEIGHTED AVERAGE EXECUTION PRICE |
| Opening balance | 2,345,563 | 17.84/30.24 | – | – |
| Granted during the year | – | – | – | – |
| Redeemed during the year | (55,848) | – | – | – |
| Exercised during the year | – | – | – | – |
| Terminated during the year | – | – | – | – |
| Existing at the period-end | 2,289,715 | 17.83/30.23 | – | – |
| Executable at the period-end | 2,289,715 | 17.83/30.23 | – | – |

(*)The value of PLN 17.83 relates to the stock options program 2008, whereas the value of PLN 30.23 relates to the stock options program 2007.

# Notes to the financial statements

(in PLN thousand)

**The table below presents the conditions of Employee Share Ownership Plan in 2016**

| | FREE SHARES |
|---|---|
| Date of Free Shares delivery to Group employees | 29 July 2016 |
| Vesting Period Start-Date | 29 July 2016 |
| Vesting Period End-Date | 31 July 2017 |
| 'Free Shares' Fair Value (per unit in EUR) | 2.058 |

**The table below presents the conditions of Employee Share Ownership Plan in 2015**

| | FREE SHARES 1ST ELECTION WINDOW | FREE SHARES 2ND ELECTION WINDOW |
|---|---|---|
| Date of Free Shares delivery to Group employees | 30 January 2015 | 31 July 2015 |
| Vesting Period Start-Date | 30 January 2015 | 31 July 2015 |
| Vesting Period End-Date | 31 January 2016 | 31 July 2016 |
| 'Free Shares' Fair Value (per unit in EUR) | 5.280 | 6.078 |

The fair value of granted rights to shares under Employee Share Ownership Plan until 31 December 2016 amounted to PLN 1 675 thousand as at 31 December 2016 (PLN 2 415 as at 31 December 2015).

The remuneration expenses for 2016 relating to the incentive programs granted to the emloyees of the Bank by UniCredit Group amounted to PLN 383 thousand (in 2015 – PLN 1 608 thousand).

### System of Variable Remuneration for the Management Team

The system of variable remuneration is addressed to Employees defined in the Bank as persons in managerial positions, who are key employees for the fulfillment of the Bank's strategy, risk management and long-term increase of the Bank's income. The aim of the system is to support the execution of the Bank's operational strategy, its risk management and to limit conflict of interests.

Under the system the participant can receive the variable compensation, which is paid out based on a bonus pool approach providing for a comprehensive performance measurement at individual level, level of his/her organizational unit and results of the entire Bank as well as verification of the Participant's compliant behaviour with respect to law provisions and standards adopted by the Bank.

The compensation consists of cash payment and cash-settled share based payment realized in the form of phantom shares as cash equivalent amounting to the value of granted phantom shares.

(in PLN thousand)

During the reporting period ending on 31 December 2016 the Bank had the following share-based payments transactions

| | SYSTEM 2012 | SYSTEM 2013 | SYSTEM 2014 | SYSTEM 2015 | SYSTEM 2016 |
|---|---|---|---|---|---|
| Transaction type | Cash-settled share based payments | | | | |
| Start date of the assessment period | 1 January 2012 | 1 January 2013 | 1 January 2014 | 1 January 2015 | 1 January 2016 |
| Program announcement date | April 2012 | April 2013 | June 2014 | July 2015 | June 2016 |
| Program granting date | 12 June 2013 | 12 June 2014 | 30 April 2015 | 16 June 2016 | Date of General Shareholders Meeting |
| Number of instruments granted (pcs) | 80 003 | 76 013 | 68 040 | 93 359 | Will be defined on granting date |
| Maturity date | 31 July 2017 | 31 July 2018 | 31 July 2020 | 31July 2021 | 31 July 2022 |
| Vesting date for Management Board Members and Executive Vice President | • 40% after 2 years from program granting date<br>• 40% after 3 years from program granting date<br>• 20% after 4 years from program granting date | • 40% in the year of program granting (settlement after 2 years retention period)<br>• 40% after 2 years from program granting date (settlement after 1 year retention period)<br>• 20% after 3 years from program granting date (settlement after 1 year retention period) | • 40% in the year of program granting (settlement after 3 years retention period)<br>• 30% after 3 years from program granting date (settlement after 1 year retention period)<br>• 30% after 4 years from program granting date (settlement after 1 year retention period) | • 40% in the year of program granting (settlement after 2 years retention period)<br>• 24% after 2 years from program granting date (settlement after 1 year retention period)<br>• 12% after 3 years from program granting date (settlement after 1 year retention period)<br>• 24% after 4 years from program granting date (settlement after 1 year retention period) | • 40% in the year of program granting (settlement after 2 years retention period)<br>• 24% after 2 years from program granting date (settlement after 1 year retention period)<br>• 12% after 3 years from program granting date (settlement after 1 year retention period)<br>• 24% after 4 years from program granting date (settlement after 1 year retention period) |
| Vesting date for remaining participants | • 20% after 1 year from program granting date<br>• 40% after 2 years from program granting date<br>• 40% after 3 years from program granting date | • 20% after 1 year from program granting date<br>• 40% after 2 years from program granting date<br>• 40% after 3 years from program granting date | • 60% in the year of program granting (settlement after 3 years retention period)<br>• 20% after 3 years from program granting date (settlement after 1 year retention period)<br>• 20% after 4 years from program granting date (settlement after 1 year retention period) | • 60% in the year of program granting (settlement after 3 years retention period)<br>• 20% after 3 years from program granting date (settlement after 1 year retention period)<br>• 20% after 4 years from program granting date (settlement after 1 year retention period) | • 60% in the year of program granting (settlement after 2 years retention period)<br>• 20% after 2 years from program granting date (settlement after 1 year retention period)<br>• 20% after 3 years from program granting date (settlement after 1 year retention period) |
| Vesting conditions | Compliance assessment, Continuous employment, Reaching the aim based on financial results of the Bank for a given period | | | | |
| Program settlement | On the vesting date, the participant will receive a cash payment amounting to the number the possessed phantom shares times the arithmetic mean of the Bank's share prices at the Warsaw Stock Exchange:<br>• in case of the settlement made at the dates of instalment after the mandatory retention period, for a month preceding the day of General Meeting approving the financial statements for a given year,<br>• in case of settlement made in the voluntary retention period, for 10 working days following the day of release of the financial report in a given quarter, and benefits from acquired phantom shares in the amount equivalent to dividend paid to shareholders in the retention period for shares acquired by the participant | | | | |

For the System 2012, 2013, 2014 and 2015 the fair value of the program was estimated based upon the Bank's shares price on the WSE as of the balance sheet date and expected number of phantom shares to which the rights will be acquired.

For the System 2016, as of 31 December 2016 the Bank prepared the program valuation, presuming that the phantom shares were granted on 31 December 2016. This value will be changed at the actual date of granting the program.

The system of variable remuneration realized in the form of phantom shares is a program settled in cash, and therefore its fair value is adjusted on each balance sheet date until the the program settlement, which in case of this program coincides with the vesting date.

(in PLN thousand)

The carrying amount of liabilities for cash-settled phantom shares amounted to PLN 22 532 thousand as at 31 December 2016 (as at 31 December 2015 – PLN 24 534 thousand).

The total intrinsic value of liabilities for vested rights to phantom shares amounted to PLN 26 446 thousand as at 31 December 2016 (as at 31 December 2015 – PLN 27 417 thousand).

The remuneration expenses for 2016 relating to the system of variable remuneration in the form of phantom shares amounted to PLN 9 189 thousand (in 2015 – PLN 6 312 thousand).

**The table below presents changes in the number of Bank's phantom shares**

| | 2016 | 2015 |
|---|---|---|
| Opening balance | 191,060 | 199,452 |
| Granted during the year | 93,359 | 68,040 |
| Redeemed during the year | – | – |
| Exercised during the year | 74,196 | 76,432 |
| Terminated during the year | – | – |
| Existing at the period-end | 210,223 | 191,060 |

The table above does not present the number of shares granted in respect of System 2016. This number will be determined in 2017 after approval of the financial statements for 2016 by the General Shareholder's Meeting. The hypothetical number of shares determined on the basis of the base value of the granted bonus to each of the program participants and arithmetic mean of the Bank's share price on the WSE in December 2016 amounts to 126 547.

### System of Variable Remuneration for the Management Team of the subsidiaries

In order to meet requirements concerning rules of establishing policy of variable remuneration's component for individuals in managerial positions (Resolution No. 258/2011 of the Polish Financial Supervision Authority issued on 4 October 2011 and the Minister of Finance Regulation dated 2 December 2011, Official Journal from 2011, No. 263, item 1569), the followinf subsidiaries: Centralny Dom Maklerski Pekao S.A., Pekao Bank Hipoteczny S.A., Pekao Leasing Sp. z o.o., Pekao Investment Banking S.A. and Pekao Financial Services Sp. z o.o. have implemented System of Variable Remuneration for the Management Team.

Within the system participant can receive the bonus depending on the performance and results of work of the participant, of the business unit and the company's results in the area of responsibility of the person, taking into account the results of the whole company, as well as verification of the compliance of Participant's behaviour with respect to law provisions and standards adopted by the company.

At least 40 % components of variable renumerations is settled and paid in the time-period of 3 to 5 years since the granting date.

The companies measure the future employees benefits at fair value of accepted liabilities, in accordance with IAS 19 'Employee benefits'. Results of liabilities meassurement at fair value are presented in income statement as personnel expenses.

The carrying amount of liabilities for cash-settled phantom shares amounted to PLN 4 026 thousand as at 31 December 2016 (as at 31 December 2015 – PLN 4 030 thousand).

The remuneration expenses for 2016 relating to the system of variable remuneration in the form of phantom shares amounted to PLN 1 545 thousand (in 2015 – PLN 127 thousand).

(in PLN thousand)

# 47. Operating lease

### The Group as a Lessor

In operating lease of buildings classified as investment properties the Group acts as a lessor.

The amount of future minimum lease payments expected to be received under non-cancellable operating lease can be summarized as follows

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Up to 1 year | 8,016 | 7,334 |
| Between 1years and 5 years | 3,436 | 2,869 |
| Over 5 years | 929 | 498 |
| **Total** | **12,381** | **10,701** |

The amount of the minimum operating lease payments classified as income in 2016 amounted to PLN 18 757 thousand (in 2015 – PLN 19 262 thousand in 2015).

### The Group as Lessee

The Group is a lessee of buildings' lease contracts classified as operating lease.

The amount of future minimum lease payments expected to be paid under non-cancellable operating lease can be summarized as follows

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Up to 1 year | 98,387 | 111,591 |
| Between 1years and 5 years | 212,397 | 243,264 |
| Over 5 years | 62,118 | 105,814 |
| **Total** | **372,902** | **460,669** |

The amount of the minimum operating lease payments recognized as an expense in 2016 amounted to PLN 172 411 thousand (expense in 2015 amounted to PLN 186 023 thousand).

The lease agreements are usually entered into for an indefinite period. In case of lease agreements concluded for an indefinite term, the minimum lease payments are determined based upon notice of termination periods ensuing from relevant contracts. The notice period is usually fixed at 3 or 6 months. Lease agreements are denominated in PLN as well as in foreign currencies. Payments are made in PLN, regardless of the contract currency.

# 48. Contingent commitments

### Litigation

In the entire year of 2016 the total value of the litigation subject in the ongoing court proceedings against the Group was PLN 1 091 638 thousand (in 2015 it was PLN 1 142 702 thousand).

In 2016 there were no proceedings before the court or state administration bodies related to the receivables or payables of the Bank and its subsidiaries in which the pursued claim value (amount to be paid) is at least 10% of the Group's equity.

In 2016 still going on was the court litigation against the Group entities, Bank Pekao S.A. and Pekao S.A. Central Brokerage House, brought by private individuals for the payment of damage arising from the purchase of stocks and the financial compensation for the injury resulting from the execution process, in which the value of the litigation subject, as at 31 December 2016, was PLN 206 422 thousand (previously PLN 306 622 thousand).
In the first half of 2015 the sentence dismissing the plaint against defendants was adjudicated. The sentence is not legally binding. The plaintiffs lodged an appeal against the sentence, i.e. its part related to the amount of PLN 206 422 thousand. In the third quarter of 2016 was issued a judgment dismissing the appeal. The plaintiffs are entitled to a cassation appeal.

(in PLN thousand)

Moreover against the Group currently are pending the following essential litigations, in which the Bank – in the current factual and legal circumstances – assess the risk of outflow as possible :

- proceedings instigated in the first quarter of 2014 as a result of the plaint brought by guarantee beneficiaries for the payment of PLN 32 750 thousand as the bank guarantee drawing,
- proceedings instigated in the second quarter of 2014 as a result of the plaint brought by a guarantee beneficiary for the payment of PLN 55 996 thousand as the bank guarantee drawing,
- proceedings instigated in the first quarter of 2015 as a result of the plaint brought by guarantee beneficiary for the payment of PLN 29 205 thousand as the bank guarantee drawing,
- proceeding instigated in the fourth quarter of 2016 as a result plaint brought by private individual for the payment of PLN 38 916 thousand taken by the Bank way of settlement of term financial transactions.

The Group created provisions for litigations against the Group entities which, according to the legal opinion, are connected with a risk of the funds outflow resulting from the fulfillment of the obligation. The value of the provisions as at 31 December 2016 is PLN 8 551 thousand (PLN 10 608 thousand as at 31 December 2015).

### Financial off–balance commitments granted

#### Financial commitments granted by entities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Financial commitments to: | | |
| financial entities | 734,503 | 700,755 |
| non – financial entities | 31,088,328 | 29,386,749 |
| budget entities | 481,482 | 848,356 |
| **Total** | **32,304,313** | **30,935,860** |

### Off–balance guarantees issued

#### Guarantees issued by entities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Issued to financial entities, including: | 991,115 | 1,311,490 |
| guarantees | 991,115 | 1,308,840 |
| confirmed export letters of credit | – | 2,650 |
| Issued to non-financial entities, including: | 9,999,478 | 12,393,161 |
| guarantees | 6,505,040 | 7,510,192 |
| securities' underwriting guarantees | 3,455,429 | 4,806,284 |
| sureties | 39,009 | 76,685 |
| Issued to budget entities, including: | 269,239 | 368,176 |
| guarantees | 11,279 | 28,176 |
| securities' underwriting guarantees | 257,960 | 340,000 |
| **Total** | **11,259,832** | **14,072,827** |

(in PLN thousand)

## Securities underwriting

As at 31 December 2016, the following securities programs have been in place, covered by underwriting

| NAME OF ISSUER | TYPE OF SECURITIES | OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF | CONTRACT LIFE |
|---|---|---|---|
| Client 1 | bonds | 1,385,000 | 23.07.10 – 30.06.20 |
| Client 2 | bonds | 265,000 | 21.06.12 – 31.12.17 |
| Client 3 | bonds | 484,880 | 22.10.13 – 31.05.22 |
| Client 4 | bonds | 35,000 | 27.01.14 – 28.04.17 |
| Client 5 | bonds | 110,510 | 30.06.14 – 31.03.17 |
| Client 6 | bonds | 2,200 | 15.09.14 – 31.03.18 |
| Client 7 | bonds | 20,000 | 15.09.14 – 31.03.18 |
| Client 8 | bonds | 150,000 | 24.05.16 – 31.03.18 |
| Client 9 | bonds | 49,000 | 22.12.14 – 30.06.17 |
| Client 10 | bonds | 230,000 | 23.02.15 – 30.06.17 |
| Client 11 | bonds | 100,000 | 23.02.15 – 30 11.22 |
| Client 12 | bonds | 84,000 | 27.01.15 – 31.12.17 |
| Client 13 | bonds | 30,000 | 14.10.15 – 31.12.17 |
| Client 14 | bonds | 7,500 | 14.10.15 – 31.12.17 |
| Client 15 | bonds | 119,985 | 18.12.15 – 28.04.17 |
| Client 16 | bonds | 20,270 | 28.12.15 – 31.12.17 |
| Client 17 | bonds | 19,504 | 09.03.16 – 30.06.17 |
| Client 18 | bonds | 22,810 | 09.03.16 – 30.06.17 |
| Client 19 | bonds | 53,500 | 21.05.16 – 21.06.19 |
| Client 20 | bonds | 3,500 | 21.05.16 – 21.06.19 |
| Client 21 | bonds | 8,000 | 06.07.16 – 31.12.18 |
| Client 22 | bonds | 67,200 | 06.07.16 – 31.12.18 |
| Client 23 | bonds | 8,680 | 06.07.16 – 31.12.18 |
| Client 24 | bonds | 8,000 | 06.07.16 – 31.12.18 |
| Client 25 | bonds | 310,600 | 31.08.16 – 30.12.19 |
| Client 26 | bonds | 13,000 | 31.08.16 – 30.12.19 |
| Client 27 | bonds | 6,000 | 08.11.16 – 31.12.17 |
| Client 28 | bonds | 4,300 | 23.12.16 – 31.12.18 |
| Client 29 | bonds | 1,000 | 22.12.16 – 30.12.16 |
| Client 30 | bonds | 6,650 | 23.12.16 – 31.12.18 |
| Client 31 | bonds | 66,000 | 20.12.16 – 31.12.20 |
| Client 32 | bonds | 15,000 | 28.12.16 – 31.08.17 |
| Client 33 | bonds | 6,300 | 29.12.16 – 31.08.17 |

Securities covered by the Bank underwriting are classified as securities with unlimited marketability, unquoted on stock exchanges and are not a subject to regulated off-the-floor trading.

(in PLN thousand)

As at 31 December 2015, the following securities programs have been in place, covered by underwriting

| NAME OF ISSUER | TYPE OF SECURITIES | OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF | CONTRACT LIFE |
|---|---|---|---|
| Client 1 | bonds | 1,385,000 | 23.07.10 – 30.06.20 |
| Client 2 | bonds | 458,000 | 21.06.12 – 31.12.17 |
| Client 3 | bonds | 99,220 | 06.12.12 – 31.03.16 |
| Client 4 | bonds | 52,400 | 28.12.12 – 30.03.16 |
| Client 5 | bonds | 76,900 | 28.12.12 – 30.03.16 |
| Client 6 | bonds | 164,700 | 01.07.11 – 20.12.17 |
| Client 7 | bonds | 11,430 | 20.05.13 – 24.02.16 |
| Client 8 | bonds | 17,200 | 14.04.15 – 10.06.16 |
| Client 9 | bonds | 78,000 | 14.04.15 – 10.06.16 |
| Client 10 | bonds | 484,880 | 22.10.13 – 14.12.16 |
| Client 11 | bonds | 50,000 | 22.10.13 – 14.12.16 |
| Client 12 | bonds | 16,250 | 27.01.14 – 30.09.16 |
| Client 13 | bonds | 6,500 | 15.05.14 – 31.12.16 |
| Client 14 | bonds | 700 | 31.05.14 – 31.12.16 |
| Client 15 | bonds | 157,510 | 30.06.14 – 31.03.17 |
| Client 16 | bonds | 61,710 | 22.07.14 – 31.07.16 |
| Client 17 | bonds | 6,530 | 22.07.14 – 31.07.16 |
| Client 18 | bonds | 100,000 | 30.07.14 – 30.06.19 |
| Client 19 | bonds | 830 | 29.07.14 – 30.06.16 |
| Client 20 | bonds | 20,450 | 29.07.14 – 30.09.16 |
| Client 21 | bonds | 25,000 | 25.08.14 – 31.08.16 |
| Client 22 | bonds | 45,770 | 29.05.14 – 30.04.16 |
| Client 23 | bonds | 29,050 | 15.09.14 – 31.12.16 |
| Client 24 | bonds | 20,000 | 15.09.14 – 31.12.16 |
| Client 25 | bonds | 5,600 | 15.09.14 – 31.12.16 |
| Client 26 | bonds | 33,790 | 31.10.14 – 31.03.16 |
| Client 27 | bonds | 50,000 | 22.12.14 – 30.06.17 |
| Client 28 | bonds | 52,135 | 30.12.14 – 30.06.16 |
| Client 29 | bonds | 1,378 | 30.12.14 – 31.03.16 |
| Client 30 | bonds | 198,780 | 30.12.14 – 09.03.16 |
| Client 31 | bonds | 20,500 | 30.12.14 – 31.12.16 |
| Client 32 | bonds | 230,000 | 23.02.15 – 30.06.17 |
| Client 33 | bonds | 100,000 | 23.02.15 – 30.11.22 |
| Client 34 | bonds | 350,000 | 20.02.15 – 30.04.16 |
| Client 35 | bonds | 16,000 | 27.01.15 – 31.12.16 |
| Client 36 | bonds | 74,000 | 31.12.15 – 31.12.16 |
| Client 37 | bonds | 39,000 | 14.10.15 – 31.12.17 |
| Client 38 | bonds | 12,500 | 14.10.15 – 31.12.17 |
| Client 39 | bonds | 154,955 | 18.12.15 – 30.09.16 |
| Client 40 | bonds | 30,000 | 28.12.15 – 31.12.17 |
| Client 41 | bonds | 409,616 | 25.08.14 – 31.12.16 |

Securities covered by the Bank underwriting are classified as securities with unlimited marketability, unquoted on stock exchanges and are not a subject to regulated off-the-floor trading.

(in PLN thousand)

**Off-balance commitments received**

**Commitments received by entities**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Financial commitments from: | 209,107 | 285,084 |
| financial entities | 209,107 | 285,084 |
| non – financial entities | – | – |
| budget entities | – | – |
| Guarantees from: | 10,818,912 | 11,674,503 |
| financial entities | 1,552,730 | 1,161,416 |
| non – financial entities | 8,344,980 | 9,759,234 |
| budget entities | 921,202 | 753,853 |
| **Total** | **11,028,019** | **11,959,587** |

Moreover, the Group can to obtain financing from the National Bank of Poland pledged on securities.

# 49. Share capital

**Shareholding structure**

| CLASS/ISSUE | TYPE OF SHARES | NUMBER OF SHARES | NOMINAL VALUE OF CLASS/ISSUE | EQUITY COVERAGE | REGISTRATION DATE | DIVIDEND RIGHTS (FROM DATE) |
|---|---|---|---|---|---|---|
| A | Common bearer stock | 137,650,000 | 137,650 | fully paid-up | 21.12.1997 | 01.01.1998 |
| B | Common bearer stock | 7,690,000 | 7,690 | fully paid-up | 06.10.1998 | 01.01.1998 |
| C | Common bearer stock | 10,630,632 | 10,631 | fully paid-up | 12.12.2000 | 01.01.2000 |
| D | Common bearer stock | 9,777,571 | 9,777 | fully paid-up | 12.12.2000 | 01.01.2000 |
| E | Common bearer stock | 373,644 | 374 | fully paid-up | 29.08.2003 | 01.01.2003 |
| F | Common bearer stock | 621,411 | 621 | fully paid-up | 29.08.2003 | 19.05.2006<br>16.05.2007 |
| G | Common bearer stock | 603,377 | 603 | fully paid-up | 29.08.2003 | 15.05.2008 |
| H | Common bearer stock | 359,840 | 360 | fully paid-up | 12.08.2004 | 01.01.2004 |
| I | Common bearer stock | 94,763,559 | 94,764 | fully paid-up | 29.11.2007 | 01.01.2008 |
| **Total number of Shares (pcs)** | | **262,470,034** | | | | |
| **Total share capital in PLN thousand** | | | **262,470** | | | |
| **Nominal value per share = PLN 1.00** | | | | | | |

**Change in the number of shares (pcs)**

| 2016 | ISSUED AND FULLY PAID-UP SHARES | TOTAL |
|---|---|---|
| Opening balance | 262,470,034 | 262,470,034 |
| Closing balance | 262,470,034 | 262,470,034 |

| 2015 | ISSUED AND FULLY PAID-UP SHARES | TOTAL |
|---|---|---|
| Opening balance | 262,470,034 | 262,470,034 |
| Closing balance | 262,470,034 | 262,470,034 |

(in PLN thousand)

# 50. Other capital and reserves, retained earnings and profit for the period

**The table below presents the structure of the Group's equity attributable to equity holders of the Bank**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Reserve capital, including: | 9,480,043 | 9,474,405 |
| issue of shares above face value | 9,137,221 | 9,137,221 |
| other | 342,822 | 337,184 |
| Revaluation reserve, including: | (223,394) | 283,597 |
| remeasurements of the defined benefit liabilities | (98,315) | (86,777) |
| deferred tax | 18,680 | 16,488 |
| revaluation of financial assets portfolio available for sale | (217,204) | 391,616 |
| deferred tax | 41,269 | (74,407) |
| revaluation of financial hedging instruments portfolio | 39,724 | 45,280 |
| deferred tax | (7,548) | (8,603) |
| Foreign currency translation differences, including: | – | – |
| foreign currency translation differences | – | – |
| deferred tax | – | – |
| General Banking Risk Fund | 1,982,324 | 1,975,415 |
| Other reserve capital | 9,092,735 | 9,092,740 |
| Bonds convertible into shares- equity component | 28,819 | 28,819 |
| Funds for brokerage activities | 15,000 | 15,000 |
| **Total other capital** | **20,375,527** | **20,869,976** |
| Profit (loss) from previous periods, allocated to Bank's shareholders | (20,253) | (16,676) |
| Net profit for the period, allocated to Bank's shareholders | 2,279,275 | 2,292,459 |
| **Total retained earnings and profit for the period** | **2,259,022** | **2,275,783** |
| **Total** | **22,634,549** | **23,145,759** |

The net profit of the Bank for 2015 in the amount of PLN 2 290 398 thousand was distributed in the following way: PLN 2 283 489 thousand – to dividend, PLN 6 909 thousand – to General Banking Risk Fund.

From 1982 to 1984 and from 1988 to 1996, the Group operated in a hyperinflationary economic environment.

IAS 29 (Financial Reporting in Hyperinflationary Economies) requires restatement of each component of owners' equity (except for retained earnings and revaluation surplus) by applying a general price index for the period of hyperinflation. This retrospective application would have resulted in an increase in share capital and other reserves and a decrease in retained earnings in equivalent amounts. This restatement would not have any effect on the total amount of the Group's equity.

(in PLN thousand)

# 51. Non – controlling interests

**The below table presents the information for each of the subsidiaries that have non-controlling interests that are material to the Group**

| NAME OF THE SUBSIDIARY | COUNTRY OF INCORPORATION AND PLACE OF BUSINESS | PERCENTAGE SHARE OF NON-CONTROLLING INTERESTS IN SHARE CAPITAL / VOTING RIGHTS | | NET PROFIT FOR THE PERIOD ATTRIBUTABLE TO NON-CONTROLLING INTERESTS | | ACCUMULATED NON-CONTROLLING INTERESTS | |
|---|---|---|---|---|---|---|---|
| | | 31.12.2016 | 31.12.2015 | 2016 | 2015 | 31.12.2016 | 31.12.2015 |
| Pekao Pioneer Powszechne Towarzystwo Emerytalne S.A. | Poland | 35.00 | 35.00 | 489 | 1,019 | 14,924 | 15,964 |
| **TOTAL** | | | | **489** | **1,019** | **14,924** | **15,964** |

**The summarized financial information of each of the subsidiaries that are material to the Group are presented below**

| | PEKAO PIONEER POWSZECHNE TOWARZYSTWO EMERYTALNE S.A. | |
|---|---|---|
| | 31.12.2016 | 31.12.2015 |
| Loans and advances to banks | 15,256 | 44,995 |
| Investments (placement) securities | 27,214 | – |
| Other items of assets | 2,385 | 2,830 |
| **TOTAL ASSETS** | **44,855** | **47,825** |
| Other items of liabilities | 2,217 | 2,458 |
| **TOTAL LIABILITIES** | **2,217** | **2,458** |

| | PEKAO PIONEER POWSZECHNE TOWARZYSTWO EMERYTALNE S.A. | |
|---|---|---|
| | 2016 | 2015 |
| Revenue | 13,996 | 14,714 |
| Net profit for the period | 1,397 | 2,913 |
| **Total comprehensive income** | **1,397** | **2,913** |
| Dividends paid to non-controlling interests | 1,529 | 8,088 |
| Cash flows from operating activities | 1,911 | 3,662 |
| Cash flows from investing activities | (27,280) | (925) |
| Cash flows from financing activities | (4,369) | (23,108) |
| Net change in cash and cash equivalents | (29,738) | (20,371) |
| Cash and cash equivalents at the beginning of the period | 44,995 | 65,366 |
| Cash and cash equivalents at the end of the period | 15,257 | 44,995 |

(in PLN thousand)

# 52. Additional information to the consolidated cash flow statement

**Cash and cash equivalents**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Cash and amounts due from Central Bank | 5,872,911 | 7,881,607 |
| Loans and receivables from banks with maturity up to 3 months | 2,793,179 | 6,631,788 |
| **Cash and Cash equivalents presented in the cash flow statement** | **8,666,090** | **14,513,395** |

Restricted availability cash and cash equivalents as at 31 December 2016 amounted to PLN 4 605 707 thousand (PLN 4 338 995 thousand as at 31 December 2015).

# 53. Related party transactions

Transactions between the Bank and related parties are typical transactions arising from current operating activities conducted by the Bank. Such transactions mainly include loans, deposits, foreign currency transactions and guarantees.

**The credit granting process applicable to the Bank's management and entities related to the Bank**
According to the Banking Act, credit transactions with Members of the Bank Management Board and Supervisory Board, persons holding managerial positions at the Bank, with the entities related financially or organizationally therewith, shall be effected according to Regulation adopted by the Supervisory Board of the Bank.

The Regulation provides detailed decision-making procedures, applicable to transactions with such persons and entities, also defining the decision-making levels, authorized to take decisions. In particular, transactions with Members of the Bank's Management Board or Supervisory Board or with an entity related therewith financially or organizationally, are subject to decisions taken by the Bank's Management Board and Supervisory Board.

Members of the Bank's Management Board and entities related therewith financially or organizationally may take advantage of credit products offered by the Bank on standard terms and conditions of the Bank. In particular, the Bank may not offer more advantageous credit interest rates to such persons or entities.

Credit risk assessment is performed using the methodology applied by the Bank, tailored to the client's segment and type of transaction.

In case of entities related to the Bank, the standard credit procedures are applied, with transaction-related decisions taken exclusively at level of the Bank's Head Office.

(in PLN thousand)

## Related party transactions

### Related party transactions as at 31 December 2016

| NAME OF ENTITY | RECEIVABLES FROM LOANS, ADVANCES AND PLACEMENTS | SECURITIES | RECEIVABLES FROM REVALUATION OF DERIVATIVES | OTHER RECEIVABLES | LIABILITIES FROM LOANS AND DEPOSITS | LIABILITIES FROM REVALUATION OF DERIVATIVES | OTHER LIABILITIES |
|---|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 187,357 | – | – | 443 | 9,261 | – | 1,674 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 682,836 | 9,719 | 32,072 | 1,306 | 614,127 | 620,819 | 2,972 |
| **Associates of Bank Pekao S.A Group** | | | | | | | |
| Dom Inwestycyjny Xelion Sp. z o.o. | – | – | – | 48 | 28,682 | – | – |
| Pioneer Pekao Investment Management S.A. | – | – | – | – | 137,850 | – | – |
| Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary) | – | – | – | 15,199 | 112,949 | – | – |
| **Total Associates of Bank Pekao S.A. Group** | **–** | – | **–** | **15,247** | **279,481** | **–** | **–** |
| Key management personnel of the Bank and UniCredit S.p.A. | 7,948 | – | – | – | 28,457 | – | – |
| **Total** | **878,141** | **9,719** | **32,072** | **16,996** | **931,326** | **620,819** | **4,646** |

### Receivables from loans and deposits by contractual maturity

| 31.12.2016 | CURRENT (*) | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 12,342 | 175,015 | – | – | – | – | 187,357 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 597,829 | 85,007 | – | – | – | – | 682,836 |
| Associates of Bank Pekao S.A Group | – | – | – | – | – | – | – |
| Key management personnel of the Bank and UniCredit S.p.A. | – | 5,506 | – | – | 202 | 2,240 | 7,948 |
| **Total** | **610,171** | **265,528** | **–** | **–** | **202** | **2,240** | **878,141** |

(*) Current receivables includude Nostro accounts and cash collaterals.

### Liabilities due to loans and deposits by contractual maturity

| 31.12.2016 | CURRENT (*) | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 9,261 | – | – | – | – | – | 9,261 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 65,821 | 126,115 | 315 | 1,451 | 420,425 | – | 614,127 |
| Associates of Bank Pekao S.A Group | 17,348 | 91,256 | 170,877 | – | – | – | 279,481 |
| Key management personnel of the Bank and UniCredit S.p.A. | 8,501 | 3,226 | 15,748 | 982 | – | – | 28,457 |
| **Total** | **100,931** | **220,597** | **186,940** | **2,433** | **420,425** | **–** | **931,326** |

(*) Current liabilities include Loro accounts and cash collaterals.

# Notes to the financial statements

(in PLN thousand)

## Receivables from loans and deposits by currency

| 31.12.2016 | EUR | USD | CHF | PLN | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 2,160 | 10,180 | – | 175,017 | – | 187,357 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 561,564 | 113 | 7 | 99,082 | 22,070 | 682,836 |
| Associates of Bank Pekao S.A Group | – | – | – | – | – | – |
| Key management personnel of the Bank and UniCredit S.p.A. | – | – | – | 7,948 | – | 7,948 |
| **Total** | **563,724** | **10,293** | **7** | **282,047** | **22,070** | **878,141** |

## Liabilities due to loans and deposits by currency

| 31.12.2016 | EUR | USD | CHF | PLN | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 543 | – | – | 8,718 | – | 9,261 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 52,131 | – | 391,206 | 167,723 | 3,067 | 614,127 |
| Associates of Bank Pekao S.A Group | – | – | – | 279,481 | – | 279,481 |
| Key management personnel of the Bank and UniCredit S.p.A. | 6,818 | 295 | – | 21,333 | 11 | 28,457 |
| **Total** | **59,492** | **295** | **391,206** | **477,255** | **3,078** | **931,326** |

## Related party transactions as at 31 December 2015

| NAME OF ENTITY | RECEIVABLES FROM LOANS, ADVANCES AND PLACEMENTS | SECURITIES | RECEIVABLES FROM REVALUATION OF DERIVATIVES | OTHER RECEIVABLES | LIABILITIES FROM LOANS AND DEPOSITS | LIABILITIES FROM REVALUATION OF DERIVATIVES | OTHER LIABILITIES |
|---|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 605,703 | – | – | 605 | 1,209 | – | 2,415 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 1,114,848 | 7,724 | 55,861 | 4,843 | 1,507,266 | 653,064 | 966 |
| **Associates of Bank Pekao S.A Group** | | | | | | | |
| Dom Inwestycyjny Xelion Sp. z o.o. | – | – | – | 3 | 25,262 | – | 29 |
| Pioneer Pekao Investment Management S.A. | – | – | – | 35 | 162,752 | – | 23 |
| Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary) | – | – | – | 16,323 | 115,116 | – | 21 |
| **Total Associates of Bank Pekao S.A. Group** | **–** | **–** | **–** | **16,361** | **303,130** | **–** | **73** |
| Key management personnel of the Bank and UniCredit S.p.A. | 8,568 | – | – | – | 22,180 | – | – |
| **Total** | **1,729,119** | **7,724** | **55,861** | **21,809** | **1,833,785** | **653,064** | **3,454** |

## Receivables from loans and deposits by contractual maturity

| 31.12.2015 | CURRENT (*) | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 8,497 | 597,206 | – | – | – | – | 605,703 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 616,160 | 94,797 | 482 | 779 | 402,630 | – | 1,114,848 |
| Associates of Bank Pekao S.A Group | – | – | – | – | – | – | – |
| Key management personnel of the Bank and UniCredit S.p.A. | – | 5,999 | – | 37 | 186 | 2,346 | 8,568 |
| **Total** | **624,657** | **698,002** | **482** | **816** | **402,816** | **2,346** | **1,729,119** |

(*) Current receivables include Nostro accounts and cash collaterals.

(in PLN thousand)

## Liabilities due to loans and deposits by contractual maturity

| 31.12.2015 | CURRENT (*) | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 1,209 | – | – | – | – | – | 1,209 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 160,673 | 8,458 | 963,829 | – | 374,306 | – | 1,507,266 |
| Associates of Bank Pekao S.A Group | 16,224 | 92,203 | 194,703 | – | – | – | 303,130 |
| Key management personnel of the Bank and UniCredit S.p.A. | 4,474 | 4,007 | 9,841 | 3,808 | 50 | – | 22,180 |
| **Total** | **182,580** | **104,668** | **1,168,373** | **3,808** | **374,356** | **–** | **1,833,785** |

(*) Current liabilities include Loro accounts and cash collaterals.

## Receivables from loans and deposits by currency

| 31.12.2015 | EUR | USD | CHF | PLN | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 243,767 | 350,936 | – | 11,000 | – | 605,703 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 598,100 | 403,900 | 7 | 67,079 | 45,762 | 1,114,848 |
| Associates of Bank Pekao S.A Group | – | – | – | – | – | – |
| Key management personnel of the Bank and UniCredit S.p.A. | – | – | – | 8,568 | – | 8,568 |
| **Total** | **841,867** | **754,836** | **7** | **86,647** | **45,762** | **1,729,119** |

## Liabilities due to loans and deposits by currency

| 31.12.2015 | EUR | USD | CHF | PLN | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | – | – | – | 1,209 | – | 1,209 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 1,010,843 | 261 | 374,306 | 121,856 | – | 1,507,266 |
| Associates of Bank Pekao S.A Group | – | – | – | 303,130 | – | 303,130 |
| Key management personnel of the Bank and UniCredit S.p.A. | 7,129 | 920 | – | 14,128 | 3 | 22,180 |
| **Total** | **1,017,972** | **1,181** | **374,306** | **440,323** | **3** | **1,833,785** |

## Income and expenses from transactions with related parties for the period from 1 January 2016 to 31 December 2016

| NAME OF ENTITY | INTEREST INCOME | INTERES EXPENSE | FEE AND COMMISSION INCOME | FEE AND COMMISSION EXPENSE | POSITIVE VALUATION OF DERIVATIVES AND OTHER INCOME | NEGATIVE VALUATION OF DERIVATIVES AND OTHER EXPENSES |
|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | (137) | (375) | 1,239 | (2,723) | 3,158 | (13,368) |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 13,416 | (4,448) | 9,282 | (246) | 18,580 | (55,879) |
| **Associates of Bank Pekao S.A Group** | | | | | | |
| Pioneer Pekao Investment Management S.A. | – | (1,862) | 197 | – | 14 | – |
| Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary) | – | (1,370) | 189,607 | – | 4 | – |
| Dom Inwestycyjny Xelion Sp.z o.o. | – | (323) | 45 | (171) | 318 | – |
| **Total Associates of Bank Pekao S.A. Group** | **–** | **(3,555)** | **189,849** | **(171)** | **336** | **–** |
| Key management personnel of the Bank and UniCredit S.p.A. | 237 | (318) | 17 | – | – | – |
| **Total** | **13,516** | **(8,696)** | **200,387** | **(3,140)** | **22,074** | **(69,247)** |

# Notes to the financial statements

(in PLN thousand)

### Income and expenses from transactions with related parties for the period from 1 January 2015 to 31 December 2015

| NAME OF ENTITY | INTEREST INCOME | INTERES EXPENSE | FEE AND COMMISSION INCOME | FEE AND COMMISSION EXPENSE | POSITIVE VALUATION OF DERIVATIVES AND OTHER INCOME | NEGATIVE VALUATION OF DERIVATIVES AND OTHER EXPENSES |
|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 216 | (246) | 1,689 | (3,070) | 811 | (15,664) |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 42,043 | (4,242) | 9,388 | (1,329) | 41,577 | (6,896) |
| **Associates of Bank Pekao S.A Group** | | | | | | |
| Pioneer Pekao Investment Management S.A. | – | (2,761) | 357 | – | 26 | – |
| Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary) | – | (1,973) | 226,313 | – | – | – |
| Dom Inwestycyjny Xelion Sp.z o.o. | – | (361) | 64 | (117) | 314 | (1) |
| Krajowa Izba Rozliczeniowa S.A. (*) | – | (135) | 57 | – | – | (4,303) |
| **Total Associates of Bank Pekao S.A. Group** | **–** | **(5,230)** | **226,791** | **(117)** | **340** | **(4,304)** |
| Key management personnel of the Bank and UniCredit S.p.A. | 253 | (419) | 17 | – | – | – |
| **Total** | **42,512** | **(10,137)** | **237,885** | **(4,516)** | **42,728** | **(26,864)** |

(*) until sale's date 3 125 shares.

### Off-balance sheet financial liabilities and guarantees as at 31 December 2016

| NAZWA JEDNOSTKI | GRANTED | | RECEIVED | |
|---|---|---|---|---|
| | FINANCIAL | GUARANTEES | FINANCIAL | GUARANTEE |
| UniCredit S.p.A. – the Bank's parent entity | 50,162 | 246,519 | – | 53,963 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 202,191 | 599,604 | 5,192 | 192,481 |
| **Associates of Bank Pekao S.A Group** | | | | |
| Pioneer Pekao Investment Management S.A. | 15 | – | – | – |
| Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary) | 96 | – | – | – |
| **Total Associates of Bank Pekao S.A. Group** | **111** | **–** | **–** | **–** |
| Key management personnel of the Bank and UniCredit S.p.A. | 217 | **–** | **–** | **–** |
| **Total** | **252,681** | **846,123** | **5,192** | **246,444** |

(in PLN thousand)

## Off-balance sheet financial commitments and guarantees by contractual maturity

| 31.12.2016 | CURRENT | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|
| FINANCIAL COMMITMENTS GRANTED | | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | – | – | – | – | – | 50,162 | 50,162 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | – | – | – | – | – | 202,191 | 202,191 |
| Associates of Bank Pekao S.A Group | – | – | | – | 111 | – | 111 |
| Key management personnel of the Bank and UniCredit S.p.A. | 30 | – | 5 | – | 182 | – | 217 |
| **Total** | **30** | **–** | **5** | **–** | **293** | **252,353** | **252,681** |
| GUARANTEES ISSUED | | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | – | 2,624 | – | 50,190 | 81,659 | 112,046 | 246,519 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | – | 9,343 | 24,475 | 113,978 | 293,599 | 158,209 | 599,604 |
| **Total** | **–** | **11,967** | **24,475** | **164,168** | **375,258** | **270,255** | **846,123** |
| FINANCIAL COMMITMENTS RECEIVED | | | | | | | |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | – | 5,192 | – | – | – | – | 5,192 |
| **Total** | **–** | **5,192** | **–** | **–** | **–** | **–** | **5,192** |
| GUARANTEES RECEIVED | | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | – | 4,645 | 752 | 33,619 | 13,399 | 1,548 | 53,963 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | – | – | 3,322 | 75,122 | 11,062 | 102,975 | 192,481 |
| **Total** | **–** | **4,645** | **4,074** | **108,741** | **24,461** | **104,523** | **246,444** |

## Off-balance sheet financial commitments and guarantees by currency

| 31.12.2016 | EUR | USD | CHF | PLN | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| FINANCIAL COMMITMENTS GRANTED | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | 30,164 | – | – | 19,998 | – | 50,162 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 98,535 | 41,716 | – | 61,580 | 360 | 202,191 |
| Associates of Bank Pekao S.A Group | – | – | – | 111 | – | 111 |
| Key management personnel of the Bank and UniCredit S.p.A. | – | – | – | 217 | – | 217 |
| **Total** | **128,699** | **41,716** | **–** | **81,906** | **360** | **252,681** |
| GUARANTEES ISSUED | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | 12,167 | – | – | 234,352 | – | 246,519 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 53,077 | – | – | 546,527 | – | 599,604 |
| **Total** | **65,244** | **–** | **–** | **780,879** | **–** | **846,123** |
| FINANCIAL COMMITMENTS RECEIVED | | | | | | |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | – | – | – | – | 5,192 | 5,192 |
| **Total** | **–** | **–** | **–** | **–** | **5,192** | **5,192** |
| GUARANTEES RECEIVED | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | 29,130 | – | – | 24,833 | – | 53,963 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 109,606 | – | – | 82,090 | 785 | 192,481 |
| **Total** | **138,736** | **–** | **–** | **106,923** | **785** | **246,444** |

(in PLN thousand)

### Off-balance sheet financial commitments and guarantees as at 31 December 2015

| NAME OF ENTITY | GRANTED FINANCIAL | GRANTED GUARANTEES | RECEIVED GUARANTEE |
|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 48,223 | 236,659 | 14,588 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 179,072 | 890,343 | 34,490 |
| **Associates of Bank Pekao S.A Group** | | | |
| Dom Inwestycyjny Xelion Sp. z o.o. | 2,000 | – | – |
| Pioneer Pekao Investment Management S.A. | 15 | – | – |
| Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary) | 52 | – | – |
| **Total Associates of Bank Pekao S.A. Group** | **2,067** | **–** | **–** |
| Key management personnel of the Bank and UniCredit S.p.A. | 697 | – | – |
| **Total** | **230,059** | **1,127,002** | **49,078** |

As at 31 December 2015, the Group did not have off-balance sheet financial commitments received from related parties.

### Off-balance sheet financial commitments and guarantees by contractual maturity

| 31.12.2015 | CURRENT | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|
| FINANCIAL COMMITMENTS GRANTED | | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | – | – | – | 28,223 | – | 20,000 | 48,223 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | – | – | – | 179,072 | – | – | 179,072 |
| Associates of Bank Pekao S.A Group | – | – | – | 2,007 | 60 | – | 2,067 |
| Key management personnel of the Bank and UniCredit S.p.A. | 30 | 515 | 5 | 18 | 129 | – | 697 |
| **Total** | **30** | **515** | **5** | **209,320** | **189** | **20,000** | **230,059** |
| GUARANTEES ISSUED | | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | – | 2,631 | 17,719 | 66,440 | 83,818 | 66,051 | 236,659 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | – | 16,189 | 98,861 | 90,053 | 322,855 | 362,385 | 890,343 |
| **Total** | **–** | **18,820** | **116,580** | **156,493** | **406,673** | **428,436** | **1,127,002** |
| GUARANTEES RECEIVED | | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | – | – | – | 11,300 | 3,288 | – | 14,588 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | – | – | 553 | 30,406 | 3,531 | – | 34,490 |
| **Total** | **–** | **–** | **553** | **41,706** | **6,819** | **–** | **49,078** |

(in PLN thousand)

**Off-balance sheet financial commitments and guarantees by currency**

| 31.12.2015 | EUR | USD | CHF | PLN | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| FINANCIAL COMMITMENTS GRANTED | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | 28,223 | – | – | 20,000 | – | 48,223 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 77,772 | – | – | 101,300 | – | 179,072 |
| Associates of Bank Pekao S.A Group | – | – | – | 2,067 | – | 2,067 |
| Key management personnel of the Bank and UniCredit S.p.A. | – | – | – | 697 | – | 697 |
| **Total** | **105,995** | **–** | **–** | **124,064** | **–** | **230,059** |
| GUARANTEES ISSUED | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | 10,497 | – | – | 226,162 | – | 236,659 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 60,778 | – | – | 829,565 | – | 890,343 |
| **Total** | **71,275** | **–** | **–** | **1,055,727** | **–** | **1,127,002** |
| GUARANTEES RECEIVED | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | 3,288 | – | – | 11,300 | – | 14,588 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 8,147 | – | – | 26,343 | – | 34,490 |
| **Total** | **11,435** | **–** | **–** | **37,643** | **–** | **49,078** |

## Remuneration of Bank's Management Board and Supervisory Board Members

Short-term employee benefits related to the Management Board of the Bank in of 2016 amounted to PLN 19 120 thousand, compared to PLN 17 144 thousand in 2015. Short-term employee benefits included: base salary, bonuses and other benefits due in next 12 months from the balance sheet date.

Long-term benefits related to the Management Board of the Bank amounted to PLN 2 083 thousand in 2016, compared to PLN 2 453 thousand in 2015 and comprised of provisions for deferred bonus payments.

The expenses in 2016 included PLN 5 393 thousand in respect of share-based payments, compared to PLN 3 473 thousand in 2015. The value of share-based payments is a part of Personnel Expenses, recognized according to IFRS 2 during the reporting period in the income statement, representing the settlement of fair value of phantom shares, granted to the Members of the Bank's Management Board.

Remuneration expenses of Supervisory Board of the Bank, comprising short-term employee benefits, amounted to PLN 1 069 thousand in 2016, compared to PLN 978 thousand in 2015.

The Bank's Management Board and Supervisory Board Members did have not received any remuneration from subsidiaries and associates in 2016 and 2015.

## Remuneration of Supervisory Boards and Management Boards of subsidiaries

Remuneration expenses of Management Boards of Group's subsidiaries, comprising short-term employee benefits, amounted to PLN 14 810 thousand in 2016, compared to PLN 14 427 thousand in 2015.

Remuneration expenses of Supervisory Boards of Group's subsidiaries, comprising short-term employee benefits, amounted to PLN 343 thousand in 2016, compared to PLN 183 thousand in 2015.

(in PLN thousand)

# 54. Repo and reverse repo transactions

The Group increases its funds by sales transactions with the repurchase promise granted (repo and sell-buy back) at the same price increased by interest.

Securities composing the balance sheet portfolio of the Group as well as securities with obligation of resale (reverse repo and buy-sell back transactions) may be a subject to repo and sell-buy back transactions.

Securities composing the balance sheet portfolio of the Group and treated as repo and sell-buy back transactions are not derecognized from the statement of financial position due to the fact that the Group holds all the benefits and the risk deriving from these assets.

| | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|
| | FAIR VALUE OF ASSETS | CARRYING AMOUNT OF RESPECTIVE LIABILITIES | FAIR VALUE OF ASSETS | CARRYING AMOUNT OF RESPECTIVE LIABILITIES |
| Financial assets available for sale | | | | |
| up to 1 month | 1,599,015 | 1,599,789 | 2,359,798 | 2,357,096 |
| from 1 to 3 months | – | – | 1,032,882 | 1,029,821 |
| from 3 months to 1 year | – | – | 1,503 | 1,504 |
| **Total financial assets available for sale** | **1,599,015** | **1,599,789** | **3,394,183** | **3,388,421** |
| Financial assets held for trading | | | | |
| up to 1 month | 175,732 | 176,019 | – | – |
| **Total financial assets held for trading** | **175,732** | **176,019** | **–** | **–** |
| Financial assets purchased under reverse-repo and buy-sell back | | | | |
| up to 1 month | – | – | 2,050,199 | 2,044,228 |
| **Total financial assets purchased under reverse-repo and buy-sell back** | **–** | **–** | **2,050,199** | **2,044,228** |
| **Total** | **1,774,747** | **1,775,808** | **5,444,382** | **5,432,649** |

The Group purchases financial instruments with the obligations of repurchase or resale (reverse-repo and buy-sell back) at the same price increased by interest.

Securities treated as reverse-repo and buy-sell back transactions are not disclosed at the statement of financial position due to the fact that the Group do not holds all the advantages of risks and awareness deriving from these assets.

| | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|
| | CARRYING AMOUNT OF ASSETS | FAIR VALUE OF HEDGE ASSETS | CARRYING AMOUNT OF ASSETS | FAIR VALUE OF HEDGE ASSETS |
| Loans and advances from banks | | | | |
| up to 1 month | 703,635 | 700,960 | 1,757,063 | 1,757,459 |
| **Total loans and advances from bank** | **703,635** | **700,960** | **1,757,063** | **1,757,459** |
| Loans and advances from customers | | | | |
| up to 1 month | – | – | 4,755,472 | 4,762,663 |
| **Total loans and advances from customers** | **–** | **–** | **4,755,472** | **4,762,663** |
| **Total** | **703,635** | **700,960** | **6,512,535** | **6,520,122** |

(in PLN thousand)

Financial assets subject to reverse repo and buy-sell back transactions constitute collateral accepted by the Group, which the Group has the right to sell or pledge.

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Fair value of assets pledged as collaterals, in this: | 700,960 | 6,520,122 |
| Short sale | 673,165 | 611,442 |
| Reverse repo transactions/ buy-sell back | – | 2,050,199 |

# 55. Company Social Benefits Fund ('ZFŚS')

The Social Benefits Fund Act of 4 March 1994 with subsequent amendments introduced the requirement to create a Company's Social Benefits Fund by all employers employing over 20 employees. The Bank and Group companies employing at least 20 staff have created the ZFŚS Fund and are making periodic charges to the ZFŚS Fund in amounts required by the Act. The basic aim of the ZFŚS Fund is to subsidize social assistance in benefit of the employees, former employees (pensioners and the retired) and entitled members of their families.

The liabilities of the ZFŚS Fund represent the accumulated value of charges made by the Company towards the ZFŚS Fund decreased by the amount of non-returnable expenditures of the ZFŚS Fund.

In the consolidated statement of financial position, the Group netted the ZFŚS Fund assets against the ZFŚS Funds value, due to the fact that the assets of the ZFŚS Fund do not represent the assets of the Group. For this reason the amount pertaining to the ZFŚS Fund in the consolidated statement of financial position as at 31 December 2016 and 31 December 2015 was zero.

**The table below presents the assets according to type and book value, the balance of the Fund and costs related to ZFŚS**

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Loans granted to employees | 39,022 | 44,030 |
| Cash at ZFŚS account | 3,760 | 8,576 |
| **ZFŚS assets** | **42,782** | **52,606** |
| **ZFŚS value** | **42,782** | **52,606** |
| | **2016** | **2015** |
| Deductions made to ZFŚS during fiscal period | 25,104 | 25,888 |

# 56. Subsequent events

There have been no significant subsequent events.

# Signatures of all Management Board Members

| | | | |
|---|---|---|---|
| 09.02.2017 | **Luigi Lovaglio** | **President of the Management Board, CEO** | |
| Date | Name/Surname | Position/Function | Signature |
| 09.02.2017 | **Diego Biondo** | **Vice President of the Management Board** | |
| Date | Name/Surname | Position/Function | Signature |
| 09.02.2017 | **Andrzej Kopyrski** | **Vice President of the Management Board** | |
| Date | Name/Surname | Position/Function | Signature |
| 09.02.2017 | **Adam Niewiński** | **Vice President of the Management Board** | |
| Date | Name/Surname | Position/Function | Signature |
| 09.02.2017 | **Grzegorz Piwowar** | **Vice President of the Management Board** | |
| Date | Name/Surname | Position/Function | Signature |
| 09.02.2017 | **Stefano Santini** | **Vice President of the Management Board** | |
| Date | Name/Surname | Position/Function | Signature |
| 09.02.2017 | **Marian Ważyński** | **Vice President of the Management Board** | |
| Date | Name/Surname | Position/Function | Signature |

# Glossary

**IFRS** – International Financial Reporting Standards – the standards, interpretations and their structure adopted by the International Accounting Standards Board (IASB.)

**IAS** – International Accounting Standards – previous name of the standards forming part of the current IFRS.

**IFRIC** – International Financial Reporting Interpretations Committee – the committee operating under the International Accounting Standards Board publishing interpretations of IFRS.

**CIRS** – Currency Interest Rate Swap – the transaction exchange of principal amounts and interest payments in different currencies between two counterparties.

**IRS** – Interest Rate Swap – the agreement between two counterparties, under which the counterparties pay each other (at specified intervals during the contract life) interest on contractual principal of the contract, charged at a different interest rate.

**FRA** – Forward Rate Agreement – the contract under which two counterparties fix the interest rate that will apply in the future for a specified amount expressed in currency of the transaction for a predetermined period.

**CAP** – the financial agreement, which limits the risk borne by lender on a variable interest rate, exposed to the potential loss as a result of increase in interest rates. Cap option is a series of call options on interest rates, in which the issuer guarantees the buyer the compensation of the additional interest costs, that the buyer must pay if the interest rate on loan increases above the fixed interest rate.

**FLOOR** –the financial agreement, which limits the risk of incurring losses resulting from decrease in interest rates by the lender providing the loan at a variable interest rate. Floor option is a series of put options on interest rates, in which the issuer guarantees the interest to be paid on the loan if the interest rate on the loan decreases below the fixed interest rate.

**IBNR** – Incurred But Not Reported losses.

**PD** – Probability Default – the parameter used in Internal Ratings-Based Approach which determines the likelihood that the debtor will be unable to meet its obligation. PD is a financial term describing the likelihood of a default over an one year time horizon.

**LGD** – Loss Given Default – the percentage of loss over the total exposure when bank's counterparty goes to default.

**EAD** – Exposure At Default.

**EL** – Expected Loss.

**CCF** – Credit Conversion Factor.

**A-IRB** – Advanced Internal Ratings-Based Approach – advanced method where all parameters of risk (PD, LGD, EAD) are estimated by the bank using its own quantitative model for calculating the risk weighted assets (RWA).

**VaR** – Value at Risk – the risk measure by which the market value of an asset or portfolio may be reduced for a given assumptions, probability and time horizon.

**EaR** – Earnings at Risk – the maximum decrease of earnings, relative to specific goal, which might occur due to impact of market risk on specific risk factors for the given time horizon and confidence level.

**ICAAP** – Internal Capital Adequacy Assessment Process – the process of assessing internal capital adequacy.

*"We have in the Bank people who know how to deliver, and with them we are ready to face new challenges and assure sustainable profitability"*

*Luigi Lovaglio, CEO and President of the Management Board of Bank Pekao S.A.*

Dear Shareholders,

Bank Pekao Group achieved last year 2 279 mln PLN net profit, successfully almost fully offsetting impact of introduced banking tax. I believe that this was another confirmation of our ability to mobilize ourselves and deliver sustainable profits despite adverse external factors.

We continued supporting the economy and Polish families, growing volumes in key retail on double digit pace, reaching PLN 128 billion of total loans and PLN 138 billion of total deposits. The number of customers, who showed us their trust and use our services, exceeded 5.2 million.

We achieved record level of consumer loans origination, maintained high level of activity in mortgages, allowing together for almost 15 bn of new retail loans. We continue investing in enhancing our digital solutions and we are rewarded by strong growth of customers actively using them.

We are number one bank of choice for Polish corporates, offering them highest quality product and services tailored to their needs.

Systematic rationalization of the processes and effective cost management enabled us to keep operating costs flat y/y, allowing for further improvement in cost to income ratio to 43.7%. The quality of our portfolio remains the benchmark in the sector and the cost of risk is among the lowest.

We achieved all this during very eventful year, both if one looks at the developments in global economy and politics and if one looks specifically at the developments directly involving our Bank.

In December 2016 a consortium of PZU and Polish Development Fund signed an agreement of purchasing from UniCredit 32.8% of outstanding Pekao shares. The finalization of this agreement is expected by the buyers in the second quarter 2017.

This transaction is closing the seventeen years chapter of Bank Pekao participation in UniCredit group. Bank benefited from this since an early stage of cooperation, thanks to transfer of know-how and expertise. Participation in UniCredit group has offered us also stability in management and shareholders structure, supporting healthy principle of long term value creation, which allowed for full concentration on executing our sustainable growth strategy.

During this time and in particular looking back at the last 6 years I have been appointed as a CEO the Bank delivered 16 bn PLN net profit, always keeping our profitability higher than cost of capital. We increased our loans portfolio by 42 bn PLN, providing Polish families with 25 bn PLN mortgages and companies with 18 bn PLN corporate loans, allowing them to develop and prosper. Last, but not least, we distributed to our shareholders 12.9 bn PLN dividends. We kept developing new innovative solutions for our customers, like first in the country mobile banking and mobile payments platforms.

I trust that new controlling shareholders will bring equal benefits to the Bank, as UniCredit did, especially thanks to their capital strengths, positively impacting on continuation of our growth strategy.

Coming back to present days, year 2016 was generally positive for Polish economy, which enjoyed sound GDP growth of 2.8%. We faced slow down compared with previous year 3.9% growth, however in the European context this is still very respectful number.

Economy was driven mainly by domestic consumption, benefitting from very strong labor market and also increased social transfers in the form of "500+" program of subsidies for families with more than one child.

Investments decreased as a result of growing uncertainty, which had an impact on demand for corporate loans.

From the perspective of banking sector the most important development was introduction of the banking tax, as high as 44 bp of adjusted assets. Bank Pekao paid 450 mn PLN of this tax, which is almost 20% of previous year net profit. Despite this, thanks to growth of our business, continued cost and risk control and also gains we achieved on disposal of VISA shares, we managed to achieve level of net profit almost the same as last year.

The sector also faced continuation of discussions on solving issue of FX mortgages, which materially increased volatility of banks shares on the market. These discussions had very limited impact on us, as we made several years ago strategic decision not to offer such products. There is still no tangible solution, keeping FX risk on Polish families and banking sector still existing.

We made strong progress last year, both for core business generation and for innovation agenda. We have in the Bank people who know how to deliver, and with them we are ready to face new challenges and keep delivering sustainable profitability.

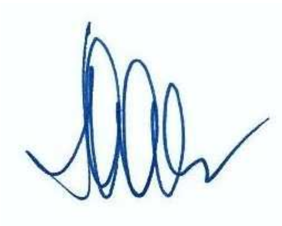
We are recognized as one of the most attractive employers in the country. As the leading institution in Poland we feel responsible for the country development, not only economic but also social one. We want to actively participate in our clients, employees and business partners' lives. We do this by sponsoring and promoting art, culture, social and environmental projects. We are the long term partner of "The Great Orchestra of Christmas Charity" and continued supporting created by us Kanton Foundation.

Year 2017 will be very interesting one. We expect some acceleration in GDP growth in Poland, driven again mainly by domestic consumption. Central bank rates, despite come back of inflation, most likely will stay thorough 2017 at current level, making stabilization in sector net interest margin the most likely scenario. Lending growth will remain moderate, as demand especially in corporate sector is expected to stay at low level.

On behalf of Management Board, I would like to thank our Clients and Shareholders for their trust and loyalty, the Supervisory Board members for their strong support.

As each year, my special thanks I address to our employees. Their dedication to our customers, hard work and respect for the values define what it really means Pekao. Our people are so good that we should say thank you every day.

I am proud to work at this company and with these outstanding people.


Luigi Lovaglio
President of the Management Board, CEO

**BANK POLSKA KASA OPIEKI S.A.**
**CAPITAL GROUP**

**WARSAW, GRZYBOWSKA 53/57**

**CONSOLIDATED FINANCIAL STATEMENTS**
**FOR THE 2016 FINANCIAL YEAR**

**WITH**

**AUDITOR'S OPINION**

**AND**

**AUDIT REPORT**

## TABLE OF CONTENTS

Deloitte.

Deloitte Polska
Spółka z ograniczoną odpowiedzialnością Sp. k.
al. Jana Pawła II 22
00-133 Warszawa
Polska

Tel.: +48 22 511 08 11
Fax: +48 22 511 08 13
www.deloitte.com/pl

# AUDITOR'S OPINION

**To the Shareholders and Supervisory Board of Bank Polska Kasa Opieki S.A.**

## Auditor's report

We have audited the attached consolidated financial statements of the Bank Polska Kasa Opieki S.A. Capital Group ("Capital Group"), for which Bank Polska Kasa Opieki S.A. ("Bank") with its registered office in Warsaw, at Grzybowska 53/57 is the Parent Company. Those consolidated financial statements include: consolidated income statement and consolidated statement of comprehensive income for the financial year from 1 January 2016 to 31 December 2016, consolidated statement of financial position prepared as of 31 December 2016, consolidated statement of changes in equity, consolidated cash flow statement for the financial year from 1 January 2016 to 31 December 2016 and notes comprising a summary of significant accounting policies and other explanatory information.

*Responsibility of the Bank's manager and persons supervising the preparation of the financial statements*

The Management Board of the Bank is responsible for the preparation of the financial statements, based on properly kept accounting records, and their fair presentation in accordance with the International Accounting Standards, International Financial Reporting Standards, related interpretations published as European Commission regulations and applicable laws. It is also obliged to ensure internal control as it determines necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Under the Accounting Act of 29 September 1994 (Journal of Laws of 2016 item 1047 as amended), hereinafter referred to as the "Accounting Act" the Management Board of the Bank and members of its Supervisory Board are obliged to ensure that the financial statements meet the requirements of the Accounting Act.

*Auditor's responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit works.

We conducted our audit in accordance with Section 7 of the Accounting Act and the National Auditing Standards in line with the wording of the International Standards on Auditing adopted by Resolution No. 2783/52/2015 of the National Council of Statutory Auditors of 10 February 2015 as amended. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Management Board of the Bank, evaluating if accounting books based on which financial statements are prepared, are properly kept, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion on the consolidated financial statements*

In our opinion, the attached consolidated financial statements:

- give a true and fair view of the economic and financial position of the Bank Polska Kasa Opieki S.A. Capital Group as at 31 December 2016 and its financial performance for the financial year from 1 January 2016 to 31 December 2016 in accordance with the International Accounting Standards, International Financial Reporting Standards, related interpretations published as European Commission regulations and the adopted accounting principles (policies),
- comply, with respect to their form and content, with the applicable provisions of law applicable to the Capital Group and the articles of association of the Bank.

**Report on other legal and regulatory requirements**

*Opinion on the report on the activities*

We do not express an opinion on the report on the activities.

It is the responsibility of the Management Board of the Bank to prepare the report on the activities of the Capital Group in accordance with the Accounting Act and other applicable laws. Moreover, the Management Board of the Bank and members of the Supervisory Board are obliged to ensure that the financial statements and the report on the activities of the Capital Group meet the requirements of the Accounting Act.

When auditing the consolidated financial statements we were obliged to examine the report on the activities of the Capital Group and indicate whether the information contained therein complies with Article 49 of the Accounting Act and the Ordinance of the Minister of Finance of 19 February 2009 on current and periodic information published by issuers of securities and the rules of equal treatment of the information required by the laws of non-member states (Journal of Laws of 2014 item 133 as amended) and is consistent with underlying information disclosed in the attached consolidated financial statements. Additionally, according to the Article 111a paragraph 3 of the Banking Law (Journal of Laws of 2016 item 1988 as amended, "Banking Law") our responsibility was to audit financial information presented in paragraph 8 of the Report on the activities of the Capital Group. The audit was performed in accordance with the scope presented in the paragraph Auditor's responsibility. Additionally, it was our responsibility to indicate whether we have detected any material misstatement in the report on the activities of the Capital Group based on our knowledge of the Capital Group and its business environment obtained in the course of the audit.

In our opinion, the information contained in the report on the activities of the Capital Group complies with Article 49 of the Accounting Act and the Ordinance of the Minister of Finance of 19 February 2009 on current and periodic information published by issuers of securities and the rules of equal treatment of the information required by the laws of non-member states (Journal of Laws of 2014 item 133 as amended) and is consistent with underlying information disclosed in the attached consolidated financial statements. Moreover, based on our knowledge of the Capital Group and its business environment obtained in the course of the audit, we have not detected any material misstatements in the report on the activities. Additionally, information presented in the paragraph 8 of the Report on the activities of the Capital Group are compliant with the requirements of the Article 111a, paragraph 1 and 2 of the Banking Law.

*Statement of compliance with corporate governance principles*

In relation to our audit of the consolidated financial statements, it was our responsibility to examine the Bank's statement of compliance with corporate governance principles, which constitutes a separate part of the report on the activities of the Capital Group. In our opinion, the Bank's statement provides all information required by the secondary legislation issued under Article 60.2 of the Act on public offering, conditions governing the introduction of financial instruments to organized trading, and public companies of 29 July 2005 (Journal of Laws of 2016 item 1639 as amended) and regulations issued under Article 61 thereof. The information is compliant with the applicable laws and information presented in the financial statements.

Dorota Snarska - Kuman
Key certified auditor
conducting the audit
No. 9667

On behalf of Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. – entity authorized to audit financial statements entered under number 73 on the list kept by the National Council of Statutory Auditors:

Dorota Snarska – Kuman –Vice-President of the Management Board of Deloitte Polska Sp. z o.o. – which is the General Partner of Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k.

Warsaw, 9 February 2017

**The above audit opinion together with audit report is a translation from the original Polish version. In case of any discrepancies between the Polish and English version, the Polish version shall prevail.**

# REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS OF THE BANK POLSKA KASA OPIEKI S.A. CAPITAL GROUP FOR THE 2016 FINANCIAL YEAR

## I. GENERAL INFORMATION

### 1. Details of the audited Parent Company

The Parent Company of the Capital Group operates under the business name Bank Polska Kasa Opieki S.A. ( "Bank"). The Bank's registered office is located in Warsaw at Grzybowska 53/57.

The Bank operates as a joint stock company. The Bank is recorded in the Register of Entrepreneurs kept by the District Court in Capital City Warsaw, XII Business-Registry Division of the National Court Register, under KRS number 0000014843, based on the decision of 2 July 2001.

The Bank operates based on the provisions of the Code of Commercial Companies and Banking Law.

As of 31 December 2016, the Bank's share capital equaled PLN 262,470 thousand and was divided into 262,470,034 ordinary shares with a face value of PLN 1 each.

Composition of the Management Board of the Bank as at the date of the opinion:

| | |
|---|---|
| – Luigi Lovaglio | President of the Management Board, |
| – Diego Biondo | Vice President of the Management Board, |
| – Andrzej Kopyrski | Vice President of the Management Board, |
| – Adam Niewiński | Vice President of the Management Board, |
| – Grzegorz Piwowar | Vice President of the Management Board, |
| – Stefano Santini | Vice President of the Management Board, |
| – Marian Ważyński | Vice President of the Management Board. |

There were no changes in the composition of the Management Board of the Bank during the audited period and until the date of the opinion.

As of 16 June 2016 (the date of the last Shareholders' Meeting) the Bank's shareholders included:

| | |
|---|---|
| – UniCredit S.p.A. | – 50.10% shares, |
| – Other Shareholders | – 49.90% shares. |

Changes in the share capital of the Bank during the financial year:

- as a result of the accelerated placement that took place on 13 July 2016, the UniCredit S.p.A. sold 26,247,003 existing ordinary shares in Bank Pekao S.A. After the completion of the Placement, UniCredit continued to hold a controlling shareholding in Pekao, corresponding to 40.10% of the Bank's share capital,
- before the mentioned above accelerated placement UniCredit S.p.A. held 131,497,488 existing ordinary shares of the Bank Pekao SA, constituting 50.10% share in the share capital of the Bank that were representing the equal amount of the shares and total number of votes at the Bank's General Shareholders Meeting,
- as of 31 December 2016 UniCredit SpA held 105,250,485 existing ordinary shares of Bank Pekao S.A., constituting 40,10% share in the share capital of the Bank and total number of votes at the Bank's General Shareholders Meeting,
- in the Current report 29/2016 dated 8 December 2016 the Bank informed about information received from Powszechny Zakład Ubezpieczeń S.A. ("PZU") regarding the conclusion of a transaction of the purchase of a significant holding of shares in Bank Polska Kasa Opieki S.A by PZU SA acting in a consortium with Polski Fundusz Rozwoju S.A. ("PFR") from

UniCredit S.p.A. On 8 December 2016 PZU, acting in a consortium with PFR, informed about signing the agreement on the sale of a block of the Bank's shares ("SPA"). The substance of the transaction provided for in the SPA is the acquisition by PZU SA and PFR, acting in concortium, of a significant (ultimately covering approx. 32.8% of the total number of votes) block of the Bank's shares.

– in the Current report 31/2016 dated 8 December 2016 the Management Board of the Bank informed about receiving an information from the UniCredit S.p.A. regarding the sale of the 1,916 certificates representing the 7.3% of existing ordinary shares of the Bank Pekao S.A.

During the audited period, the shareholding structure of the Bank's share capital did not undergo any changes other than the ones specified above.

After the balance-sheet date there were no changes in the Bank's share capital.

As of 31 December 2016, the Bank's equity amounted to PLN 22,282,557 thousand.

## 2. Structure of the Capital Group

The information regarding the entites comprising the Bank Polska Kasa Opieki S.A. Capital Group as at 31 December 2016 were presented in a detailed way in the Note 2 to the Consolidated Financial Statement of Bank Pekao S.A. Group for the year enden on 31 December 2016.

The consolidated financial statements as of 31 December 2016 included the following entities:

a) Parent Company – Bank Polska Kasa Opieki S.A.

We have audited the financial statements of the Bank Polska Kasa Opieki S.A. for the period from 1 January to 31 December 2016. As a result of our audit, on 9 February 2017 we issued an unqualified opinion.

b) Companies subject to full consolidation:

| Name and address of the Company | Interest in the share capital (%) | Name of entity that audited the financial statements and type of opinion issued | Balance sheet date of the consolidated entity |
|---|---|---|---|
| Pekao Bank Hipoteczny S.A., Warsaw | 100.00 | Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k., unqualified | 31 December 2016 |
| Centralny Dom Maklerski S.A., Warsaw | 100.00 | Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k., unqualified | 31 December 2016 |
| Pekao Investment Banking S.A., Warsaw | 100.00 | Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k., unqualified | 31 December 2016 |
| Pekao Leasing Sp. z o.o., Warsaw | 100.00 | Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k., unqualified | 31 December 2016 |
| Pekao Faktoring Sp. z o.o., Lublin | 100.00 | Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k., unqualified | 31 December 2016 |
| Pekao Pioneer Powszechne Towarzystwo Emerytalne, Warsaw | 65.00 | Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k., unqualified | 31 December 2016 |
| Centrum Kart S.A., Warsaw | 100.00 | Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k., unqualified | 31 December 2016 |
| Pekao Financial Services Sp. z o.o., Warsaw | 100.00 | Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k., unqualified | 31 December 2016 |
| Centrum Bankowości Bezpośredniej Sp. z o.o., Kraków | 100.00 | Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k., unqualified | 31 December 2016 |

| | | | |
|---|---|---|---|
| Pekao Property S.A., Warsaw | 100.00 | I.J. Konieccy biegli rewidenci s.c, unqualified | 31 December 2016 |
| Pekao Fundusz Kapitałowy Sp. z o.o. in liquidation, Warsaw | 100.00 | Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k., in progress | 31 December 2016 |

With reference to the finalization of the liquidation of the Pekao Leasing Holding S.A. on 20 September 2016 Pekao Leasing Holding S.A. (in liquidation) was deleted from the Registry.

The completion of the liquidation process of the Pekao Leasing Holding S.A. was preceeded by the transfer of ownership of the shares in Pekao Leasing Sp. z o.o. to Bank Pekao S.A. The Bank holds now 100% shares in the share capital and in the total number of votes in the General Meeting of Pekao Leasing Sp. z o.o.

## 3. Information about the consolidated financial statements for the prior financial year

The activities of the Capital Group in 2015 resulted in a net profit of PLN 2.293.478 thousand. The consolidated financial statements of the Capital Group for 2015 financial year were audited by a certified auditor. The audit was performed by authorized entity Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. The certified auditor issued an unqualified opinion on those financial statements.

The General Shareholders' Meeting which approved the consolidated financial statements for the 2015 financial year was held on 16 June 2016.

In accordance with applicable laws, the consolidated financial statements for the 2015 financial year were submitted to the National Court Register (KRS) on 1 July 2016.

## 4. Details of the authorized entity and the key certified auditor acting on its behalf

The entity authorized to audit the financial statements was appointed by the Shareholders' Meeting of the Bank. The audit of the consolidated financial statements was performed based on the agreement of 17 June 2013 concluded between the Bank Polska Kasa Opieki S.A. and Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. with its registered office in Warsaw, al. Jana Pawła II 22, recorded under number 73 on the list of entities authorized to provide audit services kept by the National Council of Statutory Auditors. On behalf of the authorized entity, the audit of the consolidated financial statements was conducted under the supervision of Dorota Snarska - Kuman, key certified auditor (No. 9667) in the registered office of the Bank, in its branches as well as outside the Bank's premises from 14 November 2016 until the date of this opinion.

Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. and the key certified auditor conducting audit confirm that they are authorized to carry out audits and meet the requirements of Article 56 of the Act on certified auditors and their self-government, entities authorized to audit financial statements and public supervision (Journal of Laws of 2016 item 1000 as amended) to express an unbiased and independent opinion on the consolidated financial statements of the Capital Group.

## 5. Availability of data and management's representations

The scope of our audit was not limited.

During the audit, necessary documents and data as well as detailed information and explanations, were provided to the authorized entity and the key certified auditor, as confirmed e.g. in the written representation of the Management Board of the Bank of 9 February 2017.

## II. ECONOMIC AND FINANCIAL POSITION OF THE CAPITAL GROUP

Presented below are the main items from the consolidated statement of financial position, consolidated income statement and consolidated statement of comprehensive income as well as financial ratios describing the financial performance of the Capital Group and its economic and financial position compared to the prior year.

| Main items from consolidated statement of financial position (PLN '000) | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Total assets | 174,214,943 | 168,785,567 |
| Cash and due from Central Bank | 5,872,911 | 7,881,607 |
| Loans and advances to banks | 3,257,829 | 7,314,724 |
| Loans and advances to customers | 118,689,267 | 118,555,199 |
| Investment (placement) securities | 35,120,619 | 21,181,723 |
| Amounts due to other banks | 4,823,440 | 5,958,449 |
| Amounts due to customers | 137,815,926 | 128,867,691 |
| Total equity, including: | 22,911,943 | 23,424,193 |
| - share capital | 262,470 | 262,470 |

| Main items from consolidated income statement and consolidated comprehensive income statement (PLN '000) | 2016 | 2015 |
|---|---|---|
| Net interest income | 4,382,005 | 4,166,570 |
| Net fee and commission income | 1,958,964 | 2,005,526 |
| Result on financial assets and liabilities held for trading | 485,409 | 428,048 |
| Gains (losses) on disposal | 435,903 | 229,601 |
| Net impairment losses on financial assets and off-balance sheet commitments | (500,629) | (517,558) |
| Operating costs | (3,927,137) | (3,625,827) |
| Income tax expense | (616,782) | (537,640) |
| Net profit for the period | 2,279,764 | 2,293,478 |
| Total comprehensive income | 1,772,773 | 2,035,100 |

| Ratio analysis | 2016 | 2015 |
|---|---|---|
| Return on equity ratio (ROE) | 9.84% | 9.72% |
| Return on assets ratio (ROA) | 1.33% | 1.36% |
| Cost to income ratio | 53.64% | 52.74% |
| Capital ratio | 17.64% | 17.66% |
| Equity ratio | 13.15% | 13.88% |

An analysis of the above figures and ratios indicated the following trends in 2016:

- return on equity ratio (ROE) calculated as a relation of net profit for the period to equity estimated as an average of the balance as at 31.12.2015 and balances as at the end of each month in 2016 increased as at the end of 2016 and amounted to 9.84% in comparison to 9.72% as at the end of 2015,
- return on assets ratio (ROA) calculated as a relation of net profit for the period to total assets estimated as an average of the balances as at 31.12.2015 and 31.12.2016 decreased as at the end of 2016 and amounted to 1.33% in comparison to 1.36% as at the end of 2015,
- cost to income ratio calculated as a relation of total costs estimated as a sum of administrative expenses, depreciation and amortization, impairment allowances of property plant and equipment and intangible assets less refund of administrative expenses to total income estimated as sum of net interest income, net fee and commission income, dividend income, result on financial assets and liabilities held for trading, result on fair value hedge

accounting, gains (losses) on disposal and other operating income (less refund of administrative expenses) increased from 52.74% for 2015 to 53.64% for 2016,

- capital ratio calculated in accordance with the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investments firms as at the end of 2016 amounted to 17.64% in comparison to 17.66% as at the end of 2015,
- equity ratio calculated as a relation of total equity to the sum of total equity and total liabilities decreased as at the end of 2016 and amounted to 13.15% in comparison to 13.88% at the end of 2015.

*Application of prudence principles*

During our audit we have not identified significant discrepancies indicating lack of application in 2016 of prudence principles determined by Polish Law, resolutions of Management of National Bank of Poland and resolutions of Polish Financial Supervision Authority.

*Capital ratio*

During our audit we have not identified significant discrepancies in the area of calculation of capital ratio as at 31 December 2016 in accordance with the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investments firms.

## III. DETAILED INFORMATION

### 1. Information about the audited consolidated financial statements

The audited consolidated financial statements were prepared as at 31 December 2016 and include:

- consolidated income statement for the period from 1 January 2016 to 31 December 2016, with a net profit in the amounts PLN 2,279,764 thousand,
- consolidated statement of comprehensive income for the period from 1 January 2016 to 31 December 2016 with a total comprehensive income of PLN 1,772,773 thousand,
- consolidated statement of financial position prepared as of 31 December 2016, with total assets and liabilities plus equity of PLN 174,214,943 thousand,
- consolidated statement of changes in equity for the period from 1 January 2016 to 31 December 2016, disclosing a decrease in equity of PLN 512,250 thousand,
- consolidated cash flow statement for the period from 1 January 2016 to 31 December 2016, showing a cash outflow of PLN 5,847,305 thousand,
- notes, comprising a summary of significant accounting policies and other explanatory information.

The audit covered the period from 1 January 2016 to 31 December 2016 and focused mainly on:

- verification of the correctness and fairness of the consolidated financial statements prepared by the Management Board of the Bank;
- verification of the consolidation documentation;
- evaluation of the correctness of the consolidation methods and procedures applied during consolidation;
- review of opinions and reports on audits of financial statements of subsidiaries and associated companies included in consolidation, prepared by other certified auditors.

### 2. Consolidation documentation

The Bank presented the consolidation documentation including:

- financial statements of entities included in the consolidated financial statements,
- financial statements of controlled entities, adjusted to the accounting principles (policy) applied during consolidation,
- financial statements of controlled entities translated into the Polish currency,
- consolidation adjustments and eliminations necessary for preparation of the consolidated financial statements,
- calculation of the fair value of the net assets of controlled entities,
- calculation of goodwill and gain from a bargain purchase as well as impairment losses for goodwill,
- calculation of non-controlling interests,
- calculation of exchange differences arising from translation of the financial statements of controlled entities denominated in foreign currencies.

The financial statements of the subsidiaries were consolidated using the full method, i.e. full amounts of all relevant items of the financial statements of the Bank and the subsidiaries included in consolidation were summed up.

The equity method was applied with respect to associated entities. The value of the Bank's interest in the associated company was adjusted by increases or decreases in the equity of the associated company attributable to the Bank, which occurred in the period covered by consolidation, and decreased by dividends due from such companies.

The Bank preparing the consolidated financial statements has not applied any material simplifications and exceptions to the consolidation principles with respect to the controlled entities.

### 3. Completeness and correctness of drawing up consolidated cash flow statement, consolidated statement of changes in equity, notes and explanations and the report on the activities of the Capital Group

The Bank confirmed the validity of the going concern basis in preparation of the consolidated financial statements. The notes and explanations to the consolidated financial statements gives a description of measurement principles regarding assets, equity, liabilities, financial performance and principles of preparation of the consolidated financial statements.

The Bank prepared notes in the form of tables to individual items of the consolidated statement of financial position and consolidated income statement and consolidated statement of comprehensive income as well as narrative descriptions in line with the requirement of IFRS.

The Bank prepared the consolidated cash flow statement and consolidated statement of changes in equity in accordance with the requirements of IFRS.

The Management Board of the Bank prepared and supplemented the consolidated financial statements with a report on the activities of the Capital Group in the 2016 financial year. The report contains information determined by Article 49.2 of the Accounting Act, Article 111a paragraph 1 and 2 of the Banking Law (Journal of Laws of 2016 item 1988 as amended, "Banking Law") and the Ordinance of the Minister of Finance Ordinance of 19 February 2009 on current and periodic information published by issuers of securities and the rules of equal treatment of the information required by the laws of non-member states (Journal of Laws of 2014 item 133 as amended). In accordance with the Article 111a, paragraph 3 of the Banking Law, we have audited the report with respect to the disclosed information derived directly from the audited financial statements, and with respect to the disclosures required by Article 111a, paragraph 2 of the Banking Law we have audited the correctness and compliance according to the mentioned above regulations.

## IV. FINAL NOTES

Management Board's Representations

Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. and the key certified auditor received a representation letter from the Bank's Management Board, in which the Board stated that the Capital Group complied with the laws in force.

Dorota Snarska - Kuman
Key certified auditor
conducting the audit
No. 9667

On behalf of Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. – entity authorized to audit financial statements entered under number 73 on the list kept by the National Council of Statutory Auditors:

Dorota Snarska - Kuman – Vice-President of the Management Board of Deloitte Polska Sp. z o.o. – which is the General Partner of Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k.

Warsaw, 9 February 2017

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

# Consolidated Financial Statements of Bank Pekao S.A. Group for the year ended on 31 December 2016

**Warsaw, February 2017**

# Table of content

# Consolidated income statement

(In PLN thousand)

| | NOTE | 2016 | 2015 |
|---|---|---|---|
| Interest income | 10 | 5 448 490 | 5 456 369 |
| Interest expense | 10 | (1 066 485) | (1 289 799) |
| **Net interest income** | | **4 382 005** | **4 166 570** |
| Fee and commission income | 11 | 2 252 085 | 2 388 523 |
| Fee and commission expense | 11 | (293 121) | (382 997) |
| **Net fee and commission income** | | **1 958 964** | **2 005 526** |
| **Dividend income** | 12 | **16 798** | **13 635** |
| **Result on financial assets and liabilities held for trading** | 13 | **485 409** | **428 048** |
| **Result on fair value hedge accounting** | 30 | **1 313** | **5 547** |
| **Gains (losses) on disposal of:** | 14 | **435 903** | **229 601** |
| loans and other financial receivables | | 159 493 | 534 |
| available for sale financial assets and held to maturity investments | | 276 493 | 229 551 |
| financial liabilities | | (83) | (484) |
| **Operating income** | | **7 280 392** | **6 848 927** |
| **Net impairment losses on financial assets and off-balance sheet commitments:** | 18 | **(500 629)** | **(517 558)** |
| loans and other financial receivables | | (401 409) | (500 355) |
| off-balance sheet commitments | | (99 220) | (17 203) |
| **Net result on financial activity** | | **6 779 763** | **6 331 369** |
| **Administrative expenses** | 15 | **(3 602 324)** | **(3 426 592)** |
| personnel expenses | | (1 896 836) | (1 908 519) |
| other administrative expenses | | (1 705 488) | (1 518 073) |
| **Depreciation and amortization** | 16 | **(340 866)** | **(331 465)** |
| **Net result on other provisions** | | **(14 475)** | **(28 766)** |
| **Net other operating income and expenses** | 17 | **30 528** | **160 996** |
| **Operating costs** | | **(3 927 137)** | **(3 625 827)** |
| **Gains (losses) on subsidiaries and associates** | 19 | **38 561** | **113 203** |
| **Gains (losses) on disposal of property, plant and equipment and intangible assets** | 20 | **5 359** | **12 373** |
| **Profit before income tax** | | **2 896 546** | **2 831 118** |
| **Income tax expense** | 21 | **(616 782)** | **(537 640)** |
| **Net profit for the period** | | **2 279 764** | **2 293 478** |
| 1. Attributable to equity holders of the Bank | | 2 279 275 | 2 292 459 |
| 2. Attributable to non-controlling interests | 51 | 489 | 1 019 |
| **Earnings per share (in PLN per share)** | | | |
| basic for the period | 22 | 8.68 | 8.73 |
| diluted for the period | 22 | 8.68 | 8.73 |

Notes to the financial statements presented on pages 10 - 151 constitute an integral part of the consolidated financial statements.

# Consolidated statement of comprehensive income

(In PLN thousand)

| | NOTE | 2016 | 2015 |
|---|---|---|---|
| **Net profit** | | **2 279 764** | **2 293 478** |
| 1. Attributable to equity holders of the Bank | | 2 279 275 | 2 292 459 |
| 2. Attributable to non-controlling interests | 51 | 489 | 1 019 |
| **Other comprehensive income** | | | |
| **Item that are or may be reclassified subsequently to profit or loss:** | | | |
| Foreign currency translation differences | | - | (1 169) |
| Change in fair value of available-for-sale financial assets | | (608 819) | (237 124) |
| Change in fair value of cash flow hedges | 30 | (5 557) | (93 341) |
| Tax on items that are or may be reclassified subsequently to profit or loss | 21 | 116 731 | 62 789 |
| **Items that will never be reclassified to profit or loss:** | | | |
| Remeasurements of the defined benefit liabilities | 45 | (11 560) | 12 900 |
| Share in remeasurements of the defined benefit liabilities of associates | | 18 | 18 |
| Tax on items that will never be reclassified to profit or loss | 21 | 2 196 | (2 451) |
| **Other comprehensive income (net of tax)** | | **(506 991)** | **(258 378)** |
| **Total comprehensive income** | | **1 772 773** | **2 035 100** |
| 1. Attributable to equity holders of the Bank | | 1 772 284 | 2 034 081 |
| 2. Attributable to non-controlling interests | 51 | 489 | 1 019 |

Notes to the financial statements presented on pages 10 – 151 constitute an integral part of the consolidated financial statements.

# Consolidated statement of financial position

(In PLN thousand)

| | NOTE | 31.12.2016 | 31.12.2015 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and due from Central Bank | 24 | 5 872 911 | 7 881 607 |
| Bill of exchange eligible for rediscounting at Central Bank | | - | 70 |
| Loans and advances to banks | 25 | 3 257 829 | 7 314 724 |
| Financial assets held for trading | 26 | 732 469 | 1 126 792 |
| Derivative financial instruments (held for trading) | 27 | 1 913 429 | 3 206 447 |
| Loans and advances to customers | 28 | 118 689 267 | 118 555 199 |
| Receivables from finance leases | 29 | 3 974 643 | 3 503 979 |
| Hedging instruments | 30 | 289 752 | 421 640 |
| Investments (placement) securities | 31 | 35 120 619 | 21 181 723 |
| 1. Available for sale | | 32 101 634 | 17 813 299 |
| 2. Held to maturity | | 3 018 985 | 3 368 424 |
| Assets held for sale | 33 | 48 277 | 45 302 |
| Investments in associates | 34 | 136 221 | 148 965 |
| Intangible assets | 35 | 596 181 | 636 717 |
| Property, plant and equipment | 36 | 1 422 930 | 1 460 652 |
| Investment properties | 37 | 24 874 | 30 221 |
| Income tax assets | | 1 104 343 | 991 804 |
| 1. Current tax assets | | 100 992 | 76 600 |
| 2. Deferred tax assets | 21 | 1 003 351 | 915 204 |
| Other assets | 38 | 1 031 198 | 2 279 725 |
| **TOTAL ASSETS** | | **174 214 943** | **168 785 567** |
| **LIABILITIES AND EQUITY** | | | |
| **Liabilities** | | | |
| Amounts due to Central Bank | 24 | 6 091 | 914 |
| Amounts due to other banks | 40 | 4 823 440 | 5 958 449 |
| Financial liabilities held for trading | 26 | 673 165 | 611 442 |
| Derivative financial instruments (held for trading) | 27 | 1 952 674 | 3 204 328 |
| Amounts due to customers | 41 | 137 815 926 | 128 867 691 |
| Hedging instruments | 30 | 1 638 718 | 1 702 759 |
| Debt securities issued | 42 | 1 522 963 | 2 903 233 |
| Income tax liabilities | | 11 579 | 6 649 |
| 1. Current tax liabilities | | 6 694 | 1 713 |
| 2. Deferred tax liabilities | 21 | 4 885 | 4 936 |
| Provisions | 43 | 560 392 | 425 374 |
| Other liabilities | 44 | 2 298 052 | 1 680 535 |
| **TOTAL LIABILITIES** | | **151 303 000** | **145 361 374** |
| **Equity** | | | |
| Share capital | 49 | 262 470 | 262 470 |
| Other capital and reserves | 50 | 20 375 527 | 20 869 976 |
| Retained earnings and profit for the period | 50 | 2 259 022 | 2 275 783 |
| **Total equity attributable to equity holders of the Bank** | | **22 897 019** | **23 408 229** |
| Non - controlling interests | 51 | 14 924 | 15 964 |
| **TOTAL EQUITY** | | **22 911 943** | **23 424 193** |
| **TOTAL LIABILITIES AND EQUITY** | | **174 214 943** | **168 785 567** |

Notes to the financial statements presented on pages 10 - 151 constitute an integral part of the consolidated financial statements.

# Consolidated statement of changes in equity

(In PLN thousand)

| | EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | OTHER CAPITAL AND RESERVES | | | | | | | | | | |
| | SHARE CAPITAL | TOTAL OTHER CAPITAL AND RESERVES | SHARE PREMIUM | GENERAL BANKING RISK FUND | OTHER RESERVE CAPITAL | REVALUATION RESERVES | FOREIGN CURRENCY TRANSLATION DIFFERENCES | OTHER | RETAINED EARNINGS AND PROFIT FOR THE PERIOD | TOTAL EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK | NON - CONTROLLING INTERESTS | TOTAL EQUITY |
| Note | 49 | 50 | | | | | | | 50 | | 51 | |
| **Equity as at 1.01.2016** | **262 470** | **20 869 976** | **9 137 221** | **1 975 415** | **9 092 740** | **283 597** | **-** | **381 003** | **2 275 783** | **23 408 229** | **15 964** | **23 424 193** |
| **Management options** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| Options exercised (share issue) | - | - | - | - | - | - | - | - | - | - | - | - |
| Revaluation of management share options | - | - | - | - | - | - | - | - | - | - | - | - |
| **Comprehensive income** | **-** | **(506 991)** | **-** | **-** | **-** | **(506 991)** | **-** | **-** | **2 279 275** | **1 772 284** | **489** | **1 772 773** |
| Remeasurements of the defined benefit liabilities (net of tax) | - | (9 346) | - | - | - | (9 346) | - | - | - | (9 346) | - | (9 346) |
| Revaluation of available-for-sale investments (net of tax) | - | (493 144) | - | - | - | (493 144) | - | - | - | (493 144) | - | (493 144) |
| Revaluation of hedging financial instruments (net of tax) | - | (4 501) | - | - | - | (4 501) | - | - | - | (4 501) | - | (4 501) |
| Foreign currency translation differences | - | - | - | - | - | - | - | - | - | - | - | - |
| Net profit for the period | - | - | - | - | - | - | - | - | 2 279 275 | 2 279 275 | 489 | 2 279 764 |
| **Appropriation of retained earnings** | **-** | **12 547** | **-** | **6 909** | **-** | **-** | **-** | **5 638** | **(2 296 036)** | **(2 283 489)** | **(1 529)** | **(2 285 018)** |
| Dividend paid | - | - | - | - | - | - | - | - | (2 283 489) | (2 283 489) | (1 529) | (2 285 018) |
| Profit appropriation to other reserves including consolidation adjustments | - | 12 547 | - | 6 909 | - | - | - | 5 638 | (12 547) | - | - | - |
| **Other** | **-** | **(5)** | **-** | **-** | **(5)** | **-** | **-** | **-** | **-** | **(5)** | **-** | **(5)** |
| Other | - | (5) | - | - | (5) | - | - | - | - | (5) | - | (5) |
| **Equity as at 31.12.2016** | **262 470** | **20 375 527** | **9 137 221** | **1 982 324** | **9 092 735** | **(223 394)** | **-** | **386 641** | **2 259 022** | **22 897 019** | **14 924** | **22 911 943** |

Notes to the financial statements presented on pages 10 - 151 constitute an integral part of the consolidated financial statements.

# Consolidated statement of changes in equity (cont.)

(In PLN thousand)

| | EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | OTHER CAPITAL AND RESERVES | | | | | | | | | | |
| | SHARE CAPITAL | TOTAL OTHER CAPITAL AND RESERVES | SHARE PREMIUM | GENERAL BANKING RISK FUND | OTHER RESERVE CAPITAL | REVALUATION RESERVES | FOREIGN CURRENCY TRANSLATION DIFFERENCES | OTHER | RETAINED EARNINGS AND PROFIT FOR THE PERIOD | TOTAL EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK | NON - CONTROLLING INTERESTS | TOTAL EQUITY |
| Note | 49 | 50 | | | | | | | 50 | | 51 | |
| **Equity as at 1.01.2015** | **262 470** | **20 990 344** | **9 137 221** | **1 937 850** | **9 002 629** | **540 806** | **1 169** | **370 669** | **2 764 875** | **24 017 689** | **28 043** | **24 045 732** |
| **Management options** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| Options exercised (share issue) | - | - | - | - | - | - | - | - | - | - | - | - |
| Revaluation of management share options | - | - | - | - | - | - | - | - | - | - | - | - |
| **Comprehensive income** | **-** | **(258 378)** | **-** | **-** | **-** | **(257 209)** | **(1 169)** | **-** | **2 292 459** | **2 034 081** | **1 019** | **2 035 100** |
| Remeasurements of the defined benefit liabilities (net of tax) | - | 10 467 | - | - | - | 10 467 | - | - | - | 10 467 | - | 10 467 |
| Revaluation of available-for-sale investments (net of tax) | - | (192 070) | - | - | - | (192 070) | - | - | - | (192 070) | - | (192 070) |
| Revaluation of hedging financial instruments (net of tax) | - | (75 606) | - | - | - | (75 606) | - | - | - | (75 606) | - | (75 606) |
| Foreign currency translation differences | - | (1 169) | - | - | - | - | (1 169) | - | - | (1 169) | - | (1 169) |
| Net profit for the period | - | - | - | - | - | - | - | - | 2 292 459 | 2 292 459 | 1 019 | 2 293 478 |
| **Appropriation of retained earnings** | **-** | **161 860** | **-** | **37 565** | **113 961** | **-** | **-** | **10 334** | **(2 781 551)** | **(2 619 691)** | **(13 098)** | **(2 632 789)** |
| Dividend paid | - | - | - | - | - | - | - | - | (2 624 701) | (2 624 701) | (8 088) | (2 632 789) |
| Profit appropriation to other reserves including consolidation adjustments | - | 161 860 | - | 37 565 | 113 961 | - | - | 10 334 | (156 850) | 5 010 | (5 010) | - |
| **Other** | **-** | **(23 850)** | **-** | **-** | **(23 850)** | **-** | **-** | **-** | **-** | **(23 850)** | **-** | **(23 850)** |
| Acquisition of Pekao Investment Banking S.A. | - | (23 850) | - | - | (23 850) | - | - | - | - | (23 850) | - | (23 850) |
| **Equity as at 31.12.2015** | **262 470** | **20 869 976** | **9 137 221** | **1 975 415** | **9 092 740** | **283 597** | **-** | **381 003** | **2 275 783** | **23 408 229** | **15 964** | **23 424 193** |

Notes to the financial statements presented on pages 10 – 151 constitute an integral part of the consolidated financial statements.

# Consolidated cash flow statement

(In PLN thousand)

| | NOTE | 2016 | 2015 |
|---|---|---|---|
| **Cash flow from operating activities – indirect method** | | | |
| **Net profit for the period** | | **2 279 275** | **2 292 459** |
| **Adjustments for:** | | **9 051 905** | **(3 592 611)** |
| Depreciation and amortization | 16 | 340 866 | 331 465 |
| Share of profit (loss) of associates | | (38 561) | (52 146) |
| (Gains) losses on investing activities | | (280 761) | (241 559) |
| Net interest income | 10 | (4 382 005) | (4 166 570) |
| Dividend income | 12 | (16 798) | (13 635) |
| Interests received | | 5 347 032 | 5 228 593 |
| Interests paid | | (1 104 545) | (1 266 247) |
| Income tax | | 800 763 | 550 623 |
| Income tax paid | | (613 243) | (607 365) |
| Change in loans and advances to banks | | 214 246 | 174 433 |
| Change in financial assets held for trading | | 393 623 | (677 498) |
| Change in derivative financial instruments (assets) | | 1 293 018 | 1 241 528 |
| Change in loans and advances to customers and bill of exchange eligible for rediscounting at Central Bank | | (42 858) | (6 507 423) |
| Change in receivables from finance leases | | (470 664) | (391 931) |
| Change in investment (placement) securities | | (928 421) | (830 115) |
| Change in other assets | | 1 228 207 | 819 733 |
| Change in amounts due to banks | | (1 128 745) | 615 159 |
| Change in financial liabilities held for trading | | 61 723 | 20 131 |
| Change in derivative financial instruments (liabilities) | | (1 251 654) | (1 213 378) |
| Change in amounts due to customers | | 8 969 426 | 3 229 320 |
| Change in debt securities issued | | 11 832 | 91 981 |
| Change in provisions | | 135 018 | (17 082) |
| Change in other liabilities | | 514 406 | 89 372 |
| **Net cash flows from operating activities** | | **11 331 180** | **(1 300 152)** |
| **Cash flow from investing activities** | | | |
| **Investing activity inflows** | | **83 089 908** | **269 003 982** |
| Sale of shares in associates | | - | 75 000 |
| Sale of investment securities | | 82 248 380 | 268 281 039 |
| Sale of intangible assets and property, plant and equipment | | 14 190 | 17 120 |
| Dividend received | 12 | 16 798 | 13 635 |
| Other investing inflows | | 810 540 | 617 188 |
| **Investing activity outflows** | | **(96 608 585)** | **(265 080 477)** |
| Acquisition of shares in subsidiary, net of cash acquired | | - | (274 329) |
| Acquisition of investment securities | | (96 335 321) | (264 510 542) |
| Acquisition of intangible assets and property, plant and equipment | 35, 36 | (273 264) | (295 606) |
| **Net cash flows from investing activities** | | **(13 518 677)** | **3 923 505** |

Notes to the financial statements presented on pages 10 - 151 constitute an integral part of the consolidated financial statements.

# Consolidated cash flow statement (cont.)

(In PLN thousand)

| | NOTE | 2016 | 2015 |
|---|---|---|---|
| **Cash flows from financing activities** | | | |
| **Financing activity inflows** | | **1 129 733** | **3 966 098** |
| Issue of debt securities | 42 | 1 129 733 | 3 966 098 |
| **Financing activity outflows** | | **(4 789 541)** | **(7 632 240)** |
| Redemption of debt securities | 42 | (2 506 052) | (5 007 539) |
| Dividends and other payments to shareholders | | (2 283 489) | (2 624 701) |
| **Net cash flows from financing activities** | | **(3 659 808)** | **(3 666 142)** |
| **Total net cash flows** | | **(5 847 305)** | **(1 042 789)** |
| including: effect of exchange rate fluctuations on cash and cash equivalents held | | 96 157 | 151 702 |
| **Net change in cash and cash equivalents** | | **(5 847 305)** | **(1 042 789)** |
| **Cash and cash equivalents at the beginning of the period** | | **14 513 395** | **15 556 184** |
| **Cash and cash equivalents at the end of the period** | 52 | **8 666 090** | **14 513 395** |

Notes to the financial statements presented on pages 10 - 151 constitute an integral part of the consolidated financial statements.

# Notes to the financial statements (cont.)

(In PLN thousand)

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

## 1. General information

The parent company of the Bank Pekao S.A. Group (the 'Group') is Bank Pekao S.A. (hereinafter referred to the 'the Parent Company', 'the Bank'), with Head Office in Warsaw, at 53/57 Grzybowska Street, 00-950 Warsaw. Bank Pekao S.A. was incorporated on 29 October 1929 in the Commercial Register of the District Court in Warsaw and has been continuously in operation since its incorporation.

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

The Bank's statistical REGON number is 000010205.

Both the Parent Company and the consolidating entities constituting the Capital Group has been estabilished for an indefinite period of time.

Bank Pekao S.A. Capital Group ('Group' or 'Bank Pekao S.A. Group') is part of the UniCredit S.p.A. Group with its seat in Roma, Italy.

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

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

**Changes in share ownership structure of the Bank**

In the current report No. 17/2016, the Management Board of Bank Pekao S.A. informed that on 18 July 2016 it received the notification from UniCredit S.p.A. according to which, UniCredit S.p.A. sold 26 247 003 shares of the Bank as a result of the execution on 13 July 2016 of the block trades concluded as a result of the accelerated book-building process. The transactions were settled on 15 July 2016.

In the current report No. 30/2016, the Management Board of Bank Pekao S.A. informed that on 8 December 2016 UniCredit S.p.A. announced it has entered into an agreement for the disposal of a 32.8% stake in Bank Pekao S.A. to Powszechny Zakład Ubezpieczeń S.A. ('PZU') and Polish Development Fund S.A. ('PFR').

The Transaction is subject to the customary regulatory and antitrust approvals and is expected to be completed around mid-2017.

Moreover in the current report No. 31/2016 on 8 December 2016 the Bank informed that it had received communication from UniCredit S.p.A. concerning announcement on sale offer of 1 916 of certificates exchangeable for the Bank shares of total reference value of approx. EUR 500 million, compulsorily settled in the Bank common shares no later than on 15 December 2019. Those certificates shall be used to sell the remaining 7.3% of the Bank shares belonging to UniCredit S.p.A. (after the conclusion of sale agreement mentioned above).

(In PLN thousand)

## 2. Group structure

The Group consists of Bank Pekao S.A. as the parent entity and the following subsidiaries

| NAME OF ENTITY | LOCATION | CORE ACTIVITY | PERCENTAGE OF THE GROUP'S OWNERSHIP RIGHTS IN SHARE CAPITAL/ VOTING | |
|---|---|---|---|---|
| | | | 31.12.2016 | 31.12.2015 |
| Pekao Bank Hipoteczny S.A. | Warsaw | Banking | 100.00 | 100.00 |
| Centralny Dom Maklerski Pekao S.A. | Warsaw | Brokerage | 100.00 | 100.00 |
| Pekao Leasing Sp. z o.o. | Warsaw | Leasing services | 100.00 | 36.49 |
| Pekao Investment Banking S.A. | Warsaw | Brokerage | 100.00 | 100.00 |
| Pekao Leasing Holding S.A. (in liquidation), including: | Warsaw | Deleted from the registry | - | 100.00 |
| *Pekao Leasing Sp. z o.o.* | *Warsaw* | *Leasing services* | - | *63.51* |
| Pekao Faktoring Sp. z o.o. | Lublin | Factoring services | 100.00 | 100.00 |
| Pekao Pioneer Powszechne Towarzystwo Emerytalne S.A. | Warsaw | Pension fund management | 65.00 | 65.00 |
| Centrum Kart S.A. | Warsaw | Financial support | 100.00 | 100.00 |
| Pekao Financial Services Sp. z o.o. | Warsaw | Transferable agent | 100.00 | 100.00 |
| Centrum Bankowości Bezpośredniej Sp. z o.o. | Cracow | Call-center services | 100.00 | 100.00 |
| Pekao Property S.A., including: | Warsaw | Real estate development | 100.00 | 100.00 |
| *FPB - Media Sp. z o.o.* | *Warsaw* | *Real estate development* | *100.00* | *100.00* |
| Pekao Fundusz Kapitałowy Sp. z o.o. (in liquidation) | Warsaw | Business consulting | 100.00 | 100.00 |

As at 31 December 2016, all of the subsidiaries have been consolidated.

**Associates**
Bank Pekao S.A. Capital Group has an interest in the following associates

| NAME OF ENTITY | LOCATION | CORE ACTIVITY | PERCENTAGE OF THE GROUP'S OWNERSHIP RIGHTS IN SHARE CAPITAL/ VOTING | |
|---|---|---|---|---|
| | | | 31.12.2016 | 31.12.2015 |
| Dom Inwestycyjny Xelion Sp. z o.o. (*) | Warsaw | Financial intermediary | 50.00 | 50.00 |
| Pioneer Pekao Investment Management S.A. | Warsaw | Asset management | 49.00 | 49.00 |
| *Pioneer Pekao TFI S.A.* | *Warsaw* | *Asset management* | *49.00* | *49.00* |
| CPF Management | Tortola, British Virgin Islands | Financial brokerage – not operating | 40.00 | 40.00 |
| Polish Banking System S.A. (in liquidation) | Warsaw | Deleted from the registry | - | 48.90 |
| PPU Budpress Sp. z o.o. (in liquidation) | Żyrardów | Deleted from the registry | - | 36.20 |

(*)The Group has no control over the entity due to provisions in the Company's Articles of Association.

As at 31 December 2016, the Group held no shares in entities under joint control.

**Changes in Group structure**

**The deletion of Polish Banking System S.A. (in liquidation) and PPU Budpress Sp. z o.o. (in liquidation) from the Registry**
On 1 January 2016 Polish Banking System S.A. (in liquidation) and PPU Budpress Sp. z o.o. (in liquidation) were deleted from the Registry.

**The deletion of Pekao Leasing Holding S.A. (in liquidation) from the Registry**
On 20 September 2016 Pekao Leasing Holding S.A. (in liquidation) was deleted from the Registry. In the course of the liquidation process of the Company, the transfer of ownership of 69 746 shares in Pekao Leasing Sp. z o.o. to Bank Pekao S.A. has been made. The Bank now holds 100% shares in the share capital and in the votes in the General Meeting of Pekao Leasing Sp. z o.o.

# 3. Business combination

In the year of 2016 there were no business combinations in the Group. In 2015 the Bank acquired 100% of the share capital of UniCredit CAIB Poland S.A. (presently Pekao Investment Banking S.A.). The transaction was detailed in the consolidated financial statements of Bank Pekao S.A. Group for the period ended on 31 December 2015.

# 4. Statement of compliance

The annual consolidated financial statements (‘financial statements’) of the Bank Pekao S.A. Group have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union, and in respect to matters that are not regulated by the above standards, in accordance with the requirements of the Accounting Act dated 29 September 1994 (Official Journal from 2016, item 1047 with further amendments) and respective operating regulations, and in accordance with the requirements for issuers of securities admitted or sought to be admitted to trading on an official stock exchange listing market.

These Consolidated Financial Statements were approved for publication by the Bank’s Management Board on 9 February 2017.

# 5. Significant accounting policies

## 5.1 Basis of preparation of Consolidated Financial Statements

**General information**
These Consolidated Financial Statements of the Group, which have been prepared for the period from 1 January to 31 December 2016, contain the financial results of the Bank and of its subsidiaries, comprising the ‘Group’, as well as the results of associated entities, measured using the equity method.

The financial statements have been prepared in Polish zloty, and all data in the financial statements are presented in PLN thousand (PLN ‘000), unless indicated otherwise.

The financial statements have been prepared on a going concern basis on the assumption that the Group will continue its business operations substantially unchanged in scope for a period of at least one year from the balance sheet date.

# Notes to financial statements (cont.)

(In PLN thousand)

The accounting principles as described below have been consistently applied for all the reporting periods. The principles have been applied consistently by all the Group entities.

Consolidated Financial Statements of the Group have been prepared based on the following valuation methods:

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

The consolidated financial statements include the requirements of all the International Financial Reporting Standards and International Accounting Standards approved by the European Union and related interpretations. Changes in published standards and interpretations, which became effective on or after 1 January 2016, had no material impact on the Group's financial statements (Note 5.10).

The financial statements does not take into consideration interpretations and amendments to Standards, pending approval by the European Union or approved by the European Union but came into force or shall come into force after the balance sheet date (Note 5.11 and Note 5.12).

In the Group's opinion, amendments to Standards and interpretations will not have a significant influence on the consolidated financial statements of the Group, with the exception of IFRS 9 'Financial Instruments'.

**IFRS 9 'Financial Instruments'**

In November 2016 the European Commission has adopted International Financial Reporting Standard no. 9 'Financial Instruments' that will replace IAS 39 'Financial Instruments: Recognition and Measurement'.

IFRS 9 will be mandatorily effective for annual periods beginning on or after 1 January 2018.

The new standard will introduce a revised model for classification and measurement of financial asserts, an impairment model for credit allowances based on 'expected loss' and a reformed approach to hedge accounting.

***Classification and measurement***

According to IFRS 9, classification of financial assets at initial recognition will be based upon:

- the entity's business model for managing the financial assets,
- the contractual cash flow characteristics of the financial asset (i.e. whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding, hereinafter 'SPPI').

Depending on the entity's business model, financial assets may be classified as:

- 'held to collect' contractual cash flows (measured at amortized cost, if SPPI criteria are met, and subject to the expected loss impairment),
- 'held to collect or sale' (measured at fair value through other comprehensive income, if SPPI criteria are met, and subject to the expected loss impairment), or
- 'held for trading' or other (measured at fair value through profit or loss).

Financial assets may be reclassified when, and only when, the Bank changes its business model for managing financial assets. In such a case the Bank shall reclassify all financial assets affected by the change of business model.

IFRS 9 allows an entity at initial recognition to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument that is not held for trading. Dividends from such an investment shall be recognized in profit or loss.

# Notes to financial statements (cont.)

(In PLN thousand)

The Bank has performed an analysis of business models used for managing the particular categories of financial assets as well as characteristics of the cash flows and concluded that:

- loans and advances to banks, loans and advances to customers and debt securities which, in accordance with IAS 39 are classified as loans and receivables and are held to collect contractual cash flows will be mostly measured at amortized cost under IFRS 9,
- debt securities, which according to IAS 39 are classified as held to maturity, are held to collect contractual cash flows and will be measured at amortized cost under IFRS 9,
- the majority of the debt securities which in accordance with IAS 39 are classified as available for sale, are held to collect contractual cash flows or for sale and will be still measured at fair value through other comprehensive income in accordance with IFRS 9,
- financial assets and liabilities held for trading, including assets and liabilities arising from derivative financial instruments, will continue to be measured at fair value through profit or loss,
- investments in equity instruments classified as available for sale according to IAS 39, will be measured at fair value through profit or loss in accordance with IFRS 9. The Bank has not yet made a final decision regarding the possibility of making an irrevocable election regarding recognition of changes in fair value of the equity instrument in other comprehensive income.

The Bank assesses that the implementation of the new standard will have no impact on the accounting treatment of financial liabilities, as IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities.

***Impairment of financial assets***

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model. Because of the aforementioned change the Bank will be obliged to calculate loss allowances based on the expected credit loss, taking into consideration forecasts of future economic conditions with regard to the measurement of the credit risk of an exposure, which is unacceptable under IAS 39.

The new impairment model will be applied to financial instruments measured, in accordance with IFRS 9, at amortized cost or at fair value through other comprehensive income, except for equity instruments.

Replacing the concept of 'incurred loss' with the concept of 'expected credit loss' will influence significantly the way of modelling credit risk parameters and the final amount of loss allowances. The currently applied loss identification period will not be used anymore, therefore the IBNR (incurred but not reported) category of loss allowance will be eliminated. In accordance with IFRS 9, the loss allowances will be calculated in the following categories (instead of the IBNR loss allowances and the loss allowances for non-performing exposures):

1. Stage 1 – 12-month expected credit losses – the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date,
2. Stage 2 and 3 – lifetime expected credit losses – the expected credit losses that result from all possible default events over the expected life of a financial instrument.

The measurement of lifetime expected credit losses will be applied to all exposures for which during the period between the initial recognition and the reporting date the Bank has identified a significant increase in credit risk (Stage 2) or has identified impairment (Stage 3). The measurement of 12-month expected credit losses (Stage 1) will be applied to all exposures for which the Bank has not identified a significant increase in credit risk or impairment during the period between the initial recognition and the reporting date.

The new approach to calculating the impairment of the financial assets will also have an impact on the interest income recognition. In particular, interest income on financial assets allocated to Stages 1 and 2 will be calculated based on the gross carrying amount of the exposure, whereas interest income on financial assets allocated to Stage 3 will be calculated based on the net carrying amount of the exposure (similarly to impaired financial assets under the requirements of IAS 39).

The Bank assumes that the implementation of the new impairment model based on the concept of ECL will have an impact on the level of the Bank's loss allowances, particularly with regard to exposures allocated to Stage 2. Contrary to IAS 39, IFRS 9 does not require the entities to identify the impairment triggers in order to estimate lifetime credit losses in Stage 2. Instead, the Bank is obliged to constantly estimate the level of credit losses since the initial recognition of a given asset until its derecognition. In the event of significant increase in credit risk since the initial recognition of the asset, the Bank will be obliged to calculate lifetime expected credit losses – Stage 2. Such an approach will result in the earlier recognition of credit losses which will cause an increase in loss allowances and therefore it will also affect profit or loss.

Within the scope of the IFRS 9 implementation project, the Bank is working on implementing a new methodology of loss allowances calculation as well as on implementing appropriate modifications in IT systems and processes used by the Bank, in particular on the foundations of the impairment model, acquiring appropriate data as well as designing the processes and tools and performing a detailed estimation of the impact of IFRS 9 on the level of loss allowances. Methodological tasks are focused on both development of currently applied solutions as well as implementation of the brand new solutions. In terms of the development of existing solutions, the Bank is currently adjusting PD, RR, EAD and CCF models so that they may be used to estimate expected credit losses.

The development of credit risk models is focused on estimating the life time credit risk parameters adjusted to take into account forward looking information in respect of Bank's expectations regarding future macroeconomic outlook. Modelling of the future exposure on the date of default will leverage on available payment schedules as well as information regarding prepayments. For the exposures without defined payment schedules the Bank is developing methodology aimed at modelling limit utilization at the date of default. In respect of transfer between Stage 1 and Stage 2 the Bank develops statistical transfer logic models utilizing probability of default parameter and other characteristics of the exposure such as product type, rating class or time to maturity, supplemented by additional qualitative transfer triggers.

In terms of new solutions, the works mainly include the development of criteria for the transfer between the stages, as well as taking into account the economic forecasts in the estimation of expected credit losses.

In the Bank's opinion, the implementation of the new Standard requires the application of more complex credit risk models of greater predictive abilities which require a significantly broader set of source data than the currently applied models.

***Hedge accounting***

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

Therefore, in the case of hedge accounting, the entry into force of IFRS 9 will have no impact on the financial position of the Bank.

***Disclosures and comparatives***

The Bank expects that new requirements of IFRS 9 will significantly change the presentation and extent of the disclosures on financial instruments, particularly in the year of the adoption of the new standard.

The Bank plans to take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 generally will be recognized in retained earnings as at 1 January 2018.

***Implementation schedule***

The Bank has launched a dedicated project of IFRS 9 implementation in 2015. The project is organized into two main streams: (1) C&M (classification and measurement including hedge accounting) and (2) LLP (impairment) which are managed by the key management persons of Finance and Risk Division respectively. Additionally the Bank has appointed the Steering Committee responsible for supervision over the project. The key members of Steering Committee are CFO, CRO and COO. Main objectives of Steering Committee are setting and monitoring key milestones and budget and taking major decisions concerning methodology and the operating model. The project involves also employees of Finance Division, Risk Division, as well as the main Business functions, Organization and Information Technology departments.

Currently, the Bank is in the process of designing and building the necessary solutions for particular requirements based on the results of the analysis gaps and defined methodological assumptions. The Bank plans to gradually finish the design work till the end of third quarter of 2017.

In parallel with the work on the methodology, the Bank develops architecture of IT systems in order to allow both the implementation of the new standard in the framework of impairment calculations and determining the risk parameters used.

***Potential impact of IFRS 9 on the financial situation and the own funds***
Quantitative assessment of the impact of changes on the financial statements upon adoption of the standard is not yet available primarily due to ongoing methodological works regarding adjustments of credit risk models to IFRS 9 requirements which are still in progress as well as from the lack of uniform market practice. From the legislative standpoint, the supervisory and regulatory authorities are working on updating prudential requirements which will be binding for the Bank. However, it needs to be noted that these works are not advanced enough to enable Bank to unambiguously determine the impact of the IFRS 9 on the financial position and capital adequacy indicators.

In the Bank’s opinion, disclosing quantitative data that would not reflect the potential impact of all aspects of IFRS 9 on the Bank’s financial situation and own funds could have a negative impact on the informative value of the financial statements for its users. Therefore, the Bank has chosen to disclose solely qualitative information on the Bank’s approach to the IFRS 9 implementation, which in the Bank’s opinion will enable the users of the financial statements to understand the impact of IFRS 9 on the financial situation and capital management of the Bank.

In the Bank’s view the implementation of the new standard, and especially the introduction of the new impairment model based on the ECL concept, will increase the value of impairment allowances, especially in terms of exposures to Stage 2. The Bank does not anticipate a significant impact on the level or volatility of P&L/OCI, as expected changes in classification and measurement methods will be limited to a minor part of financial assets. The final result will depend on the structure of assets at the date of initial application of IFRS 9. Any changes in the carrying value of financial instruments due to the adoption of IFRS 9 will be recognized in the Bank's equity as of 1 January 2018.

The most significant impact on the Bank's own funds will have the above-mentioned increase in the value of allowances for credit losses and the change in the classification and valuation of equity securities which in accordance with IAS 39 are classified to available-for-sale portfolio and measured at fair value recognized through other comprehensive income (provided that the Bank does not exercise the OCI option in accordance with IFRS 9).

Moreover, in connection to the changes resulting from implementation of IFRS 9 in the accounting regulations and lack at present of the information on the direction of the changes in the tax regulations, according to Bank’s judgment there is a significant uncertainty concerning the future shape of the tax regulations, which will have to be amended to reflect the new standard and which can have an impact on the value of the deferred tax asset of the Bank created on the cost of allowances for credit losses.

## 5.2 Consolidation

**Consolidation principles**
The consolidated financial statements of Bank Pekao S.A. Group include the financial data of Bank Pekao S.A. and its subsidiaries as at 31 December 2016. The financial statements of the subsidiaries are prepared at the same reporting date as those of the parent entity, using consistent accounting policies within the Group in all important aspects.

All intra-group balances and transactions, including unrealized gains, have been eliminated. Unrealized losses are also eliminated, unless there is an objective evidence of impairment, which should be recognized in the consolidated financial statements.

**Investments in subsidiaries**
Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group has power over an entity, is exposed to or has rights to variable returns from its involvement with the entity and has the ability to affect these returns through its power over the entity. The subsidiaries are consolidated from the date of obtaining control by the Group until the date when the control ceases.

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group. Identifiable assets acquired and liabilities assumed are measured at their fair values at the acquisition date. The Group measures any non-controlling interests in the acquire at fair value or at the present ownership instruments' proportionate share in the recognized amounts of the acquire's identifiable net assets. Acquisition-related costs are expenses as incurred (in the income statement under 'Administrative expenses').

If the business combination is achieved in stages, the acquirer remeasures its previously held equity interests in the acquiree at fair value at the acquisition date (date of obtaining control) and recognizes the resulting gain or loss in the income statement.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If the total of consideration transferred, non-controlling interest recognized and previously held interest measured is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognized directly in the income statement.

The above policy does not apply to the business combinations under common control.

The changes in a parent entity's ownership interest in a subsidiary that do not result in the parent entity losing control of the subsidiary are accounted for as equity transactions (i.e. transactions with owners of parent entity). The Group recognizes directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attributes it to the owners of the parent entity.

When the Group ceases to have control over the subsidiary, any retained interest in that subsidiary is remeasured to its fair value at the date when control is lost, with the change in carrying amount recognized in the income statement.

**Recognition of business combinations under common control at book value**
Business combinations under common control are excluded from the scope of IFRS. As a consequence, following the recommendation included in IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', in the absence of any specific guidance within IFRS, Bank Pekao S.A. has adopted the accounting policy consistently applied in all business combinations under common control within the UniCredit Group, of which the Bank is a member, which recognizes those transactions using book value.

The acquirer recognizes the assets and liabilities of the acquired entity at their current book value adjusted exclusively for the purpose of aligning the accounting principles. Neither goodwill, nor badwill is recognized.

Any difference between the book value of the net assets acquired and the fair value of the consideration paid is recognized in the Group's equity. In applying this book value method, the comparative periods are not restated.

If the transaction results in the acquisition of non-controlling interests, the acquisition of any non-controlling interest is accounted for separately.

There is no guidance in IFRS how to determine the percentage of non-controlling interests acquired from the perspective of a subsidiary. Accordingly Bank Pekao S.A. uses the same principles as the ultimate parent for estimating the value of non-controlling interests acquired.

**Investments in Associates**
An associate is an entity over which the Group has significant influence, and that is neither a subsidiary nor a joint venture. The Group usually holds from 20% to 50% of the voting rights in an associate. The equity method is calculated using the financial statements of the associates. The balance sheet dates of the Group and its associates are the same.

On acquisition of the investment, any difference between the cost of the investment and the Group's share in the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:
- goodwill relating to an associate is included in the carrying amount of the investment,
- any excess of the Group's share in the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the Group's share in the associate's profit or loss in the period in which the investment is acquired.

The Group recognizes the investments in associates applying the equity method. The investment in associates is initially recognized at cost and the carrying amount is increased or decreased to recognize the Group's share in net assets of the associate after the date of acquisition, net of any impairment allowances. The Group's share of post-acquisition profit or loss is recognized in the income statement, and its share of post-acquisition movements in other comprehensive income is recognized in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. Distributions received from an associate reduce the carrying amount of the investment.

If the Group's share in the losses of an associate equals or exceeds the Group's share in the associate, the Group ceases to recognize further losses, unless it assumed obligations or made a payment on behalf of the associate.

Unrealized profits or losses from transactions between the Group and associates are eliminated pro rata to the Group's share in the associates.

## 5.3 Accounting estimates

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

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

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

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

**Impairment of loans and advances to customers**
At each balance sheet date the Group assesses whether there is any objective evidence ('trigger') that loan exposures are impaired. Impairment losses are incurred if, and only if at least one impairment trigger is identified and the event implicating the impairment trigger has a negative impact on the estimated future cash flows of the loan exposure. Whilst the identification of loan exposures impairment the Group does not consider future events, irrespective of probability of its occurrence.

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

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

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

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

# Notes to the financial statements (cont.)

(In PLN thousand)

For all individually insignificant exposures, which are impaired as at balance sheet date, the Group measures the impairment allowance (impairment loss) as part of collective assessment. Each exposure assessed collectively is grouped based on similar credit risk characteristics (on the basis of the borrower's type, the product's type, past-due status or other relevant factors impacting on the debtor's ability to pay all amounts due according to the contractual terms). The future cash flows are estimated on the basis of historical data of cash flows and historical loss experience for exposures with credit risk characteristics similar to those in the group. Historical data, when necessary, are adjusted on the basis of current data to remove the effects of conditions in the historical period that do not exist currently. The recovery rates and the methodology and assumptions used for estimating future cash flows for particular groups of loan exposures are reviewed regularly.

For all loan exposures, for which no impairment triggers have been identified, the Group measures the allowance for losses incurred, but not reported ('IBNR').

The following table presents the impact on the net impairment losses as part of collective assessment and IBNR of a change in the estimated recovery rates (RR) and estimated probability of default (PD) by 10%.

| 31.12.2016 | NET IMPAIRMENT LOSSES ON FINANCIAL ASSETS AND OFF-BALANCE SHEET COMMITMENTS | |
|---|---|---|
| | 10% INCREASE | 10% DECREASE |
| Recovery rates (RR) | 98 821 | (99 182) |
| Probability of default (PD) | (32 689) | 32 956 |

| 31.12.2015 | NET IMPAIRMENT LOSSES ON FINANCIAL ASSETS AND OFF-BALANCE SHEET COMMITMENTS | |
|---|---|---|
| | 10% INCREASE | 10% DECREASE |
| Recovery rates (RR) | 110 990 | (112 736) |
| Probability of default (PD) | (43 102) | 43 219 |

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

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

**Measurement of derivatives and unquoted debt securities available for sale**
The fair value of non-option derivatives and debt securities available for sale that do not have a quoted market price on an active market is measured using valuation models based on discounted cash flows. Options are valued using option valuation models. Variables used for valuation purposes include, where possible, the data from observable markets. However, the Group also adopts assumptions concerning counterparty's credit risks which affect the valuation of instruments. The adoption of other measurement assumptions may affect the valuation of these financial instruments. The assumptions used for fair value measurement are described in detail in Note 6.7 'Fair value of financial assets and liabilities'.

**Provisions for defined benefit plans**
The principal actuarial assumptions applied to estimation of provisions for defined benefit plans, as well as the sensitivity analysis were presented in Note 45.

# Notes to the financial statements (cont.)

(In PLN thousand)

**Goodwill**
The Group performs an impairment test of goodwill on a yearly basis or more often if impairment triggers occur. The assessment of goodwill impairment requires an estimate of value in use of all cash-generating units to which the goodwill relates. The principal assumptions applied to an impairment test of goodwill were presented in Note 35.

## 5.4 Foreign currencies

- Functional and presentation currency
  The financial statements of individual Group entities, including the Bank's Branch in Paris, are presented in their functional currencies, i.e. in the currency of the primary economic environment in which the entity operates. The Consolidated Financial Statements are presented in Polish zloty. Polish zloty is the functional currency and the presentation currency of the Bank. The Group applies as the closing rate the average the National Bank of Poland ('NBP') exchange rate, valid as at the balance sheet date.
- Transactions and balances
  Foreign currency transactions are calculated into the functional currency using the spot exchange rate from the date of the transaction. Gains and losses from foreign currency translation differences resulting from settlements of such transactions and from the statement of financial position valuation of monetary assets and liabilities expressed in foreign currencies are recognized in the income statement.
- Foreign currency translation differences arising from non-monetary items, such as equity instruments classified as financial assets measured at fair value through the profit or loss are recognized together with the changes in the fair value of that item in the income statement.
  Foreign currency translation differences arising from non-monetary items such as equity instruments classified as available for sale financial assets are recognized in the revaluation reserves.
- Companies of the Group
  The consolidation of assets and liabilities of foreign business entities are translated into Polish currency i.e. to the presentation currency as per the closing exchange rate for the balance sheet date. Revenues and expenses are translated at the average exchange rates calculated on the basis of the exchange rates of the reporting period except for situations where exchange rates fluctuate significantly such that the average exchange rate is not an acceptable approximation of the exchange rate from the transaction date. In such situations revenue and expenses are translated on the basis of the exchange rate from the date of the transaction.

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

(In PLN thousand)

## 5.5 Income statement

**Interest income and expense**

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

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

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

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

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

**Fee and commission income and expense**

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

- fees and commissions directly attributable to financial asset or liability origination (both income and expense) are recognized in the income statement using the effective interest rate method and are described above,
- fees and commissions relating to the loans and advances without a defined repayment schedule and without a defined interest rate schedule e.g. overdraft facilities and credit cards are amortized over the life of the product using the straight line method,
- other fees and commissions arising from the Group’s financial services offering (customer account transaction charges, credit card servicing transactions, brokerage activity and canvassing) are recognized in the income statement up-front when the corresponding service is provided.

**Income and expense from bancassurance**

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

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

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

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

In 2016 the Bank recognized upfront 11% of bancassurance revenue associated with cash loans and 16% of bancassurance revenue associated with mortgage loans. The remaining portion of bancassurance revenue is amortized over the life of the associated loans as part of effective interest rate.

# Notes to the financial statements (cont.)

(In PLN thousand)

**Result on financial assets and liabilities held for trading**
Result on financial assets and liabilities held for trading include:

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

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

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

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

## 5.6 Valuation of financial assets and liabilities, derivative financial instruments

**Financial assets**
Financial assets are classified into the following categories:

- Financial assets measured at fair value through profit or loss
  This category comprises two sub-categories: financial assets held for trading and financial assets designated at initial recognition as financial assets measured at fair value through profit or loss.
  Financial assets held for trading include: debt and equity securities, loans and receivables purchased or classified into this category for the purpose of disposal thereof on a short-term basis. The classification also includes derivative instruments (not used as hedging instruments).
  Financial assets classified at the moment of original recognition as financial assets measured at fair value through profit or loss include debt securities acquired by the Group for the purpose of elimination or considerable reduction of inconsistencies in the valuation between these securities and the derivatives, which are economically hedging the interest rate risk of such securities. Otherwise, such securities would have been classified into the available for sale portfolio, with the effect of valuation recognized in revaluation reserves, and valuation of derivatives economically hedging such securities reported in the income statement.

- Held to maturity
  These are non-derivative financial assets with fixed or determinable payments and fixed maturity, for which the entity has an intent and ability to hold to maturity, other than:
  a) those that the entity upon initial recognition designates as at fair value through profit or loss,
  b) those that the entity designates as available for sale, and
  c) those that meet the definition of loans and receivables.
  Financial assets classified into this category are measured at amortized cost using the effective interest rate method. The recognition of amortized cost with the use of effective interest rate is recognized in interest income.
- Loans and receivables
  Loans and receivables are non-derivative financial assets, with fixed or determinable payments, not quoted on active markets, other than:
  a) those that the entity intends to sell immediately or in the near term which are classified as held for trading and those that the entity designates as at fair value through profit or loss upon initial recognition,
  b) those that the Group upon initial recognition designates as available for sale, or
  c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which are classified as available for sale.
  This category also contains debt securities, purchased from the issuer, for which there is no active market, as well as credits, loans, receivables from reverse repo transactions and other receivables acquired and granted. Loans and receivables are measured at amortized cost using the effective interest rate method and with consideration of impairment.
- Available for sale
  This includes financial assets with an undefined holding period. The portfolio includes: debt and equity securities, as well as loans and receivables not classified into other categories. Interest on assets available for sale is calculated using the effective interest rate method, and recognized in the income statement.
  Available for sale financial assets are measured at fair value, whereas gains and losses resulting from changes in fair value against amortized cost are recognized in the revaluation reserves. Amounts in the revaluation reserves are recognized in the income statement either on the sale of an asset, or its impairment. In case of impairment of an asset, previous increases from revaluation to fair value will decrease the ‘Revaluation reserves’. Should the amount of previously recognized increases be insufficient to cover the impairment, the difference will be recorded in the income statement as ‘Net impairment losses on financial assets and off-balance sheet commitments’.

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

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

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

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

Derivative instruments are recognized or derecognized on transaction dates.

**Reclassification of financial assets**

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

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

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

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

**Impairment of financial assets**

***Assets measured at amortized cost – loans and advances***

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

The Group splits the loan exposures into individually significant exposures and individually insignificant exposures.

In respect to exposures assessed individually the Group applies the following list of impairment triggers:

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

- disappearance of active market for given credit exposure resulted from financial difficulties of debtor. This impairment trigger could refer to financial instruments listed on stock exchanges, when due to significant deterioration in financial standing of issuer (eventually bankruptcy), the liquidity of assets trading is so low that reliable price fixing is not possible,
- receivership has been established or debtor has stopped/suspended its activity,
- unknown place of stay and not disclosed assets of the borrower.

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

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

The Group classifies the exposure as past due in case the borrower has failed to make payment on the principal and/or interest in the contractual maturity date. The Group presents the whole amount of exposure as past due, regardless of whether the delay of payment affects the whole exposure, or only part of it (installment). The number of days past due for receivables paid by installments is assumed as the period from the date of maturity of the earliest installment, when the repayment is delayed.

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

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

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

For all individually insignificant exposures, which are impaired as at balance sheet date, the Group measures the impairment allowance (impairment loss) as part of collective assessment. Each exposure assessed collectively is grouped based on similar credit risk characteristics on the basis of the borrower's type, the product's type, past-due status or other relevant factors impacting on the debtor's ability to pay all amounts due according to the contractual terms. The future cash flows are estimated on the basis of historical data of cash flows and historical loss experience for exposures with credit risk characteristics similar to those in the group (for example, the value of the real estate taken as the collateral for the mortgage). Historical data, when necessary, are adjusted on the basis of current data to remove the effects of conditions in the historical period that do not exist currently. The recovery rates ('RR') and the methodology and assumptions used for estimating future cash flows for particular groups of loan exposures are reviewed regularly.

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

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

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

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

***Financial assets available for sale***

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

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

**Off-balance sheet commitments**

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

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

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

**Repo and reverse-repo agreements**

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

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

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

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

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

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

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

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

The changes in fair value of the derivative financial instruments held for trading are recognized in the income statement.
The Group designates some of its derivative instruments as hedging items in applying hedge accounting. The Group implemented fair value hedge accounting as well as cash flow hedge accounting, under the condition of meeting the criteria of IAS 39 ‘Financial Instruments: Recognition and Measurement’.

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

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

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

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

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

# Notes to the financial statements (cont.)

(In PLN thousand)

***Cash flow hedge accounting principles***

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

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

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

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

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

**Financial liabilities**

The Group's financial liabilities are classified to the following categories:

- financial liabilities held for trading, valued at fair value,
- financial liabilities not held for trading, valued at amounts payable, measured at amortized cost using the effective interest rate method.

Financial liabilities not held for trading consist of amounts due to banks and customers, loans from other banks, and own debt securities issued.

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

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

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

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

## 5.7 Valuation of other items in the Group's consolidated statement of financial position

**Intangible assets**

***Goodwill***

Goodwill is defined as a surplus of the purchasing price over the fair value of the assets, liabilities and contingent liabilities of the acquired subsidiary, associate or a unit under joint control. Goodwill at initial recognition is carried at purchase price reduced by any accumulated impairment losses. Impairment is determined by estimating the recoverable value of the cash generating unit, to which given goodwill pertains. If the recoverable value of the cash generating unit is lower than the carrying amount an impairment charge is made. Impairment identified in the course of such tests is not subject to subsequent adjustments.

# Notes to the financial statements (cont.)

(In PLN thousand)

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

***Other intangible assets***

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

These assets include:

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

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

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

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

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

**Property, plant and equipment**

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

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

Each component of property, plant and equipment, the purchase price or production cost of which is significant compared to the purchase price or production cost of the entire item is a subject to separate depreciation. The Group separates the initial value of property, plant and equipment into its significant parts.

Subsequent expenditures relating to property plant and equipment are capitalized only when it is probable that such expenditures will result in future economic benefits to the Group, and the cost of such expenses can be reliably measured.

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

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

**Depreciation and amortization**

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

(In PLN thousand)

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

a) depreciation rates applied for non-current assets

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

b) amortization rates for intangible assets

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

c) depreciation rates for investment properties

| | |
|---|---|
| Buildings and structures | 1.5% – 10.0% |

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

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

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

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

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

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

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

# Notes to the financial statements (cont.)

(In PLN thousand)

**Leases**

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

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

***Operating leases***

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

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

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

***Finance leases***

**The Group as lessor**

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

Lease payments from agreements, which do not meet the conditions of finance lease agreements are recognized as revenues in the income statement using the straight-line method over the life of the lease.

**The Group as lessee**

For lease agreements in which in principle all risks and benefits relating to ownership of the leased assets are transferred to the Group, the leased asset is recognized as a non-current asset and simultaneously a liability is recognized in the amount equal to the present value of minimum lease payments as at the date of commencement of the lease. Lease payments are split into costs of lease charges and a reduction of liabilities in order to maintain a fixed interest rate on the outstanding liability. Financial costs are recognized directly in the income statement.

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

Lease charges from agreements that do not fulfill the criteria for finance lease agreements are recognized as costs in the income statement on a straight line basis over the lease period.

**Provisions**

The provisions are recognized when the Group has a present obligation (legal or constructive) resulting from the past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, the amount of a provision is established by discounting forecasted future cash flows to the present value, using the discount rate reflecting current market estimates of the time value of money and the possible risk associated with the obligation.

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

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

**Deferred income and accrued expenses (liabilities)**
This caption includes primarily commission income settled using the straight line method and other income charged in advance, that will be recognized in the income statement in the future periods.

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

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

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

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

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

The Group equity consists of the following:
a) share capital - applies only to the capital of the Bank as the parent entity and is presented at nominal value specified in the Articles of Association and in the entry in the Enterprises Registry,
b) 'issue premium' - surplus generated during share issues over the nominal value of such issues, remaining after the issue costs are covered. Moreover, this item also includes a change in the value of minority shares, ensuing from an increase of the share of the Parent entity in Bank's share capital. This accounting principle is in accordance with the accounting principles applied by UniCredit Group,
c) the general banking risk fund is established at Bank Pekao S.A. in keeping with the Banking Act dated 29 August 1997 from profit after tax,
d) other reserve capital utilized for the purposes defined in the Statute is created from appropriations of profits,
e) revaluation reserve includes the impact of valuation of financial instruments available for sale, effects of valuation of derivative instruments hedging cash flows, remeasurements of the defined benefit liabilities and the value of deferred tax for items classified as temporary differences, recognized as valuation allowance. In the statement of financial position, the valuation allowance is presented as net value,
f) exchange rate differences include differences arising from valuation of net assets in foreign entities and from the recalculation of the result of a foreign branch at the weighted average exchange rate at the balance sheet date in relation to the average NBP exchange rate,
g) other capital:
    - other supplementary capital, established in keeping with provisions under the Articles of Association of companies from profit appropriations,
    - capital components:
        - bonds convertible to shares - includes the fair value of financial instruments issued as part of transactions settled in equity instruments,
        - provision for purchase of parent entity stocks,
    - brokerage activity fund for stock broking operations, carried out by Bank Pekao S.A.,

- retained earnings from prior periods includes undistributed profit and uncovered losses generated/incurred in prior periods by subsidiaries consolidated full method,
- net profit/loss which constitutes profit/loss presented in the income statement for the relevant period. Net profit is after accounting for income tax.

**Non - controlling interests**
Non - controlling interests are defined as the equity in a subsidiary not attributable, directly or indirectly, to the Bank.

**Share-based payments**
Employee participation programs are established by the Group under which key management staff is granted pre-emptive rights to buy shares of the Bank, including phantom shares, and shares of UniCredit S.p.A. (Note 46).

***Bank's Pekao S.A. phantom shares-settled share-based payment transaction***
The cost of transactions settled with employees in phantom shares is measured by reference to the fair value of the liability as of the balance sheet date.
The fair value of the liability is estimated based upon the Bank's shares price on the (WSE) as of the balance sheet date and expected number of phantom shares to which full rights will be acquired.
The cost of phantom share-based payments is recognized in personnel expenses together with the accompanying increase in the value of liabilities towards employees presented in 'Provisions'.
The accumulated cost recognized for transactions settled in phantom shares for each balance sheet date until the vesting date reflects the extent of elapse of the vesting period and the number of rights to shares the rights to which – in the opinion of the Bank's Management Board for that date based on best available estimates of the number of phantom shares – will be eventually vested.

***Stock options and stock of the UniCredit S.p.A.***
The Group entities joined the UniCredit-wide long term incentive program. The aim of the program is to offer to selected key Group's employees share options and shares of UniCredit S.p.A.

The fair value of the instruments granted to the Group employees was established following the UCI Group-wide applied Hull and White model.

The expenses related to the rights granted are recognized in 'Personnel expenses' and respective increase is recognized as liabilities presented in 'Other liabilities'.

The Group is obliged to pay to UniCredit S.p.A. the fair value of the instruments vested at the time the instruments are exercised.

## 5.8 Income tax

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

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

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

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

# Notes to the financial statements (cont.)

(In PLN thousand)

## 5.9 Other

**Contingent liabilities and commitments**

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

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

The issuer of the financial guarantee contract recognizes it at the higher of:

- the amount determined in accordance with IAS 37 'Provisions, contingent liabilities and contingent assets',or
- the amount initially recognized less, when appropriate, cumulative amortization charges recognized in accordance with IAS 18 'Revenue'.

**Cash and cash equivalents**

Cash and cash equivalents in the consolidated cash flow statement include 'Cash and due from Central Bank' and loans and receivables from banks with maturities up to three months.

## 5.10 New standards, interpretations and amendments to published standards that have been approved and published by the European Union and are effective on or after 1 January 2016

| STANDARD / INTERPRETATION | DESCRIPTION | IMPACT ASSESSMENT |
|---|---|---|
| **Amendments to IFRS 10** 'Consolidated Financial Statements', **IFRS 12** 'Disclosure of interests in other entities' and **IAS 28** 'Investments in Associates and Joint Ventures' | The amendments clarify the application of the consolidation exception for investment entities and their subsidiaries.<br>Date of application: the first financial year beginning on or after 1 January 2016. | The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application. |
| **IFRS 11 (amendment)** 'Joint Arrangements' | The amendments add new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business. The amendments specify the appropriate accounting treatment for such acquisitions.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the standard's amendment will not have a material impact on its financial statements in the period of its first application. |
| **IAS 1 (amendment)** 'Presentation of the financial statements' | The amendments clarify that among others an entity should not reduce understandability by aggregating or disaggregating information in a manner that obscures useful information.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the standard's amendment will not have a material impact on its financial statements in the period of its first application. |
| **IAS 16 (amendment)** 'Property, Plant and Equipment' and **IAS 38 (amendment)** 'Intangible Assets' | The IASB has clarified that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset.<br>The IASB also clarified that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset. This presumption, however, can be rebutted in certain limited circumstances.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the standards amendments will not have a material impact on its financial statements in the period of its first application. |

# Notes to the financial statements (cont.)

(In PLN thousand)

| STANDARD / INTERPRETATION | DESCRIPTION | IMPACT ASSESSMENT |
|---|---|---|
| **IAS 16 (amendment)** 'Property, Plant and Equipment' and **IAS 41 (amendment)** 'Agriculture' | IAS 41 'Agriculture' currently requires all biological assets related to agricultural activity to be measured at fair value less costs to sell. This is based on the principle that the biological transformation that these assets undergo during their lifespan is best reflected by fair value measurement. However, there is a subset of biological assets, known as bearer plants, which are used solely to grow produce over several periods. At the end of their productive lives they are usually scrapped. Once a bearer plant is mature, apart from bearing produce, its biological transformation is no longer significant in generating future economic benefits.<br>The IASB decided that bearer plants should be accounted for in the same way as property, plant and equipment in IAS 16 'Property, Plant and Equipment', because their operation is similar to that of manufacturing.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application. |
| **IAS 19 (amendment)** 'Employee benefits' | The amendment applies to contributions from employees or third parties to defined benefit plans. The aim of the amendments is to simplify the accounting for contributions that are independent of the number of years of employee service, for example, employee contributions that are calculated according to a fixed percentage of remuneration. Date of application: the first financial year beginning on or after 1 February 2015. | The Group claims that the standard's amendment did not have a material impact on its financial statements in the period of its first application. |
| **IAS 27 (amendment)** 'Separate Financial Statements' | The amendments to IAS 27 will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application. |
| **Improvements to IFRS 2010-2012** | The annual improvements to IFRS 2010-2012 principally aim to solve inconsistencies and specify vocabulary. Date of application: the first financial year beginning on or after 1 February 2015. | The Group claims that the improvements did not have a material impact on its financial statements in the period of its first application. |
| **Improvements to IFRS 2012-2014** | The annual improvements to IFRS 2012-2014 principally aim to solve inconsistencies and specify vocabulary.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the improvements will not have a material impact on its financial statements in the period of its first application. |

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

| STANDARD / INTERPRETATION | DESCRIPTION | IMPACT ASSESSMENT |
|---|---|---|
| **IFRS 9** 'Financial Instruments' | New regulations constitute a part of changes designed to replace IAS 39 'Financial Instruments: Recognition and Measurement'. The main changes, introduced by the new standard, are as follows:<br>• new categorisation of financial assets,<br>• new criteria of assets classification to the group of financial assets measured at amortized cost,<br>• new impairment model – expected credit losses model,<br>• new principles for recognition of changes in fair value measurement of capital investment in financial instruments,<br>• elimination of the necessity to separate embedded derivatives from financial assets.<br>The major part of IAS 39 requirements relating to financial liabilities classification and valuation were transferred to IFRS 9 unchanged.<br>Date of application: the first financial year beginning after 1 January 2018. | The impact assessment of the new standard implementation on Group's financial statements is described in note 5.1 Basis of preparation of Consolidated Financial Statements. |
| **IFRS 15** 'Revenue from Contracts with Customers' | The Standard will improve the financial reporting of revenue and improve comparability of the top line in financial statements globally.<br>The core principle of the new Standard is to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. In accordance with new IFRS 15, the revenue is recognized when the control over the goods or services is transferred to the customer.<br>Date of application: the first financial year beginning after 1 January 2018. | The Group is currently assessing the impact of the IFRS 15 application on its financial statements. |

(In PLN thousand)

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

| STANDARD / INTERPRETATION | DESCRIPTION | IMPACT ASSESSMENT |
|---|---|---|
| **IFRS 14** 'Regulatory deferral accounts' | The aim of this standard is to enhance the comparability of financial reporting by entities that are engaged in rate-regulated activities.<br>Date of application: the first financial year beginning after 1 January 2016. the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard. | The Group claims that the new standard will not have a material impact on its financial statements in the period of its first application. |
| **IFRS 16 '**Leases' | Under IFRS 16 a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate. As with IFRS 16's predecessor, IAS 17, lessors classify leases as operating or finance in nature. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease. For finance leases a lessor recognises finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis.<br>Date of application: annual periods beginning on or after 1 January 2019. | The Group is currently assessing the impact of the IFRS 15 application on its financial statements. |
| **IFRS 10 (amendment)** 'Consolidated Financial Statements' and **IAS 28 (amendment)** 'Investments in Associates and Joint Ventures' | The amendments concern the sale or contribution of assets between the investor and the associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognized when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary.<br>Date of application: the first financial year beginning after 1 January 2016. | The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application. |
| **IAS 7 (amendment)** 'Statement of Cash Flows' - Disclosure Initiative | The amendments are intended to clarify IAS 7 to improve information provided to users of financial statements about an entity's financing activities. The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.<br>Date of application: annual periods beginning on or after 1 January 2017. | The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application. |
| **IAS 12 (amendment)** 'Income Taxes' | The amendments to IAS 12 clarify how to account for deferred tax assets related to debt instruments measured at fair value.<br>Date of application: annual periods beginning on or after 1 January 2017. | The Group is currently analyzing the impact of those changes on the financial statements. |
| **IFRS 2 (amendment)** 'Share-based Payment' | The amendments provide requirements on the accounting for<br>(a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments,<br>(b) share-based payment transactions with a net settlement feature for withholding tax obligations, and<br>(c) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.<br>Date of application: annual periods beginning on or after 1 January 2018. | The Group is currently analyzing the impact of those changes on the financial statements. |
| **IFRS 4 (amendment)** 'Insurance Contracts' | The amendments address concerns arising from implementing the new financial instruments standard, IFRS 9, before implementing the replacement standard that the Board is developing for IFRS 4.<br>Date of application: effective for annual periods beginning on or after 1 January 2018 or when IFRS 9 'Financial Instruments' is applied first time. | The Group claims that the standard's amendments will not have a material impact on its financial statements in the period of its first application. |

# Notes to the financial statements (cont.)

(In PLN thousand)

| STANDARD / INTERPRETATION | DESCRIPTION | IMPACT ASSESSMENT |
|---|---|---|
| **IAS 40 (amendment)** 'Investment Property' | Amendments to IAS 40 'Investment Property' - Transfers of Investment Property state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use. Amendments also state that the list of evidence in paragraph 57 was designated as non-exhaustive list of examples instead of the previous exhaustive list.<br>Date of application: annual periods beginning on or after 1 January 2018. | The Group is currently analyzing the impact of those changes on the financial statements. |
| **Improvements to IFRS 2014-2016** | Amendments result from the annual improvement project of IFRS. Amendments relate to IFRS 1, IFRS 12 and IAS 28 and were introduced primarily with a view to removing inconsistencies and clarifying wording.<br>Date of application: amendments to IFRS 12 are to be applied for annual periods beginning on or after 1 January 2017 and amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018. | The Group is currently analyzing the impact of those changes on the financial statements. |
| **IFRIC 22 '**Foreign Currency Transactions and Advance Consideration' | Interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt.<br>Date of application: annual periods beginning on or after 1 January 2018. | The Group is currently analyzing the impact of those changes on the financial statements. |

# 6. Risk management

The risk management policy of the Group has a goal of optimizing the structure of the statement of financial position and off-balance sheet positions under the consideration of all risks in relation to income and other risk that the Group encounters in conducting its daily activity. Risks are monitored and controlled with reference to profitability and equity coverage and are regularly reported in accordance with rules briefly presented below.

All important risk types, occurring in the course of the Group's operations are described as follows.

## 6.1 Organizational structure of risk management

**Supervisory Board**

The Supervisory Board provides supervision over the risk management control system, assessing the adequacy and effectiveness. Moreover, the Supervisory Board also provides supervision of the compliance with Group policy with respect to risk management as it relates to the Group's strategy and financial planning.

**Management Board**

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

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

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

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

**Committees**

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

- Assets, Liabilities and Risk Management Committee (ALCO) - in terms of market risk management, liquidity and capital adequacy,
- Liquidity and Market Risk Committee (LMRC) – in terms of liquidity and market risk management, acting as support for Assets, Liabilities and Risk Management Committee,
- Operational Risk Committee – in operational risk management,
- Credit Committee - in making credit decisions within the powers and in the case of the largest transactions in preparing recommendations for the Board of Directors,
- Change Management Committee - in the implementation of new or modification of existing products and processes in business and outside business,
- Safety Committee - in the field of security and business continuity management,
- Model Risk Committee – in terms of model risk management.

## 6.2 Credit risk

Credit risk is one of the basic risks associated with activities of the Group. The percentage share of credits and loans in the Group's statement of financial position makes the maintenance of this risk at safe level essential to the Group's performance. The process of credit risk management is centralized and managed mainly by Risk Management Division units, situated at the Bank Head Office or in local units. The integration of various risks in the Risk Management Division, where apart from credit risk, market and operational risk are dealt with, facilitates effective management of all credit-related risks. This process covers all credit functions – credit analysis, making credit decisions, monitoring and loan administration, as well as restructuring and collection. These functions are conducted in compliance with the Bank's credit policy, adopted by the Bank's Management Board and the Bank's Supervisory Board for a given year and its related guidelines. The effectiveness and efficiency of credit functions are achieved using diverse credit methods and methodologies, supported by advanced IT tools, integrated into the Bank's general IT system. The Bank's procedures facilitate credit risk mitigation. In particular those related to transaction risk evaluation, establishing collateral, setting authorization limits for granting loans and limiting of exposure to some areas of business activity in line with current client's segmentation scheme in the Bank.

The Bank's lending activity is limited by the restrictions of the Banking Act as well as internal limits in order to increase safety. These restrictions refer in particular to concentration limits for specific sectors of the economy, share of large exposures in the loan portfolio of the Bank and exposure limits for particular foreign countries, foreign banks and domestic financial institutions. Credit granting limits, concentration limits for specific business activities as well as internal and external prudential standards include not only credits, loans and guarantees, but also derivatives transactions and debt securities.

The Bank established the following portfolio limits:

- share of large exposures in the loan portfolio of the Bank – approved by the Management Board and the Supervisory Board of the Bank,
- customer segment limits – established in the Bank's credit policy,
- product limits (mortgage loans given to private individuals, financing commercial real estate) - established in the Bank's credit policy,
- concentration limits for specific sectors of the economy - approved by the Credit Committee of the Bank.

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

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

**Rating models utilized in the credit risk management process**

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

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

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

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

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

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

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

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

For internal purposes, within the Bank the following rating models are used, developed in accordance with provisions of Regulation (EU) no 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms:

1) For the private individuals, the Bank uses two separate models applicable for:
    - mortgage loans,
    - consumer loans.
2) For the corporate clients, the Bank uses rating models dividing clients for:
    - clients with income not exceeding EUR 500 million,
    - corporate clients assessed by central model with income exceeding EUR 500 million,
    - specialized lending.

# Notes to the financial statements (cont.)

(In PLN thousand)

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

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

**Rating scale**

The rating scale is determined by the client segment and the exposure type.

The proceeds of assigning a client or an exposure to a given rating class depends on its probability of default (PD parameter).

The tables below present the loan portfolio quality for exposures encompassed by internal rating models.

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

| RATING CLASS | RANGE OF PD | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|---|
| | | CARRYING AMOUNT | %PORTFOLIO | CARRYING AMOUNT | %PORTFOLIO |
| 1 | 0.00% <= PD < 0.06% | 11 544 215 | 26.2% | 10 532 502 | 25.9% |
| 2 | 0.06% <= PD < 0.19% | 6 794 533 | 15.4% | 5 936 116 | 14.6% |
| 3 | 0.19% <= PD < 0.35% | 17 482 613 | 39.7% | 16 303 771 | 40.1% |
| 4 | 0.35% <= PD < 0.73% | 5 463 689 | 12.4% | 5 213 593 | 12.8% |
| 5 | 0.73% <= PD < 3.50% | 1 435 604 | 3.3% | 1 393 240 | 3.4% |
| 6 | 3.50% <= PD < 14.00% | 638 891 | 1.5% | 651 234 | 1.6% |
| 7 | 14.00% <= PD < 100.00% | 671 745 | 1.5% | 652 160 | 1.6% |
| **Total** | | **44 031 290** | **100.0%** | **40 682 616** | **100.0%** |

# Notes to financial statements (cont.)

(In PLN thousand)

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

| RATING CLASS | RANGE OF PD | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|---|
| | | CARRYING AMOUNT | %PORTFOLIO | CARRYING AMOUNT | %PORTFOLIO |
| 1 | 0.00% <= PD < 0.34% | 687 697 | 7.9% | 573 469 | 7.4% |
| 2 | 0.34% <= PD < 0.80% | 948 701 | 10.8% | 805 937 | 10.3% |
| 3 | 0.80% <= PD < 1.34% | 1 506 160 | 17.2% | 1 390 763 | 17.8% |
| 4 | 1.34% <= PD < 2.40% | 2 669 352 | 30.5% | 2 393 959 | 30.6% |
| 5 | 2.40% <= PD < 4.75% | 1 815 307 | 20.7% | 1 594 636 | 20.4% |
| 6 | 4.75% <= PD < 14.50% | 756 550 | 8.7% | 673 978 | 8.6% |
| 7 | 14.50% <= PD < 31.00% | 186 915 | 2.1% | 187 224 | 2.4% |
| 8 | 31.00% <= PD < 100.00% | 186 336 | 2.1% | 194 052 | 2.5% |
| **Total** | | **8 757 018** | **100.0%** | **7 814 018** | **100.0%** |

The distribution of rated portfolio for corporate client segment (excluding impaired loans) – clients with income not exceeding EUR 500 million

| RATING CLASS | RANGE OF PD | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|---|
| | | CARRYING AMOUNT | %PORTFOLIO | CARRYING AMOUNT | %PORTFOLIO |
| 1 | 0.00% <= PD < 0.15% | 515 756 | 3.5% | 357 910 | 2.4% |
| 2 | 0.15% <= PD < 0.27% | 2 188 032 | 14.8% | 1 887 596 | 12.5% |
| 3 | 0.27% <= PD < 0.45% | 1 984 785 | 13.5% | 2 348 388 | 15.6% |
| 4 | 0.45% <= PD < 0.75% | 2 105 131 | 14.3% | 2 304 203 | 15.3% |
| 5 | 0.75% <= PD < 1.27% | 2 131 155 | 14.5% | 3 136 094 | 20.8% |
| 6 | 1.27% <= PD < 2.25% | 2 269 874 | 15.4% | 1 935 237 | 12.8% |
| 7 | 2.25% <= PD < 4.00% | 1 266 801 | 8.6% | 1 043 523 | 6.9% |
| 8 | 4.00% <= PD < 8.50% | 1 948 049 | 13.2% | 1 898 162 | 12.6% |
| 9 | 8.50% <= PD < 100.00% | 319 268 | 2.2% | 165 709 | 1.1% |
| **Total** | | **14 728 851** | **100.0%** | **15 076 822** | **100.0%** |

# Notes to financial statements (cont.)

(In PLN thousand)

The distribution of rated portfolio for corporate client segment (excluding impaired loans) – clients assessed by central model with income exceeding EUR 500 million

| RATING CLASS | RANGE OF PD | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|---|
| | | CARRYING AMOUNT | %PORTFOLIO | CARRYING AMOUNT | %PORTFOLIO |
| 1 | 0.0000% <= PD < 0.0011% | - | 0.0% | - | 0.0% |
| 2 | 0.0011% <= PD < 0.0031% | - | 0.0% | - | 0.0% |
| 3 | 0.0031% <= PD < 0.0069% | - | 0.0% | - | 0.0% |
| 4 | 0.0069% <= PD < 0.0124% | - | 0.0% | - | 0.0% |
| 5 | 0.0124% <= PD < 0.0223% | 1 | 0.0% | - | 0.0% |
| 6 | 0.0223% <= PD < 0.0395% | - | 0.0% | - | 0.0% |
| 7 | 0.0395% <= PD < 0.0691% | 5 | 0.0% | 1 243 315 | 24.2% |
| 8 | 0.0691% <= PD < 0.1208% | 430 448 | 8.0% | 645 108 | 12.6% |
| 9 | 0.1208% <= PD < 0.2091% | 1 029 404 | 19.1% | 629 490 | 12.3% |
| 10 | 0.2091% <= PD < 0.3581% | 255 864 | 4.8% | 375 435 | 7.3% |
| 11 | 0.3581% <= PD < 0.6132% | 2 486 615 | 46.2% | 81 377 | 1.6% |
| 12 | 0.6132% <= PD < 1.0807% | - | 0.0% | 93 303 | 1.8% |
| 13 | 1.0807% <= PD < 1.9599% | 847 569 | 15.7% | - | 0.0% |
| 14 | 1.9599% <= PD < 3.5545% | 331 740 | 6.2% | 2 063 695 | 40.2 |
| 15 | 3.5545% <= PD < 7.6705% | 11 | 0.0% | - | 0.0% |
| 16 | 7.6705% <= PD < 19.6959% | - | 0.0% | 16 | 0.0% |
| 17 | 19.6959% <= PD < 100.0000% | - | 0.0% | - | 0.0% |
| **Total** | | **5 381 657** | **100.0%** | **5 131 739** | **100.0%** |

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

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

| SUPERVISORY CATHEGORY | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|
| | CARRYING AMOUNT | %PORTFOLIO | CARRYING AMOUNT | %PORTFOLIO |
| High | 3 470 755 | 42.6% | 1 647 122 | 25.0% |
| Good | 3 623 153 | 44.5% | 4 185 156 | 63.4% |
| Satisfactory | 1 010 603 | 12.4% | 720 513 | 10.9% |
| Low | 44 728 | 0.5% | 43 078 | 0.7% |
| **Total** | **8 149 239** | **100.0%** | **6 595 869** | **100.0%** |

# Notes to the financial statements (cont.)

(In PLN thousand)

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

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Loans with no impairment:** | **120 112 554** | **119 349 516** |
| **Loans to individuals:** | **55 863 932** | **51 611 229** |
| Covered by internal rating model: | 52 788 308 | 48 496 634 |
| Mortgage loans | 44 031 290 | 40 682 616 |
| Consumer loans | 8 757 018 | 7 814 018 |
| Other, not covered by internal rating model | 3 075 624 | 3 114 595 |
| **Loans to corporates:** | **64 248 622** | **67 738 287** |
| Covered by internal rating model: | 20 110 508 | 20 208 561 |
| Clients with income not exceeding EUR 500 million | 14 728 851 | 15 076 822 |
| Clients assessed by central model with income exceeding EUR 500 million | 5 381 657 | 5 131 739 |
| Specialized lending exposures | 8 149 239 | 6 595 869 |
| Debt securities, not covered by internal rating model | 12 352 160 | 12 330 221 |
| Repo transactions, not covered by internal rating model | - | 4 755 472 |
| Other, not covered by internal rating model | 23 636 715 | 23 848 164 |
| **Impaired loans** | **2 550 658** | **2 705 410** |
| **Total loans and advances to customers (*)** | **122 663 212** | **122 054 926** |

(*) Loans and advances to customers include receivables from financial leases and bills of exchange eligible for rediscounting at Central Bank.

**Client/transaction rating and credit risk decision-making level**
Decision-making level connected with transaction approval is directly dependent upon the client's rating.

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

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

**Validation of rating models**
The internal validation of models and risk parameter assessments is focused on the quality assessment of risk models and the accuracy and stability of parameter assessments, applied by the Bank. The validation covers risk models and parameters assessed locally, whereas the validation of central models is carried out within UniCredit Group. Validation is carried out at the level of each risk model, although the Bank may apply several models for each class of exposures.

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

# Notes to the financial statements (cont.)

(In PLN thousand)

**Group's exposure to credit risk**

***The maximum credit risk exposure***

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

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Due from Central Bank | 3 233 379 | 4 930 181 |
| Loans and advances from banks and from customers (*) | 121 947 096 | 125 869 993 |
| Receivables from finance leases | 3 974 643 | 3 503 979 |
| Financial assets held for trading | 732 469 | 1 126 792 |
| Derivative financial instruments (held for trading) | 1 913 429 | 3 206 447 |
| Hedging instruments | 289 752 | 421 640 |
| Investment securities | 35 120 619 | 21 181 723 |
| Other assets (**) | 1 020 482 | 2 300 995 |
| **Balance sheet exposure (***)** | **168 231 869** | **162 541 750** |
| Obligations to grant loans | 32 126 475 | 30 825 051 |
| Other contingent liabilities | 11 473 757 | 15 130 027 |
| **Off-balance sheet exposure** | **43 600 232** | **45 955 078** |
| **Total** | **211 832 101** | **208 496 828** |

(*) Loans and advances to customers include bills of exchange eligible for rediscounting at Central Bank.

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

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

***Credit risk mitigation methods***

Bank Pekao S.A. Group has established specific policies with regard to collateral accepted to secure loans and guarantees. This policy is reflected under internal rules and regulations, which are based on supervision rules, specified in Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.

# Notes to the financial statements (cont.)

(In PLN thousand)

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

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

The financial effect of pledged collaterals for exposure portfolio with recognized impairment defined individually amounts to PLN 1 496 661 thousand as at the 31 December 2016 (1 465 933 thousand as of the 31 December 2015). The level of required impairment allowances for the portfolio would increase by this amount, if the discounted cash flows from collateral were not taken into account during estimation.

***Offsetting financial assets and financial liabilities***

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

The netting agreements concluded by the Group are:

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

# Notes to the financial statements (cont.)

(In PLN thousand)

The netting agreements do not meet the criteria for offsetting in the statement of financial position. This is because they create for the parties to the agreement a right of set-off of recognized amounts that is enforceable only following an event of default, insolvency or bankruptcy of the one of the counterparty. In addition, the Group and its counterparties do not intend to settle on a net basis or to realize the assets and settle the liabilities simultaneously.

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

- derivatives,
- repo and reverse-repo transactions.

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

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

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

| 31.12.2016 | CARRYING AMOUNT OF FINANCIAL ASSETS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION | AMOUNT OF POTENTIAL OFFSETTING | | NET AMOUNT |
|---|---|---|---|---|
| | | FINANCIAL INSTRUMENTS (INCLUDING RECEIVED COLLATERAL IN THE FORM OF SECURITIES) | CASH COLLATERAL RECEIVED | |
| **FINANCIAL ASSETS** | | | | |
| Derivatives | 1 848 236 | (1 434 265) | (182 765) | 231 206 |
| **TOTAL** | **1 848 236** | **(1 434 265)** | **(182 765)** | **231 206** |

| 31.12.2016 | CARRYING AMOUNT OF FINANCIAL LIABILITIES PRESENTED IN THE STATEMENT OF FINANCIAL POSITION | AMOUNT OF POTENTIAL OFFSETTING | | NET AMOUNT |
|---|---|---|---|---|
| | | FINANCIAL INSTRUMENTS (INCLUDING PLEDGED COLLATERAL IN THE FORM OF SECURITIES) | CASH COLLATERAL PLEDGED | |
| **FINANCIAL LIABILITIES** | | | | |
| Derivatives | 3 254 372 | (1 434 265) | (1 651 984) | 168 123 |
| **TOTAL** | **3 254 372** | **(1 434 265)** | **(1 651 984)** | **168 123** |

| 31.12.2015 | CARRYING AMOUNT OF FINANCIAL ASSETS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION | AMOUNT OF POTENTIAL OFFSETTING | | NET AMOUNT |
|---|---|---|---|---|
| | | FINANCIAL INSTRUMENTS (INCLUDING RECEIVED COLLATERAL IN THE FORM OF SECURITIES) | CASH COLLATERAL RECEIVED | |
| **FINANCIAL ASSETS** | | | | |
| Derivatives | 3 628 087 | (3 012 327) | (295 762) | 319 998 |
| **TOTAL** | **3 628 087** | **(3 012 327)** | **(295 762)** | **319 998** |

# Notes to the financial statements (cont.)

(In PLN thousand)

| 31.12.2015 | CARRYING AMOUNT OF FINANCIAL LIABILITIES PRESENTED IN THE STATEMENT OF FINANCIAL POSITION | AMOUNT OF POTENTIAL OFFSETTING | | NET AMOUNT |
|---|---|---|---|---|
| | | FINANCIAL INSTRUMENTS (INCLUDING PLEDGED COLLATERAL IN THE FORM OF SECURITIES) | CASH COLLATERAL PLEDGED | |
| **FINANCIAL LIABILITIES** | | | | |
| Derivatives | 4 907 087 | (3 012 327) | (1 339 417) | 555 343 |
| Repo transactions | 963 829 | (962 346) | - | 1 483 |
| **TOTAL** | **5 870 916** | **(3 974 673)** | **(1 339 417)** | **556 826** |

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

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

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

| 31.12.2016 | NET CARRYING AMOUNT | ITEM IN STATEMENT OF FINANCIAL POSITION | CARRYING AMOUNT IN STATEMENT OF FINANCIAL POSITION | CARRYING AMOUNT OF TRANSACTIONS NOT IN SCOPE OF OFFSETTING DISCLOSURES | NOTE |
|---|---|---|---|---|---|
| **FINANCIAL ASSETS** | | | | | |
| Derivatives | 1 791 677 | Derivative financial instruments (held for trading) | 1 913 429 | 121 752 | 27 |
| | 56 559 | Hedging instruments | 289 752 | 233 193 | 30 |
| **FINANCIAL LIABILITIES** | | | | | |
| Derivatives | 1 618 110 | Derivative financial instruments (held for trading) | 1 952 674 | 334 564 | 27 |
| | 1 636 262 | Hedging instruments | 1 638 718 | 2 456 | 30 |

| 31.12.2015 | NET CARRYING AMOUNT | ITEM IN STATEMENT OF FINANCIAL POSITION | CARRYING AMOUNT IN STATEMENT OF FINANCIAL POSITION | CARRYING AMOUNT OF TRANSACTIONS NOT IN SCOPE OF OFFSETTING DISCLOSURES | NOTE |
|---|---|---|---|---|---|
| **FINANCIAL ASSETS** | | | | | |
| Derivatives | 3 134 367 | Derivative financial instruments (held for trading) | 3 206 447 | 72 080 | 27 |
| | 421 640 | Hedging instruments | 421 640 | - | 30 |
| **FINANCIAL LIABILITIES** | | | | | |
| Derivatives | 3 106 943 | Derivative financial instruments (held for trading) | 3 204 328 | 97 385 | 27 |
| | 1 702 759 | Hedging instruments | 1 702 759 | - | 30 |
| Repo transactions | 963 829 | Amounts due to other banks | 5 958 449 | 4 994 620 | 40 |

# Notes to the financial statements (cont.)

(In PLN thousand)

***Overall characteristics of monitoring process***

The monitoring process is oriented at the identification of symptoms and threats, affecting the client, undertaking actions preventing the deterioration of credit portfolio quality for the purpose of maximizing the probability of recovery of assets made available to the client.

In particular, the monitoring of credit risk includes the control of timely debt service, analysis of client's financial standing, verification of meeting the terms of credit agreement and reviewing the collaterals.

Loans for large corporate clients are monitored using the rating system and data from both internal and external sources of information. In case of small and medium-size clients, the monitoring process is carried out using an internal tool, embedded into the statistical behavioral model. Process efficiency is further enhanced by regular reviews of the credit portfolio, carried out by representatives of the Risk Management Division and other Business Divisions for the purpose of determining the actual quality of individual exposures and of the entire credit portfolio.

The monitoring of individual clients is carried by IT systems and is based on the results of behavioral scoring.

***Overall characteristics of provisioning model***

The Group establishes loan loss provisions ('LLP') in line with International Financial Reporting Standards ('IFRS'). LLP reflects the loan impairment and whether the Group recognizes objective impairment triggers. Impairment of loans is recognized under an individual and collective approach.

The process of identifying impaired exposures covered by individual valuation is carried out with the use of an internal tool and consists of the following stages:

- identification, whether the impairment trigger for given a credit exposure has been recognized and, upon such identification, determination of the type of such trigger and assignment of default status to the exposure,
- assessment of future cash flows, discounted using the effective interest rate, generated both from collateral and client operations,
- calculation and registration of loan loss provision in the IT system.

Exposures covered by the collective approach valuation are classified into the default class for overdue amounts exceeding 90 days. For such exposures, the loan loss provision is calculated using a statistical model.

If an impairment trigger is not recognized, the Group establishes provisions for incurred but not reported losses (IBNR) applying a statistical model of expected loss.

The applied statistical models are based on historical data for homogenous groups of exposure.

Both the models and parameters applied in the establishment of loan loss provision are subject to regular validation.

# Notes to the financial statements (cont.)

(In PLN thousand)

***The quality analysis of the Group's financial assets***

The Group exposures to credit risk with impairment recognized, broken down by delays in repayment

| | LOANS AND ADVANCES TO BANKS (*) | | LOANS AND ADVANCES TO CUSTOMERS (*) | |
|---|---|---|---|---|
| | 31.12.2016 | 31.12.2015 | 31.12.2016 | 31.12.2015 |
| GROSS CARRYING AMOUNT OF EXPOSURE INDIVIDUALLY IMPAIRED | | | | |
| - not past due | - | - | 642 927 | 564 430 |
| - up to 1 month | - | - | 106 904 | 37 283 |
| - between 1 month and 3 months | - | - | 31 323 | 22 868 |
| - between 3 months and 1 year | - | - | 228 925 | 158 487 |
| - between 1 year and 5 years | 8 192 | 9 927 | 2 565 907 | 3 079 109 |
| - above 5 years | - | - | 1 498 788 | 1 429 845 |
| **Total gross carrying amount** | **8 192** | **9 927** | **5 074 774** | **5 292 022** |
| ALLOWANCE FOR IMPAIRMENT | | | | |
| - not past due | - | - | (292 907) | (238 852) |
| - up to 1 month | - | - | (30 285) | (7 530) |
| - between 1 month and 3 months | - | - | (7 077) | (5 206) |
| - between 3 months and 1 year | - | - | (121 057) | (52 140) |
| - between 1 year and 5 years | (8 192) | (9 927) | (1 563 402) | (1 738 572) |
| - above 5 years | - | - | (1 170 559) | (1 198 995) |
| **Total allowance for impairment** | **(8 192)** | **(9 927)** | **(3 185 287)** | **(3 241 295)** |
| **Net carrying amount of exposure individually impaired** | **-** | **-** | **1 889 487** | **2 050 727** |
| GROSS CARRYING AMOUNT OF EXPOSURE COLLECTIVELY IMPAIRED | | | | |
| - not past due | - | - | 166 121 | 120 069 |
| - up to 1 month | - | - | 69 664 | 42 559 |
| - between 1 month and 3 months | - | - | 56 545 | 47 688 |
| - between 3 months and 1 year | - | - | 286 856 | 303 072 |
| - between 1 year and 5 years | - | - | 1 297 813 | 1 359 720 |
| - above 5 years | 9 800 | 9 800 | 914 748 | 956 361 |
| **Total gross carrying amount** | **9 800** | **9 800** | **2 791 747** | **2 829 469** |
| ALLOWANCE FOR IMPAIRMENT | | | | |
| - not past due | - | - | (54 371) | (46 047) |
| - up to 1 month | - | - | (21 678) | (10 980) |
| - between 1 month and 3 months | - | - | (20 975) | (17 089) |
| - between 3 months and 1 year | - | - | (152 797) | (156 199) |
| - between 1 year and 5 years | - | - | (1 038 042) | (1 047 727) |
| - above 5 years | (9 800) | (9 800) | (842 713) | (896 744) |
| **Total allowance for impairment** | **(9 800)** | **(9 800)** | **(2 130 576)** | **(2 174 786)** |
| **Net carrying amount of exposure collectively impaired** | **-** | **-** | **661 171** | **654 683** |

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

# Notes to the financial statements (cont.)

(In PLN thousand)

The Group exposures to credit risk with no impairment recognized, broken down by delays in repayment

| | LOANS AND ADVANCES TO BANKS (*) | | LOANS AND ADVANCES TO CUSTOMERS (*) | | | |
|---|---|---|---|---|---|---|
| | | | CORPORATE | | RETAIL | |
| | 31.12.2016 | 31.12.2015 | 31.12.2016 | 31.12.2015 | 31.12.2016 | 31.12.2015 |
| **GROSS CARRYING AMOUNT OF EXPOSURE WITH NO IMPAIRMENT** | | | | | | |
| - not past due | 3 258 534 | 7 319 104 | 64 156 501 | 67 677 272 | 54 316 545 | 50 112 528 |
| - up to 30 days | - | - | 240 713 | 214 225 | 1 314 340 | 1 269 204 |
| - between 30 days and 60 days | - | - | 27 468 | 34 541 | 177 909 | 183 623 |
| - above 60 days | - | - | 88 700 | 89 848 | 184 075 | 194 520 |
| **Total gross carrying amount** | **3 258 534** | **7 319 104** | **64 513 382** | **68 015 886** | **55 992 869** | **51 759 875** |
| **IBNR PROVISION** | | | | | | |
| - not past due | (8) | (58) | (256 869) | (273 574) | (80 772) | (90 586) |
| - up to 30 days | - | - | (5 106) | (2 652) | (30 818) | (37 046) |
| - between 30 days and 60 days | - | - | (1 425) | (686) | (9 873) | (11 615) |
| - above 60 days | - | - | (1 360) | (687) | (7 474) | (9 399) |
| **Total IBNR provision** | **(8)** | **(58)** | **(264 760)** | **(277 599)** | **(128 937)** | **(148 646)** |
| **Net carrying amount of exposure with no impairment** | **3 258 526** | **7 319 046** | **64 248 622** | **67 738 287** | **55 863 932** | **51 611 229** |

(*) Loans and advances to banks and loans and advances to customers include receivables from financial leases and bills of exchange eligible for rediscounting at Central Bank.

The Group exposures to credit risk, broken down by impairment triggers criteria

| | LOANS AND ADVANCES TO BANKS (*) | | LOANS AND ADVANCES TO CUSTOMERS (*) | |
|---|---|---|---|---|
| | 31.12.2016 | 31.12.2015 | 31.12.2016 | 31.12.2015 |
| **IMPAIRED EXPOSURE** | | | | |
| Gross carrying amount | 17 992 | 19 727 | 7 866 521 | 8 121 491 |
| Allowance for impairment | (17 992) | (19 727) | (5 315 863) | (5 416 081) |
| **Total net carrying amount** | **-** | **-** | **2 550 658** | **2 705 410** |
| **EXPOSURES WITH IMPAIRMENT TRIGGERS FOR WHICH NO IMPAIRMENT HAS BEEN IDENTIFIED** | | | | |
| Gross carrying amount, in this: | - | - | 100 560 | 78 166 |
| *Exposure with collateral value included in expected discounted cash flow, in this* | - | - | *100 560* | *78 166* |
| *Past due exposures* | - | - | *35 382* | *31 741* |
| IBNR provision | - | - | (2 610) | (1 362) |
| **Total net carrying amount** | **-** | **-** | **97 950** | **76 804** |
| **EXPOSURES WITH NO IMPAIRMENT TRIGGERS** | | | | |
| Gross carrying amount | 3 258 534 | 7 319 104 | 120 405 691 | 119 697 595 |
| IBNR provision | (8) | (58) | (391 087) | (424 883) |
| **Total net carrying amount** | **3 258 526** | **7 319 046** | **120 014 604** | **119 272 712** |

(*) Loans and advances to banks and loans and advances to customers include receivables from financial leases and bills of exchange eligible for rediscounting at Central Bank.

# Notes to the financial statements (cont.)

(In PLN thousand)

Classification of exposures to debt securities according to Standard & Poor's ratings as at 31 December 2016

| RATING | DEBT SECURITIES | | | | |
|---|---|---|---|---|---|
| | HELD FOR TRADING | AVAILABLE FOR SALE | HELD TO MATURITY | REPO TRANSACTIONS (***) | TOTAL |
| AA+ to AA- | - | 327 613 | - | - | 327 613 |
| A+ to A- | 654 918 | 24 719 097 | 2 998 379 | 700 960 | 29 073 354 |
| BBB+ to BBB- | 9 719 | - | - | - | 9 719 |
| no rating | 66 113 | 6 903 060 (*) | 20 606 (**) | - | 6 989 779 |
| **Total** | **730 750** | **31 949 770** | **3 018 985** | **700 960** | **36 400 465** |

(*) Including NBP bills in an amount of PLN 5 978 629 thousand.
(**) Including NBP bills in an amount of PLN 20 606 thousand.
(***) Fair value of debt securities purchased in the reverse repo transactions.

Classification of exposures to debt securities according to Standard & Poor's ratings as at 31 December 2015

| RATING | DEBT SECURITIES | | | | |
|---|---|---|---|---|---|
| | HELD FOR TRADING | AVAILABLE FOR SALE | HELD TO MATURITY | REPO TRANSACTIONS(***) | TOTAL |
| A+ to A- | 1 003 007 | 15 954 349 | 2 497 324 | 6 520 122 | 25 974 802 |
| BBB+ to BBB- | 7 724 | 251 367 | - | - | 259 091 |
| no rating | 113 986 | 1 312 168 (*) | 871 100 (**) | - | 2 297 254 |
| **Total** | **1 124 717** | **17 517 884** | **3 368 424** | **6 520 122** | **28 531 147** |

(*) Including NBP bills in an amount of PLN 628 454 thousand.
(**) Including NBP bills in an amount of PLN 871 100 thousand.
(***) Fair value of debt securities purchased in the reverse repo transactions.

Classification of exposures to derivative financial instruments according to Standard & Poor's ratings as at 31 December 2016

| RATING | DERIVATIVES | | | | | | |
|---|---|---|---|---|---|---|---|
| | TRADING DERIVATIVES | | | DERIVATIVE HEDGING INSTRUMENTS | | | TOTAL |
| | BANKS | OTHER FINANCIAL INSTITUTIONS | NON-FINANCIAL ENTITIES | BANKS | OTHER FINANCIAL INSTITUTIONS | NON-FINANCIAL ENTITIES | |
| AAA | 143 | - | - | - | - | - | 143 |
| AA+ to AA- | 75 047 | - | - | 1 044 | - | - | 76 091 |
| A+ to A- | 581 997 | 179 546 | - | 22 224 | - | - | 783 767 |
| BBB+ to BBB- | 379 748 | - | - | 4 414 | - | - | 384 162 |
| no rating | 303 021 | 69 325 | 324 602 | 26 868 | 235 202 | - | 959 018 |
| **Total** | **1 339 956** | **248 871** | **324 602** | **54 550** | **235 202** | **-** | **2 203 181** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Classification of exposures to derivative financial instruments according to Standard & Poor's ratings as at 31 December 2015

| RATING | DERIVATIVES | | | | | | TOTAL |
|---|---|---|---|---|---|---|---|
| | TRADING DERIVATIVES | | | DERIVATIVE HEDGING INSTRUMENTS | | | |
| | BANKS | OTHER FINANCIAL INSTITUTIONS | NON-FINANCIAL ENTITIES | BANKS | OTHER FINANCIAL INSTITUTIONS | NON-FINANCIAL ENTITIES | |
| AAA | 90 | - | - | - | - | - | 90 |
| AA+ to AA- | 126 730 | - | - | 3 032 | - | - | 129 762 |
| A+ to A- | 1 044 437 | 272 974 | | 64 698 | - | 749 | 1 382 858 |
| BBB+ to BBB- | 1 003 930 | - | 503 | 319 425 | - | - | 1 323 858 |
| BB+ to BB- | - | - | 1 454 | - | - | - | 1 454 |
| no rating | 464 159 | 52 220 | 239 950 | 29 798 | 3 938 | - | 790 065 |
| **Total** | **2 639 346** | **325 194** | **241 907** | **416 953** | **3 938** | **749** | **3 628 087** |

**Forbearance measures**

With reference to European Securities and Markets Authority (ESMA) document 2012/853 and instructions issued by European Banking Authority in terms of disclosure as far as forborne exposures, the Group in cooperation with its mother company has implemented a process of classification of this type of exposures.

Forborne exposures are debt contracts in respect of which forbearance measures have been extended. Forbearance measures occur in situations in which the borrower is considered to be unable to meet the terms and conditions of the contract due to financial difficulties. Based on these difficulties, the Group decides to modify the terms and conditions of the contract to allow the borrower sufficient ability to service the debt or refinance the contract, either totally or partially. Modification of the terms and conditions of the contract may include i.e. the reduction of the interest rate, principal, accrued interest or the rescheduling of the dates of payment of principal and/or interests.

In particular, the Group assumes that the forbearance has taken place when:

- the modified contract was classified as impaired and the modifications were made within restructuring activities,
- the modified contract was totally or partially past-due by more than 30 days (without being impaired) at least once during the three months prior to its modification or would be more than 30 days past-due, totally or partially, without modification,
- simultaneously with or close in time to the concession of additional debt by the Group, the debtor made payments of principal or interest on another contract with the Group that was totally or partially 30 days past due at least once during the three months prior to its refinancing.

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

- the contract is considered as exposure without impairment triggers,
- a minimum 2 year probation period has passed from the date the forborne exposure was considered as exposure without impairment triggers,
- regular payments of more than an insignificant amount of principal or interest have been made,
- none of the exposures to the debtor is more than 30 days past-due at the end of the probation period of forborne exposure.

If a decision is made to extend a concession, modify the contractual terms or refinance, which is not related to the financial difficulties of the borrower, then forbearance has not occurred.

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

# Notes to the financial statements (cont.)

(In PLN thousand)

When the exposure is classified as forborne and at each balance sheet date the Group assesses whether there is any objective evidence that the exposure is impaired. The accounting policies in respect to the evaluation and the provisioning of the forborne exposures generally follow the principles in line with the provisions of IAS 39, i.e. whether there are objective evidences that it has incurred a loss for impairment of loans valued at amortized cost, the amount of the loss is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not yet incurred) discounted at the original effective interest rate of the loan.

When the forbearance measures lead to derecognition of the original loan, the Group recognizes the new loan at its fair value. The difference between the carrying amount of the original loan and the fair value of the new loan is recognised in income statement.

The Group also performs an in-depth analysis of the credit risk characteristics of assets for which forbearance measures have been applied, when assessing for specific as well as collective impairment.

Share of forborne exposures in the Group's loan portfolio

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| LOANS AND ADVANCES TO CUSTOMERS | | |
| **Exposures with no impairment, of which:** | **120 112 554** | **119 349 516** |
| forborne exposures | 574 117 | 422 649 |
| **Impaired exposures, of which:** | **2 550 658** | **2 705 410** |
| forborne exposures | 1 476 521 | 1 537 735 |
| **Total net carrying amount, of which:** | **122 663 212** | **122 054 926** |
| forborne exposures | 2 050 638 | 1 960 384 |

The quality analysis of forborne exposures

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Exposures with no impairment** | | |
| Gross carrying amount | 587 347 | 437 459 |
| IBNR provisions | (13 230) | (14 810) |
| **Net carrying amount** | **574 117** | **422 649** |
| **Impaired exposures** | | |
| Gross carrying amount, of which: | 3 152 110 | 2 957 036 |
| exposures individually impaired | 2 816 470 | 2 745 545 |
| exposures collectively impaired | 335 640 | 211 491 |
| Allowances for impairment, of which: | (1 675 589) | (1 419 301) |
| exposures individually impaired | (1 524 510) | (1 323 802) |
| exposures collectively impaired | (151 079) | (95 499) |
| **Net carrying amount** | **1 476 521** | **1 537 735** |
| **Total net carrying amount** | **2 050 638** | **1 960 384** |

The Group holds the collaterals for forborne exposures amounting to PLN 1 023 631 thousand as at 31 December 2016 (PLN 881 711 thousand at 31 December 2015).

# Notes to the financial statements (cont.)

(In PLN thousand)

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

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Gross carrying amount of exposures with no impairment, of which:** | **587 347** | **437 459** |
| - not past due | 483 434 | 285 368 |
| - up to 30 days | 73 519 | 95 039 |
| - between 30 days and 60 days | 19 513 | 27 860 |
| - above 60 days | 10 881 | 29 192 |
| **IBNR provisions for exposures with no impairment, of which:** | **(13 230)** | **(14 810)** |
| - not past due | (8 476) | (5 807) |
| - up to 30 days | (3 051) | (5 673) |
| - between 30 days and 60 days | (1 037) | (1 533) |
| - above 60 days | (666) | (1 797) |
| **Gross carrying amount of impaired exposures, of which:** | **3 152 110** | **2 957 036** |
| - not past due | 627 945 | 571 632 |
| - up to 1 month | 150 815 | 46 871 |
| - between 1 month and 3 months | 46 077 | 32 999 |
| - between 3 months and 1 year | 214 022 | 131 902 |
| - between 1 year and 5 years | 2 026 748 | 2 124 721 |
| - above 5 years | 86 503 | 48 911 |
| **Allowances for impairment, of which:** | **(1 675 589)** | **(1 419 301)** |
| - not past due | (270 904) | (198 882) |
| - up to 1 month | (44 380) | (11 312) |
| - between 1 month and 3 months | (13 893) | (7 510) |
| - between 3 months and 1 year | (116 608) | (42 355) |
| - between 1 year and 5 years | (1 168 335) | (1 120 572) |
| - above 5 years | (61 469) | (38 670) |
| **Total net carrying amount** | **2 050 638** | **1 960 384** |

Changes in net carrying amount of forborne exposures

| | 2016 | 2015 |
|---|---|---|
| **Net carrying amount at the beginning** | **1 960 384** | **2 168 125** |
| Amount of exposures recognized in the period | 569 808 | 229 336 |
| Amount of exposures derecognized in the period | (218 057) | (152 818) |
| Changes in impairment allowances | (118 306) | (217 882) |
| Other changes | (143 191) | (66 377) |
| **Net carrying amount at the end** | **2 050 638** | **1 960 384** |
| Interest income | 139 522 | 168 659 |

# Notes to the financial statements (cont.)

(In PLN thousand)

Forborne exposures by type of forbearance activity

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Modification of terms and conditions | 3 546 182 | 3 199 428 |
| Refinancing | 193 275 | 195 067 |
| **Total gross carrying amount** | **3 739 457** | **3 394 495** |
| Impairment allowances | (1 688 819) | (1 434 111) |
| **Total net carrying amount** | **2 050 638** | **1 960 384** |

Forborne exposures by product type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Mortgage loans | 1 293 194 | 979 328 |
| Current accounts | 264 371 | 301 434 |
| Operating loans | 966 079 | 879 129 |
| Investment loans | 844 813 | 935 210 |
| Cash loans | 221 506 | 206 771 |
| Other loans and advances | 149 494 | 92 623 |
| **Total gross carrying amount** | **3 739 457** | **3 394 495** |
| Impairment allowances | (1 688 819) | (1 434 111) |
| **Total net carrying amount** | **2 050 638** | **1 960 384** |

Forborne exposures by industrial sectors

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Corporations: | 3 122 618 | 2 818 427 |
| Manufacturing | 770 470 | 718 779 |
| Construction | 770 424 | 604 287 |
| Real estate activities | 481 286 | 468 815 |
| Professional, scientific and technical activities | 554 119 | 523 922 |
| Accommodation and food service activities | 230 080 | 212 819 |
| Wholesale and retail trade | 155 655 | 128 840 |
| Mining and quarrying | 58 100 | 77 734 |
| Transportation and storage | 60 215 | 63 613 |
| Agriculture, forestry and fishing | 14 495 | 2 816 |
| Other sectors | 27 774 | 16 802 |
| Individuals | 616 839 | 576 068 |
| **Total gross carrying amount** | **3 739 457** | **3 394 495** |
| Impairment allowances | (1 688 819) | (1 434 111) |
| **Total net carrying amount** | **2 050 638** | **1 960 384** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Forborne exposures by geographical structure

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Poland | 3 391 584 | 3 082 046 |
| Ukraine | 319 396 | 292 314 |
| Cyprus | 26 874 | 18 503 |
| Other countries | 1 603 | 1 632 |
| **Total gross carrying amount** | **3 739 457** | **3 394 495** |
| Impairment allowances | (1 688 819) | (1 434 111) |
| **Total net carrying amount** | **2 050 638** | **1 960 384** |

**Credit risk concentration**

According to the current legislation the total exposure of the Group to the risks associated with the single borrower or a group of borrowers in which entities are related by capital or management may not exceed 25% of the Group's equity. In 2016 the maximum exposure limits were not exceeded.

a) Breakdown by individual entities:

As at 31 December 2016

| EXPOSURE TO 10 LARGEST CLIENTS OF THE GROUP | % SHARE OF PORTFOLIO |
|---|---|
| Client 1 | 1.5% |
| Client 2 | 1.3% |
| Client 3 | 1.1% |
| Client 4 | 0.9% |
| Client 5 | 0.9% |
| Client 6 | 0.8% |
| Client 7 | 0.7% |
| Client 8 | 0.7% |
| Client 9 | 0.6% |
| Client 10 | 0.5% |
| **Total** | **9.0%** |

b) Concentration by capital groups:

As at 31 December 2016

| EXPOSURE TO 5 LARGEST CAPITAL GROUPS SERVICED BY THE GROUP | % SHARE OF PORTFOLIO |
|---|---|
| Group 1 | 1.7% |
| Group 2 | 1.4% |
| Group 3 | 1.3% |
| Group 4 | 1.3% |
| Group 5 | 1.2% |
| **Total** | **6.9%** |

# Notes to the financial statements (cont.)

(In PLN thousand)

c) Breakdown by industrial sectors:

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

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

The table below presents the structure of exposures by industrial sectors

| SECTOR DESCRIPTION | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Wholesale and retail trade; repair of motor vehicles | 15.4% | 15.2% |
| Real estate activities | 12.4% | 10.5% |
| Public administration and defence | 10.3% | 10.9% |
| Electricity, gas, steam | 7.3% | 8.6% |
| Construction | 6.8% | 6.3% |
| Transportation and storage | 6.4% | 7.2% |
| Manufacture of metals, metal products and machinery | 5.0% | 4.0% |
| Manufacture of coke, rafined petroleum products, chemicals and pharmaceutical products | 4.5% | 2.9% |
| Manufacture of beverages and food products | 4.4% | 3.8% |
| Financial and insurance activities | 4.1% | 7.8% |
| Mining and quarrying | 3.2% | 4.4% |
| Other manufacturing | 7.6% | 7.3% |
| Other sectors | 12.6% | 11.1% |
| **Total** | **100.0%** | **100.0%** |

**CHF loans to individuals**

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

A few concepts of restructuring of CHF mortgage loans for individuals have been proposed recently, including the President's draft of the act on the restoration of the equality of parties of certain loan agreements. The proposed solutions are under discussion and may change significantly. Therefore, at the moment, the Group is not able to reliably estimate the impact of the proposed solutions on the financial statements. However, taking into account the relatively minor share of these loans in the total assets and limited market share, the Group assesses that potentially taken solutions should not materially affect the financial standing of the Group.

# Notes to the financial statements (cont.)

(In PLN thousand)

The tables below present the structure and quality of CHF loans for individuals.

Gross and net amount of CHF loans to individuals

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Gross carrying amount, of which:** | **4 492 086** | **4 761 295** |
| - denominated in CHF | 4 461 077 | 4 719 657 |
| - indexed to CHF | 31 009 | 41 638 |
| **Impairment allowances, of which:** | **(91 931)** | **(78 963)** |
| - denominated in CHF | (91 604) | (78 616) |
| - indexed to CHF | (327) | (347) |
| **Net carrying amount, of which:** | **4 400 155** | **4 682 332** |
| - denominated in CHF | 4 369 473 | 4 641 041 |
| - indexed to CHF | 30 682 | 41 291 |

Quality of CHF loans to individuals

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Gross carrying amount of exposures with no impairment, of which:** | **4 302 638** | **4 599 473** |
| - not past due | 3 956 983 | 4 251 469 |
| - up to 30 days | 280 365 | 277 566 |
| - between 30 days and 60 days | 47 308 | 41 226 |
| - above 60 days | 17 982 | 29 212 |
| **IBNR provisions for exposures with no impairment, of which:** | **(11 261)** | **(13 479)** |
| - not past due | (4 183) | (5 144) |
| - up to 30 days | (4 464) | (4 898) |
| - between 30 days and 60 days | (1 755) | (1 542) |
| - above 60 days | (859) | (1 895) |
| **Gross carrying amount of impaired exposures, of which:** | **189 448** | **161 822** |
| - not past due | 31 997 | 25 499 |
| - up to 1 month | 18 589 | 12 076 |
| - between 1 month and 3 months | 12 590 | 9 211 |
| - between 3 months and 1 year | 32 948 | 30 569 |
| - between 1 year and 5 years | 55 254 | 53 721 |
| - above 5 years | 38 070 | 30 746 |
| **Allowances for impairment, of which:** | **(80 670)** | **(65 484)** |
| - not past due | (6 020) | (4 356) |
| - up to 1 month | (2 867) | (1 507) |
| - between 1 month and 3 months | (2 720) | (1 764) |
| - between 3 months and 1 year | (9 379) | (6 250) |
| - between 1 year and 5 years | (31 609) | (27 927) |
| - above 5 years | (28 075) | (23 680) |
| **Total net carrying amount** | **4 400 155** | **4 682 332** |

As of 31 December 2016 the average LTV for CHF loans to individuals granted by the Group amounted to 56.3% (56.5% as at 31 December 2015), with an average LTV for the whole portfolio of 66.0% (66.4% as at 31 December 2015).

# Notes to the financial statements (cont.)

(In PLN thousand)

**Credit exposures towards Ukraine**
In 2016 Group exposure towards Ukraine in the form of interbank placements were repaid in full.

As at 31 December 2016, the net balance sheet value of remaining exposures towards Ukraine amounted to PLN 111 million (which constitutes 0.1% of total Group exposures), less by PLN 481 million in comparison to the end of December 2015.

The below table presents the Group's exposure towards the Ukrainian entities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Balance sheet exposure** | | |
| Loans and advances to banks | - | 402 630 |
| Loans and advances to customers | 321 048 | 300 551 |
| **Total gross carrying amount** | **321 048** | **703 181** |
| IBNR / Impairment allowances | (209 687) | (110 605) |
| **Total net carrying amount** | **111 361** | **592 576** |
| **Off-balance sheet exposure** | | |
| Credit lines granted | 428 | 4 049 |
| **Total gross carrying amount** | **428** | **4 049** |
| IBNR | - | (27) |
| **Total net carrying amount** | **428** | **4 022** |

## 6.3 Market risk

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

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

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

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

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

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

# Notes to the financial statements (cont.)

(In PLN thousand)

**Market risk of the trading book**

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

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

The model is subject to continuous, statistical verification by comparing the VaR values to actual and revaluated performance figures. Results of analyses carried out in 2016 and 2015 confirmed the adequacy of the model applied.

The tables below presents the market risk exposure of the trading portfolio of the Group measured by Value at Risk in 2016 and 2015

| | 31.12.2016 | MINIMUM VALUE | AVERAGE VALUE | MAXIMUM VALUE |
|---|---|---|---|---|
| foreign exchange risk | 60 | 14 | 275 | 1 958 |
| interest rate risk | 819 | 804 | 1 106 | 1 677 |
| Trading portfolio | 791 | 791 | 1 187 | 2 174 |

| | 31.12.2015 | MINIMUM VALUE | AVERAGE VALUE | MAXIMUM VALUE |
|---|---|---|---|---|
| foreign exchange risk | 54 | 15 | 203 | 1 674 |
| interest rate risk | 1 176 | 676 | 1 175 | 2 103 |
| Trading portfolio | 1 282 | 854 | 1 179 | 1 880 |

**Interest rate risk of the banking book**

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

The table below presents the sensitivity levels of the contractual interest income (NII) to the interest rate change by 100 b.p. and of economic value of the Group's equity (EVE) to the interest rate change by 200 b.p. for the end of December 2016 and December 2015. Both analyses assume instant change of market rates. Interest rates of banking products change according to contractual notations, nevertheless in case of contractual NII, for retail deposits the drop of interest rates is limited by 0. In case of EVE sensitivity for current deposits in PLN, the deposit model is applied, which adjusts deposits revaluation profile.

| SENSITIVITY IN % | 31.12.2016 | 31.12.2015 |
|---|---|---|
| NII | (8.03) | (5.97) |
| EVE | (0.76) | (0.77) |

# Notes to the financial statements (cont.)

(In PLN thousand)

**Currency risk**

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

The table below presents the Group's foreign currency risk profile measured at Value at Risk

| CURRENCY | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Currencies total (*) | 208 | 1 538 |

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

**Foreign currency position of the Group**

| 31.12.2016 | BALANCE SHEET OPERATIONS | | OFF-BALANCE SHEET OPERATIONS-DERIVATIVES | | NET POSITION |
|---|---|---|---|---|---|
| | ASSETS | LIABILITIES | LONG POSITION | SHORT POSITION | |
| EUR | 21 197 815 | 17 067 038 | 12 655 773 | 16 763 013 | 23 537 |
| USD | 5 210 025 | 7 710 838 | 6 409 305 | 3 980 769 | (72 277) |
| CHF | 4 722 131 | 1 049 133 | 3 606 673 | 7 285 284 | (5 613) |
| GBP | 212 581 | 869 553 | 687 217 | 29 324 | 921 |
| CZK | 34 786 | 529 413 | 602 343 | 107 358 | 358 |
| Other currencies | 262 357 | 164 008 | 208 033 | 304 055 | 2 327 |
| **TOTAL** | **31 639 695** | **27 389 983** | **24 169 344** | **28 469 803** | **(50 747)** |

| 31.12.2015 | BALANCE SHEET OPERATIONS | | OFF-BALANCE SHEET OPERATIONS-DERIVATIVES | | NET POSITION |
|---|---|---|---|---|---|
| | ASSETS | LIABILITIES | LONG POSITION | SHORT POSITION | |
| EUR | 18 890 563 | 17 929 313 | 11 066 799 | 11 841 800 | 186 249 |
| USD | 6 294 671 | 8 290 240 | 7 077 654 | 5 116 063 | (33 978) |
| CHF | 4 700 851 | 606 176 | 3 221 543 | 7 319 753 | (3 535) |
| GBP | 318 067 | 708 529 | 622 872 | 232 423 | (13) |
| CZK | 37 732 | 16 591 | 183 225 | 204 259 | 107 |
| Other currencies | 273 984 | 161 448 | 73 793 | 183 113 | 3 216 |
| **TOTAL** | **30 515 868** | **27 712 297** | **22 245 886** | **24 897 411** | **152 046** |

The amount of the net long position in EUR (equivalent of PLN 186 249 thousand) as at 31 December 2015 mainly resulted from the recognition of the fair value valuation of shares in Visa Europe (Note 31) in the amount of EUR 40 866 611 (equivalent of PLN 174 153 thousand). The foreign currency position from the valuation of shares in Visa Europe was closed on January 2016.

# Notes to the financial statements (cont.)

(In PLN thousand)

## 6.4 Liquidity risk

The objective of liquidity risk management is to:

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

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

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

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

Scenario-based stress analyses, conducted on a monthly basis, constitute an integral part of the Group's liquidity monitoring process. Within the scope of these analyses the Group's liquidity is assessed under the conditions of crisis which is caused by financial markets or is caused by internal factors, specific to the Group. In 2016 the Bank widened the scope of applied tests without making significant changes in their logic.

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

In order to define the principles of contingency liquidity management, Bank introduced, approved by the Management Board, 'Contingency Liquidity Policy', which defines the contingency procedures in the event of crisis situations. This policy involves daily monitoring of the system and specific early-warning indicators for the Bank and the Group as well as three levels of liquidity risk states depending on the level of early-warning indicators, the Bank's, the Group's and market situation. It also defines the sources for covering the expected outflows from the Group. This document sets the procedures for monitoring the liquidity states, emergency action procedures, task forces dedicated for restoring the Group's liquidity and the Management's responsibilities for taking necessary decisions to restore the required liquidity level. In 2016, the Policy was updated in order to be adjusted to the Recovery Plan that is in force in the Bank.

Below are presented basic quantitative information concerning the Group's liquidity at the end of 2016 year in comparison to the end of 2015. They cover the structure of financial liabilities by contractual maturity, adjusted liquidity gap and financial flows from derivative transactions.

# Notes to the financial statements (cont.)

(In PLN thousand)

Structure of financial liabilities by contractual maturities

| 31.12.2016 | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| **BALANCE SHEET LIABILITIES** | | | | | | |
| Amounts due to banks (*) | 1 568 626 | 7 866 | 62 274 | 1 490 498 | 1 775 910 | 4 905 174 |
| Amounts due to customers | 107 386 695 | 11 705 237 | 18 590 217 | 529 562 | 81 291 | 138 293 002 |
| Debt securities issued | 28 936 | 194 369 | 171 915 | 1 056 438 | 206 332 | 1 657 990 |
| Financial liabilities held for trading | 102 076 | - | 131 194 | 263 435 | 176 460 | 673 165 |
| **Total** | **109 086 333** | **11 907 472** | **18 955 600** | **3 339 933** | **2 239 993** | **145 529 331** |
| **OFF-BALANCE SHEET COMMITMENTS (**)** | | | | | | |
| Financial liabilities granted | 32 304 313 | - | - | - | - | 32 304 313 |
| Guarantees issued | 11 259 832 | - | - | - | - | 11 259 832 |
| **Total** | **43 564 145** | **-** | **-** | **-** | **-** | **43 564 145** |

| 31.12.2015 | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| **BALANCE SHEET LIABILITIES)** | | | | | | |
| Amounts due to banks (*) | 1 606 000 | 1 066 155 | 108 638 | 1 204 022 | 2 124 172 | 6 108 987 |
| Amounts due to customers | 96 357 303 | 12 213 137 | 17 987 883 | 2 777 981 | 55 721 | 129 392 025 |
| Debt securities issued | 336 500 | 1 034 304 | 409 535 | 616 862 | 661 531 | 3 058 732 |
| Financial liabilities held for trading | - | - | 170 729 | 382 663 | 58 050 | 611 442 |
| **Total** | **98 299 803** | **14 313 596** | **18 676 785** | **4 981 528** | **2 899 474** | **139 171 186** |
| **OFF-BALANCE SHEET COMMITMENTS (**)** | | | | | | |
| Financial liabilities granted | 30 935 860 | - | - | - | - | 30 935 860 |
| Guarantees issued | 14 072 827 | - | - | - | - | 14 072 827 |
| **Total** | **45 008 687** | **-** | **-** | **-** | **-** | **45 008 687** |

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

### Adjusted liquidity gap

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

# Notes to the financial statements (cont.)

(In PLN thousand)

Adjusted liquidity gap

| 31.12.2016 | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| Balance sheet assets | 42 255 570 | 4 225 036 | 24 539 554 | 50 597 089 | 52 597 694 | 174 214 943 |
| Balance sheet liabilities | 19 300 857 | 6 459 100 | 18 513 533 | 20 417 900 | 109 523 553 | 174 214 943 |
| Off-balance sheet assets/liabilities (net) | (4 956 771) | (16 411) | 862 106 | 1 309 640 | 1 496 475 | (1 304 961) |
| **Periodic gap** | **17 997 942** | **(2 250 475)** | **6 888 127** | **31 488 829** | **(55 429 384)** | **(1 304 961)** |
| **Cumulated gap** | **-** | **15 747 467** | **22 635 594** | **54 124 423** | **(1 304 961)** | **-** |

| 31.12.2015 | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| Balance sheet assets | 39 156 141 | 7 110 676 | 24 968 630 | 50 455 851 | 47 094 269 | 168 785 567 |
| Balance sheet liabilities | 16 049 305 | 8 827 295 | 18 770 564 | 19 999 689 | 105 138 714 | 168 785 567 |
| Off-balance sheet assets/liabilities (net) | (6 717 006) | 568 926 | 1 240 893 | 2 489 137 | 1 254 323 | (1 163 727) |
| **Periodic gap** | **16 389 830** | **(1 147 693)** | **7 438 959** | **32 945 299** | **(56 790 122)** | **(1 163 727)** |
| **Cumulated gap** | **-** | **15 242 137** | **22 681 096** | **55 626 395** | **(1 163 727)** | **-** |

**Off-balance derivative transactions**

The tables below show the financial flows relating to derivative off balance transactions.

According to Group's policy, off-balance derivative transactions settled in net amounts include:

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

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

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

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

| | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| 31.12.2016 | 26 757 | 51 903 | 131 715 | 1 219 802 | 449 921 | **1 880 098** |
| 31.12.2015 | 70 648 | 104 854 | 151 485 | 2 007 425 | 889 219 | **3 223 631** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Cash flows related to off-balance derivative transactions settled in gross amounts

| | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|
| **31.12.2016** | | | | | | |
| inflows | 20 805 957 | 6 032 490 | 7 701 296 | 8 030 511 | 2 915 201 | **45 485 455** |
| outflows | 20 827 342 | 6 055 624 | 7 823 747 | 8 745 485 | 3 322 026 | **46 774 224** |
| **31.12.2015** | | | | | | |
| inflows | 16 745 976 | 6 290 357 | 7 529 685 | 8 415 940 | 2 830 603 | **41 812 561** |
| outflows | 16 750 719 | 6 249 486 | 7 612 854 | 9 216 680 | 3 152 969 | **42 982 708** |

## 6.5 Operational risk

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

Operational risk management is based on internal procedures that are consistent with the law requirements, resolutions, recommendations and guidelines of the supervisor, and the standards of UniCredit Group. Operational risk management includes identification, assessment, monitoring, preventing and reporting. Identification and assessment of operational risk is based on an analysis of internal factors and external factors that may have a significant impact on the achievement of the objectives of the Group. The main tools used in identifying and assessing operational risk are: internal operational events, external operational events, key risk indicators, scenario analysis and self-assessment of operational risk. Monitoring activities are conducted on three levels of control: operational control (all employees), risk management control (Financial and Operational Risk Management Department) and internal audit (Internal Audit Department). Preventing operational risk includes definition of operational risk limits and the obligation to initiate mitigation actions in case they are exceeded, the system of internal control, business continuity plans and insurance coverage. Operational risk reporting system enables the assessment of the Group's exposure to operational risk and the effective management of this risk, and also plays a fundamental role in the process of informing the Supervisory Board, the Management Board and executives of the Group's exposure to operational risk. It is based in particular on the quarterly reports on operational risk control that include, among others: profile of operational risk, loss limit utilization, analysis of trends in the relevant categories of operational risk, potential losses, information on key indicators of operational risk and operational risk capital requirement.

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

Operational risk management system is subject to internal validation at least once a year. Validation aims at verification of compliance with regulatory requirements and standards of the UniCredit Group.

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

- internal frauds – losses resulting from acts of intended fraud, misappropriation of property, circumvention of regulations, the laws and internal policies of a company, excluding losses resulting from diversity or discrimination of employees, which concern at least one internal party,
- external frauds – losses being a consequence of acts of defraud, misappropriation of property or circumvention of regulations performed by a third party,
- employment practices and workplace safety – losses due to acts inconsistent with regulations or employment agreements, workplace health and safety agreements, payments from personal injuries claims or losses from discrimination and unequal employee treatment,

(In PLN thousand)

- clients, products and business practices – losses arising from failures of meeting professional obligations towards clients due to unintended or negligent acts (including custody requirements and appropriate behavior) or concerning specific features or a design of a product,
- damages to physical assets – losses due to damage or loss of tangible assets resulting from natural disasters or other events,
- business disruption and system failures – losses stemming from business or system failures,
- execution, delivery and process management – losses resulting from failed transaction settlements or process management and losses from relations with cooperating parties and vendors.

| OPERATING EVENTS BY CATEGORIES | 2016 | 2015 |
|---|---|---|
| Internal frauds | 10.62% | 20.50% |
| External frauds | 18.08% | 4.70% |
| Employment practices and workplace safety | 14.26% | 1.12% |
| Clients, products and business practices | 7.35% | 59.15% |
| Damages to physical assets | 32.00% | 4.70% |
| Business disruption and system failures | 0.40% | 0.71% |
| Execution, delivery and process management | 17.29% | 9.12% |
| **Total** | **100.00%** | **100.00%** |

## 6.6 Capital management

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

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

The Bank Pekao S.A. has put in place a formalized process of capital management and monitoring, established within the scope of ICAAP process. The Finance Division under the Chief Financial Officer is responsible for functioning of the capital management process in the Bank. The ultimate responsibility for capital management is allocated to the Management Board of the Bank, supported by the Assets, Liabilities and Risk Management Committee, which approves the capital management process. The Bank has also implemented the Capital Contingency Policy which establishes rules and obligations in the event of crisis appearance or further development that would significantly reduce capitalization level of the Bank or Group. The policy defines the principles of supervision including split of responsibilities for the purpose of early and consistent management in case of crisis situation development.

The Capital Management Strategy defines the objectives and general rules of the management and monitoring of the Group's capital adequacy, such as the guidelines concerning risk coverage sources, preferred structure of capital for risk coverage, long-term capital targets, capital limits system and sources of additional capital under contingency.

# Notes to the financial statements (cont.)

(In PLN thousand)

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

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

**Regulatory capital requirements**

Calculations of the regulatory capital requirements were done based on Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, with further amendments as well as Commission Implementing and Delegated Regulations (EU) (hereinafter: 'Regulation 575/2013').

Capital ratios are the basic measures applied for the measurement of capital adequacy. Minimum capital ratios required by law equal 10.0% for TCR and 8.0% for CET1 which are the sum of minimum value defined in Regulation 575/2013 (8.0% for TCR and 6.0% for T1) and the combined buffer requirement defined in Act on macroprudential supervision (total of 2.0% in line with Chapter 2). According to the recommendation of the Polish Financial Supervision Authority (KNF) total capital ratio of the Pekao Group, taking into account of Other Systemically Important Institution buffer of 0.75%, must be not lower than 14.0% and Tier I capital ratio not lower than 11.0%.

As at 31 December 2016 total capital ratio of the Group amounted at 17.64% (as at 31 December 2015 – 17.66%).

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **CAPITAL REQUIREMENTS** | | |
| Credit and counterparty risk including CVA | 8 511 165 | 8 527 666 |
| Market risk | 44 022 | 63 578 |
| Operational risk | 493 557 | 564 787 |
| **Total capital requirement** | **9 048 744** | **9 156 031** |
| **OWN FUNDS** | | |
| Common Equity Tier 1 capital | 19 954 579 | 20 209 595 |
| **Own funds for total capital ratio** | **19 954 579** | **20 209 595** |
| **OWN FUNDS REQUIREMENTS** | | |
| **Common Equity Tier 1 capital ratio (%)** | **17.64%** | **17.66%** |
| **Total capital ratio (%)** | **17.64%** | **17.66%** |

Total capital ratio at the end of 2016 compared with the end of 2015 decreased by 0.02 p.p. due to decrease of own funds by 1.3% despite decrease of total capital requirement by 1.2%.

Total capital requirement decreased in 2016 as a result of decrease of capital requirements for all risks.

For the purpose of capital requirement calculation the Group uses:

- Standardised Approach for credit risk capital requirement calculation,
- Financial Collateral Comprehensive Method for credit risk mitigation,
- Mark-to-Market Method for counterparty credit risk capital requirement calculation,
- Standardised Approach for capital requirement calculation of specific risk and duration-based calculation for general risk of debt instruments,
- Standardised Approach for capital requirement calculation of general and specific risk of equity instruments,

# Notes to the financial statements (cont.)

(In PLN thousand)

- Standardised Approach for capital requirement calculation for pre-funded contributions to the default fund of a qualifying central counterparty,
- Standardised Approach for foreign-exchange risk capital requirement calculation,
- Simplified approach for commodities risk capital requirement calculation,
- Standardised Approach for capital requirements for credit risk valuation adjustment risk,
- Advanced Measurement Approach for operational risk measurement in case of Bank and Standardised Approach for Bank's subsidiaries.

**Own funds**

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

The Group's own funds consist only of Common Equity Tier 1 capital. Additional Tier 1 capital and Tier 2 capital are not identified in the Group.

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **OWN FUNDS** | | |
| **Capital** | **22 911 943** | **23 424 193** |
| **Different scope of consolidation** | **16 361** | **15 826** |
| **Component of the capital not included into own funds, in which:** | **(2 279 275)** | **(2 292 459)** |
| Current year net profit | (2 279 275) | (2 292 459) |
| **Regulatory adjustments, in which:** | **(694 450)** | **(937 965)** |
| Intangible assets | (531 041) | (570 309) |
| Capital from revaluation | (32 177) | (36 678) |
| Unrealised loss from debt and capital instruments available for sale | - | - |
| Unrealised gain from debt and capital instruments available for sale | (51 593) | (267 136) |
| Deferred tax assets that rely on future profitability | (18 876) | (16 490) |
| Additional value adjustments due to prudent calculation | (45 839) | (31 388) |
| Minority interests | (14 924) | (15 964) |
| **Common Equity Tier 1 capital** | **19 954 579** | **20 209 595** |
| **Own funds for total capital ratio** | **19 954 579** | **20 209 595** |

Components of capital not included into own funds:

- Current year net profit – net profit of current reporting period, verified by statutory auditor responsible for auditing of the Group's accounts reduced by all foreseeable charge and dividend, can be included into Common Equity Tier 1 capital only with the permission of KNF. As at 31 of December 2016, current profit of the Group was not included into Common Equity Tier 1 capital.

Regulatory adjustments:

- intangible assets (after deduction of related deferred tax liabilities) decrease Common Equity Tier 1 capital, according to Article 36 of Regulation No 575/2013,
- capital from revaluation reflects fair value of cash flow hedges is not included in any element of own funds, according to Article 33 of Regulation No 575/2013,
- unrealised losses from debt and capital instruments classified as available for sale according to Article 467 of Regulation No 575/2013 using national options defined in Article 171a. Banking Act, decrease Common Equity Tier 1 capital in 100%,
- unrealised gains from debt and capital instruments classified as available for sale according to Article 468 of Regulation No 575/2013 using national options defined in Article 171a. Banking Act are included in 60% to Common Equity Tier 1 capital,

- deferred tax assets based on future profitability decrease Common Equity Tier 1 capital according to Article 36 of Regulation No 575/2013 only in 60% (Article 469 of Regulation No 575/2013 using national options defined in Article 171a Banking Act),
- additional value adjustments due to prudent valuation are created for every asset measured at fair value, according to Article 34 of Regulation No 575/2013,
- minority interests are deducted from Group's capital because requirements laid down in Regulation No 575/2013 are not meet.

**Internal capital adequacy assessment**
To assess the internal capital adequacy of the Group, the Bank applies methods designed internally.

The Group takes the following risk types into consideration:
- credit risk,
- operational risk,
- market risk,
- liquidity risk,
- real estate risk,
- macroeconomic risk,
- business risk (including strategic risk),
- compliance risk,
- reputational risk,
- model risk,
- excessive leverage risk,
- bancassurance risk,
- financial investment risk.

For each risk deemed material, the Group develops and applies adequate risk assessment and measurement methods. The Group applies the following risk assessment methods:
- qualitative assessment – applied in case of risks which are difficult to measure or for which capital is not a sufficient mean to cover losses (compliance, reputational and bancassurance risks) with potencial capital coverage in other risks areas,
- assessment by estimation of capital buffer, for risks that are not easily quantifiable however some aggregate assessment of their impact is possible (model risk and macroeconomic risk),
- quantitative assessment – applied for risks which can be measured with the use of economic capital (other risk types apart from liquidity risk and excessive leverage risk) or based on other risk-specific measures (liquidity risk and excessive leverage risk).

Preferred methods of measuring quantifiable risks and determining the resulting capital requirements are Value at Risk models, based on assumptions derived from the Group's risk appetite. The models are developed in compliance with the best market practices and regulatory requirements and supplemented with stress tests or scenario analyses. In case of risk types for which such methodologies have not been finally developed or implemented, the Group uses modified regulatory models supplemented with stress tests or simplified measurement methods.
Also, a consistent methodology for estimating the buffer for macroeconomic changes and model risks has been developed. The macroeconomic changes risk capital buffer is determined on the basis of the impact of the economic slowdown scenario on economic capital in the forecast horizon.

Model risk is assessed with scenario analyses making it possible to evaluate the impact of potential model inconsistencies on its output. Based on the aggregated output, the model risk capital buffer is determined.

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

(In PLN thousand)

## 6.7 Fair value of financial assets and liabilities

**Financial instruments that are measured at fair value in the consolidated statement of financial position of the Group**

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

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

As of 31 December 2016 and 31 December 2015, the Group classified the financial assets and liabilities measured at fair value into the following hierarchy of three categories based on the valuation method:

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

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

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

| 31.12.2016 | LEVEL 1 | LEVEL 2 | LEVEL 3 | TOTAL |
|---|---|---|---|---|
| **Assets:** | **20 944 182** | **13 685 790** | **407 312** | **35 037 284** |
| Financial assets held for trading | 636 385 | 29 971 | 66 113 | 732 469 |
| Derivative financial instruments, including: | 1 | 1 913 428 | - | 1 913 429 |
| - Banks | - | 1 339 956 | - | 1 339 956 |
| - Customers | 1 | 573 472 | - | 573 473 |
| Hedging instruments, including: | - | 289 752 | - | 289 752 |
| - Banks | - | 54 550 | - | 54 550 |
| - Customers | - | 235 202 | - | 235 202 |
| Securities available for sale | 20 307 796 | 11 452 639 | 341 199 | 32 101 634 |
| **Liabilities:** | **527 840** | **3 736 717** | **-** | **4 264 557** |
| Financial liabilities held for trading | 527 836 | 145 329 | - | 673 165 |
| Derivative financial instruments, including: | 4 | 1 952 670 | - | 1 952 674 |
| - Banks | - | 1 349 082 | - | 1 349 082 |
| - Customers | 4 | 603 588 | - | 603 592 |
| Hedging instruments, including: | - | 1 638 718 | - | 1 638 718 |
| - Banks | - | 1 636 262 | - | 1 636 262 |
| - Customers | - | 2 456 | - | 2 456 |

# Notes to the financial statements (cont.)

(In PLN thousand)

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

| 31.12.2015 | LEVEL 1 | LEVEL 2 | LEVEL 3 | TOTAL |
|---|---|---|---|---|
| **Assets:** | **15 929 590** | **6 134 087** | **504 501** | **22 568 178** |
| Financial assets held for trading | 936 763 | 142 640 | 47 389 | 1 126 792 |
| Derivative financial instruments, including: | 28 | 3 205 476 | 943 | 3 206 447 |
| - Banks | - | 2 639 346 | - | 2 639 346 |
| - Customers | 28 | 566 130 | 943 | 567 101 |
| Hedging instruments, including: | - | 421 640 | - | 421 640 |
| - Banks | - | 416 953 | - | 416 953 |
| - Customers | - | 4 687 | - | 4 687 |
| Securities available for sale | 14 992 799 | 2 364 331 | 456 169 | 17 813 299 |
| **Liabilities:** | **611 443** | **4 907 086** | **-** | **5 518 529** |
| Financial liabilities held for trading | 611 442 | - | - | 611 442 |
| Derivative financial instruments, including: | 1 | 3 204 327 | - | 3 204 328 |
| - Banks | - | 2 747 772 | - | 2 747 772 |
| - Customers | 1 | 456 555 | - | 456 556 |
| Hedging instruments, including: | - | 1 702 759 | - | 1 702 759 |
| - Banks | - | 1 702 759 | - | 1 702 759 |
| - Customers | - | - | - | - |

Change in fair value of financial instruments measured at fair value according to Level 3 by the Group

| 2016 | FINANCIAL ASSETS HELD FOR TRADING | DERIVATIVE FINANCIAL INSTRUMENTS (ASSETS) | SECURITIES AVAILABLE FOR SALE |
|---|---|---|---|
| **Opening balance** | **47 389** | **943** | **456 169** |
| Increases, including: | 188 786 | - | 68 170 |
| Reclassification | - | - | - |
| Acquisition | 187 298 | - | 58 952 |
| Settlement | - | - | - |
| Gains on financial instruments | 1 488 | - | 9 218 |
| recognized in the income statement | 1 488 | - | 7 598 |
| recognized in revaluation reserves | - | - | 1 620 |
| Decreases, including: | (170 062) | (943) | (183 140) |
| Reclassification | - | (943) | - |
| Settlement / redemption | (23 454) | - | (181 678) |
| Sale | (146 585) | - | - |
| Loss on financial instruments | (23) | - | (1 462) |
| recognized in the income statement | (23) | - | (4) |
| recognized in revaluation reserves | - | - | (1 458) |
| **Closing balance** | **66 113** | **-** | **341 199** |
| **Unrealized income from financial instruments held in portfolio until end of period, recognized in:** | **25** | **-** | **(1 187)** |
| Income statement: | 25 | - | 271 |
| net interest income | 41 | - | 271 |
| result on financial assets and liabilities held for trading | (16) | - | - |
| Other components income | - | - | (1 458) |

# Notes to the financial statements (cont.)

(In PLN thousand)

Change in fair value of financial instruments measured at fair value according to Level 3 by the Group

| 2015 | FINANCIAL ASSETS HELD FOR TRADING | DERIVATIVE FINANCIAL INSTRUMENTS (ASSETS) | SECURITIES AVAILABLE FOR SALE |
|---|---|---|---|
| **Opening balance** | **99 784** | **2 967** | **263 815** |
| Increases, including: | 10 663 874 | 1 942 | 200 231 |
| Reclassification | - | 1 942 | 313 |
| Acquisition | 10 661 018 | - | - |
| Settlement | - | - | - |
| Gains on financial instruments | 2 856 | - | 199 918 |
| recognized in the income statement | 2 856 | - | 11 077 |
| recognized in revaluation reserves | - | - | 188 841 |
| Decreases, including: | (10 716 269) | (3 966) | (7 877) |
| Reclassification | (55 052) | (2 967) | - |
| Settlement / redemption | (435 186) | (891) | (7 877) |
| Sale | (10 225 856) | - | - |
| Loss on financial instruments | (175) | (108) | - |
| recognized in the income statement | (175) | (108) | - |
| **Closing balance** | **47 389** | **943** | **456 169** |
| **Unrealized income from financial instruments held in portfolio until end of period, recognized in:** | **(63)** | **(108)** | **2 674** |
| Income statement: | 108 | (108) | 268 |
| net interest income | 108 | - | 268 |
| result on financial assets and liabilities held for trading | - | (108) | - |
| Other components income | (171) | - | 2 406 |

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

In the period from 1 January to 31 December 2016 the following transfers between fair value hierarchy levels were performed:

- Government bonds in foreign currencies were transferred from Level 1 to Level 2 due to a change in the availability of active market quotations.
- Interest rate derivatives and commodity derivatives (concluded within the year) were transferred from Level 3 to Level 2 due to the decrease of impact on the fair value of credit parameters and correlation parameter respectively.

In the period from 1 January to 31 December 2016 there were no other transfers between fair value hierarchy levels.

The impact of estimated parameters on measurement of financial instruments for which the Group applies fair value valuation according to Level 3 as at 31 December 2016 and 31 December 2015 is as follows

| FINANCIAL ASSET/LIABILITY | FAIR VALUE AS AT 31.12.2016 | VALUATION TECHNIQUE | UNOBSERVABLE FACTOR | ALTERNATIVE FACTOR RANGE (WEIGHTED AVERAGE) | IMPACT ON FAIR VALUE AS AT 31.12.2016 | |
|---|---|---|---|---|---|---|
| | | | | | POSITIVE SCENARIO | NEGATIVE SCENARIO |
| Corporate debt securities | 316 025 | Discounted cash flow | Credit spread | 0.32%-1.13% | 613 | (627) |

# Notes to the financial statements (cont.)

(In PLN thousand)

| FINANCIAL ASSET/LIABILITY | FAIR VALUE AS AT 31.12.2015 | VALUATION TECHNIQUE | UNOBSERVABLE FACTOR | ALTERNATIVE FACTOR RANGE (WEIGHTED AVERAGE) | IMPACT ON FAIR VALUE AS AT 31.12.2015 | |
|---|---|---|---|---|---|---|
| | | | | | POSITIVE SCENARIO | NEGATIVE SCENARIO |
| Corporate debt securities | 298 756 | Discounted cash flow | Credit spread | 0.54%-1% | 526 | (1 427) |
| Interest rate derivatives | 943 | Discounted cash flow | PD | 2.1%-5.4% | 39 | (44) |
| | | | LGD | 40.1%-54.1% | 16 | (16) |

**Financial instruments that are not measured at fair value in the consolidated statement of financial position of the Group**

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

As of 31 December 2016 and on 31 December 2015, the Group classified the financial assets and liabilities not measured at fair value in the consolidated statement of financial position into the following three categories based on the valuation level:

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

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

In the case of loans for which no quoted market values are available, the fair values presented are generally estimated using valuation techniques taking into consideration the assumption, that at the moment when the loan is granted its fair value is equal to its carrying amount. Fair value of non-impaired loans is equal to the sum of future expected cash flows, discounted at the balance sheet date. The discount rate is defined as the appropriate market risk-free rate plus the credit risk margin and current sales margin for the given loan products group. The margin is computed on loans granted during last three months broken down by loan product groups and maturity. For the purpose of the fair value of foreign currency loans estimation, the margin on PLN loans adjusted by the cross-currency basis swap quotes is used. The fair value of impaired loans is defined as equal to the sum of expected recoveries, discounted with the use of effective interest rate, since the average expected recovery values take the element of credit risk fully into consideration. In case of loans without repayment schedule (loans in current account, overdrafts and credit cards), the fair value was assumed as equal to the carrying amount.

For the Group's capital exposure, for which no active market prices are available and market values are unattainable, the Group does not measure their fair value. Such exposures include companies from financial sector, associated with the use of the financial and banking infrastructure and payment card services and companies taken-over as a result of debt restructuring.

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

# Notes to the financial statements (cont.)

(In PLN thousand)

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

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

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

| 31.12.2016 | CARRYING AMOUNT | FAIR VALUE | OF WHICH: | | |
|---|---|---|---|---|---|
| | | | LEVEL 1 | LEVEL 2 | LEVEL 3 |
| **Assets** | | | | | |
| Cash and due from Central Bank | 5 872 911 | 5 872 802 | 2 639 531 | 3 233 271 | - |
| Loans and advance to banks | 3 257 829 | 3 257 936 | - | 1 089 488 | 2 168 448 |
| Loans and advances to customers | 118 689 267 | 117 912 278 | - | 5 789 241 | 112 123 037 |
| Receivables from financial leases | 3 974 643 | 4 038 178 | - | - | 4 038 178 |
| Debt securities held to maturity | 3 018 985 | 3 033 397 | 3 012 791 | 20 606 | - |
| **Total assets** | **134 813 635** | **134 114 591** | **5 652 322** | **10 132 606** | **118 329 663** |
| **Liabilities** | | | | | |
| Amounts due to Central Bank | 6 091 | 6 185 | - | - | 6 185 |
| Amounts due to other banks | 4 823 440 | 4 870 778 | - | 482 375 | 4 388 403 |
| Amounts due to customers | 137 815 926 | 137 494 049 | - | 1 436 240 | 136 057 809 |
| Debt securities issued | 1 522 963 | 1 565 925 | - | 1 565 925 | - |
| **Total liabilities** | **144 168 420** | **143 936 937** | **-** | **3 484 540** | **140 452 397** |

| 31.12.2015 | CARRYING AMOUNT | FAIR VALUE | OF WHICH: | | |
|---|---|---|---|---|---|
| | | | LEVEL 1 | LEVEL 2 | LEVEL 3 |
| **Assets** | | | | | |
| Cash and due from Central Bank | 7 881 607 | 7 881 607 | 2 951 414 | 4 930 193 | - |
| Loans and advance to banks | 7 314 724 | 7 311 058 | - | 5 301 176 | 2 009 882 |
| Loans and advances to customers (*) | 118 555 269 | 117 717 427 | - | 7 140 550 | 110 576 877 |
| Receivables from financial leases | 3 503 979 | 3 568 200 | - | - | 3 568 200 |
| Debt securities held to maturity | 3 368 424 | 3 380 400 | 2 509 227 | 871 173 | - |
| **Total assets** | **140 624 003** | **139 858 692** | **5 460 641** | **18 243 092** | **116 154 959** |
| **Liabilities** | | | | | |
| Amounts due to Central Bank | 914 | 928 | - | - | 928 |
| Amounts due to other banks | 5 958 449 | 6 002 687 | - | 1 182 111 | 4 820 576 |
| Amounts due to customers | 128 867 691 | 128 479 792 | - | 4 468 820 | 124 010 972 |
| Debt securities issued | 2 903 233 | 2 959 349 | - | 2 959 349 | - |
| **Total liabilities** | **137 730 287** | **137 442 756** | **-** | **8 610 280** | **128 832 476** |

(*) Including bills of exchange eligible for rediscounting at Central Bank.

# 7. Custody activity

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

As at 31 December 2016 the Bank maintained 12 333 securities accounts (in comparison to 12 077 securities accounts as at 31 December 2015).

# 8. Brokerage activity

The Group offers a wide range of capital market products and services via specialized Bank's organizational unit – Dom Maklerski Pekao (DM) and by the agency of Centralny Dom Maklerski Pekao S.A. (CDM) and Pekao Investment Banking S.A. (Pekao IB) a subsidiaries of the Bank Pekao S.A.

**Dom Maklerski Pekao and Centralny Dom Maklerski Pekao S.A.**
Dom Maklerski Pekao is a specialized organizational unit of the Bank designed to sell capital market products. The objective of the entity is to provide the highest quality brokerage services. The comprehensive offer enables investors, especially the individual clients of the Bank to invest in financial instruments traded on the regulated market and on the alternative trading platform organized by the Warsaw Stock Exchange (GPW S.A.) and by the BondSpot S.A. (i.e. shares, treasury and corporate bonds, derivatives - futures and options, ETF, certificates, warrants) as well as the instruments traded on the particular foreign markets using any service channel (mobile application, Internet, mobile service, phone, direct contact in the Brokerage Services Spots) after activation of the service. Dom Maklerski Pekao intermediates also in sales of the Structured Certificates of Deposit issued by Bank Pekao S.A., enables investors to acquire instruments in the IPO's and makes the transactions on the non-public market. The service for the clients is provided in more than 390 Brokerage Services Spots located in the Bank branches throughout Poland and via remote channels of Pekao24Makler (Internet, mobile service, phone, mobile application) fully integrated with the Bank's electronic banking platform Pekao24.

Centralny Dom Maklerski Pekao S.A. (CDM) is the largest and oldest brokerage firm on the Polish capital market. The aim of CDM is to service investment accounts. The offering enables Clients to invest in inter alia shares, Treasury bonds, corporate bonds, certificates, funds' units, ETF, structured products, insurance and pension programs. CDM grants to clients access to invest on derivatives markets, foreign markets and OTC markets. Clients are served in 48 Consumer Service Spots located mainly in Bank branches throughout Poland and additionally in 12 points dedicated to service for strategic clients and through remote service channels of CDM24 (CDMInternet, TeleCDM, CDM Mobile) enabling connection to electronic banking platform Pekao24.

The tight cooperation of Dom Maklerski Pekao and CDM on the realization of the projects conducted on the primary market and in the other areas of market activities of both entities ensures professional and comprehensive brokerage services.

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

Both entities conform to the Good Practices Code of Brokerage Firms guaranteeing comprehensive services in accordance with highest ethics standards. Both DM and CDM actively participate in capital market development in Poland.

# Notes to the financial statements (cont.)

(In PLN thousand)

**Pekao Investment Banking S.A.**

Pekao Investment Banking S.A. operates as a brokerage house supervised by the Financial Supervision Commission, focusing on the service of institutional and corporate clients. The scope of services provided by Pekao IB comprises in particular acceptance and transfer of orders for purchase or sale of financial instruments, execution of these orders on account of the person or entity placing the order, offering of financial instruments, advisory services for enterprises on capital structure, corporate strategy or other matters related to such structure or strategy as well as advisory services and other services relating to mergers, divisions and acquisitions of companies. Pekao IB also performs the market maker's function both on the capital market and on the derivatives market, being one of the most active market makers.

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

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

| | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|
| | QUANTITY (pcs) | VALUE | QUANTITY (pcs) | VALUE |
| **CLIENTS' FINANCIAL INSTRUMENTS** | | | | |
| Held on securities accounts | 3 556 221 597 | 24 707 398 | 4 085 831 592 | 28 594 389 |
| Equity securities and rights to such financial assets | 3 550 120 296 | 23 236 537 | 4 075 825 419 | 27 191 398 |
| Debt instruments and rights to such financial assets | 6 101 301 | 1 470 861 | 10 006 173 | 1 402 991 |
| Stored in a form of document | 2 623 762 193 | 6 291 869 | 3 767 973 072 | 16 232 127 |
| Equity securities and rights to such financial assets | 2 623 762 193 | 6 291 869 | 3 763 773 072 | 16 074 480 |
| Debt instruments and rights to such financial assets | - | - | 4 200 000 | 157 647 |

Customers' cash on brokerage accounts

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Deposited on cash accounts in brokerage house and paid for securities bought in IPO or on the primary market | 1 100 623 | 857 944 |
| Other customers' cash | 40 955 | 45 571 |
| **Total** | **1 141 578** | **903 515** |

Settlements due to unsettled transactions

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Receivables from executed transactions | 32 061 | - |
| Liabilities from executed transactions | - | 13 201 |

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

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Receivables from clearing fund | 24 817 | 18 727 |
| Receivables from margin deposits | 32 391 | 29 866 |
| Other receivables | 1 252 | 231 |
| **Total receivables** | **58 460** | **48 824** |
| Amounts due on margin deposits | 921 | 4 421 |
| Other liabilities | 317 | 331 |
| **Total liabilities** | **1 238** | **4 752** |

# Notes to the financial statements (cont.)

(In PLN thousand)

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

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Receivables from compensation fund | 11 432 | 10 914 |
| Prepaid expenses - system maintenance fees | 1 764 | 1 456 |
| Deferred income – benefits from system | (13 411) | (12 549) |
| **Total net balance sheet items concerning participation in the compensation fund** | **(215)** | **(179)** |

Settlement with entities running regulated securities markets and commodity exchanges

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Amounts due to Warsaw Stock Exchange | 527 | 638 |
| **Total liabilities** | **527** | **638** |

## 9. Operating segments

Data reported in the section steem from the application of the management model ('Model') in which the main criterion for segmentation is the classification of customers based on their profile and service model.

Reporting and monitoring of results, for managerial purposes, includes all components of the income statement up to the gross profit level. Therefore, the income from the segment's activities as well as operating costs related to those activities (including direct and allocated costs in line with the allocation model applied) and other components of income statement are attached to each segment.

The Group settles transactions between segments on an arm's length basis by applying current market prices. Fund transfers between retail, private, corporate and investment banking segments, and the assets and liabilities management and other area are based on market prices applicable to the funds' currency and maturity, including liquidity margins.

**Operating segments**
The operating segments of the Group are as follows:

- Retail banking – all banking activites related to retail customers (excluding private banking customers), small and micro companies with annual turnover not exceeding PLN 20 million, as well as results of the subsidiaries, and shares in net profit of associates accounted for using the equity method, that are assigned to the retail banking activity,
- Private banking – all banking activites related to the most affluent individual customers,
- Corporate and Investment banking – all banking activites related to the medium and large companies, interbank market, debt securities and other instruments, and results of the of the subsidiaries that are assigned to the Corporate and Investment banking activity,
- assets and liabilities management and other – supervision and monitoring of fund transfers, other activities centrally managded as well as the results of subsidiaries and share in net profit of associated accounted for using equity method that are not assigned to other reported segments.

# Notes to the financial statements (cont.)

(In PLN thousand)

Operating segments reporting for the period from 1 January to 31 December 2016

| | RETAIL BANKING | PRIVATE BANKING | CORPORATE AND INVESTMENT BANKING | ASSETS AND LIABILITIES MANAGEMENT AND OTHER | TOTAL |
|---|---|---|---|---|---|
| **Total net interest income** | **2 406 728** | **47 529** | **1 634 037** | **349 089** | **4 437 383** |
| **Non-interest income** | **1 523 051** | **30 608** | **925 353** | **430 823** | **2 909 835** |
| **Operating income** | **3 929 779** | **78 137** | **2 559 390** | **779 912** | **7 347 218** |
| Personnel expenses | (1 111 686) | (25 335) | (261 344) | (498 471) | (1 896 836) |
| Other administrative expenses | (1 250 524) | (25 125) | (336 035) | 637 480 | (974 204) |
| Depreciation and amortisation | (177 566) | (1 714) | (22 642) | (138 944) | (340 866) |
| **Operating costs** | **(2 539 776)** | **(52 174)** | **(620 021)** | **65** | **(3 211 906)** |
| **Gross operating profit** | **1 390 003** | **25 963** | **1 939 369** | **779 977** | **4 135 312** |
| Net impairment losses on loans and off-balance sheet commitments | (250 042) | (133) | (252 807) | 2 353 | (500 629) |
| **Net operating profit** | **1 139 961** | **25 830** | **1 686 562** | **782 330** | **3 634 683** |
| Net result on other provisions | (651) | (514) | 1 259 | (14 569) | (14 475) |
| Guarantee funds charges | (99 618) | (632) | (154 296) | (24 922) | (279 468) |
| Tax on certain financial institutions | - | - | - | (449 533) | (449 533) |
| Net result on investment activities | (170) | - | 498 | 5 011 | 5 339 |
| **Profit before tax** | **1 039 522** | **24 684** | **1 534 023** | **298 317** | **2 896 546** |
| Income tax expense | | | | | (616 782) |
| **Net profit for the period** | | | | | **2 279 764** |
| **Attributable to equity holders of the Bank** | | | | | **2 279 275** |
| Attributable to non-controling interests | | | | | 489 |
| Allocated assets | 63 640 992 | 261 932 | 105 098 620 | (3 929 788) | 165 071 756 |
| Unallocated assets | | | | | 9 143 187 |
| **Total assets** | | | | | **174 214 943** |
| Allocated liabilities | 79 287 145 | 8 304 002 | 63 233 403 | (5 142 417) | 145 682 133 |
| Unallocated liabilities | | | | | 28 532 810 |
| **Total liabilities** | | | | | **174 214 943** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Operating segments reporting for the period from 1 January to 31 December 2015

| | RETAIL BANKING | PRIVATE BANKING | CORPORATE AND INVESTMENT BANKING | ASSETS AND LIABILITIES MANAGEMENT AND OTHER | TOTAL |
|---|---|---|---|---|---|
| **Total net interest income** | **2 306 368** | **25 162** | **1 603 118** | **297 648** | **4 232 296** |
| **Non-interest income** | **1 537 516** | **33 061** | **1 122 692** | **133 017** | **2 826 286** |
| **Operating income** | **3 843 884** | **58 223** | **2 725 810** | **430 665** | **7 058 582** |
| Personnel expenses | (1 132 086) | (23 226) | (261 916) | (491 291) | (1 908 519) |
| Other administrative expenses | (1 236 547) | (25 573) | (342 781) | 625 213 | (979 688) |
| Depreciation and amortisation | (170 218) | (1 571) | (23 181) | (136 495) | (331 465) |
| **Operating costs** | **(2 538 851)** | **(50 370)** | **(627 878)** | **(2 573)** | **(3 219 672)** |
| **Gross operating profit** | **1 305 033** | **7 853** | **2 097 932** | **428 092** | **3 838 910** |
| Net impairment losses on loans and off-balance sheet commitments | (185 573) | (1 066) | (352 613) | 21 694 | (517 558) |
| **Net operating profit** | **1 119 460** | **6 787** | **1 745 319** | **449 786** | **3 321 352** |
| Net result on other provisions | (283) | (388) | 15 | (28 110) | (28 766) |
| Guarantee funds charges | (106 880) | (796) | (171 233) | (256 044) | (534 953) |
| Tax on certain financial institutions | - | - | - | - | - |
| Net result on investment activities | (122) | - | 386 | 73 221 | 73 485 |
| **Profit before tax** | **1 012 175** | **5 603** | **1 574 487** | **238 853** | **2 831 118** |
| Income tax expense | | | | | (537 640) |
| **Net profit for the period** | | | | | **2 293 478** |
| **Attributable to equity holders of the Bank** | | | | | **2 292 459** |
| Attributable to non-controling interests | | | | | 1 019 |
| Allocated assets | 59 276 412 | 299 794 | 97 664 414 | (283 705) | 156 956 915 |
| Unallocated assets | | | | | 11 828 652 |
| **Total assets** | | | | | **168 785 567** |
| Allocated liabilities | 71 778 919 | 8 353 642 | 64 094 425 | (4 755 682) | 139 471 304 |
| Unallocated liabilities | | | | | 29 314 263 |
| **Total liabilities** | | | | | **168 785 567** |

Reconciliation of operating income for reportable segments

| | 2016 | 2015 |
|---|---|---|
| **Total operating income for reportable segments** | **7 347 218** | **7 058 582** |
| Share in gains (losses) from associates | (38 580) | (52 091) |
| Net other operating income and expenses | (30 528) | (160 996) |
| Refunding of administrative expenses | 2 282 | 3 432 |
| **Operating income** | **7 280 392** | **6 848 927** |

**Geographical segment**

The operating activity of Bank Pekao S.A. Group is concentrated in Poland through the network of branches and the subsidiaries.

(In PLN thousand)

# 10. Interest income and expense

Interest income

| | 2016 | 2015 |
|---|---|---|
| Loans and other receivables from customers | 4 431 535 | 4 410 834 |
| Interbank placements | 79 776 | 103 034 |
| Reverse repo transactions | 50 078 | 77 626 |
| Investment securities | 736 789 | 699 863 |
| Hedging derivatives | 138 866 | 150 934 |
| Financial assets held for trading | 11 446 | 14 078 |
| **Total** | **5 448 490** | **5 456 369** |

Interest income for 2016 includes income from impaired financial assets in the amount of PLN 243 131 thousand (in 2015 PLN 301 340 thousand).

Total amount of interest income for 2016 measured at amortized cost using the effective interest rate method, which applies to financial assets not measured at fair value through profit or loss, amounted to PLN 3 797 006 thousand (in 2015 PLN 3 730 968 thousand).

Interest expense

| | 2016 | 2015 |
|---|---|---|
| Deposits from customers | (941 996) | (1 097 030) |
| Interbank deposits | (24 257) | (23 156) |
| Repo transactions | (44 045) | (59 001) |
| Loans and advances received | (10 817) | (19 940) |
| Debt securities issued | (45 370) | (90 672) |
| **Total** | **(1 066 485)** | **(1 289 799)** |

Total amount of interest expense for 2016, measured at amortized cost using the effective interest rate method with reference to financial liabilities, which are not valued at fair value through profit or loss amounted to PLN 868 315 thousand (in 2015 PLN 1 094 924 thousand).

# 11. Fee and commission income and expense

Fee and commission income

| | 2016 | 2015 |
|---|---|---|
| Accounts maintenance, payment orders and cash transactions | 636 652 | 651 507 |
| Payment cards | 598 246 | 693 067 |
| Loans and advances | 460 543 | 432 269 |
| Investment products sales intermediation | 248 716 | 294 648 |
| Securities operations | 91 198 | 96 794 |
| Custody activity | 62 842 | 69 519 |
| Pension and investment funds service fees | 48 920 | 50 246 |
| Guarantees, letters of credit and similar transactions | 54 774 | 51 050 |
| Other | 50 194 | 49 423 |
| **Total** | **2 252 085** | **2 388 523** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Fee and commission expense

| | 2016 | 2015 |
|---|---|---|
| Payment cards | (218 109) | (322 424) |
| Money orders and transfers | (20 077) | (21 708) |
| Securities and derivatives operations | (28 578) | (13 840) |
| Accounts maintenance | (5 236) | (4 275) |
| Custody activity | (14 378) | (13 388) |
| Pension funds management charges | (856) | (868) |
| Acquisition services | (3 968) | (3 404) |
| Other | (1 919) | (3 090) |
| **Total** | **(293 121)** | **(382 997)** |

## 12. Dividend income

| | 2016 | 2015 |
|---|---|---|
| Issuers of securities held for trading | 89 | 530 |
| Issuers of securities available for sale | 16 709 | 13 105 |
| **Total** | **16 798** | **13 635** |

## 13. Result on financial assets and liabilities held for trading

| | 2016 | 2015 |
|---|---|---|
| Foreign currency exchange result | 416 031 | 367 908 |
| Gains (losses) on derivatives | 45 994 | 64 206 |
| Gains (losses) on securities | 23 384 | (4 066) |
| **Total** | **485 409** | **428 048** |

In 2016, the total change in the fair value of financial instruments valued at fair value through profit or loss, determined with the use of valuation techniques (when no published quotations from active markets are available) amounted to PLN 53 902 thousand (in 2015 PLN 64 586 thousand).

## 14. Gains (losses) on disposal

Realized gains

| | 2016 | 2015 |
|---|---|---|
| Loans and other financial receivables (*) | 159 495 | 534 |
| Available for sale financial assets – debt instruments | 14 531 | 229 592 |
| Available for sale financial assets – equity instruments (**) | 262 826 | - |
| Debt securities issued | 1 | 6 |
| **Total** | **436 853** | **230 132** |

(*) In 2016 the Bank sold loans with a total debt of PLN 1 863 million. The realized gross result on the transaction was PLN 149.9 million.
(**) In 2016 the Bank has received information about the closing of the acquisition of Visa Europe Limited by Visa Inc. The details of the transactions are presented in the Note 31.

(In PLN thousand)

Realized losses

| | 2016 | 2015 |
|---|---|---|
| Loans and other financial receivables | (2) | - |
| Available for sale financial assets – debt instruments | (864) | (41) |
| Debt securities issued | (84) | (490) |
| **Total** | **(950)** | **(531)** |

| | | |
|---|---|---|
| **Net realized profit** | **435 903** | **229 601** |

The change in fair value of financial assets available for sale transferred in 2016 directly to equity amounted to PLN 332 328 thousand (decrease), in 2015 PLN 7 573 thousand (decrease).

The change in fair value of financial assets, transferred in 2016 from equity to financial income amounted to PLN 276 493 thousand (profit), in 2015 PLN 229 551 thousand (profit).

## 15. Administrative expenses

Personnel expenses

| | 2016 | 2015 |
|---|---|---|
| Wages and salaries | (1 600 420) | (1 609 253) |
| Insurance and other charges related to employees | (286 844) | (291 849) |
| Share-based payments expenses | (9 572) | (7 417) |
| **Total** | **(1 896 836)** | **(1 908 519)** |

Other administrative expenses

| | 2016 | 2015 |
|---|---|---|
| General expenses | (924 479) | (916 571) |
| Taxes and charges (*) | (40 874) | (74 850) |
| Bank Guarantee Fund fee (**) | (278 929) | (509 127) |
| Financial supervision authority fee (KNF) | (11 673) | (17 525) |
| Tax on certain financial institutions (***) | (449 533) | - |
| **Total** | **(1 705 488)** | **(1 518 073)** |

| | | |
|---|---|---|
| **Total administrative expenses** | **(3 602 324)** | **(3 426 592)** |

(*) In 2015 this item includes the amount of PLN 26 469 thousand representing the cost of provision for the contribution to the Borrowers Support Fund.
(**) In 2016 this item includes the amount of PLN 16 604 thousand contributed by the Group to BFG for the purpose of payments of the funds guaranteed to the depositors of Bank Spółdzielczy in Nadarzyn, respectively in 2015 the amount of PLN 234 081 thousand concerns Spółdzielczy Bank Rzemiosła i Rolnictwa in Wołomin.
(***) On 1 February 2016 tax on certain financial institutions was introduced under the Act on tax on certain financial institutions.

## 16. Depreciation and amortization

| | 2016 | 2015 |
|---|---|---|
| Property, plant and equipment | (168 077) | (180 457) |
| Investment property | (1 183) | (1 654) |
| Intangible assets | (171 606) | (149 354) |
| **Total** | **(340 866)** | **(331 465)** |

(In PLN thousand)

# 17. Net other operating income and expenses

Other operating income

| | 2016 | 2015 |
|---|---|---|
| Rental income | 21 259 | 22 096 |
| Miscellaneous income | 17 608 | 15 504 |
| Recovery of debt collection costs | 13 539 | 16 369 |
| Revenues from sale of products, goods and services | 16 442 | 5 778 |
| Excess payments, repayments | 9 692 | 9 152 |
| Compensation, penalty fees and fines received (including received compensations from damages in relation to fixed assets) | 5 885 | 116 510 |
| Revenues from leasing activity | 2 615 | 15 559 |
| Refunding of administrative expenses | 2 282 | 3 432 |
| Income from written off liabilities | 3 512 | 4 624 |
| Releases of impairment allowances for litigation and other assets | 1 021 | 3 093 |
| Gains on sale of leasing assets for third person and other assets | 883 | 764 |
| Other | 4 967 | 7 555 |
| **Total** | **99 705** | **220 436** |

Other operating expenses

| | 2016 | 2015 |
|---|---|---|
| Costs related to leasing activity | (2 262) | (2 443) |
| Credit insurance expenses | (11 163) | (10 101) |
| Sundry expenses | (15 501) | (14 541) |
| Reimbursement and deficiencies | (2 877) | (4 021) |
| Costs from sale of products, goods and services | (13 119) | (2 358) |
| Customers complaints expenses | (1 734) | (2 311) |
| Impairment allowance for litigations and other assets | (4 418) | (9 167) |
| Costs of litigation and claims | (1 394) | (2 130) |
| Compensation, penalty fees and fines paid | (1 682) | (644) |
| Losses on disposal of leasing assets for third person and other assets | (466) | (604) |
| Other | (14 561) | (11 120) |
| **Total** | **(69 177)** | **(59 440)** |

| | | |
|---|---|---|
| **Net other operating income and expenses** | **30 528** | **160 996** |

# Notes to the financial statements (cont.)

(In PLN thousand)

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

| 2016 | OPENING BALANCE | INCREASES | | DECREASES | | | CLOSING BALANCE | IMPACT ON INCOME STATEMENT(**) |
|---|---|---|---|---|---|---|---|---|
| | | IMPARIMENT CHARGES | OTHER (*) | WRITE-OFFS OF ASSETS FROM THE BALANCE SHEET | RELEASE OF IMPARIMENT CHARGES | OTHER (*) | | |
| **Impairment of financial assets and off-balance sheet commitments** | | | | | | | | |
| Loans and advances to banks valued at amortized cost | 19 774 | 590 | 1 451 | - | (2 933) | (889) | 17 993 | 2 343 |
| Loans and advances to customers valued at amortized cost | 5 678 633 | 1 021 762 | 167 086 | (583 975) | (602 645) | (138 242) | 5 542 619 | (419 117) |
| Receivables from financial leases | 163 704 | 17 112 | 3 | (86) | (13 244) | (542) | 166 947 | (3 868) |
| Financial assets available for sale | 122 | - | - | - | - | (122) | - | - |
| Off-balance sheet commitments | 120 771 | 160 561 | 992 | - | (61 341) | - | 220 983 | (99 220) |
| **Total financial assets and off-balance sheet commitments** | **5 983 004** | **1 200 025** | **169 532** | **(584 061)** | **(680 163)** | **(139 795)** | **5 948 542** | **(519 862)** |
| **Impairment of other assets** | | | | | | | | |
| Investments in associates | 60 | - | - | - | - | (60) | - | - |
| Intangible assets | 10 961 | - | - | (10 961) | - | - | - | - |
| Property, plant and equipment | 8 451 | - | - | (693) | - | - | 7 758 | - |
| Investment properties | 8 682 | - | - | (926) | - | (725) | 7 031 | - |
| Other | 77 736 | 4 418 | 1 369 | (2 230) | (1 021) | (6) | 80 266 | (3 397) |
| **Total impairment of other assets** | **105 890** | **4 418** | **1 369** | **(14 810)** | **(1 021)** | **(791)** | **95 055** | **(3 397)** |
| **Total** | **6 088 894** | **1 204 443** | **170 901** | **(598 871)** | **(681 184)** | **(140 586)** | **6 043 597** | **(523 259)** |

(*) Including foreign exchange differences and transfers between positions.

(**) ‘Impairment of financial assets and off-balance sheet commitments’ includes net impairment in the amount of PLN minus 519 862 thousand and proceeds from recovered bad debt in the amount of PLN 19 233 thousand, the total is PLN minus 500 629 thousand.

# Notes to the financial statements (cont.)

(In PLN thousand)

| 2015 | OPENING BALANCE | INCREASES | | DECREASES | | | CLOSING BALANCE | IMPACT ON INCOME STATEMENT(**) |
|---|---|---|---|---|---|---|---|---|
| | | IMPARIMENT CHARGES | OTHER (*) | WRITE-OFFS OF ASSETS FROM THE BALANCE SHEET | RELEASE OF IMPARIMENT CHARGES | OTHER (*) | | |
| **Impairment of financial assets and off-balance sheet commitments** | | | | | | | | |
| Loans and advances to banks valued at amortized cost | 19 360 | 684 | 1 541 | - | (870) | (941) | 19 774 | 186 |
| Loans and advances to customers valued at amortized cost | 5 582 478 | 1 156 227 | 100 138 | (445 826) | (646 377) | (68 007) | 5 678 633 | (509 850) |
| Receivables from financial leases | 187 901 | 23 834 | - | (139) | (19 101) | (28 791) | 163 704 | (4 733) |
| Financial assets available for sale | 122 | - | - | - | - | - | 122 | - |
| Off-balance sheet commitments | 102 386 | 71 614 | 1 182 | - | (54 411) | - | 120 771 | (17 203) |
| **Total financial assets and off-balance sheet commitments** | **5 892 247** | **1 252 359** | **102 861** | **(445 965)** | **(720 759)** | **(97 739)** | **5 983 004** | **(531 600)** |
| **Impairment of other assets** | | | | | | | | |
| Investments in associates | 60 | - | - | - | - | - | 60 | - |
| Intangible assets | 10 961 | - | - | - | - | - | 10 961 | - |
| Property, plant and equipment | 6 667 | 610 | 1 569 | (152) | - | (243) | 8 451 | (610) |
| Investment properties | 8 682 | - | - | - | - | - | 8 682 | - |
| Other | 76 532 | 9 167 | 626 | (3 592) | (3 093) | (1 904) | 77 736 | (6 074) |
| **Total impairment of other assets** | **102 902** | **9 777** | **2 195** | **(3 744)** | **(3 093)** | **(2 147)** | **105 890** | **(6 684)** |
| **Total** | **5 995 149** | **1 262 136** | **105 056** | **(449 709)** | **(723 852)** | **(99 886)** | **6 088 894** | **(538 284)** |

(*) Including foreign exchange differences and transfers between positions.
(**) 'Impairment of financial assets and off-balance sheet commitments' includes net impairment in the amount of PLN minus 531 600 thousand and proceeds from recovered bad debt in the amount of PLN 14 042 thousand, the total is PLN minus 517 558 thousand.

(In PLN thousand)

# 19. Gains (losses) on subsidiaries and associates

Share of profit (losses) from associates

| | 2016 | 2015 |
|---|---|---|
| **Share in gains (losses) from associates** | | |
| Dom Inwestycyjny Xelion Sp. z o.o. | 2 179 | 1 965 |
| Pioneer Pekao Investment Management S.A. | 36 401 | 44 649 |
| Krajowa Izba Rozliczeniowa S.A. | - | 5 477 |
| **Total share in gains (losses) from associates** | **38 580** | **52 091** |
| **Gains (losses) on liquidation of subsidiaries** | **(19)** | **55** |
| **Gains (losses) on disposal of associates** | **-** | **61 057** |
| **Total gains (losses) from subsidiaries and associates** | **38 561** | **113 203** |

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

| | 2016 | 2015 |
|---|---|---|
| Gains (losses) on disposal of property, plant and equipment classified as assets held for sale | 1 029 | - |
| Gains (losses) on de-recognition of property, plant and equipment and intangible assets other than classified as assets held for sale | 4 330 | 12 373 |
| **Total gains (losses) on disposal of property, plant and equipment and intangible assets** | **5 359** | **12 373** |

# 21. Income tax

The below additional information notes present the Group gross profit's.

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

| | 2016 | 2015 |
|---|---|---|
| **Profit before income tax** | **2 896 546** | **2 831 118** |
| **Tax charge according to applicable tax rate** | **550 344** | **537 912** |
| **Permanent differences:** | **66 438** | **(272)** |
| Non taxable income | (35 001) | (28 950) |
| Non tax deductible costs | 105 720 | 29 252 |
| Impact of other tax rates applied under a different tax jurisdiction | - | - |
| Impact of utilized tax losses | - | - |
| Tax relieves not included in the income statement | 80 | 185 |
| Other | (4 361) | (759) |
| **Effective income tax charge on gross profit** | **616 782** | **537 640** |

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

# Notes to the financial statements (cont.)

(In PLN thousand)

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

| | 2016 | 2015 |
|---|---|---|
| INCOME STATEMENT | | |
| **Current tax** | **(586 052)** | **(469 589)** |
| Current tax charge in the income statement | (585 499) | (489 233) |
| Adjustments related to the current tax from previous years | 207 | 22 393 |
| Other taxes (e.g. withholding tax, income tax relating to foreign branch) | (760) | (2 749) |
| **Deferred tax** | **(30 730)** | **(68 051)** |
| Occurrence and reversal of temporary differences | (30 730) | (68 051) |
| **Tax charge in the consolidated income statement** | **(616 782)** | **(537 640)** |
| EQUITY | | |
| **Deferred tax** | **118 927** | **60 338** |
| Income and costs disclosed in other comprehensive income: | | |
| revaluation of financial instruments - cash flows hedges | 1 056 | 17 735 |
| revaluation of available for sale financial assets – debt securities | 77 187 | 84 422 |
| revaluation of available for sale financial assets – equity securities | 38 488 | (39 368) |
| **Tax on items that are or may be reclassified subsequently to profit or loss** | **116 731** | **62 789** |
| **Tax charge on items that will never be reclassified to profit or loss** | **2 196** | **(2 451)** |
| revaluation of the defined benefit liabilities | 2 196 | (2 451) |
| **Total charge** | **(497 855)** | **(477 302)** |

# Notes to the financial statements (cont.)

(In PLN thousand)

| | CHANGES IN TEMPORARY DIFFERENCES IN 2016 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | OPENING BALANCE | | | CHANGES RECOGNIZED IN | | CLOSING BALANCE | | |
| | TOTAL DEFERRED TAX | RECOGNIZED IN THE INCOME STATEMENT | IN EQUITY | THE INCOME STATEMENT | IN EQUITY | TOTAL DEFERRED TAX | THE INCOME STATEMENT | IN EQUITY |
| DEFFERED TAX LIABILITY | | | | | | | | |
| Accrued income – securities | - | - | - | 46 320 | - | 46 320 | 46 320 | - |
| Accrued income – loans | 128 540 | 128 540 | - | 15 592 | - | 144 132 | 144 132 | - |
| Change in revaluation of financial assets | 102 790 | 19 661 | 83 129 | (14 955) | (75 267) | 12 568 | 4 706 | 7 862 |
| Accelerated depreciation | 123 326 | 123 326 | - | (7 422) | - | 115 904 | 115 904 | - |
| Investment relief | 5 724 | 5 724 | - | (407) | - | 5 317 | 5 317 | - |
| Other | 90 118 | 90 118 | - | 14 219 | - | 104 337 | 104 337 | - |
| **Gross deferred tax liability** | **450 498** | **367 369** | **83 129** | **53 347** | **(75 267)** | **428 578** | **420 716** | **7 862** |
| DEFFERED TAX ASSET | | | | | | | | |
| Accrued expenses - securities | 23 366 | 23 366 | - | (21 853) | - | 1 513 | 1 513 | - |
| Accrued expenses - deposits and loans | 45 339 | 45 339 | - | ( 7 388) | - | 37 951 | 37 951 | - |
| Downward revaluation of financial assets | 256 958 | 256 958 | - | 4 114 | 41 465 | 302 537 | 261 072 | 41 465 |
| Income received to be amortized over time from loans and current accounts | 174 097 | 174 097 | - | 3 313 | - | 177 410 | 177 410 | - |
| Loan provisions charges | 493 328 | 493 328 | - | 47 379 | - | 540 707 | 540 707 | - |
| Personnel related provisions | 114 657 | 98 174 | 16 483 | 1 435 | 2 196 | 118 288 | 99 609 | 18 679 |
| Accruals | 19 517 | 19 517 | - | (1 847) | - | 17 670 | 17 670 | - |
| Previous year losses | 10 033 | 10 033 | - | 21 427 | - | 31 460 | 31 460 | - |
| Other | 223 471 | 223 471 | - | (23 963) | - | 199 508 | 199 508 | - |
| **Gross deferred tax asset** | **1 360 766** | **1 344 283** | **16 483** | **22 617** | **43 661** | **1 427 044** | **1 366 900** | **60 144** |
| **Deferred tax charge** | **x** | **x** | **x** | **(30 730)** | **118 928** | **x** | **x** | **x** |
| **Net deferred tax assets** | **915 204** | **981 850** | **(66 646)** | **x** | **x** | **1 003 351** | **951 069** | **52 282** |
| **Net deferred tax provision** | **4 936** | **4 936** | **-** | **x** | **x** | **4 885** | **4 885** | **-** |

# Notes to the financial statements (cont.)

(In PLN thousand)

| | CHANGES IN TEMPORARY DIFFERENCES IN 2015 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | OPENING BALANCE | | | CHANGES RECOGNIZED | | CHANGES RESULTING FROM CHANGES IN THE SCOPE OF CONSOLIDATION AND OTHER | | CLOSING BALANCE | | |
| | TOTAL DEFERRED TAX | RECOGNIZED IN THE INCOME STATEMENT | IN EQUITY | IN THE INCOME STATEMENT | IN EQUITY | RECOGNIZED IN THE INCOME STATEMENT | IN EQUITY | TOTAL DEFERRED TAX | RECOGNIZED IN THE INCOME STATEMENTS | IN EQUITY |
| **DEFFERED TAX LIABILITY** | | | | | | | | | | |
| Accrued income – securities | - | - | - | - | - | - | - | - | - | - |
| Accrued income – loans | 104 485 | 104 485 | - | 24 055 | - | - | - | 128 540 | 128 540 | - |
| Change in revaluation of financial assets | 258 875 | 113 075 | 145 800 | (93 473) | (62 789) | 59 | 118 | 102 790 | 19 661 | 83 129 |
| Accelerated depreciation | 125 491 | 125 491 | - | (2 165) | - | - | - | 123 326 | 123 326 | - |
| Investment relief | 6 459 | 6 459 | - | (735) | - | - | - | 5 724 | 5 724 | - |
| Other | 90 351 | 90 351 | - | (233) | - | - | - | 90 118 | 90 118 | - |
| **Gross deferred tax liability** | **585 661** | **439 861** | **145 800** | **(72 551)** | **(62 789)** | **59** | **118** | **450 498** | **367 369** | **83 129** |
| **DEFFERED TAX ASSET** | | | | | | | | | | |
| Accrued expenses – securities | 97 700 | 97 700 | - | (74 334) | - | - | - | 23 366 | 23 366 | - |
| Accrued expenses – loans and deposits | 40 482 | 40 482 | - | 4 857 | - | - | - | 45 339 | 45 339 | - |
| Downward revaluation of financial assets | 298 354 | 298 354 | - | (44 155) | - | 2 759 | - | 256 958 | 256 958 | - |
| Income received to be amortized over time from loans and current accounts | 156 639 | 156 639 | - | 17 458 | - | - | - | 174 097 | 174 097 | - |
| Loan provision expenses | 524 936 | 524 936 | - | (31 608) | - | - | - | 493 328 | 493 328 | - |
| Personnel related provisions | 105 139 | 86 205 | 18 934 | 9 942 | (2 451) | 2 027 | - | 114 657 | 98 174 | 16 483 |
| Accruals | 25 331 | 25 331 | - | (5 814) | - | - | - | 19 517 | 19 517 | - |
| Previous year loss | - | - | - | (1 412) | - | 11 445 | - | 10 033 | 10 033 | - |
| Other | 212 406 | 212 406 | - | (15 536) | - | 26 601 | - | 223 471 | 223 471 | - |
| **Gross deferred tax asset** | **1 460 987** | **1 442 053** | **18 934** | **(140 602)** | **(2 451)** | **42 832** | **-** | **1 360 766** | **1 344 283** | **16 483** |
| **Deferred tax expenses** | **x** | **x** | **x** | **(68 051)** | **60 338** | **42 773** | **(118)** | **x** | **x** | **x** |
| **Net deferred tax assets** | **877 419** | **1 004 285** | **(126 866)** | **x** | **x** | **x** | **x** | **915 204** | **981 850** | **(66 646)** |
| **Net deferred tax provision** | **2 093** | **2 093** | **-** | **x** | **x** | **x** | **x** | **4 936** | **4 936** | **-** |

(In PLN thousand)

In the opinion of the Group the deferred tax asset in the amount of PLN 1 003 351 thousand reported as at 31 December 2016 is sustainable in total amount. The analysis was performed based on the past results of the Group's companies and assumed results in the future periods. The analysis assumed the five years' time horizon.

As at 31 December 2016 and 31 December 2015, there were temporary differences related to investments in subsidiaries and associates, for which deferred tax liability was not created as a result of meeting the conditions of controlling the terms of temporary differences' reversing and being probable that these differences will not reverse in foreseeable future.

The table below presents the amount of negative temporary differences, unrecognized tax losses, unutilized tax reliefs, in relation to which deferred tax asset was not recognized in the statement of financial position as well as the expiration date of temporary differences.

| EXPIRATION YEAR OF TEMPORARY DIFFERENCES | AMOUNT OF DIFFERENCES AS AT 31.12.2016 | AMOUNT OF DIFFERENCES AS AT 31.12.2015 |
|---|---|---|
| 2016 | - | 20 753 |
| 2017 | 13 242 | 13 193 |
| 2018 | 14 165 | 10 150 |
| 2019 | 7 730 | 8 801 |
| 2020 | 313 | 888 |
| 2021 | - | - |
| No time limits | 32 043 | 26 448 |
| **Total** | **67 493** | **80 233** |

## 22. Earnings per share

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

| | 2016 | 2015 |
|---|---|---|
| Net profit | 2 279 275 | 2 292 459 |
| Weighted average number of ordinary shares in the period | 262 470 034 | 262 470 034 |
| Earnings per share (in PLN per share) | 8.68 | 8.73 |

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

As at 31 December 2016 there no diluting instruments in the form of convertible bonds in the Group.

| | 2016 | 2015 |
|---|---|---|
| Net profit | 2 279 275 | 2 292 459 |
| Weighted average number of ordinary shares in the period | 262 470 034 | 262 470 034 |
| Weighted average number of ordinary shares for the purpose of calculation of diluted earnings per share | 262 470 034 | 262 470 034 |
| Diluted earnings per share (in PLN per share) | 8.68 | 8.73 |

# Notes to the financial statements (cont.)

(In PLN thousand)

## 23. Dividend proposal

The Management Board of the Bank has decided to propose to the Ordinary General Meeting of Shareholders a dividend payment for 2016 in the amount of PLN 8.68 per share. Total dividend proposed to be paid amounts to 2 278 240 thousand. The dividend has not been recognized as liabilities and there are no tax consequences for the Bank.

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

## 24. Cash and balances with Central Bank

| CASH AND DUE FROM CENTRAL BANK | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Cash | 2 639 532 | 2 951 414 |
| Current account at Central Bank | 1 718 775 | 4 930 181 |
| Other | 1 514 604 | 12 |
| **Total** | **5 872 911** | **7 881 607** |

| AMOUNTS DUE TO CENTRAL BANK | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Term deposits | 6 091 | 914 |
| **Total** | **6 091** | **914** |

Cash and balances with Central Bank by currencies

| 31.12.2016 | ASSETS | LIABILITIES |
|---|---|---|
| PLN | 4 944 326 | 6 091 |
| EUR | 443 480 | - |
| USD | 260 015 | - |
| CHF | 59 727 | - |
| Other currencies | 165 363 | - |
| **Total** | **5 872 911** | **6 091** |

| 31.12.2015 | ASSETS | LIABILITIES |
|---|---|---|
| PLN | 6 900 383 | 914 |
| EUR | 513 012 | - |
| USD | 247 073 | - |
| CHF | 64 635 | - |
| Other currencies | 156 504 | - |
| **Total** | **7 881 607** | **914** |

During the day, the Bank may use funds from the mandatory reserve account for ongoing payments pursuant to an instruction, submitted to the National Bank of Poland. It must, however, ensure that the average monthly balance on such accounts comply with the requirements described in the mandatory reserve declaration.

As at 31 December 2016 the interest rate of funds held on the mandatory reserve account is at 1.35% (0.9 of NBP reference rate). As at 31 December 2015 the interest rate was at 1.35% (0.9 of rediscount rate for bills of exchange).

(In PLN thousand)

## 25. Loans and advances to banks

Loans and advances to banks by product type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Current accounts | 118 142 | 89 553 |
| Interbank placements | 267 828 | 3 461 155 |
| Loans and advances | 34 517 | 59 224 |
| Cash collateral | 1 771 842 | 1 675 589 |
| Reverse repo transactions | 703 635 | 1 757 063 |
| Cash in transit | 379 858 | 291 914 |
| **Total gross amount** | **3 275 822** | **7 334 498** |
| Impairment allowances | (17 993) | (19 774) |
| **Total net amount** | **3 257 829** | **7 314 724** |

Loans and advances to banks by quality

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Loans and advances to banks, including: | | |
| non impaired (gross) | 3 257 830 | 7 314 771 |
| impaired (gross) | 17 992 | 19 727 |
| individual impairment allowances | (8 192) | (9 927) |
| collective impairment allowances (*) | (9 801) | (9 847) |
| **Total** | **3 257 829** | **7 314 724** |

(*) Including estimated impairment allowances for losses incurred but not reported (IBNR).

Loans and advances to banks by contractual maturities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Loans and advances to banks, including: | | |
| up to 1 month | 3 178 259 | 6 919 511 |
| between 1 and 3 months | 345 | 11 481 |
| between 3 months and 1 year | 69 684 | 21 852 |
| between 1 and 5 years | 47 | 351 334 |
| over 5 years | 2 | 2 |
| past due | 27 485 | 30 318 |
| **Total gross amount** | **3 275 822** | **7 334 498** |
| Impairment allowances | (17 993) | (19 774) |
| **Total net amount** | **3 257 829** | **7 314 724** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Loans and advances to banks by currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 1 012 264 | 2 758 456 |
| CHF | 19 462 | 30 586 |
| EUR | 2 010 070 | 1 959 303 |
| USD | 68 792 | 2 214 880 |
| Other currencies | 147 241 | 351 499 |
| **Total** | **3 257 829** | **7 314 724** |

Changes in the level of impairment allowances in 2016 and 2015 are presented in the Note 18.

## 26. Financial assets and liabilities held for trading

Financial assets and liabilities held for trading by product type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **FINANCIAL ASSETS** | | |
| Debt securities | 730 750 | 1 124 717 |
| Equity securities | 1 719 | 2 075 |
| **Total financial assets** | **732 469** | **1 126 792** |
| **FINANCIAL LIABILITIES** | | |
| Debt securities | 673 165 | 611 442 |
| **Total financial liabilities** | **673 165** | **611 442** |

Debt securities held for trading

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **FINANCIAL ASSETS** | | |
| Debt securities issued by State Treasury | 654 918 | 1 003 007 |
| T- bills | - | - |
| T- bonds | 654 918 | 1 003 007 |
| Debt securities issued by banks | 9 719 | 45 590 |
| Debt securities issued by business entities | 66 113 | 76 120 |
| Debt securities issued by local governments | - | - |
| **Total financial assets** | **730 750** | **1 124 717** |
| **FINANCIAL LIABILITIES** | | |
| Debt securities issued by State Treasury | 673 165 | 611 442 |
| T- bonds | 673 165 | 611 442 |
| **Total financial liabilities** | **673 165** | **611 442** |

Equity securities held for trading

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Shares | 1 719 | 2 075 |
| **Total** | **1 719** | **2 075** |

(In PLN thousand)

Debt securities held for trading by maturity

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **FINANCIAL ASSETS** | | |
| Debt securities, including: | | |
| up to 1 month | - | 39 222 |
| between 1 and 3 months | 239 | 23 294 |
| between 3 months and 1 year | 117 804 | 358 297 |
| between 1 and 5 years | 324 868 | 163 737 |
| over 5 years | 278 120 | 532 443 |
| unspecified term | 9 719 | 7 724 |
| **Total financial assets** | **730 750** | **1 124 717** |
| **FINANCIAL LIABILITIES** | | |
| Debt securities, including: | | |
| up to 1 month | 102 076 | - |
| between 1 and 3 months | - | - |
| between 3 months and 1 year | 131 194 | 170 729 |
| between 1 and 5 years | 263 435 | 382 663 |
| over 5 years | 176 460 | 58 050 |
| **Total financial liabilities** | **673 165** | **611 442** |

Debt securities held for trading by currency

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **FINANCIAL ASSETS** | | |
| PLN | 710 575 | 1 110 529 |
| EUR | 5 629 | 10 072 |
| USD | 14 546 | 4 116 |
| **Total financial assets** | **730 750** | **1 124 717** |
| **FINANCIAL LIABILITIES** | | |
| PLN | 673 165 | 611 442 |
| **Total financial liabilities** | **673 165** | **611 442** |

## 27. Derivative financial instruments (held for trading)

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

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

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

# Notes to the financial statements (cont.)

(In PLN thousand)

Foreign exchange options with delivery are defined as contracts, where one of the parties, i.e. the option buyer, purchases from the other party, referred to as the option writer, at a so-called premium price the right without the obligation to buy (call option) or to sell (put option), at a specified point of time in the future or during a specified time range a foreign currency amount specified in the contract at the exchange rate set during the conclusion of the option agreement.

In case of options settled in net amounts, upon acquisition of the rights, the buyer receives an amount of money equal to the product of notional and difference between spot ad strike price.

Barrier option with one barrier is a type of option where exercise of the option depends on the underlying crossing or reaching a given barrier level. A barrier may be reached starting from lower ('UP') or from higher ('DOWN') level of the underlying instrument. 'IN' options start their lives worthless and only become active when a predetermined knock-in barrier price is breached. 'OUT' options start their lives active and become null and void when a certain knock-out barrier price is breached.
Foreign exchange options are priced using the Garman-Kohlhagen valuation model (and in case of barrier and Asian options using the so-called expanded Garman-Kohlhagen model). Parameters of the model based on market quotations of plain-vanilla at-the-money options and market spreads for out-of-the-money and in-the-money options (volatility smile) for standard maturities.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Risk involved in financial derivatives**
Market risk and credit risk are the basic types of risk, associated with derivatives.

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

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

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

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

# Notes to the financial statements (cont.)

(In PLN thousand)

Fair value of trading derivatives

| 31.12.2016 | ASSETS | LIABILITIES |
|---|---|---|
| Interest rate transactions | | |
| Interest Rate Swaps (IRS) | 1 517 526 | 1 503 394 |
| Forward Rate Agreements (FRA) | 347 | 155 |
| Options | 1 837 | 1 710 |
| Other | 426 | 618 |
| Foreign currency and gold transactions | | |
| Cross-Currency Interest Rate Swaps (CIRS) | 49 978 | 161 421 |
| Currency Forward Agreements | 183 636 | 84 759 |
| Currency Swaps (FX–Swap) | 62 207 | 93 089 |
| Options for currency and for gold | 52 971 | 53 605 |
| Transactions based on equity securities and stock indexes | | |
| Options | 5 403 | 5 422 |
| Other | 1 | 9 723 |
| Transactions based on commodities and precious metals | | |
| Options | 2 113 | 1 971 |
| Other | 36 984 | 36 807 |
| **Total** | **1 913 429** | **1 952 674** |

| 31.12.2015 | ASSETS | LIABILITIES |
|---|---|---|
| Interest rate transactions | | |
| Interest Rate Swaps (IRS) | 2 866 458 | 2 857 159 |
| Forward Rate Agreements (FRA) | 960 | 906 |
| Options | 10 129 | 10 046 |
| Other | 3 515 | 3 278 |
| Foreign currency and gold transactions | | |
| Cross-Currency Interest Rate Swaps (CIRS) | 28 626 | 99 948 |
| Currency Forward Agreements | 80 894 | 76 309 |
| Currency Swaps (FX-Swap) | 134 707 | 70 979 |
| Options for currency and gold | 44 658 | 41 557 |
| Transactions based on equity securities and stock indexes | | |
| Options | 8 366 | 8 366 |
| Other | 28 | 7 725 |
| Transactions based on commodities and precious metals | | |
| Options | 12 120 | 12 182 |
| Other | 15 986 | 15 873 |
| **Total** | **3 206 447** | **3 204 328** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Nominal value of trading derivatives

| 31.12.2016 | CONTRACTUAL MATURITY | | | | | TOTAL |
|---|---|---|---|---|---|---|
| | UP TO 1MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | |
| Interest rate transactions | | | | | | |
| Interest Rate Swaps (IRS) | 2 064 679 | 2 846 675 | 11 640 203 | 51 529 159 | 12 317 504 | 80 398 220 |
| Forward Rate Agreements (FRA) | 275 000 | 750 000 | 300 000 | - | - | 1 325 000 |
| Options | 700 000 | 604 917 | 857 351 | 3 907 471 | 165 096 | 6 234 835 |
| Other | 458 475 | - | - | - | - | 458 475 |
| Foreign currency and gold transactions | | | | | | |
| Cross-Currency Interest Rate Swaps (CIRS) - currency bought | - | 413 339 | 652 407 | 1 959 424 | 1 071 214 | 4 096 384 |
| Cross-Currency Interest Rate Swaps (CIRS) - currency sold | - | 427 850 | 665 328 | 2 022 765 | 1 086 332 | 4 202 275 |
| Currency Forward Agreements - currency bought | 6 765 791 | 2 525 196 | 3 177 714 | 1 337 691 | - | 13 806 392 |
| Currency Forward Agreements - currency sold | 6 791 531 | 2 541 317 | 3 101 465 | 1 346 657 | - | 13 780 970 |
| Currency Swaps (FX-Swap) – currency bought | 13 380 696 | 2 643 905 | 2 799 405 | 115 108 | - | 18 939 114 |
| Currency Swaps (FX-Swap) – currency sold | 13 369 780 | 2 644 057 | 2 797 880 | 110 600 | - | 18 922 317 |
| Options bought | 463 120 | 540 425 | 2 526 286 | 186 400 | - | 3 716 231 |
| Options sold | 465 995 | 545 333 | 2 538 592 | 186 400 | - | 3 736 320 |
| Transactions based on equity securities and stock indexes | | | | | | |
| Options | - | - | - | 73 865 | - | 73 865 |
| Other | - | 863 | 1 037 | - | 21 000 | 22 900 |
| Transactions based on commodities and precious metals | | | | | | |
| Options | 8 693 | 13 039 | 80 418 | - | - | 102 150 |
| Other | 61 558 | 78 176 | 218 647 | 272 791 | - | 631 172 |
| **Total** | **44 805 318** | **16 575 092** | **31 356 733** | **63 048 331** | **14 661 146** | **170 446 620** |

# Notes to the financial statements (cont.)

(In PLN thousand)

| 31.12.2015 | CONTRACTUAL MATURITY | | | | | TOTAL |
|---|---|---|---|---|---|---|
| | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | |
| Interest rate transactions | | | | | | |
| Interest Rate Swaps (IRS) | 5 430 113 | 7 313 716 | 11 740 420 | 71 051 076 | 16 922 760 | 112 458 085 |
| Forward Rate Agreements (FRA) | 2 710 000 | 1 715 000 | 2 600 000 | - | - | 7 025 000 |
| Options | - | - | 449 753 | 4 067 896 | - | 4 517 649 |
| Other | 2 151 319 | - | - | - | - | 2 151 319 |
| Foreign currency and gold transactions | | | | | | |
| Cross-Currency Interest Rate Swaps (CIRS) - currency bought | - | - | 190 050 | 1 767 090 | 738 117 | 2 695 257 |
| Cross-Currency Interest Rate Swaps (CIRS) - currency sold | - | - | 191 768 | 1 824 407 | 738 117 | 2 754 292 |
| Currency Forward Agreements - currency bought | 5 449 992 | 1 556 316 | 2 378 828 | 1 490 042 | - | 10 875 178 |
| Currency Forward Agreements - currency sold | 5 466 131 | 1 564 270 | 2 392 129 | 1 489 816 | - | 10 912 346 |
| Currency Swaps (FX-Swap) – currency bought | 9 712 492 | 4 346 841 | 3 556 983 | 44 767 | - | 17 661 083 |
| Currency Swaps (FX-Swap) – currency sold | 9 724 187 | 4 295 106 | 3 510 929 | 43 527 | - | 17 573 749 |
| Options bought | 449 287 | 437 335 | 2 339 376 | 1 921 686 | - | 5 147 684 |
| Options sold | 448 167 | 437 504 | 2 335 255 | 1 921 686 | - | 5 142 612 |
| Transactions based on equity securities and stock indexes | | | | | | |
| Options | 83 326 | 81 857 | - | - | - | 165 183 |
| Other | - | 941 | 684 | - | 21 000 | 22 625 |
| Transactions based on commodities and precious metals | | | | | | |
| Options | 55 650 | 38 465 | 180 543 | 23 048 | - | 297 706 |
| Other | 647 | 3 652 | 143 299 | 20 985 | - | 168 583 |
| **Total** | **41 681 311** | **21 791 003** | **32 010 017** | **85 666 026** | **18 419 994** | **199 568 351** |

# Notes to the financial statements (cont.)

(In PLN thousand)

## 28. Loans and advances to customers

Loans and advances to customers by product type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Mortgage loans | 54 713 809 | 49 231 194 |
| Current accounts | 10 599 898 | 11 230 205 |
| Operating loans | 13 897 871 | 15 070 467 |
| Investment loans | 16 810 632 | 17 071 901 |
| Cash loans | 10 211 931 | 9 087 671 |
| Payment cards receivables | 970 673 | 873 287 |
| Factoring | 2 890 930 | 2 610 926 |
| Other loans and advances | 1 595 088 | 1 855 173 |
| Debt securities | 12 451 372 | 12 376 949 |
| Reverse repo transactions | - | 4 755 472 |
| Cash in transit | 89 682 | 70 587 |
| **Total gross amount** | **124 231 886** | **124 233 832** |
| Impairment allowances | (5 542 619) | (5 678 633) |
| **Total net amount** | **118 689 267** | **118 555 199** |

Loans and advances to customers by customer type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Corporate | 55 257 059 | 58 541 698 |
| Individuals | 58 379 647 | 54 155 797 |
| Budget entities | 10 595 180 | 11 536 337 |
| **Total gross amount** | **124 231 886** | **124 233 832** |
| Impairment allowances | (5 542 619) | (5 678 633) |
| **Total net amount** | **118 689 267** | **118 555 199** |

Loans and advances to customers by quality

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Loans and advances to customers, including: | | |
| non impaired (gross) | 116 571 271 | 116 339 786 |
| impaired (gross) | 7 660 615 | 7 894 046 |
| individual impairment allowances | (3 189 149) | (3 248 513) |
| collective impairment allowances (*) | (2 353 470) | (2 430 120) |
| **Total** | **118 689 267** | **118 555 199** |

(*) Including estimated impairment allowances for losses incurred but not reported (IBNR).

# Notes to the financial statements (cont.)

(In PLN thousand)

Loans and advances to customers by contractual maturities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Loans and advances to customers, including: | | |
| up to 1 month | 15 184 650 | 17 494 117 |
| between 1 and 3 months | 3 050 503 | 4 172 392 |
| between 3 months and 1 year | 12 393 167 | 12 542 056 |
| between 1 and 5 years | 37 323 318 | 37 537 504 |
| over 5 years | 50 359 575 | 46 398 538 |
| past due | 5 920 673 | 6 089 225 |
| **Total gross amount** | **124 231 886** | **124 233 832** |
| Impairment allowances | (5 542 619) | (5 678 633) |
| **Total net amount** | **118 689 267** | **118 555 199** |

Loans and advances to customers by currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 96 647 980 | 98 406 507 |
| CHF | 4 640 419 | 4 975 796 |
| EUR | 13 934 872 | 11 871 781 |
| USD | 3 289 584 | 3 198 687 |
| Other currencies | 176 412 | 102 428 |
| **Total** | **118 689 267** | **118 555 199** |

Changes in impairment allowances in 2016 and 2015 are presented in the Note 18.

## 29. Receivables from finance leases

The Group conducts leasing operations through its subsidiary Pekao Leasing Sp. z o.o.

The value of gross lease investments and minimum lease payments are follows as

| 31.12.2016 | GROSS LEASING INVESTMENT | PRESENT VALUE OF MINIMUM LEASING PAYMENTS |
|---|---|---|
| Up to 1 year | 1 632 601 | 1 492 018 |
| Between 1 and 5 years | 2 520 358 | 2 353 845 |
| Over 5 years | 322 590 | 295 727 |
| **Total** | **4 475 549** | **4 141 590** |
| Unrealized financial income | (333 959) | |
| **Net leasing investment** | **4 141 590** | |
| Unguaranteed residual values accruing to the benefit of the lessor | - | |
| Present value of minimum lease payments | 4 141 590 | |
| Impairment allowances | (166 947) | |
| **Balance sheet value** | **3 974 643** | |

# Notes to the financial statements (cont.)

(In PLN thousand)

The value of gross lease investments and minimum lease payments are follows as

| 31.12.2015 | GROSS LEASING INVESTMENT | PRESENT VALUE OF MINIMUM LEASING PAYMENTS |
|---|---|---|
| Up to 1 year | 1 464 287 | 1 355 346 |
| Between 1 and 5 years | 2 156 562 | 2 037 787 |
| Over 5 years | 284 717 | 274 550 |
| **Total** | **3 905 566** | **3 667 683** |
| Unrealized financial income | (237 883) | |
| **Net leasing investment** | **3 667 683** | |
| Unguaranteed residual values accruing to the benefit of the lessor | - | |
| Present value of minimum lease payments | 3 667 683 | |
| Impairment allowances | (163 704) | |
| **Balance sheet value** | **3 503 979** | |

The Group is acting as a lessor in finance leases mainly for transport vehicles, machines and equipment.

Moreover, when the Group is a lessee in a finance lease contract among the Group entities, the inter-company transactions relating to the finance lease are eliminated in the consolidated financial statements.

Lease financing receivables from banks by quality

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Receivables from financial leases from banks, including: | | |
| non impaired (gross) | 704 | 4 334 |
| impaired (gross) | - | - |
| individual impairment allowances | - | - |
| collective impairment allowances (*) | (6) | (11) |
| **Total** | **698** | **4 323** |

(*) Including estimated impairment allowances for losses, incurred but not reported (IBNR).

Lease financing receivables from customers by quality

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Receivables from financial leases from customers, including: | | |
| non impaired (gross) | 3 934 980 | 3 435 904 |
| impaired (gross) | 205 906 | 227 445 |
| individual impairment allowances | (30 047) | (31 556) |
| collective impairment allowances (*) | (136 894) | (132 137) |
| **Total** | **3 973 945** | **3 499 656** |

(*) Including estimated impairment allowances for losses, incurred but not reported (IBNR).

Receivables from finance leases by currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 2 450 665 | 2 227 320 |
| CHF | 1 416 | 2 390 |
| EUR | 1 522 242 | 1 270 687 |
| USD | 320 | 3 582 |
| **Total** | **3 974 643** | **3 503 979** |

Changes in impairment allowances in 2016 and 2015 are presented in the Note 18.

# Notes to the financial statements (cont.)

(In PLN thousand)

## 30. Hedge accounting

As at 31 December 2016 the Group applies fair value hedge accounting and cash flow hedge accounting.

In the period from 1 January to 31 December 2016 the Group continued to apply the following hedge accounting:

- fair value hedge accounting for fixed coupon debt securities classified as available-for-sale (AFS) hedged with interest rate swap (IRS) transactions – described in point 1 of the table with details of hedging relationships,
- cash flow hedge accounting for floating-rate financial assets and liabilities hedged with cross-currency interest rate swap (CIRS) transactions – described in point 2 of the table with details of hedging relationships,
- cash flow hedge accounting for floating-rate financial assets hedged with interest rate swap (IRS) transactions – described in point 3 of the table with details of hedging relationships,
- cash flow hedge accounting for variable portfolio of loans in EUR and USD hedged with FX-Swap instruments – described in point 4 of the table with details of hedging relationships,
- fair value hedge accounting for fixed coupon debt securities classified as loans and receivables hedged with interest rate swaps (IRS) – described in point 5 of the table with details of hedging relationships.

In the period from 1 January to 31 December 2016 the Group designated to the hedge accounting the hedging relationship and terminated the relationship – cash flow hedge accounting for highly probable cash flow denominated in EUR (long position in EUR for the Group) hedged with foreign exchange forward transactions (a series of FX-Spot and FX-Swap transactions) - described in point 6 of the table with details of hedging relationships. Termination of the relationship resulted from settlement of transactions included in the hedging relationship. Last cash flows from hedged items occurred on 27 June 2016.

The table below presents the fair values of hedging derivatives

| 31.12.2016 | ASSETS | LIABILITIES |
|---|---|---|
| Fair value hedge accounting | | |
| Interest rate swaps (IRS) | 14 683 | 267 311 |
| Cross-currency interest rate swaps (CIRS) | - | - |
| Cash flow hedge accounting | | |
| Interest rate swaps (IRS) | 263 752 | - |
| Cross-currency interest rate swaps (CIRS) | - | 1 370 905 |
| Currency Swaps (FX–Swap) | 11 317 | 502 |
| **Total** | **289 752** | **1 638 718** |

| 31.12.2015 | ASSETS | LIABILITIES |
|---|---|---|
| Fair value hedge accounting | | |
| Interest rate swaps (IRS) | 5 737 | 269 817 |
| Cross-currency interest rate swaps (CIRS) | - | - |
| Cash flow hedge accounting | | |
| Interest rate swaps (IRS) | 355 731 | - |
| Cross-currency interest rate swaps (CIRS) | 56 840 | 1 431 956 |
| Currency Swaps (FX–Swap) | 3 332 | 986 |
| **Total** | **421 640** | **1 702 759** |

# Notes to the financial statements (cont.)

(In PLN thousand)

The table below presents nominal values of hedging derivatives

| 31.12.2016 | CONTRACTS ACCORDING TO MATURITIES | | | | | TOTAL |
|---|---|---|---|---|---|---|
| | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | |
| Fair value hedge accounting | | | | | | |
| Interest rate swaps (IRS) | - | 553 000 | - | 1 627 612 | 2 113 964 | 4 294 576 |
| Cross-currency interest rate swaps (CIRS) | - | - | - | - | - | - |
| Cash flow hedge accounting | | | | | | |
| Interest rate swaps (IRS) | - | 25 000 | 150 000 | 3 600 000 | - | 3 775 000 |
| Cross-currency interest rate swaps (CIRS) | 867 025 | - | 1 033 820 | 9 883 752 | 4 079 680 | 15 864 277 |
| Currency Swaps (FX–Swap) | - | 892 450 | 1 297 025 | - | - | 2 189 475 |
| **Total** | **867 025** | **1 470 450** | **2 480 845** | **15 111 364** | **6 193 644** | **26 123 328** |

| 31.12.2015 | CONTRACTS ACCORDING TO MATURITIES | | | | | TOTAL |
|---|---|---|---|---|---|---|
| | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | |
| Fair value hedge accounting | | | | | | |
| Interest rate swaps (IRS) | - | - | - | 1 511 172 | 1 451 033 | 2 962 205 |
| Cross-currency interest rate swaps (CIRS) | - | - | - | - | - | - |
| Cash flow hedge accounting | | | | | | |
| Interest rate swaps (IRS) | - | - | 215 000 | 3 775 000 | - | 3 990 000 |
| Cross-currency interest rate swaps (CIRS) | - | - | 2 708 866 | 10 972 969 | 4 507 339 | 18 189 174 |
| Currency Swaps (FX–Swap) | 992 573 | 777 310 | 212 988 | - | - | 1 982 871 |
| **Total** | **992 573** | **777 310** | **3 136 854** | **16 259 141** | **5 958 372** | **27 124 250** |

The table below presents the amounts recognized in the income statement and in the revaluation reserves due to cash flow hedge accounting

| | 2016 | 2015 |
|---|---|---|
| Revaluation reserves (deferral of fair value changes of hedging instruments related to the portion recognized as effective hedge - gross value) | 39 724 | 45 280 |
| Net interest income on hedging derivatives | 212 587 | 208 571 |
| Ineffective portion in changes in fair value of hedging transactions recognized in income statement | (756) | 795 |

The table below presents changes in the revaluation reserves during the period due to cash flow hedge accounting

| | 2016 | 2015 |
|---|---|---|
| **Opening balance** | **45 280** | **138 621** |
| Deferral of fair value changes of hedging instruments related to the portion recognized as effective hedge | (5 451) | (93 277) |
| Amount of the deferral of fair value changes of hedging instruments of the effective hedge removed from revaluation reserves and presented in net profit or loss | (105) | (64) |
| **Closing balance** | **39 724** | **45 280** |

# Notes to the financial statements (cont.)

(In PLN thousand)

The table below presents the amounts recognized in the income statement due to the fair value hedge accounting

| TYPE OF GAINS/LOSSES | 2016 | 2015 |
|---|---|---|
| Gains/losses from revaluation of hedging instruments to fair value | 26 502 | 40 167 |
| Gains/losses from revaluation of hedged item associated with hedged risk to fair value | (25 189) | (34 620) |
| **Result on fair value hedge accounting** | **1 313** | **5 547** |
| Net interest income of hedging derivatives | (73 721) | (57 637) |

Detailed description of hedging relationships applied by the Group during the period from 1 January to 31 December 2016

| DESCRIPTION OF THE HEDGING RELATIONSHIP | HEDGED ITEM | HEDGING DERIVATIVES | FINANCIAL STATEMENTS PRESENTATION | PERIOD IN WHICH THE CASH FLOWS RELATED TO THE HEDGED ITEMS ARE EXPECTED TO OCCUR |
|---|---|---|---|---|
| **1. Fair value hedge of fixed-coupon debt securities** | | | | |
| The Group hedges a portion of the interest rate risk resulting from the fair value changes of the hedged item related to the volatility of market swap curves with the designated IRS transactions. | The hedged items are fixed coupon debt securities classified as AFS, denominated in PLN, EUR and USD. | The hedging derivatives consist of IRS transactions in PLN, EUR and USD (short position in fixed-rate) for which the Group receives floating-rate payments, and pays fixed-rate. | The result of the change in the hedged items' fair value that relates to the hedged risk is presented in the income statement line item 'Result on fair value hedge accounting'. The remaining portion of the change in the hedged items' fair value (resulting from spread between swap yield curve and bond yield curve) is recognized in accordance with the accounting principles applicable to AFS (i.e. in the revaluation reserve in equity). Interest accrued on AFS bonds is presented in the net interest income.<br>Changes in the fair value of hedging derivatives under the fair value hedge accounting are presented in the income statement line item 'Result on fair value hedge accounting'. Interest accrued on the hedging derivatives under the fair value hedge accounting is presented in the net interest income. | It is expected that the cash flows related to the hedged items will occur until 18 January 2036. |
| **2. Cash flow hedge of floating-rate loans and floating-rate deposits** | | | | |
| The Group hedges a portion of the interest rate risk and the foreign currency risk resulting from the volatility of cash flows from floating-rate assets and liabilities with the designated CIRS transactions (basis swap). | Hedged item consists of two separate components, which are cash flows arising from floating-rate assets portfolio and floating-rate liabilities portfolio. | Hedging derivatives consist of a portfolio of CIRS transactions (basis swap), where the Group pays floating-rate currency cash flows, and receives floating-rate PLN/currency cash-flows. CIRS transactions are decomposed into the part hedging the assets portfolio and the part hedging the liabilities portfolio. | The effective portion of the change in fair value of hedging derivatives' is recognized in the revaluation reserve in equity. The ineffective portion of the change in fair value of hedging derivatives is recognized in the result on financial assets and liabilities held for trading. The interest on CIRS transactions and hedged items is presented in the net interest income. | It is expected that the cash flows related to the hedged items will occur until 15 May 2029. |
| **3. Cash flow hedge of floating-rate loans** | | | | |
| The Group hedges a portion of the interest rate risk related to the volatility of cash flows on floating-rate assets with the designated IRS transactions. | The hedged items consist of the cash flows from floating-rate assets. | The hedging derivatives consist of portfolio of IRS transactions (short position in floating rate – the Group receives fixed payments and pays floating-rate). | The effective portion of the change in fair value of hedging derivatives is recognized in the revaluation reserve in equity. The ineffective portion of change in fair value hedging derivatives is recognized in the result on financial assets and liabilities held for trading. The interest on IRS transactions and hedged items is presented in the net interest income. | It is expected that the cash flows related to the hedged items will occur until 29 April 2020. |

# Notes to the financial statements (cont.)

(In PLN thousand)

| DESCRIPTION OF THE HEDGING RELATIONSHIP | HEDGED ITEM | HEDGING DERIVATIVES | FINANCIAL STATEMENTS PRESENTATION | PERIOD IN WHICH THE CASH FLOWS RELATED TO THE HEDGED ITEMS ARE EXPECTED TO OCCUR |
|---|---|---|---|---|
| **4. Cash flow hedge of floating-rate currency assets hedged with FX-Swap transactions against the exchange and interest rate risk** | | | | |
| The Group hedges volatility of cash flows constituting floating-rate financial assets (loans in EUR and USD) with FX-Swap transactions. The currency and interest rate risk is hedged. | Loans with variable interest rate risk, denominated in EUR and USD constitute hedged items. | FX-Swap transaction portfolio constitutes the hedging position. | The effective portion of the change in fair value of hedging derivatives is recognized in the revaluation reserve in equity. The ineffective portion of the change in fair value of hedging derivatives is recognized in the result on financial assets and liabilities held for trading. Settled part of the swap points on the hedging instrument is transferred from the revaluation reserve in equity and recognized in interest income. Currency revaluation regarding the first capital exchange on the hedging instrument is transferred from the revaluation reserve in equity and recognized in the foreign currency exchange result. | It is expected that the cash flows related to the hedged items will occur until 18 April 2017. |
| **5. Fair value hedge of fixed-coupon debt securities** | | | | |
| The Group hedges a portion of the interest rate risk resulting from the fair value changes of the hedged item related to the volatility of market swap curves with the designated IRS transactions. | The hedged items are fixed coupon debt securities classified as loans and receivables, denominated in PLN. | The hedging derivatives consist of IRS transactions in PLN (short position in fixed-rate) for which the Group receives floating-rate payments, and pays fixed-rate. | The result of the change in the hedged items' fair value that relates to the hedged risk is presented in the income statement line item 'Result on fair value hedge accounting'. Interest accrued on bonds is presented in the net interest income. Changes in the fair value of hedging derivatives under the fair value hedge accounting are presented in the income statement line item 'Result on fair value hedge accounting'. Interest accrued on the hedging derivatives under the fair value hedge accounting is presented in the net interest income. | It is expected that the cash flows related to the hedged items will occur until 22 December 2026. |
| **6. Cash flow hedge of expected future inflows in foreign currency – relationship completed** | | | | |
| The Group hedged the volatility of cash flows denominated in EUR constituting the projected inflows from expected sales with the designated FX-Forward transactions. The currency risk was being hedged. Discontinuation of the hedge accounting resulted from settlement of transactions included in the hedging relationship. | Projected inflows dependent on EUR and Polish zloty exchange rates were the hedged item | The hedging derivatives consisted of a portfolio of FX-Forward transactions (FX-Spot and series of FX-Swap), in which the Group sold EUR currency in exchange for PLN currency on 27 June 2016 at an agreed exchange rate. | The amount of the settlement of hedging transactions adjusted the settlement of the hedged item.net interest income. | - |

## 31. Investment (placement) securities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Debt securities available for sale (AFS) | 31 949 770 | 17 517 884 |
| Equity securities available for sale (AFS) | 151 864 | 295 415 |
| Debt securities held to maturity (HTM) | 3 018 985 | 3 368 424 |
| **Total** | **35 120 619** | **21 181 723** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Debt securities available for sale (AFS)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Securities issued by State Treasury | 25 046 710 | 15 954 349 |
| T-bills | - | - |
| T-bonds | 25 046 710 | 15 954 349 |
| Securities issued by Central Banks | 5 978 629 | 628 454 |
| Securities issued by business entities | 249 912 | 251 367 |
| Securities issued by local governments | 674 519 | 683 714 |
| **Total** | **31 949 770** | **17 517 884** |
| including impairment of assets | - | - |

Equity securities available for sale (AFS)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Shares | 151 864 | 295 415 |
| **Total** | **151 864** | **295 415** |
| including impairment of assets | - | (122) |

In June 2016 the Bank has received information about the closing of the acquisition of Visa Europe Limited by Visa Inc. As a result of the settlement of this transaction the Bank has recognized in the financial statements for 2016:

- the cash received in the amount of EUR 43.6 million, equivalent to PLN 191.4 million at the average NBP exchange rate as of 21 June 2016,
- 15 818 preferred shares of Visa Inc. Series C, whose value has been estimated by the Bank at EUR 12.7 million, which is equivalent to PLN 55.8 million according to the average NBP exchange rate as of 21 June 2016. The shares have been classified to the available for sale portfolio of securities. Preferred shares of Visa Inc. Series C will be converted into ordinary shares of Visa Inc. Conversion of all preferred shares will take place no later than 2028. Until then, the transfer of shares by the Bank is subject to restrictions. The current conversion of preferred shares into ordinary shares may be decreased until 2028, which depends on the compensation paid by Visa during this period,
- receivables from deferred payments in cash in the amount of EUR 3.8 million (ie. 16.5 million at the average NBP exchange rate as of 21 June 2016). This amount will be paid on the third anniversary of the closing date, ie. in the second quarter of 2019.

On the same time the Bank derecognised the share in Visa Europe, together with its valuation. The carrying value of the share amounted to EUR 40.9 million (PLN 179.5 million as of 21 June 2016).

As a result of the settlement, the Bank has recognized the gain of PLN 263.7 million (before tax) in the Income Statement.

Debt securities held to maturity (HTM)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Securities issued by State Treasury | 2 998 379 | 2 497 324 |
| T- bills | - | - |
| T- bonds | 2 998 379 | 2 497 324 |
| Securities issued by Central Banks | 20 606 | 871 100 |
| **Total** | **3 018 985** | **3 368 424** |
| including impairment of assets | - | - |

# Notes to the financial statements (cont.)

(In PLN thousand)

Investment debt securities according to contractual maturities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Debt securities, including: | | |
| up to 1 month | 7 424 354 | 1 499 554 |
| between 1 and 3 months | 573 661 | 443 644 |
| between 3 months and 1 year | 6 072 130 | 2 696 342 |
| between 1 and 5 years | 12 109 707 | 10 646 471 |
| over 5 years | 8 788 903 | 5 600 297 |
| **Total** | **34 968 755** | **20 886 308** |

Investment debt securities according to currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 30 844 812 | 17 835 368 |
| EUR | 2 790 183 | 2 635 034 |
| USD | 1 333 760 | 415 906 |
| **Total** | **34 968 755** | **20 886 308** |

Changes in investment (placement) securities

| | 2016 | 2015 |
|---|---|---|
| **SECURITIES AVAILABLE FOR SALE (AFS)** | | |
| **Opening balance** | **17 813 299** | **23 111 208** |
| Increases (purchase) | 89 733 305 | 217 273 604 |
| Decreases (sale and redemption) | (75 816 126) | (222 978 862) |
| Changes in fair value | (460 735) | (257 139) |
| Exchange rate differences | 170 926 | 179 036 |
| Accrued interest | 705 443 | 618 156 |
| Other changes | (44 478) | (132 704) |
| **Closing balance** | **32 101 634** | **17 813 299** |
| **DEBT SECURITIES HELD UNTIL MATURITY (HTM)** | | |
| **Opening balance** | **3 368 424** | **1 601 568** |
| Increases (purchase) | 6 660 966 | 47 236 297 |
| Decreases (sale and redemption) | (7 069 725) | (45 530 013) |
| Accrued interest | 28 096 | 21 238 |
| Other changes | 31 224 | 39 334 |
| **Closing balance** | **3 018 985** | **3 368 424** |
| **Net total investment (placement) securities** | **35 120 619** | **21 181 723** |

## 32. Reclassification of securities

IAS 39 ‘Financial Instruments: Recognition and Measurement’ and IFRS 7 ‘Financial Instruments: Disclosures’ provide, under certain conditions, the possibility for reclassification of financial instruments into other categories.

In 2016 and 2015, the Group did not reclassify any financial instruments into other categories.

On 1 October 2008, however, due to the exceptional situation related to the financial crisis, the Group made use of the possibility for reclassification of its financial instruments.

(In PLN thousand)

The tables below present the information on the reclassified financial assets

| | AMOUNT OF RECLASSIFICATION | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|---|
| | | CARRYING AMOUNT | FAIR VALUE | CARRYING AMOUNT | FAIR VALUE |
| Financial assets reclassified from Available for Sale assets to Loans and advances to customers | 1 331 580 | 64 381 | 61 109 | 68 974 | 65 191 |
| Financial assets reclassified from Held for Trading assets to Held to Maturity assets | 602 507 | 217 365 | 219 258 | 666 725 | 673 607 |
| **Total** | **1 934 087** | **281 746** | **280 367** | **735 699** | **738 798** |

If the Group failed to perform the reclassification, the income and revaluation equity would have changed as follows

| 31.12.2016 | NET INCOME FROM FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE | REVALUATION RESERVE |
|---|---|---|
| Financial assets reclassified from Available for Sale assets to Loans and advances to customers | - | 263 |
| Financial assets reclassified from Held for Trading assets to Held to Maturity assets | (5 633) | - |
| **Total** | **(5 633)** | **263** |

| 31.12.2015 | NET INCOME FROM FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE | REVALUATION RESERVE |
|---|---|---|
| Financial assets reclassified from Available for Sale assets to Loans and advances to customers | - | 127 |
| Financial assets reclassified from Held for Trading assets to Held to Maturity assets | (6 713) | - |
| **Total** | **(6 713)** | **127** |

Net interest income on reclassified financial assets

| | 2016 | 2015 |
|---|---|---|
| Financial assets reclassified from Available for Sale assets to Loans and advances to customers | 1 580 | 1 998 |
| Financial assets reclassified from Held for Trading assets to Held to Maturity assets | 10 625 | 12 770 |
| **Total** | **12 205** | **14 768** |

# 33. Assets and liabilities held for sale

According to IFRS 5 ‘Non-current Assets Held for Sale and Discontinued Operations’, the Group identified non-current assets meeting requirements of IFRS 5 (concerning classification of non-current assets as held for sale) from the item ‘Assets held for sale’.

As at 31 December 2016, non-current assets classified as held for sale are as follows:

- real estate,
- other property, plant and equipment.

# Notes to the financial statements (cont.)

(In PLN thousand)

Assets held for sale and liabilities associated with assets held for sale are presented below

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **ASSETS HELD FOR SALE** | | |
| Property, plant and equipment | 25 703 | 22 787 |
| Other assets | 22 574 | 22 515 |
| **Total assets** | **48 277** | **45 302** |

The changes in the balance of assets held for sale and liabilities associated with assets held for sale are presented in the table below

| ASSETS HELD FOR SALE | 2016 | 2015 |
|---|---|---|
| **Opening balance** | **45 302** | **37 102** |
| Increases including: | 11 541 | 51 929 |
| transfer from property, plant and equipment | 3 113 | 27 008 |
| transfer from investment properties | 8 295 | - |
| transfer from investments in associates | - | 24 119 |
| other changes | 133 | 802 |
| Decreases including: | (8 566) | (43 729) |
| transfer from property, plant and equipment | (1 250) | (13 460) |
| transfer from investment properties | (4 466) | - |
| sale of shares in associate | - | (24 119) |
| disposal | (2 820) | (5 879) |
| other changes | (30) | (271) |
| **Stan na koniec okresu** | **48 277** | **45 302** |

The effect of disposal of property, plant and equipment and other assets is as follows

| | 2016 | 2015 |
|---|---|---|
| Sales revenues | 3 849 | 5 150 |
| Net carrying amount of disposed assets (including costs to sell) | (2 820) | (5 150) |
| **Profit/loss on sale before income tax** | **1 029** | **-** |

## 34. Investments in associates

The below tables present the information about associates that are material to the Group

| NAME OF ASSOCIATE | COUNTRY OF INCORPORATION AND PLACE OF BUSINESS | PERCENTAGE OF THE GROUP'S OWNERSHIP RIGHTS IN SHARE CAPITAL/ VOTING | | MEASUREMENT METHOD | NATURE OF THE RELATIONSHIP |
|---|---|---|---|---|---|
| | | 31.12.2016 | 31.12.2015 | | |
| Dom Inwestycyjny Xelion Sp. z o.o. | Poland | 50.00 | 50.00 | Equity method | The strategic Entity providing affluent customers with services of assets management. |
| Pioneer Pekao Investment Management S.A. | Poland | 49.00 | 49.00 | Equity method | The Entity deals with management of investment funds assets and is of strategic importance for the Group that distributes and supporting such products. |

# Notes to the financial statements (cont.)

(In PLN thousand)

The summarized financial information of the associates are presented below. The information derives from the financial statements, which are in the process of auditing by the entities authorizing to audit financial statements. The audit opinions on those financial statements will be expressed after the release date of the consolidated financial statements of Bank Pekao S.A. Group.

| | DOM INWESTYCYJNY XELION SP. Z O.O. | | PIONEER PEKAO INVESTMENT MANAGEMENT S.A. | |
|---|---|---|---|---|
| | 31.12.2016 | 31.12.2015 | 31.12.2016 | 31.12.2015 |
| Current assets | 53 997 | 48 090 | 281 275 | 313 553 |
| Non-current assets | 2 175 | 3 269 | 8 605 | 9 295 |
| **TOTAL ASSETS** | **56 172** | **51 359** | **289 880** | **322 848** |
| Current liabilities | 26 380 | 26 361 | 33 299 | 35 284 |
| Non-current liabilities | 4 348 | 3 913 | 4 541 | 5 070 |
| **TOTAL LIABILITIES** | **30 728** | **30 274** | **37 840** | **40 354** |
| **NET ASSETS** | **25 444** | **21 085** | **252 040** | **282 494** |

| | DOM INWESTYCYJNY XELION SP. Z O.O. | | PIONEER PEKAO INVESTMENT MANAGEMENT S.A. | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Revenue | 57 129 | 56 331 | 324 839 | 383 019 |
| Net profit (loss) for the period from continuing operations | 4 359 | 3 930 | 74 437 | 91 284 |
| Other comprehensive income | - | - | 37 | 36 |
| **Total comprehensive income** | **4 359** | **3 930** | **74 474** | **91 320** |

Reconciliation of the summarized financial information to the carrying amount of the interests in associates

| | DOM INWESTYCYJNY XELION SP. Z O.O. | | PIONEER PEKAO INVESTMENT MANAGEMENT S.A. | | RAZEM | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Group's interest in net assets at beginning of the year | 10 542 | 8 577 | 138 423 | 141 985 | 148 965 | 150 562 |
| Group's interest in net profit (loss) for the period (*) | 2 179 | 1 965 | 36 401 | 44 649 | 38 580 | 46 614 |
| Group's interest in other comprehensive income | - | - | 18 | 18 | 18 | 18 |
| Dividend received from associates | - | - | (51 342) | (48 229) | (51 342) | (48 229) |
| Group's interest in net assets at beginning of the year | 12 721 | 10 542 | 123 500 | 138 423 | 136 221 | 148 965 |
| **Carrying amount of the interests** | **12 721** | **10 542** | **123 500** | **138 423** | **136 221** | **148 965** |

(*) Group's interest includes the changes in net profit (loss) for the previous period, that arose after the release date of financial statements of Bank Pekao S.A. Group and before the approval date of financial statements of particular associates.

# Notes to the financial statements (cont.)

(In PLN thousand)

## 35. Intangible assets

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Intangible assets, including: | 540 661 | 581 197 |
| research and development expenditures | 3 024 | 7 948 |
| licenses and patents | 455 647 | 446 987 |
| other | 7 688 | 11 183 |
| assets under construction | 74 302 | 115 079 |
| Goodwill | 55 520 | 55 520 |
| **Total** | **596 181** | **636 717** |

The goodwill was transferred to Bank Pekao S.A. on integration with Bank BPH S.A. It represents the goodwill recognized upon acquisition of Pierwszy Komercyjny Bank S.A. in Lublin (‘PKBL’) by Bank BPH S.A. and relates to those branches of the PKBL which were transferred to Bank Pekao S.A. as a result of integration with Bank BPH S.A. It is determined the smallest identifiable cash-generating units (‘CGU’), to which the goodwill has been allocated in the amount of PLN 51 675 thousand.

Moreover in the line ‘Goodwill’ are presented:

- goodwill recognized upon acquisition of Spółdzielcza Kasa Oszczędnościowo – Kredytowa im. Mikołaja Kopernika by Bank Pekao S.A. It is determined the smallest identifiable cash-generating units (‘CGU’), to which the goodwill has been allocated in the amount of PLN 960 thousand,
- goodwill recognized upon acquisition of Pekao Leasing i Finanse S.A. (formerly BPH Leasing S.A.) by Pekao Leasing Holding S.A. (ex. BPH PBK Leasing S.A.). It is determined the smallest identifiable cash-generating units (‘CGU’), to which the goodwill has been allocated in the amount of PLN 2 885 thousand.

In respect to the goodwill, the impairment test is performed annually, irrespective of whether there is any indication that it may be impaired.

The impairment test is performed by comparing the carrying amount of the CGU, including the goodwill, with the recoverable amount of the CGU. The recoverable amount is estimated on the basis of value in use of the CGU. The value in use is the present, estimated value of the future cash flows for the period of 5 years, taking into account the residual value of the CGU. The residual value of the CGU is calculated based on an extrapolation of cash flows projections beyond the forecast period using the growth rate of 2.5%. The forecasts of the future cash flows are based on the assumptions included the Bank’s budget for 2017 and financial plan for 2018-2021. To discount the future cash flows, it is applied the discount rate of 8.38%, which includes the risk-free rate and the risk premium.

The impairment test performed as at 31 December 2016 showed the surplus of the recoverable amount over the carrying amount of the CGU, and therefore no CGU impairment was recognized.

# Notes to the financial statements (cont.)

(In PLN thousand)

Changes in 'Intangibles assets' in the course of the reporting period

| 2016 | RESEARCH AND DEVELOPMENT COSTS | LICENSES AND PATENTS | OTHER | ASSETS UNDER CONSTRUCTION | TOTAL |
|---|---|---|---|---|---|
| GROSS VALUE | | | | | |
| **Opening balance** | **90 174** | **2 279 571** | **51 326** | **115 079** | **2 536 150** |
| Increases including: | - | 171 830 | 312 | 125 093 | 297 235 |
| acquisitions | - | 5 089 | - | 125 093 | 130 182 |
| other | - | 183 | - | - | 183 |
| transfer from investments outlays | - | 166 558 | 312 | - | 166 870 |
| Decreases, including: | - | (20 889) | (16 445) | (165 870) | (203 204) |
| liquidation | - | (20 621) | (16 445) | - | (37 066) |
| other | - | (268) | - | - | (268) |
| transfer from investments outlays | - | - | - | (165 870) | (165 870) |
| **Closing balance** | **90 174** | **2 430 512** | **35 193** | **74 302** | **2 630 181** |
| ACCUMULATED AMORTIZATION | | | | | |
| **Opening balance** | **82 226** | **1 832 584** | **29 182** | **-** | **1 943 992** |
| Amortization | 4 924 | 163 345 | 3 337 | - | 171 606 |
| Liquidation | - | (21 064) | (5 014) | - | (26 078) |
| Other | - | - | - | - | - |
| **Closing balance** | **87 150** | **1 974 865** | **27 505** | **-** | **2 089 520** |
| IMPAIRMENT | | | | | |
| **Opening balance** | **-** | **-** | **10 961** | **-** | **10 961** |
| Increases | - | - | - | - | - |
| Decreases | - | - | (10 961) | - | (10 961) |
| **Closing balance** | **-** | **-** | **-** | **-** | **-** |
| NET VALUE | | | | | |
| **Opening balance** | **7 948** | **446 987** | **11 183** | **115 079** | **581 197** |
| **Closing balance** | **3 024** | **455 647** | **7 688** | **74 302** | **540 661** |

(In PLN thousand)

| 2015 | RESEARCH AND DEVELOPMENT COSTS | LICENSES AND PATENTS | OTHER | ASSETS UNDER CONSTRUCTION | TOTAL |
|---|---|---|---|---|---|
| GROSS VALUE | | | | | |
| **Opening balance** | **89 362** | **2 132 059** | **49 663** | **113 316** | **2 384 400** |
| Increases including: | 812 | 157 708 | 1 677 | 154 937 | 315 134 |
| acquisitions | - | 2 826 | - | 154 937 | 157 763 |
| other | - | 36 741 | - | - | 36 741 |
| transfer from investments outlays | 812 | 118 141 | 1 677 | - | 120 630 |
| Decreases, including: | - | (10 196) | (14) | (153 174) | (163 384) |
| liquidation | - | (7 319) | - | - | (7 319) |
| other | - | (2 877) | (14) | (32 544) | (35 435) |
| transfer from investments outlays | - | - | - | (120 630) | (120 630) |
| **Closing balance** | **90 174** | **2 279 571** | **51 326** | **115 079** | **2 536 150** |
| ACCUMULATED AMORTIZATION | | | | | |
| **Opening balance** | **78 950** | **1 695 120** | **27 857** | **-** | **1 801 927** |
| Amortization | 3 276 | 144 738 | 1 340 | - | 149 354 |
| Liquidation | - | (7 228) | (15) | - | (7 243) |
| Other | - | (46) | - | - | (46) |
| **Closing balance** | **82 226** | **1 832 584** | **29 182** | **-** | **1 943 992** |
| IMPAIRMENT | | | | | |
| **Opening balance** | **-** | **-** | **10 961** | **-** | **10 961** |
| **Closing balance** | **-** | **-** | **10 961** | **-** | **10 961** |
| NET VALUE | | | | | |
| **Opening balance** | **10 412** | **436 939** | **10 845** | **113 316** | **571 512** |
| **Closing balance** | **7 948** | **446 987** | **11 183** | **115 079** | **581 197** |

In the period from 1 January to 31 December 2016, the Group acquired intangible assets in the amount of PLN 130 182 thousand (in 2015 - PLN 157 763 thousand).

In the period from 1 January to 31 December 2016 and in 2015 there have been no intangible assets whose title is restricted and pledged as security for liabilities.

**Contractual commitments**

As at 31 December 2016 the contractual commitments for the acquisition of intangible assets amounted to PLN 43 930 thousand, whereas as at 31 December 2015 - PLN 49 487 thousand.

## 36. Property, plant and equipment

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Non-current assets, including: | 1 308 234 | 1 376 409 |
| land and buildings | 1 000 882 | 1 055 147 |
| machinery and equipment | 245 479 | 245 717 |
| transport vehicles | 24 026 | 34 170 |
| other | 37 847 | 41 375 |
| Non-current assets under construction and prepayments | 114 696 | 84 243 |
| **Total** | **1 422 930** | **1 460 652** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Changes in 'Property, plant and equipment' in the course of the reporting period

| 2016 | LANDS AND BUILDINGS | MACHINERY AND EQUIPMENT | MEANS OF TRANSPORTATION | OTHER | NON-CURRENT ASSETS UNDER CONSTRUCTION AND PREPAYMENTS | TOTAL |
|---|---|---|---|---|---|---|
| GROSS VALUE | | | | | | |
| **Opening balance** | **2 278 125** | **1 452 658** | **83 169** | **326 314** | **84 826** | **4 225 092** |
| Increases, including: | 21 640 | 81 249 | 4 882 | 4 996 | 133 837 | 246 604 |
| acquisitions | 1 969 | 5 233 | 1 412 | 630 | 133 837 | 143 081 |
| other | 2 | 610 | 3 470 | 48 | - | 4 130 |
| transfer from non-current assets under construction | 19 669 | 75 406 | - | 4 318 | - | 99 393 |
| Decreases, including: | (35 556) | (64 734) | (7 291) | (10 486) | (103 967) | (222 034) |
| liquidation and sale | (32 398) | (64 257) | (7 291) | (8 837) | - | (112 783) |
| transfer to non-current assets held for sale | (2 886) | (149) | - | (78) | - | (3 113) |
| other | (272) | (328) | - | (1 571) | (4 574) | (6 745) |
| transfer from non-current assets under construction | - | - | - | - | (99 393) | (99 393) |
| **Closing balance** | **2 264 209** | **1 469 173** | **80 760** | **320 824** | **114 696** | **4 249 662** |
| ACCUMULATED DEPRECIATION | | | | | | |
| **Opening balance** | **1 219 079** | **1 203 090** | **48 999** | **284 821** | **-** | **2 755 989** |
| Increases, including: | 66 805 | 80 631 | 12 575 | 8 371 | - | 168 382 |
| depreciation | 66 805 | 80 326 | 12 575 | 8 371 | - | 168 077 |
| other | - | 305 | - | - | - | 305 |
| Decreases, including: a\\ | (26 410) | (63 814) | (4 840) | (10 333) | - | (105 397) |
| liquidation and sale | (25 385) | (63 376) | (4 783) | (10 255) | - | (103 799) |
| transfer to non-current assets held for sale | (1 025) | (147) | - | (78) | - | (1 250) |
| other | - | (291) | (57) | - | - | (348) |
| **Closing balance** | **1 259 474** | **1 219 907** | **56 734** | **282 859** | **-** | **2 818 974** |
| IMPAIRMENT | | | | | | |
| **Opening balance** | **3 899** | **3 851** | **-** | **118** | **583** | **8 451** |
| Increases | - | - | - | - | - | - |
| Decreases | (46) | (64) | - | - | (583) | (693) |
| **Closing balance** | **3 853** | **3 787** | **-** | **118** | **-** | **7 758** |
| NET VALUE | | | | | | |
| **Opening balance** | **1 055 147** | **245 717** | **34 170** | **41 375** | **84 243** | **1 460 652** |
| **Closing balance** | **1 000 882** | **245 479** | **24 026** | **37 847** | **114 696** | **1 422 930** |

# Notes to the financial statements (cont.)

(In PLN thousand)

| 2015 | LANDS AND BUILDINGS | MACHINERY AND EQUIPMENT | MEANS OF TRANSPORTATION | OTHER | NON-CURRENT ASSETS UNDER CONSTRUCTION AND PREPAYMENTS | TOTAL |
|---|---|---|---|---|---|---|
| GROSS VALUE | | | | | | |
| **Opening balance** | **2 303 114** | **1 495 518** | **94 510** | **344 297** | **86 054** | **4 323 493** |
| Increases, including: | 49 589 | 79 072 | 7 718 | 7 385 | 110 597 | 254 361 |
| acquisitions | 9 541 | 12 235 | 4 324 | 1 611 | 110 132 | 137 843 |
| other | 2 228 | 1 053 | 3 360 | 77 | 465 | 7 183 |
| transfer from non-current assets under construction | 37 820 | 65 784 | 34 | 5 697 | - | 109 335 |
| Decreases, including: | (74 578) | (121 932) | (19 059) | (25 368) | (111 825) | (352 762) |
| liquidation and sale | (29 005) | (121 719) | (11 692) | (25 335) | (53) | (187 804) |
| transfer to non-current assets held for sale | (26 956) | (52) | - | - | - | (27 008) |
| other | (18 617) | (161) | (7 367) | (33) | (2 437) | (28 615) |
| transfer from non-current assets under construction | - | - | - | - | (109 335) | (109 335) |
| **Closing balance** | **2 278 125** | **1 452 658** | **83 169** | **326 314** | **84 826** | **4 225 092** |
| ACCUMULATED DEPRECIATION | | | | | | |
| **Opening balance** | **1 196 576** | **1 230 481** | **47 209** | **298 421** | **-** | **2 772 687** |
| Increases, including: | 76 894 | 93 557 | 15 331 | 11 297 | - | 197 079 |
| depreciation | 69 957 | 84 941 | 14 923 | 10 026 | - | 179 847 |
| other | 6 937 | 8 616 | 408 | 1 271 | - | 17 232 |
| Decreases, including: a\\ | (54 391) | (120 948) | (13 541) | (24 897) | - | (213 777) |
| liquidation and sale | (33 002) | (120 742) | (13 533) | (24 883) | - | (192 160) |
| transfer to non-current assets held for sale | (13 414) | (47) | - | - | - | (13 461) |
| other | (7 975) | (159) | (8) | (14) | - | (8 156) |
| **Closing balance** | **1 219 079** | **1 203 090** | **48 999** | **284 821** | **-** | **2 755 989** |
| IMPAIRMENT | | | | | | |
| **Opening balance** | **2 565** | **3 961** | **-** | **141** | **-** | **6 667** |
| Increases | 1 560 | 35 | - | 1 | 583 | 2 179 |
| Decreases | (226) | (145) | - | (24) | - | (395) |
| **Closing balance** | **3 899** | **3 851** | **-** | **118** | **583** | **8 451** |
| NET VALUE | | | | | | |
| **Opening balance** | **1 103 973** | **261 076** | **47 301** | **45 735** | **86 054** | **1 544 139** |
| **Closing balance** | **1 055 147** | **245 717** | **34 170** | **41 375** | **84 243** | **1 460 652** |

In the period from 1 January to 31 December 2016 the Group acquired property, plant and equipment in the amount of PLN 143 081thousand (in 2015 - PLN 137 843 thousand), while the value of property, plant and equipment sold amounted to PLN 8 150 thousand (in 2015 - PLN 7 717 thousand).

The amount of compensations received from third parties for impairment of loss of property, plant and equipment items recognized in the income statement for 2016 stood at PLN 3 551 thousand (in 2015 - PLN 1 995 thousand).

In 2016 and 2015 there have been no restrictions to legal titles to property, plant and equipment, nor pledges in place as security for liabilities.

**Contractual commitments**

As at 31 December 2016 the contractual commitments for the acquisition of property, plant and equipment amounted to PLN 17 525 thousand, whereas as at 31 December 2015 - PLN 57 012 thousand.

(In PLN thousand)

## 37. Investment property

The Group values investment property using the historical cost model.

The rights to sell the investment property and the rights to transfer related revenues and profits are not a subject to limitations.

Changes in 'Investment property' in the course of the reporting period

| | 2016 | 2015 |
|---|---|---|
| GROSS VALUE | | |
| **Opening balance** | **66 253** | **71 461** |
| Increases, including: | 431 | 10 341 |
| acquisitions | 431 | 324 |
| transfer from property plant and equipment | - | 10 017 |
| transfer from non-current assets held for sale | - | - |
| Decreases, including: | (11 120) | (15 549) |
| sale of real estate | (2 777) | (15 437) |
| transfer to non-current assets held for sale | (8 295) | - |
| other | (48) | (112) |
| **Closing balance** | **55 564** | **66 253** |
| ACCUMULATED DEPRECIATION | | |
| **Opening balance** | **27 350** | **27 484** |
| Increases, including: | 1 183 | 9 628 |
| depreciation for the period | 1 183 | 1 654 |
| transfer from property plant and equipment | - | 7 974 |
| other | - | - |
| Decreases, including: | (4 874) | (9 762) |
| sale of real estate | (1 133) | (9 650) |
| transfer from non-current assets held for sale | (3 741) | - |
| other | - | (112) |
| **Closing balance** | **23 659** | **27 350** |
| IMPAIRMENT | | |
| **Opening balance** | **8 682** | **8 682** |
| Increases, including: | - | - |
| impairment charges | - | - |
| Decreases, including: | (1 651) | - |
| sale of real estate | (926) | - |
| transfer from non-current assets held for sale | (725) | - |
| **Closing balance** | **7 031** | **8 682** |
| NET VALUE | | |
| **Opening balance** | **30 221** | **35 295** |
| **Closing balance** | **24 874** | **30 221** |

# Notes to the financial statements (cont.)

(In PLN thousand)

The fair value of investment property as at 31 December 2016 stood at PLN 14 599 thousand (PLN 43 889 thousand as at 31 December 2015). The fair value of investment property are categorized in Level 3 of the fair value hierarchy. The fair value was measured based on valuations of the property appraisers, having appropriate professional qualifications and recent experience in the location of the properties being valued. The valuations of investment property are based on investment method or profits method, taking into account such unobservable input data as expected rental growth rate, void periods, occupancy rate, discount rate.

The following amounts of revenues and costs associated with investment properties have been recognized in the income statement

| | 2016 | 2015 |
|---|---|---|
| Rental revenues from investment properties | 4 069 | 4 319 |
| Direct operating expenses associated with investment properties (including repair and maintenance costs) which generated rental revenues during the reporting period | (1 568) | (1 485) |
| Direct operating expenses associated with investment properties (including repair and maintenance costs) which did not generate rental revenues during the reporting period | - | (371) |

## 38. Other assets

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Prepaid expenses | 132 063 | 112 514 |
| Perpetual usufruct rights | 14 876 | 15 181 |
| Accrued income | 78 756 | 52 595 |
| Interbank and interbranch settlements | 156 | 1 770 |
| Other debtors | 325 351 | 289 515 |
| Card settlements | 479 996 | 1 808 150 |
| **Total** | **1 031 198** | **2 279 725** |

Prepaid expenses represent expenditures, which will be amortized against income statement in the forthcoming reporting periods.

The item ‘Other debtors’ includes assets for sale in the amount of PLN 90 thousand as at 31 December 2016 (PLN 90 thousand as at 31 December 2015). Assets for sale represent assets taken over for debts. They are presented in a debt value reduced by impairment charge, calculated as a difference between the amount of debt and fair value of taken over assets (if lower than the amount of debt). In case of surplus between the fair value of taken over asset and the amount of debt, the difference is recognized as a liability to debtor.

The Group disposes of the assets for sale taken over for debts. The period in which the assets should be disposed is 5 years for real estate and 3 years for other assets for sale (the period starts from the date of assets’ taken over). When the period expires, the Group reclassifies the carrying value of unsold assets for sales into appropriate category of property, plant and equipment used by the Group.

(In PLN thousand)

## 39. Assets pledged as collateral

As at 31 December 2016 the Group held the following financial assets pledged as security for liabilities

| TYPE OF TRANSACTION | SECURITY | CARRYING VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES | NOMINAL VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES | VALUE OF LIABILITIES SUBJECT TO SECURITY |
|---|---|---|---|---|
| Repo transaction | bonds | 1 774 747 | 1 678 677 | 1 775 808 |
| Coverage of Fund for protection of guaranteed assets to the benefit of the Bank Guarantee Fund | bonds | 750 701 | 720 200 | - |
| Lombard and technical loan | bonds | 4 808 629 | 4 515 159 | - |
| Other loans | bonds | 357 614 | 353 900 | 297 497 |
| Issue of mortgage bonds | receivables backed by mortgage, bonds | 1 678 258 | 1 679 057 | 1 222 018 |
| Coverage of the Gurantee Fund for the Settlement of Stock Exchange Transactions to Central Securities Depository (KDPW) | bonds, cash deposit | 51 155 | 50 890 | - |
| Derivatives | bonds | 60 792 | 65 302 | 31 987 |

As at 31 December 2015 the Group held the following financial assets pledged as security for liabilities

| TYPE OF TRANSACTION | SECURITY | CARRYING VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES | NOMINAL VALUE OF ASSETS PLEDGED AS SECURITY FOR LIABILITIES | VALUE OF LIABILITIES SUBJECT TO SECURITY |
|---|---|---|---|---|
| Repo transaction | bonds | 3 394 183 | 3 152 162 | 3 388 421 |
| Coverage of Fund for protection of guaranteed assets to the benefit of the Bank Guarantee Fund | bonds | 703 818 | 680 200 | - |
| Lombard and technical loan | bonds | 4 750 392 | 4 504 675 | - |
| Other loans | bonds | 490 285 | 481 200 | 328 076 |
| Issue of mortgage bonds | receivables backed by mortgage, bonds | 1 679 460 | 1 683 864 | 1 234 528 |
| Coverage of the Gurantee Fund for the Settlement of Stock Exchange Transactions to Central Securities Depository (KDPW) | bonds, cash deposit | 39 296 | 38 802 | - |
| Derivatives | bonds | 45 708 | 47 163 | 24 771 |

The freeze on securities is a consequence of:

- in case of Repo and Sell-buy-back transactions – binding money market standards for such transactions,
- in case of freeze to the benefit of BFG – binding provisions of the Law on Banking Guaranty Fund BFG,
- in case of lombard and technical loans – policy and standards, applied by the National Bank of Poland NBP,
- in case of other loans, deposits and derivatives – terms and conditions of the agreement, entered between Bank Pekao S.A. and its clients,
- in case of issue of mortgage bonds – binding provisions of the Law on Mortgage Bonds and Mortgage Banks,
- in case of freeze to the benefit of KDPW – with the status of the clearing member for brokerage transactions.

(In PLN thousand)

# 40. Amounts due to other banks

Amounts due to other banks by product type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Current accounts | 902 856 | 1 121 885 |
| Interbank deposits and other liabilities | 309 837 | 581 301 |
| Loans and advances received | 3 249 417 | 3 263 303 |
| Repo transactions | 339 568 | 963 830 |
| Cash in transit | 21 762 | 28 130 |
| **Total** | **4 823 440** | **5 958 449** |

Amounts due to other banks by currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 1 442 611 | 1 379 402 |
| CHF | 731 657 | 744 746 |
| EUR | 2 592 591 | 3 774 189 |
| USD | 48 467 | 50 277 |
| Other currencies | 8 114 | 9 835 |
| **Total** | **4 823 440** | **5 958 449** |

# 41. Amounts due to customers

Amounts due to customers by product type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Amounts due to corporate, including: | 57 989 927 | 55 167 425 |
| current accounts | 33 946 882 | 29 048 523 |
| term deposits and other liabilities | 24 043 045 | 26 118 902 |
| Amounts due to budget entities, including: | 7 809 235 | 5 610 623 |
| current accounts | 5 461 224 | 4 689 452 |
| term deposits and other liabilities | 2 348 011 | 921 171 |
| Amounts due to individuals, including: | 70 347 039 | 63 434 250 |
| current accounts | 39 682 587 | 33 827 209 |
| term deposits and other liabilities | 30 664 452 | 29 607 041 |
| Repo transactions | 1 436 241 | 4 468 820 |
| Cash in transit | 233 484 | 186 573 |
| **Total** | **137 815 926** | **128 867 691** |

Amounts due to customers by currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 115 090 198 | 106 548 096 |
| CHF | 315 787 | 234 011 |
| EUR | 13 400 735 | 13 215 198 |
| USD | 7 476 067 | 8 013 651 |
| Other currencies | 1 533 139 | 856 735 |
| **Total** | **137 815 926** | **128 867 691** |

# Notes to the financial statements (cont.)

(In PLN thousand)

## 42. Debt securities issued

Debt securities issued by type

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Certificates of deposit | 300 945 | 1 668 706 |
| Mortgage bonds | 1 222 018 | 1 234 527 |
| **Total** | **1 522 963** | **2 903 233** |

The Group redeems its own debt securities issued on a timely basis.

Debt securities issued by currencies

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| PLN | 1 200 548 | 2 592 848 |
| EUR | 322 415 | 310 385 |
| USD | - | - |
| **Total** | **1 522 963** | **2 903 233** |

Changes in debt securities issued

| | 2016 | 2015 |
|---|---|---|
| **Opening balance** | **2 903 233** | **3 857 043** |
| Increase (issuance) | 1 129 733 | 3 966 098 |
| Decrease (redemption) | (2 467 807) | (4 999 636) |
| Decrease (partial redemption) | (38 245) | (7 903) |
| Foreign currency exchange differences | 11 885 | (1 053) |
| Purchase | - | (33) |
| Sale | - | 90 989 |
| Other | (15 836) | (2 272) |
| **Closing balance** | **1 522 963** | **2 903 233** |

## 43. Provisions

Change in provisions in the reporting period

| 2016 | PROVISIONS FOR LITIGATION AND CLAIMS | PROVISIONS FOR DEFINED BENEFIT PLANS | PROVISIONS FOR UNDRAWN CREDIT FACILITIES AND GUARANTEES ISSUED | OTHER PROVISIONS | TOTAL |
|---|---|---|---|---|---|
| **Opening balance** | **10 608** | **268 858** | **120 771** | **25 137** | **425 374** |
| Provision charges/revaluation | 4 092 | 26 635 | 160 561 | 23 386 | 214 674 |
| Provision utilization | (3 405) | (13 020) | - | (11 207) | (27 632) |
| Provision releases | (3 202) | (19) | (61 341) | (442) | (65 004) |
| Foreign currency exchange differences | - | - | 992 | - | 992 |
| Other changes | 458 | 11 560 | - | (30) | 11 988 |
| **Closing balance** | **8 551** | **294 014** | **220 983** | **36 844** | **560 392** |
| Short term | 3 214 | 47 435 | 67 159 | 14 201 | 132 009 |
| Long term | 5 337 | 246 579 | 153 824 | 22 643 | 428 383 |

# Notes to the financial statements (cont.)

(In PLN thousand)

Change in provisions in the reporting period

| 2015 | PROVISIONS FOR LITIGATION AND CLAIMS | PROVISIONS FOR DEFINED BENEFIT PLANS | PROVISIONS FOR UNDRAWN CREDIT FACILITIES AND GUARANTEES ISSUED | OTHER PROVISIONS | TOTAL |
|---|---|---|---|---|---|
| **Opening balance** | **37 873** | **267 991** | **102 386** | **34 206** | **442 456** |
| Provision charges/revaluation | 31 147 | 23 655 | 71 614 | 5 814 | 132 230 |
| Provision utilization | (56 417) | (10 246) | - | (14 435) | (81 098) |
| Provision releases | (2 310) | (84) | (54 411) | (76) | (56 881) |
| Foreign currency exchange differences | - | - | 1 182 | - | 1 182 |
| Other changes | 315 | (12 458) | - | (372) | (12 515) |
| **Closing balance** | **10 608** | **268 858** | **120 771** | **25 137** | **425 374** |
| Short term | 4 113 | 21 180 | 67 527 | 145 | 92 965 |
| Long term | 6 495 | 247 678 | 53 244 | 24 992 | 332 409 |

**Provisions for litigation and claims**
Provisions for litigation and claims include court, administrative and other legal proceedings. The provisions were estimated in the amount of expected outflow of resources embodying econimic benefits.

**Provisions for defined benefit plans**
Detailed information in respect to provisions for defined benefit plans were presented in Note 45.

**Other provisions**
Other provisions include in particular provisions for other employee benefits.

## 44. Other liabilities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Deferred income | 115 137 | 120 308 |
| Provisions for holiday leave | 56 924 | 56 983 |
| Provisions for other employee-related liabilities | 251 582 | 255 274 |
| Provisions for administrative costs | 90 461 | 103 348 |
| Other costs to be paid (*) | 111 239 | 162 048 |
| Other creditors | 338 335 | 274 565 |
| Interbank and interbranch settlements | 1 029 899 | 515 533 |
| Card settlements | 304 475 | 192 476 |
| **Total** | **2 298 052** | **1 680 535** |

(*) in this as at 31 December 2016 is PLN 95 346 thousand of provision for future refunds of the part of the remuneration for sale of insurance products linked to loans (PLN 104 122 as at 31 December 2015).

(In PLN thousand)

## 45. Defined benefit plans

Based on internal regulations in respect to remuneration, the employees of the Group or their families are entitled to defined benefits other than remuneration:
a) retirement benefits,
b) death-in-service benefits.

The present value of such obligations is measured by an independent actuary using the projected unit credit method.
The amount of the retirement benefits and death-in-service benefits is dependent on length of service and amount of remuneration. The expected amount of the benefits is discounted actuarially, taking into account the financial discount rate and the probability of an individual get to the retirement age or die while working respectively. The financial discount rate is determined by reference to market yields at the end of reporting period on government bonds. The probability of an individual get to the retirement age or die while working is determined using the multiple decrement model, taking into consideration the following risks: possibility of dismissal from service, risk of total disability to work and risk of death.

These defined benefit plans expose the Group to actuarial risk, such as:
- interest rate risk – the decrease in market yields on government bonds would increase the defined benefit plans obligations,
- remuneration risk – the increase in remuneration of the Group's employees would increase the defined benefit plans obligations,
- longevity risk – the increase in life expectancy of the Group's employees would increase the defined benefit plans obligations.

The principal actuarial assumptions as at 31 December 2016 are as follows:
- the discount rate at the level of 3.50% (2.90 % as at 31 December 2015),
- the future salary growth rate at the level of 2.50% (2.50 % as at 31 December 2015),
- the probable number of leaving employees calculated on the basis of historical data concerning personnel rotation in the Group,
- the mortality adopted in accordance with Life Expectancy Tables for men and women, published the Central Statistical Office, adequately adjusted on the basis of historical data of the Group.

**Reconciliation of the present value of defined benefit plans obligations**
The following table presents a reconciliation from the opening balances to closing balances for the present value of defined benefit plans obligations.

| | 2016 | 2015 |
|---|---|---|
| **Opening balance** | **268 858** | **267 991** |
| Current service cost | 18 845 | 16 594 |
| Interest expense | 7 771 | 6 978 |
| Remeasurements of the defined benefit obligations: | 11 560 | (12 900) |
| actuarial gains and losses arising from changes in demographic assumptions | 33 812 | (134) |
| actuarial gains and losses arising from changes in financial assumptions | (16 128) | (9 611) |
| actuarial gains and losses arising from experience adjustments | (6 124) | (3 155) |
| Contributions paid by the employer | (13 020) | (10 247) |
| Business combination | - | 442 |
| **Closing balance** | **294 014** | **268 858** |

(In PLN thousand)

**Sensitivity analysis**

The following table presents how the impact on the defined benefits obligations would have increased (decreased) as a result of a change in the respective actuarial assumptions by one percent.

| 31.12.2016 | DEFINED BENEFIT PLANS OBLIGATIONS | |
|---|---|---|
| | 1 PERCENT INCREASE | 1 PERCENT DECREASE |
| Discount rate | (23 580) | 27 509 |
| Future salary growth rate | 26 278 | (23 033) |

| 31.12.2015 | DEFINED BENEFIT PLANS OBLIGATIONS | |
|---|---|---|
| | 1 PERCENT INCREASE | 1 PERCENT DECREASE |
| Discount rate | (28 208) | 34 057 |
| Future salary growth rate | 34 158 | (28 801) |

**Maturity of defined benefit plans obligations**

The following table presents the maturity profile of the defined benefit plans obligations

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| The weighted average duration of the defined benefit plans obligations (in years) | 8.8 | 11.7 |

# 46. Share-based payments

**The UniCredit Group incentive program**

In the current and comparative reporting periods the following incentive programs granted to employees of the Bank Pekao Group by the UniCredit Group existed:

- The long-term UniCredit Group Incentive Program 2007 in respect to share options. The rights to exercise the option were acquired in 2011. Strike price is EUR 7.094. The option will expire in 2017,
- The long-term UniCredit Group Incentive Program 2008 in respect to share options. The rights to exercise the option were acquired in 2012. Strike price is EUR 4.185. The option will expire in 2018,
- Employee Share Ownership Plan that offers to eligible UniCredit Group employees the possibility to buy UniCredit ordinary shares with the following advantages: obtaining Free Shares ('Free Shares') granted free of charge based on the number of the Investment shares purchased by each participant. The granting of free ordinary shares depends on the vesting conditions stated in the rules of the Plan.

The above mentioned share-based payments are recognized as cash-settled transactions.

The fair value of share options and shares of UniCredit S.p.A. was established based on the Hull and White model.

The tables below present changes in the number of stock options and performance shares of UniCredit S.p.A., as well as the weighted average exercise prices

| 2016 | STOCK OPTIONS | | PERFORMANCE SHARES | |
|---|---|---|---|---|
| | NUMBER | WEIGHTED AVERAGE EXECUTION PRICE (*) | NUMBER | WEIGHTED AVERAGE EXECUTION PRICE |
| Opening balance | 2 289 715 | 17.83/30.23 | - | - |
| Granted during the year | - | - | - | - |
| Redeemed during the year | (24 167) | - | - | - |
| Exercised during the year | - | - | - | - |
| Terminated during the year | - | - | - | - |
| Existing at the period-end | 2 265 548 | 17.83/30.23 | - | - |
| Executable at the period-end | 2 265 548 | 17.83/30.23 | - | - |

(*)The value of PLN 17.83 relates to the stock options program 2008, whereas the value of PLN 30.23 relates to the stock options program 2007.

(In PLN thousand)

The tables below present changes in the number of stock options and performance shares of UniCredit S.p.A., as well as the weighted average exercise prices

| 2015 | STOCK OPTIONS | | PERFORMANCE SHARES | |
|---|---|---|---|---|
| | NUMBER | WEIGHTED AVERAGE EXECUTION PRICE (*) | NUMBER | WEIGHTED AVERAGE EXECUTION PRICE |
| Opening balance | 2 345 563 | 17.84/30.24 | - | - |
| Granted during the year | - | - | - | - |
| Redeemed during the year | (55 848) | - | - | - |
| Exercised during the year | - | - | - | - |
| Terminated during the year | - | - | - | - |
| Existing at the period-end | 2 289 715 | 17.83/30.23 | - | - |
| Executable at the period-end | 2 289 715 | 17.83/30.23 | - | - |

(*)The value of PLN 17.83 relates to the stock options program 2008, whereas the value of PLN 30.23 relates to the stock options program 2007.

The table below presents the conditions of Employee Share Ownership Plan in 2016

| | FREE SHARES |
|---|---|
| Date of Free Shares delivery to Group employees | 29 July 2016 |
| Vesting Period Start-Date | 29 July 2016 |
| Vesting Period End-Date | 31 July 2017 |
| 'Free Shares' Fair Value (per unit in EUR) | 2.058 |

The table below presents the conditions of Employee Share Ownership Plan in 2015

| | FREE SHARES 1ST ELECTION WINDOW | FREE SHARES 2ND ELECTION WINDOW |
|---|---|---|
| Date of Free Shares delivery to Group employees | 30 January 2015 | 31 July 2015 |
| Vesting Period Start-Date | 30 January 2015 | 31 July 2015 |
| Vesting Period End-Date | 31 January 2016 | 31 July 2016 |
| 'Free Shares' Fair Value (per unit in EUR) | 5.280 | 6.078 |

The fair value of granted rights to shares under Employee Share Ownership Plan until 31 December 2016 amounted to PLN 1 675 thousand as at 31 December 2016 (PLN 2 415 as at 31 December 2015).

The remuneration expenses for 2016 relating to the incentive programs granted to the emloyees of the Bank by UniCredit Group amounted to PLN 383 thousand (in 2015 - PLN 1 608 thousand).

**System of Variable Remuneration for the Management Team**
The system of variable remuneration is addressed to Employees defined in the Bank as persons in managerial positions, who are key employees for the fulfillment of the Bank's strategy, risk management and long-term increase of the Bank's income. The aim of the system is to support the execution of the Bank's operational strategy, its risk management and to limit conflict of interests.

Under the system the participant can receive the variable compensation, which is paid out based on a bonus pool approach providing for a comprehensive performance measurement at individual level, level of his/her organizational unit and results of the entire Bank as well as verification of the Participant's compliant behaviour with respect to law provisions and standards adopted by the Bank.

The compensation consists of cash payment and cash-settled share based payment realized in the form of phantom shares as cash equivalent amounting to the value of granted phantom shares.

# Notes to the financial statements (cont.)

(In PLN thousand)

During the reporting period ending on 31 December 2016 the Bank had the following share-based payments transactions

| | SYSTEM 2012 | SYSTEM 2013 | SYSTEM 2014 | SYSTEM 2015 | SYSTEM 2016 |
|---|---|---|---|---|---|
| Transaction type | Cash-settled share based payments | | | | |
| Start date of the assessment period | 1 January 2012 | 1 January 2013 | 1 January 2014 | 1 January 2015 | 1 January 2016 |
| Program announcement date | April 2012 | April 2013 | June 2014 | July 2015 | June 2016 |
| Program granting date | 12 June 2013 | 12 June 2014 | 30 April 2015 | 16 June 2016 | Date of General Shareholders Meeting |
| Number of instruments granted (pcs) | 80 003 | 76 013 | 68 040 | 93 359 | Will be defined on granting date |
| Maturity date | 31 July 2017 | 31 July 2018 | 31 July 2020 | 31July 2021 | 31 July 2022 |
| Vesting date for Management Board Members and Executive Vice President | • 40% after 2 years from program granting date<br>• 40% after 3 years from program granting date<br>• 20% after 4 years from program granting date | • 40% in the year of program granting (settlement after 2 years retention period)<br>• 40% after 2 years from program granting date (settlement after 1 year retention period)<br>• 20% after 3 years from program granting date (settlement after 1 year retention period) | • 40% in the year of program granting (settlement after 3 years retention period)<br>• 30% after 3 years from program granting date (settlement after 1 year retention period)<br>• 30% after 4 years from program granting date (settlement after 1 year retention period) | • 40% in the year of program granting (settlement after 2 years retention period)<br>• 24% after 2 years from program granting date (settlement after 1 year retention period)<br>• 12% after 3 years from program granting date (settlement after 1 year retention period)<br>• 24% after 4 years from program granting date (settlement after 1 year retention period) | • 40% in the year of program granting (settlement after 2 years retention period)<br>• 24% after 2 years from program granting date (settlement after 1 year retention period)<br>• 12% after 3 years from program granting date (settlement after 1 year retention period)<br>• 24% after 4 years from program granting date (settlement after 1 year retention period) |
| Vesting date for remaining participants | • 20% after 1 year from program granting date<br>• 40% after 2 years from program granting date<br>• 40% after 3 years from program granting date | • 20% after 1 year from program granting date<br>• 40% after 2 years from program granting date<br>• 40% after 3 years from program granting date | • 60% in the year of program granting (settlement after 3 years retention period)<br>• 20% after 3 years from program granting date (settlement after 1 year retention period)<br>• 20% after 4 years from program granting date (settlement after 1 year retention period) | • 60% in the year of program granting (settlement after 3 years retention period)<br>• 20% after 3 years from program granting date (settlement after 1 year retention period)<br>• 20% after 4 years from program granting date (settlement after 1 year retention period) | • 60% in the year of program granting (settlement after 2 years retention period)<br>• 20% after 2 years from program granting date (settlement after 1 year retention period)<br>• 20% after 3 years from program granting date (settlement after 1 year retention period) |
| Vesting conditions | Compliance assessment, Continuous employment, Reaching the aim based on financial results of the Bank for a given period | | | | |
| Program settlement | On the vesting date, the participant will receive a cash payment amounting to the number the possessed phantom shares times the arithmetic mean of the Bank's share prices at the Warsaw Stock Exchange:<br>• in case of the settlement made at the dates of instalment after the mandatory retention period, for a month preceding the day of General Meeting approving the financial statements for a given year,<br>• in case of settlement made in the voluntary retention period, for 10 working days following the day of release of the financial report in a given quarter, and benefits from acquired phantom shares in the amount equivalent to dividend paid to shareholders in the retention period for shares acquired by the participant | | | | |

(In PLN thousand)

For the System 2012, 2013, 2014 and 2015 the fair value of the program was estimated based upon the Bank's shares price on the WSE as of the balance sheet date and expected number of phantom shares to which the rights will be acquired.

For the System 2016, as of 31 December 2016 the Bank prepared the program valuation, presuming that the phantom shares were granted on 31 December 2016. This value will be changed at the actual date of granting the program.

The system of variable remuneration realized in the form of phantom shares is a program settled in cash, and therefore its fair value is adjusted on each balance sheet date until the the program settlement, which in case of this program coincides with the vesting date.

The carrying amount of liabilities for cash-settled phantom shares amounted to PLN 22 532 thousand as at 31 December 2016 (as at 31 December 2015 – PLN 24 534 thousand).

The total intrinsic value of liabilities for vested rights to phantom shares amounted to PLN 26 446 thousand as at 31 December 2016 (as at 31 December 2015 – PLN 27 417 thousand).

The remuneration expenses for 2016 relating to the system of variable remuneration in the form of phantom shares amounted to PLN 9 189 thousand (in 2015 - PLN 6 312 thousand).

The table below presents changes in the number of Bank's phantom shares

| | 2016 | 2015 |
|---|---|---|
| Opening balance | 191 060 | 199 452 |
| Granted during the year | 93 359 | 68 040 |
| Redeemed during the year | - | - |
| Exercised during the year | 74 196 | 76 432 |
| Terminated during the year | - | - |
| Existing at the period-end | 210 223 | 191 060 |

The table above does not present the number of shares granted in respect of System 2016. This number will be determined in 2017 after approval of the financial statements for 2016 by the General Shareholder's Meeting. The hypothetical number of shares determined on the basis of the base value of the granted bonus to each of the program participants and arithmetic mean of the Bank's share price on the WSE in December 2016 amounts to 126 547.

**System of Variable Remuneration for the Management Team of the subsidiaries**
In order to meet requirements concerning rules of establishing policy of variable remuneration's component for individuals in managerial positions (Resolution No. 258/2011 of the Polish Financial Supervision Authority issued on 4 October 2011 and the Minister of Finance Regulation dated 2 December 2011, Official Journal from 2011, No. 263, item 1569), the followinf subsidiaries: Centralny Dom Maklerski Pekao S.A., Pekao Bank Hipoteczny S.A., Pekao Leasing Sp. z o.o., Pekao Investment Banking S.A. and Pekao Financial Services Sp. z o.o. have implemented System of Variable Remuneration for the Management Team.

Within the system participant can receive the bonus depending on the performance and results of work of the participant, of the business unit and the company's results in the area of responsibility of the person, taking into account the results of the whole company, as well as verification of the compliance of Participant's behaviour with respect to law provisions and standards adopted by the company.

At least 40 % components of variable renumerations is settled and paid in the time-period of 3 to 5 years since the granting date.

The companies measure the future employees benefits at fair value of accepted liabilities, in accordance with IAS 19 'Employee benefits'. Results of liabilities meassurement at fair value are presented in income statement as personnel expenses.

(In PLN thousand)

The carrying amount of liabilities for cash-settled phantom shares amounted to PLN 4 026 thousand as at 31 December 2016 (as at 31 December 2015 – PLN 4 030 thousand).

The remuneration expenses for 2016 relating to the system of variable remuneration in the form of phantom shares amounted to PLN 1 545 thousand (in 2015 - PLN 127 thousand).

# 47. Operating lease

**The Group as a Lessor**
In operating lease of buildings classified as investment properties the Group acts as a lessor.

The amount of future minimum lease payments expected to be received under non-cancellable operating lease can be summarized as follows

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Up to 1 year | 8 016 | 7 334 |
| Between 1years and 5 years | 3 436 | 2 869 |
| Over 5 years | 929 | 498 |
| **Total** | **12 381** | **10 701** |

The amount of the minimum operating lease payments classified as income in 2016 amounted to PLN 18 757 thousand (in 2015 - PLN 19 262 thousand in 2015).

**The Group as Lessee**
The Group is a lessee of buildings' lease contracts classified as operating lease.

The amount of future minimum lease payments expected to be paid under non-cancellable operating lease can be summarized as follows

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Up to 1 year | 98 387 | 111 591 |
| Between 1years and 5 years | 212 397 | 243 264 |
| Over 5 years | 62 118 | 105 814 |
| **Total** | **372 902** | **460 669** |

The amount of the minimum operating lease payments recognized as an expense in 2016 amounted to PLN 172 411 thousand (expense in 2015 amounted to PLN 186 023 thousand).

The lease agreements are usually entered into for an indefinite period. In case of lease agreements concluded for an indefinite term, the minimum lease payments are determined based upon notice of termination periods ensuing from relevant contracts. The notice period is usually fixed at 3 or 6 months. Lease agreements are denominated in PLN as well as in foreign currencies. Payments are made in PLN, regardless of the contract currency.

# 48. Contingent commitments

**Litigation**
In the entire year of 2016 the total value of the litigation subject in the ongoing court proceedings against the Group was PLN 1 091 638 thousand (in 2015 it was PLN 1 142 702 thousand).

In 2016 there were no proceedings before the court or state administration bodies related to the receivables or payables of the Bank and its subsidiaries in which the pursued claim value (amount to be paid) is at least 10% of the Group's equity.

# Notes to the financial statements (cont.)

(In PLN thousand)

In 2016 still going on was the court litigation against the Group entities, Bank Pekao SA and Pekao SA Central Brokerage House, brought by private individuals for the payment of damage arising from the purchase of stocks and the financial compensation for the injury resulting from the execution process, in which the value of the litigation subject, as at 31 December 2016, was PLN 206 422 thousand (previously PLN 306 622 thousand). In the first half of 2015 the sentence dismissing the plaint against defendants was adjudicated. The sentence is not legally binding. The plaintiffs lodged an appeal against the sentence, i.e. its part related to the amount of PLN 206 422 thousand. In the third quarter of 2016 was issued a judgment dismissing the appeal. The plaintiffs are entitled to a cassation appeal.

Moreover against the Group currently are pending the following essential litigations, in which the Bank – in the current factual and legal circumstances – assess the risk of outflow as possible :

- proceedings instigated in the first quarter of 2014 as a result of the plaint brought by guarantee beneficiaries for the payment of PLN 32 750 thousand as the bank guarantee drawing,
- proceedings instigated in the second quarter of 2014 as a result of the plaint brought by a guarantee beneficiary for the payment of PLN 55 996 thousand as the bank guarantee drawing,
- proceedings instigated in the first quarter of 2015 as a result of the plaint brought by guarantee beneficiary for the payment of PLN 29 205 thousand as the bank guarantee drawing,
- proceeding instigated in the fourth quarter of 2016 as a result plaint brought by private individual for the payment of PLN 38 916 thousand taken by the Bank way of settlement of term financial transactions.

The Group created provisions for litigations against the Group entities which, according to the legal opinion, are connected with a risk of the funds outflow resulting from the fulfillment of the obligation. The value of the provisions as at 31 December 2016 is PLN 8 551 thousand (PLN 10 608 thousand as at 31 December 2015).

**Financial off–balance commitments granted**
Financial commitments granted by entities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Financial commitments to: | | |
| financial entities | 734 503 | 700 755 |
| non - financial entities | 31 088 328 | 29 386 749 |
| budget entities | 481 482 | 848 356 |
| **Total** | **32 304 313** | **30 935 860** |

**Off–balance guarantees issued**
Guarantees issued by entities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Issued to financial entities, including: | 991 115 | 1 311 490 |
| guarantees | 991 115 | 1 308 840 |
| confirmed export letters of credit | - | 2 650 |
| Issued to non-financial entities, including: | 9 999 478 | 12 393 161 |
| guarantees | 6 505 040 | 7 510 192 |
| securities’ underwriting guarantees | 3 455 429 | 4 806 284 |
| sureties | 39 009 | 76 685 |
| Issued to budget entities, including: | 269 239 | 368 176 |
| guarantees | 11 279 | 28 176 |
| securities’ underwriting guarantees | 257 960 | 340 000 |
| **Total** | **11 259 832** | **14 072 827** |

# Notes to the financial statements (cont.)

(In PLN thousand)

**Securities underwriting**

As at 31 December 2016, the following securities programs have been in place, covered by underwriting

| NAME OF ISSUER | TYPE OFSECURITIES | OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF | CONTRACT LIFE |
|---|---|---|---|
| Client 1 | bonds | 1 385 000 | 23.07.10 - 30.06.20 |
| Client 2 | bonds | 265 000 | 21.06.12 - 31.12.17 |
| Client 3 | bonds | 484 880 | 22.10.13 - 31.05.22 |
| Client 4 | bonds | 35 000 | 27.01.14 - 28.04.17 |
| Client 5 | bonds | 110 510 | 30.06.14 - 31.03.17 |
| Client 6 | bonds | 2 200 | 15.09.14 - 31.03.18 |
| Client 7 | bonds | 20 000 | 15.09.14 - 31.03.18 |
| Client 8 | bonds | 150 000 | 24.05.16 - 31.03.18 |
| Client 9 | bonds | 49 000 | 22.12.14 - 30.06.17 |
| Client 10 | bonds | 230 000 | 23.02.15 - 30.06.17 |
| Client 11 | bonds | 100 000 | 23.02.15 - 30 11.22 |
| Client 12 | bonds | 84 000 | 27.01.15 - 31.12.17 |
| Client 13 | bonds | 30 000 | 14.10.15 - 31.12.17 |
| Client 14 | bonds | 7 500 | 14.10.15 - 31.12.17 |
| Client 15 | bonds | 119 985 | 18.12.15 - 28.04.17 |
| Client 16 | bonds | 20 270 | 28.12.15 - 31.12.17 |
| Client 17 | bonds | 19 504 | 09.03.16 - 30.06.17 |
| Client 18 | bonds | 22 810 | 09.03.16 - 30.06.17 |
| Client 19 | bonds | 53 500 | 21.05.16 - 21.06.19 |
| Client 20 | bonds | 3 500 | 21.05.16 - 21.06.19 |
| Client 21 | bonds | 8 000 | 06.07.16 - 31.12.18 |
| Client 22 | bonds | 67 200 | 06.07.16 - 31.12.18 |
| Client 23 | bonds | 8 680 | 06.07.16 - 31.12.18 |
| Client 24 | bonds | 8 000 | 06.07.16 - 31.12.18 |
| Client 25 | bonds | 310 600 | 31.08.16 - 30.12.19 |
| Client 26 | bonds | 13 000 | 31.08.16 - 30.12.19 |
| Client 27 | bonds | 6 000 | 08.11.16 - 31.12.17 |
| Client 28 | bonds | 4 300 | 23.12.16 - 31.12.18 |
| Client 29 | bonds | 1 000 | 22.12.16 - 30.12.16 |
| Client 30 | bonds | 6 650 | 23.12.16 - 31.12.18 |
| Client 31 | bonds | 66 000 | 20.12.16 - 31.12.20 |
| Client 32 | bonds | 15 000 | 28.12.16 - 31.08.17 |
| Client 33 | bonds | 6 300 | 29.12.16 - 31.08.17 |

Securities covered by the Bank underwriting are classified as securities with unlimited marketability, unquoted on stock exchanges and are not a subject to regulated off-the-floor trading.

# Notes to the financial statements (cont.)

(In PLN thousand)

As at 31 December 2015, the following securities programs have been in place, covered by underwriting

| NAME OF ISSUER | TYPE OFSECURITIES | OUTSTANDING UNDERWRITING AMOUNT TO WHICH THE BANK HAS UNDERTAKEN TO COMMIT IT SELF | CONTRACT LIFE |
|---|---|---|---|
| Client 1 | bonds | 1 385 000 | 23.07.10 - 30.06.20 |
| Client 2 | bonds | 458 000 | 21.06.12 - 31.12.17 |
| Client 3 | bonds | 99 220 | 06.12.12 - 31.03.16 |
| Client 4 | bonds | 52 400 | 28.12.12 - 30.03.16 |
| Client 5 | bonds | 76 900 | 28.12.12 - 30.03.16 |
| Client 6 | bonds | 164 700 | 01.07.11 - 20.12.17 |
| Client 7 | bonds | 11 430 | 20.05.13 - 24.02.16 |
| Client 8 | bonds | 17 200 | 14.04.15 - 10.06.16 |
| Client 9 | bonds | 78 000 | 14.04.15 - 10.06.16 |
| Client 10 | bonds | 484 880 | 22.10.13 - 14.12.16 |
| Client 11 | bonds | 50 000 | 22.10.13 - 14.12.16 |
| Client 12 | bonds | 16 250 | 27.01.14 - 30.09.16 |
| Client 13 | bonds | 6 500 | 15.05.14 - 31.12.16 |
| Client 14 | bonds | 700 | 31.05.14 - 31.12.16 |
| Client 15 | bonds | 157 510 | 30.06.14 - 31.03.17 |
| Client 16 | bonds | 61 710 | 22.07.14 - 31.07.16 |
| Client 17 | bonds | 6 530 | 22.07.14 - 31.07.16 |
| Client 18 | bonds | 100 000 | 30.07.14 - 30.06.19 |
| Client 19 | bonds | 830 | 29.07.14 - 30.06.16 |
| Client 20 | bonds | 20 450 | 29.07.14 - 30.09.16 |
| Client 21 | bonds | 25 000 | 25.08.14 - 31.08.16 |
| Client 22 | bonds | 45 770 | 29.05.14 - 30.04.16 |
| Client 23 | bonds | 29 050 | 15.09.14 - 31.12.16 |
| Client 24 | bonds | 20 000 | 15.09.14 - 31.12.16 |
| Client 25 | bonds | 5 600 | 15.09.14 - 31.12.16 |
| Client 26 | bonds | 33 790 | 31.10.14 - 31.03.16 |
| Client 27 | bonds | 50 000 | 22.12.14 - 30.06.17 |
| Client 28 | bonds | 52 135 | 30.12.14 - 30.06.16 |
| Client 29 | bonds | 1 378 | 30.12.14 - 31.03.16 |
| Client 30 | bonds | 198 780 | 30.12.14 - 09.03.16 |
| Client 31 | bonds | 20 500 | 30.12.14 - 31.12.16 |
| Client 32 | bonds | 230 000 | 23.02.15 - 30.06.17 |
| Client 33 | bonds | 100 000 | 23.02.15 - 30.11.22 |
| Client 34 | bonds | 350 000 | 20.02.15 - 30.04.16 |
| Client 35 | bonds | 16 000 | 27.01.15 - 31.12.16 |
| Client 36 | bonds | 74 000 | 31.12.15 - 31.12.16 |
| Client 37 | bonds | 39 000 | 14.10.15 - 31.12.17 |
| Client 38 | bonds | 12 500 | 14.10.15 - 31.12.17 |
| Client 39 | bonds | 154 955 | 18.12.15 - 30.09.16 |
| Client 40 | bonds | 30 000 | 28.12.15 - 31.12.17 |
| Client 41 | bonds | 409 616 | 25.08.14 - 31.12.16 |

Securities covered by the Bank underwriting are classified as securities with unlimited marketability, unquoted on stock exchanges and are not a subject to regulated off-the-floor trading.

# Notes to the financial statements (cont.)

(In PLN thousand)

**Off-balance commitments received**
Commitments received by entities

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Financial commitments from: | 209 107 | 285 084 |
| financial entities | 209 107 | 285 084 |
| non - financial entities | - | - |
| budget entities | - | - |
| Guarantees from: | 10 818 912 | 11 674 503 |
| financial entities | 1 552 730 | 1 161 416 |
| non - financial entities | 8 344 980 | 9 759 234 |
| budget entities | 921 202 | 753 853 |
| **Total** | **11 028 019** | **11 959 587** |

Moreover, the Group can to obtain financing from the National Bank of Poland pledged on securities.

## 49. Share capital

Shareholding structure

| CLASS/ISSUE | TYPE OF SHARES | NUMBER OF SHARES | NOMINAL VALUE OF CLASS/ISSUE | EQUITY COVERAGE | REGISTRATION DATE | DIVIDEND RIGHTS (FROM DATE) |
|---|---|---|---|---|---|---|
| A | Common bearer stock | 137 650 000 | 137 650 | fully paid-up | 21.12.1997 | 01.01.1998 |
| B | Common bearer stock | 7 690 000 | 7 690 | fully paid-up | 06.10.1998 | 01.01.1998 |
| C | Common bearer stock | 10 630 632 | 10 631 | fully paid-up | 12.12.2000 | 01.01.2000 |
| D | Common bearer stock | 9 777 571 | 9 777 | fully paid-up | 12.12.2000 | 01.01.2000 |
| E | Common bearer stock | 373 644 | 374 | fully paid-up | 29.08.2003 | 01.01.2003 |
| F | Common bearer stock | 621 411 | 621 | fully paid-up | 29.08.2003 | 19.05.2006<br>16.05.2007 |
| G | Common bearer stock | 603 377 | 603 | fully paid-up | 29.08.2003 | 15.05.2008 |
| H | Common bearer stock | 359 840 | 360 | fully paid-up | 12.08.2004 | 01.01.2004 |
| I | Common bearer stock | 94 763 559 | 94 764 | fully paid-up | 29.11.2007 | 01.01.2008 |
| **Total number of Shares (pcs)** | | **262 470 034** | | | | |
| **Total share capital in PLN thousand** | | | **262 470** | | | |
| **Nominal value per share = PLN 1.00** | | | | | | |

Change in the number of shares (pcs)

| 2016 | ISSUED AND FULLY PAID-UP SHARES | TOTAL |
|---|---|---|
| Opening balance | 262 470 034 | 262 470 034 |
| Closing balance | 262 470 034 | 262 470 034 |

| 2015 | ISSUED AND FULLY PAID-UP SHARES | TOTAL |
|---|---|---|
| Opening balance | 262 470 034 | 262 470 034 |
| Closing balance | 262 470 034 | 262 470 034 |

# Notes to the financial statements (cont.)

(In PLN thousand)

## 50. Other capital and reserves, retained earnings and profit for the period

The table below presents the structure of the Group's equity attributable to equity holders of the Bank

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Reserve capital, including: | 9 480 043 | 9 474 405 |
| issue of shares above face value | 9 137 221 | 9 137 221 |
| other | 342 822 | 337 184 |
| Revaluation reserve, including: | (223 394) | 283 597 |
| remeasurements of the defined benefit liabilities | (98 315) | (86 777) |
| deferred tax | 18 680 | 16 488 |
| revaluation of financial assets portfolio available for sale | (217 204) | 391 616 |
| deferred tax | 41 269 | (74 407) |
| revaluation of financial hedging instruments portfolio | 39 724 | 45 280 |
| deferred tax | (7 548) | (8 603) |
| Foreign currency translation differences, including: | - | - |
| foreign currency translation differences | - | - |
| deferred tax | - | - |
| General Banking Risk Fund | 1 982 324 | 1 975 415 |
| Other reserve capital | 9 092 735 | 9 092 740 |
| Bonds convertible into shares- equity component | 28 819 | 28 819 |
| Funds for brokerage activities | 15 000 | 15 000 |
| **Total other capital** | **20 375 527** | **20 869 976** |
| Profit (loss) from previous periods, allocated to Bank's shareholders | (20 253) | (16 676) |
| Net profit for the period, allocated to Bank's shareholders | 2 279 275 | 2 292 459 |
| **Total retained earnings and profit for the period** | **2 259 022** | **2 275 783** |
| **Total** | **22 634 549** | **23 145 759** |

The net profit of the Bank for 2015 in the amount of PLN 2 290 398 thousand was distributed in the following way: PLN 2 283 489 thousand – to dividend, PLN 6 909 thousand – to General Banking Risk Fund.

From 1982 to 1984 and from 1988 to 1996, the Group operated in a hyperinflationary economic environment.

IAS 29 (Financial Reporting in Hyperinflationary Economies) requires restatement of each component of owners' equity (except for retained earnings and revaluation surplus) by applying a general price index for the period of hyperinflation. This retrospective application would have resulted in an increase in share capital and other reserves and a decrease in retained earnings in equivalent amounts. This restatement would not have any effect on the total amount of the Group's equity.

(In PLN thousand)

## 51. Non - controlling interests

The below table presents the information for each of the subsidiaries that have non-controlling interests that are material to the Group

| NAME OF THE SUBSIDIARY | COUNTRY OF INCORPORATION AND PLACE OF BUSINESS | PERCENTAGE SHARE OF NON-CONTROLLING INTERESTS IN SHARE CAPITAL / VOTING RIGHTS | | NET PROFIT FOR THE PERIOD ATTRIBUTABLE TO NON-CONTROLLING INTERESTS | | ACCUMULATED NON-CONTROLLING INTERESTS | |
|---|---|---|---|---|---|---|---|
| | | 31.12.2016 | 31.12.2015 | 2016 | 2015 | 31.12.2016 | 31.12.2015 |
| Pekao Pioneer Powszechne Towarzystwo Emerytalne S.A. | Poland | 35.00 | 35.00 | 489 | 1 019 | 14 924 | 15 964 |
| **TOTAL** | | | | **489** | **1 019** | **14 924** | **15 964** |

The summarized financial information of each of the subsidiaries that are material to the Group are presented below

| | PEKAO PIONEER POWSZECHNE TOWARZYSTWO EMERYTALNE S.A. | |
|---|---|---|
| | 2016 | 2015 |
| Loans and advances to banks | 15 256 | 44 995 |
| Investments (placement) securities | 27 214 | - |
| Other items of assets | 2 385 | 2 830 |
| **TOTAL ASSETS** | **44 855** | **47 825** |
| Other items of liabilities | 2 217 | 2 458 |
| **TOTAL LIABILITIES** | **2 217** | **2 458** |

| | PEKAO PIONEER POWSZECHNE TOWARZYSTWO EMERYTALNE S.A. | |
|---|---|---|
| | 2016 | 2015 |
| Revenue | 13 996 | 14 714 |
| Net profit for the period | 1 397 | 2 913 |
| **Total comprehensive income** | **1 397** | **2 913** |
| Dividends paid to non-controlling interests | 1 529 | 8 088 |
| Cash flows from operating activities | 1 911 | 3 662 |
| Cash flows from investing activities | (27 280) | (925) |
| Cash flows from financing activities | (4 369) | (23 108) |
| Net change in cash and cash equivalents | (29 738) | (20 371) |
| Cash and cash equivalents at the beginning of the period | 44 995 | 65 366 |
| Cash and cash equivalents at the end of the period | 15 257 | 44 995 |

(In PLN thousand)

# 52. Additional information to the consolidated cash flow statement

Cash and cash equivalents

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Cash and amounts due from Central Bank | 5 872 911 | 7 881 607 |
| Loans and receivables from banks with maturity up to 3 months | 2 793 179 | 6 631 788 |
| **Cash and Cash equivalents presented in the cash flow statement** | **8 666 090** | **14 513 395** |

Restricted availability cash and cash equivalents as at 31 December 2016 amounted to PLN 4 605 707 thousand (PLN 4 338 995 thousand as at 31 December 2015).

# 53. Related party transactions

Transactions between the Bank and related parties are typical transactions arising from current operating activities conducted by the Bank. Such transactions mainly include loans, deposits, foreign currency transactions and guarantees.

**The credit granting process applicable to the Bank's management and entities related to the Bank**
According to the Banking Act, credit transactions with Members of the Bank Management Board and Supervisory Board, persons holding managerial positions at the Bank, with the entities related financially or organizationally therewith, shall be effected according to Regulation adopted by the Supervisory Board of the Bank.

The Regulation provides detailed decision-making procedures, applicable to transactions with such persons and entities, also defining the decision-making levels, authorized to take decisions. In particular, transactions with Members of the Bank's Management Board or Supervisory Board or with an entity related therewith financially or organizationally, are subject to decisions taken by the Bank's Management Board and Supervisory Board.

Members of the Bank's Management Board and entities related therewith financially or organizationally may take advantage of credit products offered by the Bank on standard terms and conditions of the Bank. In particular, the Bank may not offer more advantageous credit interest rates to such persons or entities.

Credit risk assessment is performed using the methodology applied by the Bank, tailored to the client's segment and type of transaction.

In case of entities related to the Bank, the standard credit procedures are applied, with transaction-related decisions taken exclusively at level of the Bank's Head Office.

# Notes to the financial statements (cont.)

(In PLN thousand)

**Related party transactions**

Related party transactions as at 31 December 2016

| NAME OF ENTITY | RECEIVABLES FROM LOANS, ADVANCES AND PLACEMENTS | SECURITIES | RECEIVABLES FROM REVALUATION OF DERIVATIVES | OTHER RECEIVABLES | LIABILITIES FROM LOANS AND DEPOSITS | LIABILITIES FROM REVALUATION OF DERIVATIVES | OTHER LIABILITIES |
|---|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 187 357 | - | - | 443 | 9 261 | - | 1 674 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 682 836 | 9 719 | 32 072 | 1 306 | 614 127 | 620 819 | 2 972 |
| **Associates of Bank Pekao S.A Group** | | | | | | | |
| Dom Inwestycyjny Xelion Sp. z o.o. | - | - | - | 48 | 28 682 | - | - |
| Pioneer Pekao Investment Management S.A. | - | - | - | - | 137 850 | - | - |
| Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary) | - | - | - | 15 199 | 112 949 | - | - |
| **Total Associates of Bank Pekao S.A. Group** | **-** | **-** | **-** | **15 247** | **279 481** | **-** | **-** |
| Key management personnel of the Bank and UniCredit S.p.A. | 7 948 | - | - | - | 28 457 | - | - |
| **Total** | **878 141** | **9 719** | **32 072** | **16 996** | **931 326** | **620 819** | **4 646** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by contractual maturity

| 31.12.2016 | CURRENT (*) | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 12 342 | 175 015 | - | - | - | - | 187 357 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 597 829 | 85 007 | - | - | - | - | 682 836 |
| Associates of Bank Pekao S.A Group | - | - | - | - | - | - | - |
| Key management personnel of the Bank and UniCredit S.p.A. | - | 5 506 | - | - | 202 | 2 240 | 7 948 |
| **Total** | **610 171** | **265 528** | **-** | **-** | **202** | **2 240** | **878 141** |

(*) Current receivables includude Nostro accounts and cash collaterals.

Liabilities due to loans and deposits by contractual maturity

| 31.12.2016 | CURRENT (*) | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 9 261 | - | - | - | - | - | 9 261 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 65 821 | 126 115 | 315 | 1 451 | 420 425 | - | 614 127 |
| Associates of Bank Pekao S.A Group | 17 348 | 91 256 | 170 877 | - | - | - | 279 481 |
| Key management personnel of the Bank and UniCredit S.p.A. | 8 501 | 3 226 | 15 748 | 982 | - | - | 28 457 |
| **Total** | **100 931** | **220 597** | **186 940** | **2 433** | **420 425** | **-** | **931 326** |

(*) Current liabilities include Loro accounts and cash collaterals.

# Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by currency

| 31.12.2016 | EUR | USD | CHF | PLN | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 2 160 | 10 180 | - | 175 017 | - | 187 357 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 561 564 | 113 | 7 | 99 082 | 22 070 | 682 836 |
| Associates of Bank Pekao S.A Group | - | - | - | - | - | - |
| Key management personnel of the Bank and UniCredit S.p.A. | - | - | - | 7 948 | - | 7 948 |
| **Total** | **563 724** | **10 293** | **7** | **282 047** | **22 070** | **878 141** |

Liabilities due to loans and deposits by currency

| 31.12.2016 | EUR | USD | CHF | PLN | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 543 | - | - | 8 718 | - | 9 261 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 52 131 | - | 391 206 | 167 723 | 3 067 | 614 127 |
| Associates of Bank Pekao S.A Group | - | - | - | 279 481 | - | 279 481 |
| Key management personnel of the Bank and UniCredit S.p.A. | 6 818 | 295 | - | 21 333 | 11 | 28 457 |
| **Total** | **59 492** | **295** | **391 206** | **477 255** | **3 078** | **931 326** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Related party transactions as at 31 December 2015

| NAME OF ENTITY | RECEIVABLES FROMLOANS, ADVANCES AND PLACEMENTS | SECURITIES | RECEIVABLES FROM REVALUATION OF DERIVATIVES | OTHER RECEIVABLES | LIABILITIES FROM LOANS AND DEPOSITS | LIABILITIES FROM REVALUATION OF DERIVATIVES | OTHER LIABILITIES |
|---|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 605 703 | - | - | 605 | 1 209 | - | 2 415 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 1 114 848 | 7 724 | 55 861 | 4 843 | 1 507 266 | 653 064 | 966 |
| **Associates of Bank Pekao S.A Group** | | | | | | | |
| Dom Inwestycyjny Xelion Sp. z o.o. | - | - | - | 3 | 25 262 | - | 29 |
| Pioneer Pekao Investment Management S.A. | - | - | - | 35 | 162 752 | - | 23 |
| Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary) | - | - | - | 16 323 | 115 116 | - | 21 |
| **Total Associates of Bank Pekao S.A. Group** | **-** | **-** | **-** | **16 361** | **303 130** | **-** | **73** |
| Key management personnel of the Bank and UniCredit S.p.A. | 8 568 | - | - | - | 22 180 | - | - |
| **Total** | **1 729 119** | **7 724** | **55 861** | **21 809** | **1 833 785** | **653 064** | **3 454** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by contractual maturity

| 31.12.2015 | CURRENT (*) | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 8 497 | 597 206 | - | - | - | - | 605 703 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 616 160 | 94 797 | 482 | 779 | 402 630 | - | 1 114 848 |
| Associates of Bank Pekao S.A Group | - | - | - | - | - | - | - |
| Key management personnel of the Bank and UniCredit S.p.A. | - | 5 999 | - | 37 | 186 | 2 346 | 8 568 |
| **Total** | **624 657** | **698 002** | **482** | **816** | **402 816** | **2 346** | **1 729 119** |

(*) Current receivables include Nostro accounts and cash collaterals.

Liabilities due to loans and deposits by contractual maturity

| 31.12.2015 | CURRENT (*) | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 1 209 | - | - | - | - | - | 1 209 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 160 673 | 8 458 | 963 829 | - | 374 306 | - | 1 507 266 |
| Associates of Bank Pekao S.A Group | 16 224 | 92 203 | 194 703 | - | - | - | 303 130 |
| Key management personnel of the Bank and UniCredit S.p.A. | 4 474 | 4 007 | 9 841 | 3 808 | 50 | - | 22 180 |
| **Total** | **182 580** | **104 668** | **1 168 373** | **3 808** | **374 356** | **-** | **1 833 785** |

(*) Current liabilities include Loro accounts and cash collaterals.

# Notes to the financial statements (cont.)

(In PLN thousand)

Receivables from loans and deposits by currency

| 31.12.2015 | EUR | USD | CHF | PLN | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 243 767 | 350 936 | - | 11 000 | - | 605 703 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 598 100 | 403 900 | 7 | 67 079 | 45 762 | 1 114 848 |
| Associates of Bank Pekao S.A Group | - | - | - | - | - | - |
| Key management personnel of the Bank and UniCredit S.p.A. | - | - | - | 8 568 | - | 8 568 |
| **Total** | **841 867** | **754 836** | **7** | **86 647** | **45 762** | **1 729 119** |

Liabilities due to loans and deposits by currency

| 31.12.2015 | EUR | USD | CHF | PLN | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | - | - | - | 1 209 | - | 1 209 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 1 010 843 | 261 | 374 306 | 121 856 | - | 1 507 266 |
| Associates of Bank Pekao S.A Group | - | - | - | 303 130 | - | 303 130 |
| Key management personnel of the Bank and UniCredit S.p.A. | 7 129 | 920 | - | 14 128 | 3 | 22 180 |
| **Total** | **1 017 972** | **1 181** | **374 306** | **440 323** | **3** | **1 833 785** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Income and expenses from transactions with related parties for the period from 1 January 2016 to 31 December 2016

| NAME OF ENTITY | INTEREST INCOME | INTERES EXPENSE | FEE AND COMMISSION INCOME | FEE AND COMMISSION EXPENSE | POSITIVE VALUATION OF DERIVATIVES AND OTHER INCOME | NEGATIVE VALUATION OF DERIVATIVES AND OTHER EXPENSES |
|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | (137) | (375) | 1 239 | (2 723) | 3 158 | (13 368) |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 13 416 | (4 448) | 9 282 | (246) | 18 580 | (55 879) |
| **Associates of Bank Pekao S.A Group** | | | | | | |
| Pioneer Pekao Investment Management S.A. | - | (1 862) | 197 | - | 14 | - |
| Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary) | - | (1 370) | 189 607 | - | 4 | - |
| Dom Inwestycyjny Xelion Sp.z o.o. | - | (323) | 45 | (171) | 318 | - |
| **Total Associates of Bank Pekao S.A. Group** | **-** | **(3 555)** | **189 849** | **(171)** | **336** | **-** |
| Key management personnel of the Bank and UniCredit S.p.A. | 237 | (318) | 17 | - | - | - |
| **Total** | **13 516** | **(8 696)** | **200 387** | **(3 140)** | **22 074** | **(69 247)** |

Income and expenses from transactions with related parties for the period from 1 January 2015 to 31 December 2015

| NAME OF ENTITY | INTEREST INCOME | INTERES EXPENSE | FEE AND COMMISSION INCOME | FEE AND COMMISSION EXPENSE | POSITIVE VALUATION OF DERIVATIVES AND OTHER INCOME | NEGATIVE VALUATION OF DERIVATIVES AND OTHER EXPENSES |
|---|---|---|---|---|---|---|
| UniCredit S.p.A. – the Bank's parent entity | 216 | (246) | 1 689 | (3 070) | 811 | (15 664) |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 42 043 | (4 242) | 9 388 | (1 329) | 41 577 | (6 896) |
| **Associates of Bank Pekao S.A Group** | | | | | | |
| Pioneer Pekao Investment Management S.A. | - | (2 761) | 357 | - | 26 | - |
| Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary) | - | (1 973) | 226 313 | - | - | - |
| Dom Inwestycyjny Xelion Sp.z o.o. | - | (361) | 64 | (117) | 314 | (1) |
| Krajowa Izba Rozliczeniowa S.A. (*) | - | (135) | 57 | - | - | (4 303) |
| **Total Associates of Bank Pekao S.A. Group** | **-** | **(5 230)** | **226 791** | **(117)** | **340** | **(4 304)** |
| Key management personnel of the Bank and UniCredit S.p.A. | 253 | (419) | 17 | - | - | - |
| **Total** | **42 512** | **(10 137)** | **237 885** | **(4 516)** | **42 728** | **(26 864)** |

(*) until sale's date 3 125 shares.

# Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial liabilities and guarantees as at 31 December 2016

| NAME OF ENTITY | GRANTED | | RECEIVED | |
|---|---|---|---|---|
| | FINANCIAL | GUARANTEES | FINANCIAL | GUARANTEE |
| UniCredit S.p.A. – the Bank's parent entity | 50 162 | 246 519 | - | 53 963 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 202 191 | 599 604 | 5 192 | 192 481 |
| **Associates of Bank Pekao S.A Group** | | | | |
| Pioneer Pekao Investment Management S.A. | 15 | - | - | - |
| Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary) | 96 | - | - | - |
| **Total Associates of Bank Pekao S.A. Group** | **111** | **-** | **-** | **-** |
| Key management personnel of the Bank and UniCredit S.p.A. | 217 | - | - | - |
| **Total** | **252 681** | **846 123** | **5 192** | **246 444** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees by contractual maturity

| 31.12.2016 | CURRENT | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|
| **FINANCIAL COMMITMENTS GRANTED** | | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | - | - | - | - | - | 50 162 | 50 162 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | - | - | - | - | - | 202 191 | 202 191 |
| Associates of Bank Pekao S.A Group | - | - | | - | 111 | - | 111 |
| Key management personnel of the Bank and UniCredit S.p.A. | 30 | - | 5 | - | 182 | - | 217 |
| **Total** | **30** | **-** | **5** | **-** | **293** | **252 353** | **252 681** |
| **GUARANTEES ISSUED** | | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | - | 2 624 | - | 50 190 | 81 659 | 112 046 | 246 519 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | - | 9 343 | 24 475 | 113 978 | 293 599 | 158 209 | 599 604 |
| **Total** | **-** | **11 967** | **24 475** | **164 168** | **375 258** | **270 255** | **846 123** |
| **FINANCIAL COMMITMENTS RECEIVED** | | | | | | | |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | - | 5 192 | - | - | - | - | 5 192 |
| **Total** | **-** | **5 192** | **-** | **-** | **-** | **-** | **5 192** |
| **GUARANTEES RECEIVED** | | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | - | 4 645 | 752 | 33 619 | 13 399 | 1 548 | 53 963 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | - | - | 3 322 | 75 122 | 11 062 | 102 975 | 192 481 |
| **Total** | **-** | **4 645** | **4 074** | **108 741** | **24 461** | **104 523** | **246 444** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees by currency

| 31.12.2016 | EUR | USD | CHF | PLN | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| **FINANCIAL COMMITMENTS GRANTED** | | | | | | |
| UniCredit S.p.A. – the Bank‘s parent entity | 30 164 | - | - | 19 998 | - | 50 162 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 98 535 | 41 716 | - | 61 580 | 360 | 202 191 |
| Associates of Bank Pekao S.A Group | - | - | - | 111 | - | 111 |
| Key management personnel of the Bank and UniCredit S.p.A. | - | - | - | 217 | - | 217 |
| **Total** | **128 699** | **41 716** | **-** | **81 906** | **360** | **252 681** |
| **GUARANTEES ISSUED** | | | | | | |
| UniCredit S.p.A. – the Bank‘s parent entity | 12 167 | - | - | 234 352 | - | 246 519 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 53 077 | - | - | 546 527 | - | 599 604 |
| **Total** | **65 244** | **-** | **-** | **780 879** | **-** | **846 123** |
| **FINANCIAL COMMITMENTS RECEIVED** | | | | | | |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | - | - | - | - | 5 192 | 5 192 |
| **Total** | **-** | **-** | **-** | **-** | **5 192** | **5 192** |
| **GUARANTEES RECEIVED** | | | | | | |
| UniCredit S.p.A. – the Bank‘s parent entity | 29 130 | - | - | 24 833 | - | 53 963 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 109 606 | - | - | 82 090 | 785 | 192 481 |
| **Total** | **138 736** | **-** | **-** | **106 923** | **785** | **246 444** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees as at 31 December 2015

| NAME OF ENTITY | GRANTED | | RECEIVED |
|---|---|---|---|
| | FINANCIAL | GUARANTEES | GUARANTEE |
| UniCredit S.p.A. – the Bank's parent entity | 48 223 | 236 659 | 14 588 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 179 072 | 890 343 | 34 490 |
| **Associates of Bank Pekao S.A Group** | | | |
| Dom Inwestycyjny Xelion Sp. z o.o. | 2 000 | - | - |
| Pioneer Pekao Investment Management S.A. | 15 | - | - |
| Pioneer Pekao TFI S.A. (PPIM S.A. subsidiary) | 52 | - | - |
| **Total Associates of Bank Pekao S.A. Group** | **2 067** | **-** | **-** |
| Key management personnel of the Bank and UniCredit S.p.A. | 697 | - | - |
| **Total** | **230 059** | **1 127 002** | **49 078** |

As at 31 December 2015, the Group did not have off-balance sheet financial commitments received from related parties.

# Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees by contractual maturity

| 31.12.2015 | CURRENT | UP TO 1 MONTH | BETWEEN 1 AND 3 MONTHS | BETWEEN 3 MONTHS AND 1 YEAR | BETWEEN 1 AND 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|
| **FINANCIAL COMMITMENTS GRANTED** | | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | - | - | - | 28 223 | - | 20 000 | 48 223 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | - | - | - | 179 072 | - | - | 179 072 |
| Associates of Bank Pekao S.A Group | - | - | - | 2 007 | 60 | - | 2 067 |
| Key management personnel of the Bank and UniCredit S.p.A. | 30 | 515 | 5 | 18 | 129 | - | 697 |
| **Total** | **30** | **515** | **5** | **209 320** | **189** | **20 000** | **230 059** |
| **GUARANTEES ISSUED** | | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | - | 2 631 | 17 719 | 66 440 | 83 818 | 66 051 | 236 659 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | - | 16 189 | 98 861 | 90 053 | 322 855 | 362 385 | 890 343 |
| **Total** | **-** | **18 820** | **116 580** | **156 493** | **406 673** | **428 436** | **1 127 002** |
| **GUARANTEES RECEIVED** | | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | - | - | - | 11 300 | 3 288 | - | 14 588 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | - | - | 553 | 30 406 | 3 531 | - | 34 490 |
| **Total** | **-** | **-** | **553** | **41 706** | **6 819** | **-** | **49 078** |

# Notes to the financial statements (cont.)

(In PLN thousand)

Off-balance sheet financial commitments and guarantees by currency

| 31.12.2015 | EUR | USD | CHF | PLN | OTHER | TOTAL |
|---|---|---|---|---|---|---|
| **FINANCIAL COMMITMENTS GRANTED** | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | 28 223 | - | - | 20 000 | - | 48 223 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 77 772 | - | - | 101 300 | - | 179 072 |
| Associates of Bank Pekao S.A Group | - | - | - | 2 067 | - | 2 067 |
| Key management personnel of the Bank and UniCredit S.p.A. | - | - | - | 697 | - | 697 |
| **Total** | **105 995** | **-** | **-** | **124 064** | **-** | **230 059** |
| **GUARANTEES ISSUED** | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | 10 497 | - | - | 226 162 | - | 236 659 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 60 778 | - | - | 829 565 | - | 890 343 |
| **Total** | **71 275** | **-** | **-** | **1 055 727** | **-** | **1 127 002** |
| **GUARANTEES RECEIVED** | | | | | | |
| UniCredit S.p.A. – the Bank's parent entity | 3 288 | - | - | 11 300 | - | 14 588 |
| Entities of UniCredit Group excluding of Bank Pekao S.A. Group entities | 8 147 | - | - | 26 343 | - | 34 490 |
| **Total** | **11 435** | **-** | **-** | **37 643** | **-** | **49 078** |

(In PLN thousand)

**Remuneration of Bank's Management Board and Supervisory Board Members**
Short-term employee benefits related to the Management Board of the Bank in of 2016 amounted to PLN 19 120 thousand, compared to PLN 17 144 thousand in 2015. Short-term employee benefits included: base salary, bonuses and other benefits due in next 12 months from the balance sheet date.

Long-term benefits related to the Management Board of the Bank amounted to PLN 2 083 thousand in 2016, compared to PLN 2 453 thousand in 2015 and comprised of provisions for deferred bonus payments.

The expenses in 2016 included PLN 5 393 thousand in respect of share-based payments, compared to PLN 3 473 thousand in 2015. The value of share-based payments is a part of Personnel Expenses, recognized according to IFRS 2 during the reporting period in the income statement, representing the settlement of fair value of phantom shares, granted to the Members of the Bank's Management Board.

Remuneration expenses of Supervisory Board of the Bank, comprising short-term employee benefits, amounted to PLN 1 069 thousand in 2016, compared to PLN 978 thousand in 2015.

The Bank's Management Board and Supervisory Board Members did have not received any remuneration from subsidiaries and associates in 2016 and 2015.

**Remuneration of Supervisory Boards and Management Boards of subsidiaries**
Remuneration expenses of Management Boards of Group's subsidiaries, comprising short-term employee benefits, amounted to PLN 14 810 thousand in 2016, compared to PLN 14 427 thousand in 2015.

Remuneration expenses of Supervisory Boards of Group's subsidiaries, comprising short-term employee benefits, amounted to PLN 343 thousand in 2016, compared to PLN 183 thousand in 2015.

# 54. Repo and reverse repo transactions

The Group increases its funds by sales transactions with the repurchase promise granted (repo and sell-buy back) at the same price increased by interest.

Securities composing the balance sheet portfolio of the Group as well as securities with obligation of resale (reverse repo and buy-sell back transactions) may be a subject to repo and sell-buy back transactions.

Securities composing the balance sheet portfolio of the Group and treated as repo and sell-buy back transactions are not derecognized from the statement of financial position due to the fact that the Group holds all the benefits and the risk deriving from these assets.

| | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|
| | FAIR VALUE OF ASSETS | CARRYING AMOUNT OF RESPECTIVE LIABILITIES | FAIR VALUE OF ASSETS | CARRYING AMOUNT OF RESPECTIVE LIABILITIES |
| Financial assets available for sale | | | | |
| up to 1 month | 1 599 015 | 1 599 789 | 2 359 798 | 2 357 096 |
| from 1 to 3 months | - | - | 1 032 882 | 1 029 821 |
| from 3 months to 1 year | - | - | 1 503 | 1 504 |
| **Total financial assets available for sale** | **1 599 015** | **1 599 789** | **3 394 183** | **3 388 421** |
| Financial assets held for trading | | | | |
| up to 1 month | 175 732 | 176 019 | - | - |
| **Total financial assets held for trading** | **175 732** | **176 019** | **-** | **-** |
| Financial assets purchased under reverse-repo and buy-sell back | | | | |
| up to 1 month | - | - | 2 050 199 | 2 044 228 |
| **Total financial assets purchased under reverse-repo and buy-sell back** | **-** | **-** | **2 050 199** | **2 044 228** |
| **Total** | **1 774 747** | **1 775 808** | **5 444 382** | **5 432 649** |

# Notes to the financial statements (cont.)

(In PLN thousand)

The Group purchases financial instruments with the obligations of repurchase or resale (reverse-repo and buy-sell back) at the same price increased by interest.

Securities treated as reverse-repo and buy-sell back transactions are not disclosed at the statement of financial position due to the fact that the Group do not holds all the advantages of risks and awareness deriving from these assets.

| | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|
| | CARRYING AMOUNT OF ASSETS | FAIR VALUE OF HEDGE ASSETS | CARRYING AMOUNT OF ASSETS | FAIR VALUE OF HEDGE ASSETS |
| Loans and advances from banks | | | | |
| up to 1 month | 703 635 | 700 960 | 1 757 063 | 1 757 459 |
| **Total loans and advances from bank** | **703 635** | **700 960** | **1 757 063** | **1 757 459** |
| Loans and advances from customers | | | | |
| up to 1 month | - | - | 4 755 472 | 4 762 663 |
| **Total loans and advances from customers** | **-** | **-** | **4 755 472** | **4 762 663** |
| **Total** | **703 635** | **700 960** | **6 512 535** | **6 520 122** |

Financial assets subject to reverse repo and buy-sell back transactions constitute collateral accepted by the Group, which the Group has the right to sell or pledge.

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Fair value of assets pledged as collaterals, in this: | 700 960 | 6 520 122 |
| Short sale | 673 165 | 611 442 |
| Reverse repo transactions/ buy-sell back | - | 2 050 199 |

## 55. Company Social Benefits Fund (‘ZFŚS’)

The Social Benefits Fund Act of 4 March 1994 with subsequent amendments introduced the requirement to create a Company’s Social Benefits Fund by all employers employing over 20 employees. The Bank and Group companies employing at least 20 staff have created the ZFŚS Fund and are making periodic charges to the ZFŚS Fund in amounts required by the Act. The basic aim of the ZFŚS Fund is to subsidize social assistance in benefit of the employees, former employees (pensioners and the retired) and entitled members of their families.

The liabilities of the ZFŚS Fund represent the accumulated value of charges made by the Company towards the ZFŚS Fund decreased by the amount of non-returnable expenditures of the ZFŚS Fund.

In the consolidated statement of financial position, the Group netted the ZFŚS Fund assets against the ZFŚS Funds value, due to the fact that the assets of the ZFŚS Fund do not represent the assets of the Group. For this reason the amount pertaining to the ZFŚS Fund in the consolidated statement of financial position as at 31 December 2016 and 31 December 2015 was zero.

(In PLN thousand)

The table below presents the assets according to type and book value, the balance of the Fund and costs related to ZFŚS:

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Loans granted to employees | 39 022 | 44 030 |
| Cash at ZFŚS account | 3 760 | 8 576 |
| **ZFŚS assets** | **42 782** | **52 606** |
| **ZFŚS value** | **42 782** | **52 606** |
| | **2016** | **2015** |
| Deductions made to ZFŚS during fiscal period | 25 104 | 25 888 |

## 56. Subsequent events

There have been no significant subsequent events.

# Signatures of all Management Board Members

| Date | Name/Surname | Position/Function | Signature |
|---|---|---|---|
| 09.02.2017 | Luigi Lovaglio | President of the Management Board, CEO | |
| 09.02.2017 | Diego Biondo | Vice President of the Management Board | |
| 09.02.2017 | Andrzej Kopyrski | Vice President of the Management Board | |
| 09.02.2017 | Adam Niewiński | Vice President of the Management Board | |
| 09.02.2017 | Grzegorz Piwowar | Vice President of the Management Board | |
| 09.02.2017 | Stefano Santini | Vice President of the Management Board | |
| 09.02.2017 | Marian Ważyński | Vice President of the Management Board | |

# Glossary

## Glossary

**IFRS** – International Financial Reporting Standards – the standards, interpretations and their structure adopted by the International Accounting Standards Board (IASB.)

**IAS** – International Accounting Standards – previous name of the standards forming part of the current IFRS.

**IFRIC** – International Financial Reporting Interpretations Committee – the committee operating under the International Accounting Standards Board publishing interpretations of IFRS.

**CIRS** – Currency Interest Rate Swap – the transaction exchange of principal amounts and interest payments in different currencies between two counterparties.

**IRS** – Interest Rate Swap – the agreement between two counterparties, under which the counterparties pay each other (at specified intervals during the contract life) interest on contractual principal of the contract, charged at a different interest rate.

**FRA** – Forward Rate Agreement – the contract under which two counterparties fix the interest rate that will apply in the future for a specified amount expressed in currency of the transaction for a predetermined period.

**CAP** – the financial agreement, which limits the risk borne by lender on a variable interest rate, exposed to the potential loss as a result of increase in interest rates. Cap option is a series of call options on interest rates, in which the issuer guarantees the buyer the compensation of the additional interest costs, that the buyer must pay if the interest rate on loan increases above the fixed interest rate.

**FLOOR** –the financial agreement, which limits the risk of incurring losses resulting from decrease in interest rates by the lender providing the loan at a variable interest rate. Floor option is a series of put options on interest rates, in which the issuer guarantees the interest to be paid on the loan if the interest rate on the loan decreases below the fixed interest rate.

**IBNR** – Incurred But Not Reported losses.

**PD** – Probability Default – the parameter used in Internal Ratings-Based Approach which determines the likelihood that the debtor will be unable to meet its obligation. PD is a financial term describing the likelihood of a default over an one year time horizon.

**LGD** – Loss Given Default – the percentage of loss over the total exposure when bank's counterparty goes to default.

**EAD** – Exposure At Default.

**EL** – Expected Loss.

**CCF** – Credit Conversion Factor.

**A-IRB** – Advanced Internal Ratings-Based Approach – advanced method where all parameters of risk (PD, LGD, EAD) are estimated by the bank using its own quantitative model for calculating the risk weighted assets (RWA).

**VaR** – Value at Risk – the risk measure by which the market value of an asset or portfolio may be reduced for a given assumptions, probability and time horizon.

**EaR** – Earnings at Risk – the maximum decrease of earnings, relative to specific goal, which might occur due to impact of market risk on specific risk factors for the given time horizon and confidence level.

**ICAAP** – Internal Capital Adequacy Assessment Process – the process of assessing internal capital adequacy.

# Report on the activities of Bank Pekao S.A. Group for the year 2016

**Warsaw, February 2017**

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

# Table of Contents

# Report on the activities of Bank Pekao S.A. Group for the year 2016

## 1 Highlights of Bank Pekao S.A. Group

| | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|---|
| **INCOME STATEMENT CONTINUED OPERATIONS – SELECTED ITEMS(*)** | | | | | | *(in PLN million)* |
| Operating income | 7,347 | 7,059 | 7,346 | 7,494 | 7,790 | 7,567 |
| Operating costs | (3,212) | (3,220) | (3,286) | (3,331) | (3,445) | (3,497) |
| Operating profit | 4,135 | 3,839 | 4,060 | 4,162 | 4,345 | 4,070 |
| Profit before income tax | 2,897 | 2,831 | 3,360 | 3,433 | 3,619 | 3,519 |
| Net profit for the period attributable to equity holders of the Bank | 2,279 | 2,293 | 2,715 | 2,767 | 2,906 | 2,842 |
| **INCOME STATEMENT – SELECTED ITEMS** | | | | | | *(in PLN million)* |
| Operating income | 7,347 | 7,059 | 7,346 | 7,565 | 7,953 | 7,808 |
| Operating costs | (3,212) | (3,220) | (3,286) | (3,376) | (3,529) | (3,583) |
| Operating profit | 4,135 | 3,839 | 4,060 | 4,189 | 4,424 | 4,225 |
| Profit before income tax | 2,897 | 2,831 | 3,360 | 3,454 | 3,664 | 3,593 |
| Net profit for the period attributable to equity holders of the Bank | 2,279 | 2,293 | 2,715 | 2,785 | 2,943 | 2,899 |
| **PROFITABILITY RATIOS** | | | | | | |
| Return on average equity (ROE) | 9.8% | 9.7% | 11.5% | 12.0% | 13.3% | 14.2% |
| Return on assets (ROA) | 1.4% | 1.4% | 1.8% | 1.9% | 2.0% | 2.2% |
| Net interest margin | 2.8% | 2.8% | 3.1% | 3.4% | 3.7% | 3.7% |
| Non-interest income / operating income | 39.6% | 40.0% | 38.3% | 39.6% | 37.3% | 40.6% |
| Cost / income | 43.7% | 45.6% | 44.7% | 44.6% | 44.4% | 45.9% |
| **STATEMENT OF FINANCIAL POSITION – SELECTED ITEMS** | | | | | | *(in PLN million)* |
| Total assets | 174,215 | 168,786 | 167,625 | 158,522 | 150,755 | 146,590 |
| Net loans and advances to customers(**) | 122,663 | 117,299 | 109,189 | 101,356 | 94,864 | 93,895 |
| Amounts due to customers(***) | 136,380 | 124,399 | 120,630 | 116,129 | 102,898 | 103,822 |
| Debt securities issued | 1,523 | 2,903 | 3,857 | 3,064 | 4,759 | 3,044 |
| Equity | 22,912 | 23,424 | 24,046 | 23,514 | 23,264 | 21,357 |
| **STATEMENT OF FINANCIAL POSITION STRUCTURE RATIOS** | | | | | | |
| Net loans(**) / total assets | 70.4% | 69.5% | 65.1% | 63.9% | 62.9% | 64.1% |
| Securities / total assets | 20.6% | 13.2% | 15.0% | 22.2% | 19.5% | 20.4% |
| Deposits(****) / total assets | 79.2% | 75.4% | 74.3% | 75.2% | 71.4% | 72.9% |
| Net loans(**) / deposits(****) | 88.9% | 92.1% | 87.7% | 85.0% | 88.1% | 87.9% |
| Equity / total assets | 13.2% | 13.9% | 14.3% | 14.8% | 15.4% | 14.6% |
| Total capital ratio (Basel III)(*****) | 17.6% | 17.7% | 17.3% | 18.3% | 18.1% | 17.0% |
| **EMPLOYEES AND NETWORK** | | | | | | |
| Total number of employees | 17,757 | 18,327 | 18,765 | 18,916 | 19,816 | 20,357 |
| Number of outlets (Bank Pekao S.A. and PJSC UniCredit Bank) | 928 | 975 | 1,034 | 1,001 | 1,040 | 1,051 |
| Number of ATMs (Bank Pekao S.A. and PJSC UniCredit Bank) | 1,761 | 1,759 | 1,825 | 1,847 | 1,919 | 1,910 |

(*) As financial data for the period 2014 – 2016 don't include results of PJSC UniCredit Bank – sold on July 16, 2013, in order to ensure comparability, the section "Income statement continued operations – selected items" was added where for the previous periods only results of continued operations are reported.

(**) Including debt securities eligible for rediscounting at Central Bank and net investments in financial leases to customers and excluding reverse repo transactions.

(***) Excluding repo transactions.

(****) Deposits include amounts due to customers and debt securities issued.

(*****) The total capital ratio for the period 2012- 2016 is calculated in accordance with the 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 force since January 1, 2014. The total capital ratio (previously capital adequacy ratios) for 2011 was calculated in accordance with the methodology which was in force before January 1, 2014.

Note: Since 2013 in the income statement in a presentation form, to align the presentation to the standards implemented by the major Polish and European banks, gains on disposal of available for sale financial assets and held to maturity investments are reported under trading result (and thus in operating income, operating profit and respective ratios). In order to ensure comparability, data for the period 2011 – 2012 have been restated in comparison to those previously published.

In relation to changes in accounting policy in 2013 (for description refer to the Note 5 to the Consolidated Financial Statement of Bank Pekao S.A. Group for the period ended on December 31, 2014) data for the period 2012-2016 have been presented in accordance with the new rules. Data for earlier period remain unchanged.

Since 2014, the financial data include data of Spółdzielcza Kasa Oszczędnościowo Kredytowa named Mikołaj Kopernik in Ornontowice, took over by Bank Pekao S.A. following decision of The Polish Financial Supervision Authority on December 5, 2014.

Income statement data included in the table above and other notes to the Report on activities were presented according to income statement in a presentation form, which differs from the long form of the income statement presented in the Financial statements of the Group. Reconciliation of income statement in the presentation form and the long form is in the point 7.4.4 of the Report on activities of the Group.

# 2 Summary of Performance

Net profit of Bank Pekao S.A. Group attributable to equity holders for 2016 amounted to PLN 2,279.3 million after tax on certain financial institutions in the amount of PLN 449.5 million and the extraordinary one-off charge of PLN 16.6 million to the Bank Guarantee Fund in relation to bankruptcy of Bank Spółdzielczy in Nadarzyn. Strong contribution to the results was brought by a substantial growth of loan and deposit volumes in key strategic areas, further progress in cost optimization and lower cost of risk, also thanks to successful recoveries from vindication activity.

Underlying net profit of Bank Pekao S.A. Group i.e. excluding net impact of significant extraordinary charges and one-off non-recurring items in 2016 would amount to PLN 2,367.8 million and would be higher by PLN 185.9 million, i.e. 8.5% than comparable net profit achieved in 2015.

Thanks to the effective commercial activity of the Group in 2016 a significant growth in loan volumes was reported in the area of retail loans (an increase of 7.7% year on year) and a 1.3% year on year growth in the area of corporate loans and non-quoted securities. Such increase in lending was financed by higher volumes of retail deposits growing 11.0% year on year.

The solid liquidity structure of Bank Pekao S.A. Group is reflected by net loans to deposits ratio at 88.9% as at the end of December 2016. This, together with high equity level reflected by total capital ratio (Basel III) amounting to 17.6%, enables for further sound and stable development of the Group's activities.

### Main P&L items

In 2016, the Group's operating income amounted to PLN 7,347.2 million, an increase of PLN 288.6 million, i.e. 4.1% in comparison to 2015 with the following trends:

– Total net interest income, dividend income and income from equity investments in 2016 amounted to PLN 4,437.4 million and was higher by PLN 205.1 million, i.e. 4.8% compared to 2015 driven by higher volumes,

– Net non-interest income in 2016 amounted to PLN 2,909.8 million, higher by PLN 83.5 million, i.e. 3.0% in comparison with 2015 thanks to higher trading result supported also by gains on settlement of the transaction of the acquisition of Visa Europe Limited by Visa Inc. and by higher net other operating income supported by disposal of loans, with net fee and commission income lower by 2.3% compared to 2015 mainly due to some pressure observed on capital market related fees.

The operating costs amounted to PLN 3,211.9 million in 2016. They were lower by PLN 7.8 million, i.e. 0.2% as compared with 2015.

Guarantee funds charges in 2016, amounted to PLN 262.9 million, a decrease of PLN 11.5 million, i.e. 4.2% in comparison with 2015.

On February 1, 2016 tax on certain financial institutions under the Act on tax on certain financial institutions was introduced. In 2016, it amounted to PLN 449.5 million.

In 2016, the Group additionally incurred one-off charges in the amount of PLN 16.6 million related to the contribution to the BGF for the purpose of payments of the funds guaranteed to the depositors of the bankrupt Bank Spółdzielczy in Nadarzyn.

The Group's net impairment losses on loans and off-balance sheet commitments amounted to PLN 500.6 million in 2016, a decrease of PLN 16.9 million, i.e. 3.3% as compared with 2015.

### Volumes

As at the end of December 2016, loans and advances at nominal value and securities issued by non-monetary entities amounted to PLN 128,304.3 million, an increase of PLN 5,048.9 million, i.e. 4.1% in comparison to the end of December 2015 with significant growth in key strategic areas.

- As at the end of December 2016, the volume of retail loans amounted to PLN 58,109.9 million, an increase of PLN 4,165.3 million, i.e. 7.7% in comparison to the end of December 2015,
- The volume of corporate loans, non-quoted securities and securities issued by non-monetary entities amounted to PLN 70,194.4 million as at the end of December 2016, an increase of PLN 883.6 million, i.e. 1.3% as compared to the end of December 2015.

As at the end of December 2016, there were no reverse repo transactions. As of December 31, 2015, reverse repo transactions amounted to PLN 4,753.2 million.

As of December 31, 2016, the ratio of impaired receivables to total receivables excluding reverse repo transactions amounted to 6.0% as compared to 6.5% as at the end of December 2015.

As at the end of December 2016, the total amounts due to the Group's customers and debt securities issued amounted to PLN 137,902.7 million, an increase of PLN 10,600.7 million, i.e. 8.3% in comparison to the end of December 2015.

- The total volume of retail customers deposits, Structured Certificates of Deposit and other amounted to PLN 70,724.8 million as at the end of December 2016, an increase of PLN 6,859.5 million, i.e. 10.7% in comparison to the end of December 2015,
- The total volume of corporate deposits, Certificates of Deposit, Pekao Bank Hipoteczny S.A. covered bonds, interest and other amounted to PLN 67,177.9 million as at the end of December 2016, an increase of PLN 3,741.2 million, i.e. 5.9% as compared to the end of December 2015 while continuing selective pricing approach and focus on securing liquidity needs of the Group.

Repo transactions amounted to PLN 1,436.2 million as at the end of December 2016, a decrease by PLN 3,032.7 million, i.e. 67.9% in comparison to the end of December 2015.

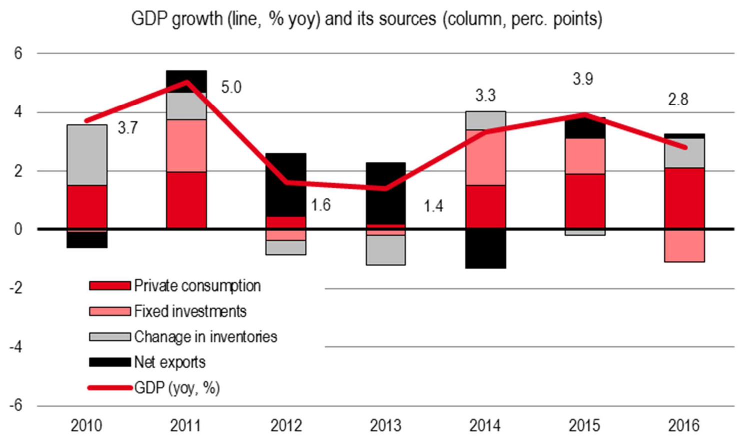
The value of net assets of investment funds managed by Pioneer Pekao TFI S.A. amounted to PLN 16,793.9 million as at the end of December 2016, an increase of PLN 91.4 million, i.e. 0.5% in comparison to the end of December 2015.

# 3 External Activity Conditions

**Economic growth**

Poland's economic growth in 2016 estimated by Główny Urząd Statystyczny (Central Statistical Office) accounted for 2.8% as compared with the GDP growth of 3.9% in 2015. Economic growth slowed markedly, moderating towards about 2.5% year on year in the second half of 2016 due to deepening declines in investments. In 2016 as a whole, fixed investments decreased by 5.5% after an increase of 6.1% in 2015. The main engine of economic growth in 2016 was households consumption growth by 3.6% on the back of continued improvement on the labour market, what positively influenced disposable income of households. Consumer incomes were also supported by payments of Family 500 plus government program (in total just over PLN 17 billion in 2016). Foreign trade had neutral impact on the GDP growth in 2016. Net exports contributed positively to the GDP in 2016 and accounted for ca. 0.1 p.p. vs. 0.7 p.p. in 2015.

In 2017, the GDP growth is expected to accelerate slightly to ca. 3.0%. Domestic demand will still be supported by a robust growth of households consumption fueled by further improvement in the labour market conditions and higher social transfers (households will receive ca. PLN 23 billion within Family 500 plus program). At the same time, delays in implementing projects co-financed with the European Union funds from 2014-2020 financial perspective along with subdued propensity to invest in the private sector are likely to translate into further slight decline in fixed investments. Key external risks are linked to developments in the troubled Italian banking sector and changes in the U.S. economic policy under the new U.S. administration.

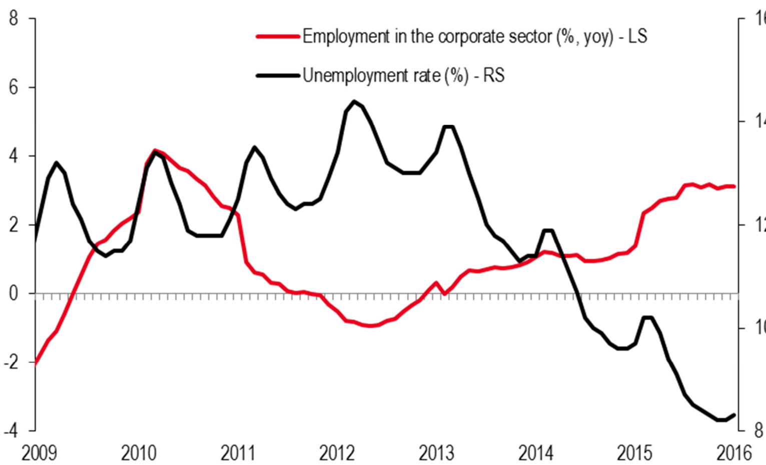


**Labor market**

Average employment in the Polish corporate sector amounted to 5,799 thousand people in December 2016, by ca. 173 thousand more than in December 2015. The increase in employment in 2016, was a continuation of the upward trend in the number of jobs, which began in mid-2013 and in 2016 noted considerable acceleration. The centers of job creation in 2016 were still, as in the previous year, the manufacturing sector, trade and services (especially transportation), while job cuts still dominated in the construction sector (the fifth consecutive year) and the mining industry (long-term trend).

In 2016, it was a continuation of the downward trend in unemployment rate, which in December 2016 was at 8.3% compared to 9.7% in December 2015. It is expected that in 2017, the downward trend in unemployment rate will be continued, though at a much slower pace than in the recent years due to the emerging constraints of labour supply.

Wage growth rate in the Polish corporate sector in 2016 registered slight acceleration, which was supported by rising tensions on the domestic labour market resulting from shortage of labour supply. The average wage in the corporate sector increased in 2016 by 3.8% compared with an increase of 3.5% in the previous year. As a result, wage bill in the corporate sector increased in 2016 in nominal terms by 6.7% against 4.8% in 2015, which after adjusting for deflation resulted in an increase in real terms by 7.4% in 2016 compared to 5.8% in 2015.



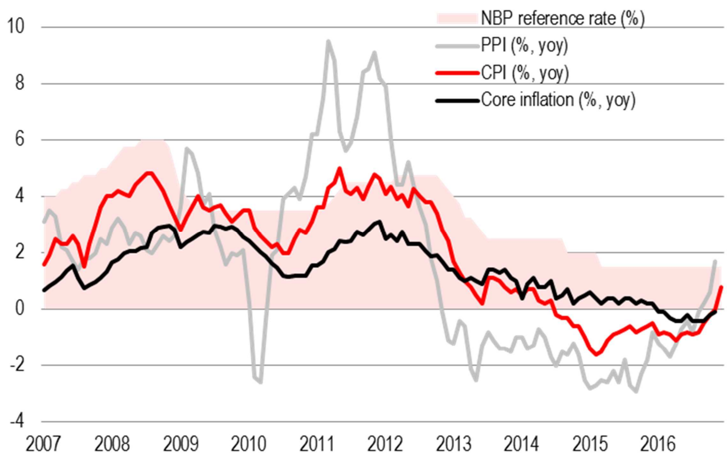
**Inflation and monetary policy**

Data from the Central Statistical Office showed that average level of inflation amounted to -0.6% in 2016 vs. -0.9% in 2015. The CPI has been below the lower limit of the range of permissible deviations from the inflation target of the National Bank of Poland (NBP) since February 2013, the center of which is defined at 2.5%, and the scope ranges from 1.5-3.5%. In December 2016, the CPI reached 0.8% year on year.

The biggest impact on low inflation level came from declines in prices of transport, clothing and footwear, and goods and services from the category of "recreation and culture". In 2016, there was a decline in core inflation (excluding food and energy prices) to 0.0% from 0.3% in 2015. Besides a decrease in consumer price inflation, it was recorded a drop in producer prices in 2016.

The Monetary Policy Council (MPC) kept interest rates unchanged throughout 2016. The reference rate remained at 1.50%, the Lombard rate at 2.50% and the deposit rate at 0.50%.

In 2017, it is expected a strong increase in CPI inflation. It will be largely due to higher food and transport prices. Inflation may return to the NBP target (2.5%) in the third quarter of 2017.

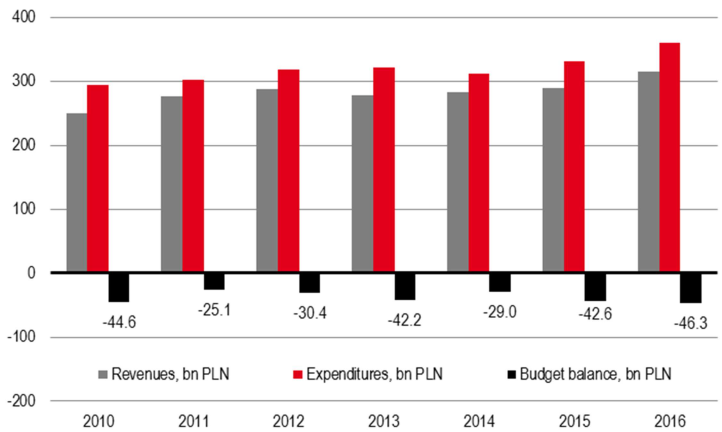


**Fiscal policy**

According to the preliminary estimated data of the Ministry of Finance, the state budget deficit in 2016, amounted to PLN 46.3 billion i.e. 84.6% of the annual limit envisaged by the 2016 budget act at PLN 54.7 billion and was higher than deficit at the level of PLN 42.6 billion in 2015. In 2016, state budget revenues amounted to PLN 314.6 billion, i.e. 100.3% of the plan, and the expenditure amounted to PLN 360.9 billion, i.e. 97.9% of the plan. Revenues from VAT collections amounted to PLN 126.6 billion and were merely 2.8% higher as compared to 2015. The Ministry of Finance announced that Eurostat probably considers that proceeds from LTE, which in February 2016 credited the state budget with the amount of PLN 9.2 billion, according to the European definition methodology (ESA2010), will not be treated as the assets sale but as revenues from lease. Due to the fact that the digital frequencies were reserved for 15 years, then in subsequent years income of the general government will be increased by 1/15 of the amount of proceeds received in cash. In case of such interpretation, the general government deficit in the first quarter of 2016, will be enlarged by ca. 0.5% of the GDP. Combined with the lower than planned revenues from VAT, it pushes the government estimates of the general government deficit in 2016 to the level of 2.8-2.9% of the GDP (ESA2010 methodology).

The 2017 draft budget assumes the state budget deficit at record-high level of PLN 59.3 billion. In the budget bill it was stated that legal and enforcement actions will translate into significant improvement in tax collections. The Ministry of Finance projects that VAT collections will improve by PLN 16.9 billion (+13.3%). At the same time the budget expenditures will need to cover full annual cost of Family 500 plus program and the cost of lowering of the retirement age, effective from the fourth quarter of 2017. In cash terms, the support for income may come from higher-than-assumed payment from the NBP profit. Officials declare that the deficit according to the ESA2010 will be kept below the level required by the Stability and Growth Pact of 3% of the GDP.

The State Public Debt at the end of 2016 is estimated at 52.2% of the GDP vs. 48.8% of the GDP at the end of 2015.



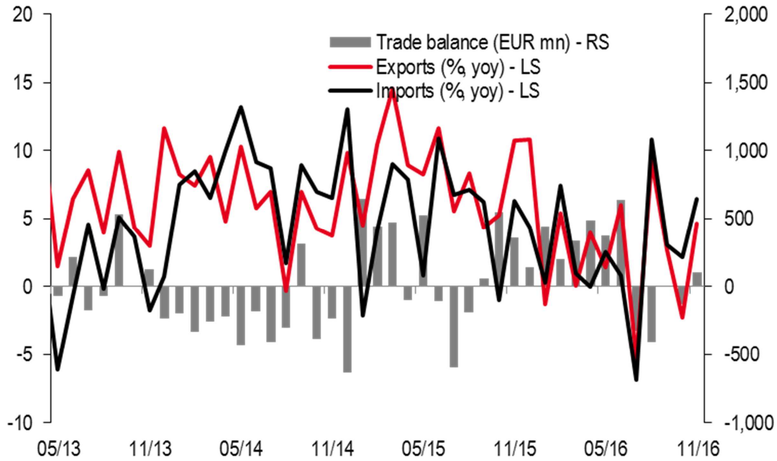
**Foreign Sector**

The NBP data indicate that in the period January-November 2016 the current account deficit amounted to EUR 2.0 billion vs. EUR 1.7 billion in the corresponding period of 2015, which translates into stabilization of 12-month relation to the GDP at the level of 0.7%.

A slightly deeper deficit of the current account resulted mainly from a deeper deficit of primary income due to a shift of inflow of part of the funds within the Common Agricultural Policy for 2017 (a deficit of EUR 14.9 billion in January-November 2016 against a deficit of EUR 13.5 billion in the corresponding period of 2015). A negative factor for the current account balance was also a slight decrease in the trade surplus (EUR 1.7 billion vs. EUR 2.1 billion in 2015) amid a larger scale of slowdown in exports growth (2.1% year on year vs. 8.3% year on year in 2015) than in imports growth (2.4% year on year vs. 5.0% year on year), as well as a deeper deficit of secondary income (EUR 0.9 billion vs. EUR 0.4 billion in 2015). A positive contribution to the current account balance was, in turn, a higher surplus of the services account (EUR 12.1 billion against EUR 10.1 billion a year earlier).

As for the financing side, there was a decline in foreign direct investment (FDI). In the period January-November 2016 there was an inflow of EUR 10.3 billion compared with EUR 14.3 billion in the corresponding period of 2015. In the case of portfolio investment, there was an outflow of funds (EUR 1.2 billion vs. an inflow of EUR 4.7 billion in 2015), both from the domestic debt market (an outflow of EUR 1.0 billion vs. an inflow of EUR 3.0 billion in 2015) and the stock market (an outflow of EUR 0.3 billion vs. an inflow of EUR 1.6 billion in 2015). Due to delays of the implementation of the EU new financial perspective there was a strong decrease of the EU capital transfers inflow - to EUR 3.4 billion from EUR 10.4 billion in 2015.

In 2016, a considerable increase in the Treasury's foreign debt was recorded. According to the Ministry of Finance data, at the end of October 2015, the Treasury's foreign debt amounted to PLN 307.4 billion, which means an increase by ca. PLN 16.1 billion in comparison to December 2015 (by 5.5%). The growth of the Treasury's foreign debt was partly caused by the weakening of the złoty against foreign currencies, in which it is denominated.



**Capital market**

In spite of the risk of continuation of the cycle of tightening monetary policy by the U.S. Fed, key global stock indices remained in upward trend throughout 2016. Meanwhile an unexpected outcome of the UK referendum on Brexit (June 2016) and victory in the U.S. presidential elections (November 2016) triggered corrections, though short-lived only. They did not disrupt the long-term trend, however. Moreover the Republican candidate's success was a key supportive factor for equities later in the year. As a result the main indices increased by 14.4% (FTSE), 13.4% (Dow Jones), 9.5% (S&P 500) and 6.9% (DAX) during a whole year. The outlook for the financial markets remains mixed in the coming months. The economic policy of a new U.S. administration, the U.S interest rate path and a risk of "hard Brexit" will be key market points of interest in the near future.

Despite a promising beginning of 2016 on the Warsaw Stock Exchange (WSE) - as equities gained in the first quarter - following months brought a decline in the WIG and WIG20 indices and then a long-term consolidation, despite better situation in core markets. Concerns about Poland rating after the S&P downgraded it in January 2016 affected investment sentiment. Equities remained under pressure of uncertainty regarding Open Pension Funds and plans on the CHF mortgages. Banking tax, introduced in February 2016, was another adverse factors for banking sector. Solid demand for equities in the world in November and December 2016, helped to improve annual performance on the WSE and sent rates of return above zero in case of the biggest companies. The WIG index gained 11.4%, while the WIG20 index rose by 4.8%. Smaller companies outperformed the basket another year in a row. The mWIG40 grew by 18.2%, reaching the highest levels since 2007 (4,215.54 at the end of the period). As for the sub-indices, WIG-mining (79.7%), WIG-IT (33.7%) and WIG-oil & gas (26.9%) were top-performers. Chemical, energy, telecommunications and construction companies affected performance of the WIG index.

The capitalization of domestic companies rose to PLN 557.1 billion from PLN 516.8 billion in 2015. On the other hand, foreign companies capitalization fell to PLN 558.6 billion from PLN 566.1 billion in the previous year. The value of total turnover on the stock market fell to PLN 202.3 billion vs. PLN 225.3 billion in 2015.

The value of investment funds' assets increased slightly to PLN 258.9 billion in 2016. If not for the outflows by ca. PLN 9 billion from non-retail funds in December, the balance would be much better. Assets reached a record high level in November (PLN 265.2 billion).

If the Fed's interest rates path is neutral for investors and the European Central Bank leaves rates at a record lows, capital outflows from emerging markets should be an alternative scenario only. Domestic factors will be key market drivers as well, including economy performance after the GDP slowdown in the second half of 2016.

**Banking sector**

In 2016, financial results of banks improved, which was however a result of a one-off event and base effect. According to Financial Supervision Authority (KNF), data in the period of January-November 2016 banking sector achieved a total net profit of PLN 13.1 billion (+20.5% year on year). Positive influence had transaction of the selling of banks' shares in Visa Europe to Visa Inc. (it is estimated, that it contributed over PLN 2 billion to gross profit). The event was reflected in growth of 30.6% year on year on so-called other positions from banking activity. Strong pace of growth was also influenced by base effect connected to the bankruptcy of SK Bank in November 2015. It lowered the banking sector's results in fourth quarter of 2015 due to payments within the deposits guarantee system and higher risk costs. In consequence costs related to assets' impairments and provisions in January-November 2016 fell by 12.4% year on year. Although banks' operating costs still rose by 5.4%, the mentioned base effect eased to some extent the negative impact of the implementation of the so-called banking levy. In the first eleven months of 2016 positive contribution to profits was also visible in case of net interest income (growth of 7.4% year on year). In turn a negative impact on results had a decline in net income from fees and commissions (-5.7% year on year).

According to KNF data the pace of growth of banking sector's assets was moderate – at the end of November of 2016 amounted to 6.1% year on year (in comparison to 6.7% in November 2015). At the same time deposits of the non-financial sector grew by 10.0% year on year (10.8% y/y in November 2015), while receivables by 5.3% year on year (8.0% year on year in November 2015).

In terms of main deposit categories, in 2016 the following developments were noted[1]

– a growth of households' deposits at a similar rate as year before – as at the end of the year they increased by 9.1% year on year (9.2% in 2015). A high pace of growth was maintained mainly as a result of: improving financial situation of households, inflow of funds from government's new social programs (mainly Family 500 plus program) and limited propensity to invest in more risky assets (e.g. investment funds units, shares),

– weaker than in previous year, but still robust growth of corporate deposits portfolio – as at the end of the year they increased by 7.8% year on year, while in 2015 the growth pace amounted to 10.4% year on year. Continuing positive situation in corporate deposits stems mainly from their good financial performance and limited propensity to invest,

– relatively strong growth of other deposits – as at the end of the year the growth pace reached 7.5% year on year (in comparison to 3.2% year on year in 2015).

As at the end of December 2016, household deposits accounted for 65.2% (64.9% as at the end of 2015), corporate deposits for 24.9% (25.0% as at the end of 2015), and other deposits for 9.9% (10.1% as at the end of 2015) of all deposits.

In terms of main receivables categories, in 2016 the following developments were noted:

– an increase in households' receivables – as at the end of the year they increased by 5.1% year on year (6.6% at the end of 2015). This pace can be perceived as relatively weak, which is mainly connected with persistently low growth rate of housing loans, caused by growing requirements in terms of own contribution. At the same time, consumer loans' value is increasing relatively fast, which in turn can be associated with improving situation of households and thus higher propensity to take out loans on current needs,

– an increase in corporate receivables, though the pace was much slower than in previous year – as at the end of the year they increased by 4.9% year on year (8.6% year on year at the end of 2015). Deteriorating pace was mainly influenced by limited demand for current funds and falling investment activity,

– a minor decline in other receivables – as at the end of the year they decreased by 0.4% year on year (compared to a growth by 5.1% year on year at the end of 2015).

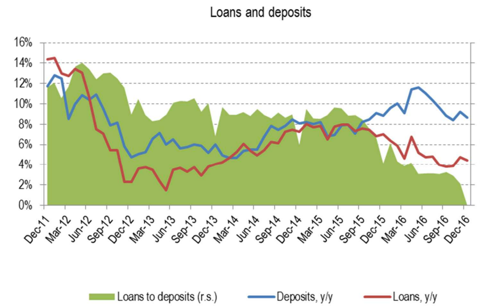
As at the end of December 2016, loans to households accounted for 59.2% (58.8% as at the end of 2015), corporate loans for 30.2% (30.1% as at the end of 2015) and other loans for 10.6% (11.1% as at the end of 2015) of all loans.

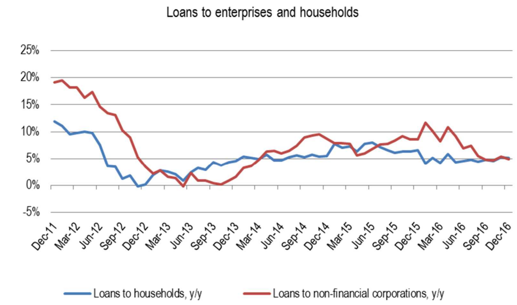
[1] Segment data for deposits and receivables are based on NBP monetary statistics.

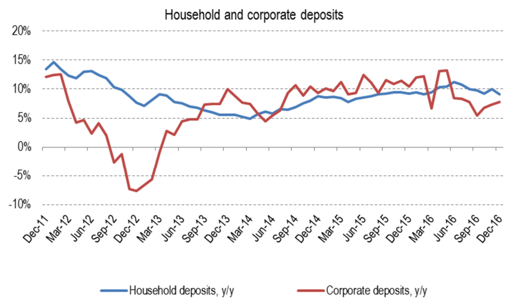
In terms of loan portfolio quality, in 2016 the following developments were noted:

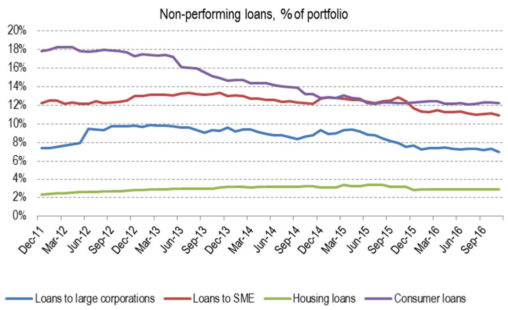
- further decline in terms of the share of non-performing loans (NPLs) in the corporate loans portfolio. In November 2016, NPLs made up 9.2% of the portfolio, while as at the end of 2015 it was 10.0%. A similar fall of NPLs' share concerned both loans to large corporates (7.0% in November 2016 in comparison to 7.7% as at the end of 2015) and loans to SMEs (10.9% in November 2016 in comparison to 11.7% as at the end of 2015),
- stabilization of non-performing loans share in case of households' loan portfolio – the ratio was 6.2% in November 2016, similarly to the end of 2015. The NPL ratio remained the same for housing loans (2.9% both as at the end of November 2016 and 2015), while it decreased slightly for consumer loans (from 12.3% as at the end of 2015 to 12.2% as at the end of November 2016).

As far as the regulatory environment is concerned, an important event in 2016 was the introduction, from February, of tax on certain financial institutions. In case of banks, the tax base is assets value (net of selected items). The banks' activity was also affected by growing equity requirements and the need to support the Bank Guarantee Fund (BFG) caused by the bankruptcy of one of the cooperative banks.



# 4 Important Events and Achievements

## 4.1 Changes in the Group' structure

The composition of Bank Pekao S.A. Group is presented in the Note 2 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December, 2016.

The most significant changes concerning the Group occurred in 2016 are presented below.

**The deletion of Polish Banking System S.A. (in liquidation) and PPU Budpress Sp. z o.o. (in liquidation) from the Registry**
On January 1, 2016 the following associates entities of the Bank: Polish Banking System S.A. (in liquidation) and PPU Budpress Sp. z o.o. (in liquidation) were deleted from the Registry.

**Opening of liquidation of the company**
On July 21, 2016 the Extraordinary Shareholders Meeting of Pekao Fundusz Kapitałowy Sp. z o. o. (a subsidiary of the Bank) took the resolution on starting liquidation procedure of the Company.

**Termination of liquidation procedure**
In connection with termination of liquidation procedure of Pekao Leasing Holding S.A. (in liquidation), on September 20, 2016 the Company was removed from the National Court Register.

Termination of liquidation procedure of Pekao Leasing Holding S.A. was preceded by the transfer of shares of Pekao Leasing Sp. z o.o. held by the Company to Bank Pekao S.A. Currently, the Bank holds directly 100% share in the capital and votes in the General Meeting of Pekao Leasing Sp. z o.o.

**Transfer of asset management directly to Pioneer Pekao TFI S.A.**
On September 30, 2016, Pioneer Pekao Investment Management S.A. (PPIM) made an agreement with Pioneer Pekao Towarzystwo Funduszy Inwestycyjnych S.A. (TFI) on transfer of organized part of the enterprise being, in the internal organizational structure of PPIM, separate organizationally, financially and functionally set of tangibles, intangibles and liabilities designed to perform business activities within the scope of portfolios management which include one or more numbers of financial instruments. Transfer of the organized part of the enterprise was conducted on October 1, 2016 as a contribution in kind to cover shares acquired by PPIM in the increased share capital of TFI.

**Restructuring Agreement**
In accordance with the Restructuring Agreement between PBG S.A. and the creditors, on November 14, 2016 Bank Pekao S.A. became the owner of 62,848,380 H series stocks of PBG S.A., with a nominal value of PLN 0.02 representing 8.15% in the votes and the share capital of the Company.

## 4.2 Changes in the Statutory Bodies of the Bank

**Supervisory Board**

On June 16, 2016, the Management Board of Bank Pekao S.A. informed in the current report No. 10/2016 that, taking into account the fulfillment of suitability assessment, the Ordinary General Meeting of the Bank on June 16, 2016 appointed Mr. Dariusz Filar, Mr. Massimiliano Fossati, Ms. Katarzyna Majchrzak, Mr. Gianni Papa, Mr. Leszek Pawłowicz, Ms. Laura Penna, Ms. Wioletta Rosołowska, Ms. Doris Tomanek and Mr. Jerzy Woźnicki as Members of the Supervisory Board of the Bank for the three-year joint term of office, starting on June 17, 2016.

On December 12, 2016, the Management Board of Bank Pekao S.A. informed in the current report No. 33/2016 about resignation from the position of Member of the Supervisory Board of the Bank as of December 31, 2016 by Mrs. Wioletta Rosołowska.

On January 13, 2017, the Management Board of Bank Pekao S.A. informed, in the current report No. 2/2017, on resignations of Mr. Gianni Papa, Mr. Massimiliano Fossati, Ms. Laura Stefania Penna and Ms. Doris Tomanek from the positions of Members of the Supervisory Board of the Bank subject to the condition and with effect as of the date of: (i) the indirect sale by UniCredit S.p.A. of 52,494,007 shares in the Bank to Powszechny Zakład Ubezpieczeń S.A. and (ii) the direct sale by UniCredit S.p.A. of 26,247,003 shares in the Bank to Polski Fundusz Rozwoju S.A.

Composition of the Supervisory Board:

| DECEMBER 31, 2016 | DECEMBER 31, 2015 |
|---|---|
| Jerzy Woźnicki<br>Chairman of the Supervisory Board (*) | Jerzy Woźnicki<br>Chairman of the Supervisory Board |
| Gianni Papa<br>Deputy Chairman of the Supervisory Board (*) | Roberto Nicastro<br>Deputy Chairman of the Supervisory Board |
| Leszek Pawłowicz<br>Deputy Chairman of the Supervisory Board (*) | Leszek Pawłowicz<br>Deputy Chairman of the Supervisory Board |
| Massimiliano Fossati<br>Secretary of the Supervisory Board (*) | Alessandro Decio<br>Secretary of the Supervisory Board |
| Dariusz Filar<br>Member of the Supervisory Board | Dariusz Filar<br>Member of the Supervisory Board |
| Katarzyna Majchrzak<br>Member of the Supervisory Board | Katarzyna Majchrzak<br>Member of the Supervisory Board |
| Laura Penna<br>Member of the Supervisory Board | Laura Penna<br>Member of the Supervisory Board |
| Wioletta Rosołowska<br>Member of the Supervisory Board | Wioletta Rosołowska<br>Member of the Supervisory Board |
| Doris Tomanek<br>Member of the Supervisory Board | Doris Tomanek<br>Member of the Supervisory Board |

(*) The Supervisory Board of the Bank elected at the meeting held on July 22, 2016, Mr. Jerzy Woźnicki as Chairman of the Supervisory Board, Mr. Gianni Papa as Deputy Chairman of the Supervisory Board, Mr. Leszek Pawłowicz as Deputy Chairman of the Supervisory Board and Mr. Massimiliano Fossati as Secretary of the Supervisory Board.

**Management Board of the Bank**

As of December 31, 2016 the composition of the Management Board had not changed compared to December 31, 2015 and was as follows:

| DECEMBER 31, 2016 | DECEMBER 31, 2015 |
|---|---|
| Luigi Lovaglio<br>President of the Management Board, CEO | Luigi Lovaglio<br>President of the Management Board, CEO |
| Diego Biondo<br>Vice President of the Management Board | Diego Biondo<br>Vice President of the Management Board |
| Andrzej Kopyrski<br>Vice President of the Management Board | Andrzej Kopyrski<br>Vice President of the Management Board |
| Adam Niewiński<br>Vice President of the Management Board | Adam Niewiński<br>Vice President of the Management Board |
| Grzegorz Piwowar<br>Vice President of the Management Board | Grzegorz Piwowar<br>Vice President of the Management Board |
| Stefano Santini<br>Vice President of the Management Board | Stefano Santini<br>Vice President of the Management Board |
| Marian Ważyński<br>Vice President of the Management Board | Marian Ważyński<br>Vice President of the Management Board |

Members of the Management Board of the Bank are appointed for a joint three-year term of office.

Members of the Management Board are appointed and removed from office by the Supervisory Board, taking into account assessment of fulfillment of suitability requirements. Vice Presidents and Members of the Management Board of the Bank are appointed and removed from office upon the request of the President of the Management Board of the Bank, taking into account assessment of fulfillment of suitability requirements. Appointment of two Members of the Management Board, including the President of the Management Board and the Member of the Management Board supervising the management of significant risk in the Bank operations and to entrust this function to the appointed Member of the Management Board, is subject to approval by the Polish Financial Supervision Authority, taking into account assessment of fulfillment of suitability requirements. The body which applies for the approval is the Supervisory Board.

The Management Board of the Bank runs the Bank's affairs and represents the Bank. The scope of activities of the Management Board of the Bank includes all matters which, pursuant to the provisions of law or the Bank's Statute do not fall within the scope of competence of other bodies. The rules and procedures governing the activities of the Bank's Management Board are stipulated in the Rules of Procedure for the Management Board of the Bank.

Members of the Management Board of the Bank coordinate and supervise the activity of the Bank in accordance with the division of powers enacted by the Management Board of the Bank and approved by the Supervisory Board.

Mr. Luigi Lovaglio, President of the Management Board of the Bank, coordinates the activities of the Members of the Management Board of the Bank, supervising also, in particular the following areas of the Bank's activity: internal audit, compliance, and corporate communication, including investor relations.

Mr. Luigi Lovaglio heads the Management Board, convenes and presides over the Board meetings, presents its stance to other governing bodies of the Bank and in relations with third parties, in particular with the State authorities, and issues internal regulations.

Mr. Diego Biondo, Vice President of the Management Board of the Bank supervises the activity of the Risk Management Division.

Mr. Andrzej Kopyrski, Vice President of the Management Board of the Bank supervises the activity of the Corporate Banking and MIB Division.

Mr. Adam Niewiński, Vice President of the Management Board of the Bank supervises the activity of the Private Banking Division.

Mr. Grzegorz Piwowar, Vice President of the Management Board of the Bank supervises the activity of the Retail Banking Division.

Mr. Stefano Santini, Vice President of the Management Board of the Bank supervises the activity of the Finance Division.

Mr. Marian Ważyński, Vice President of the Management Board of the Bank supervises the activity of the Logistics and Procurement Division.

## 4.3 Organizational changes

In 2016, there were organizational changes in the Bank's Head Office impacting Financial Division and Global Banking Services Area.

The aim of the changes in the Global Banking Services Area was to centralize the process for data management and data quality in the Bank, their collection, processing and sharing.

In the Global Banking Services Area was created function of Chief Data Officer responsible for the overall management of data in the Bank, development and implementation of strategies and methods of management and use of data.

From the Financial Division to the Global Banking Services Area has been moved MIS Department responsible for the maintenance and development of the Management Information System, preparation and implementation of data management strategy and their quality. It was also separated unit (Data Architecture Team) dedicated to supporting processes of architecture and data quality management as well as the development and maintenance of Data Architecture Repository.

In addition in 2016, it was continued the process of centralization of operational activities which resulted in transferring tasks related to Money Transfer service (Western Union) from the Retail Banking Division to the Central Back Office.

## 4.4 Awards and distinctions

**Global Finance: Bank Pekao S.A. Innovator of the Year 2016 in transactional banking**
Bank Pekao S.A. was awarded the title of „Innovators 2016 – Transactions Services" in the international ranking organized by Global Finance magazine. Independent experts appreciated new solution for corporate clients – the Digital Gate which allows the use of multiple financial services and products through the Internet banking system PekaoBiznes24 based on one agreement. The Digital Gate offers the widest range of products and services on the market, including treasury products, integrated in one package.

**Global Finance: Bank Pekao S.A. Best Sub-Custodian Bank in Poland**
Bank Pekao S.A. for the fifth consecutive year won the title of the "Best Sub-Custodian Bank in Poland 2016" in the ranking organized by the Global Finance magazine what confirms professional and comprehensive approach of the Bank to custodian services.

Bank Pekao S.A. received the highest award due to such criteria as individual service by dedicated advisor, opportunity to conduct transaction through any brokerage house, opportunity to collect on escrow account any types of securities and full service of corporate rights arising from the securities.

**EMEA Finance: EFRA project financed by Bank Pekao S.A. the best transaction of 2015 in Oil & Gas sector**

In June 2016, EFRA project was recognized as the best transaction of 2015 in Oil & Gas sector by EMEA Finance magazine. EFRA transaction is a financing for the amount of USD 432 million and PLN 300 million for LOTOS Asfalt belonging to LOTOS Group. Bank Pekao S.A. in consortium with 7 financial institutions signed credit facility agreements with LOTOS Asfalt to finance the construction of an advanced Delayed Coking Unit (DCU) with auxiliary installations on the premises of the refinery in Gdańsk.

Bank Pekao S.A. was entrusted with the role of the coordinator, arranger and agent for this strategic project. EFRA project is one of the largest Project Finance transactions in the history of the Polish market in terms of both structure and scale.

**Najwyższa Jakość Quality International: Digital Gate offered by Bank Pekao S.A. awarded with the Gold Emblem of Quality International**

Digital Gate offered by Bank Pekao S.A. and dedicated to corporate clients, won a prestigious title of the Highest Quality Service in the Quality International 2016 competition in QI Services category.

The Chapter of the Program, for the consecutive time, appreciated quality of services offered by Bank Pekao S.A. The Gold Emblem for the Digital Gate is an acknowledgement of the Bank's involvement in the improvement of quality of services provided to its clients.

Najwyższa Jakość Quality International competition is held under the auspices of the Polish Agency for Enterprise Development, Polski Komitet Normalizacyjny (Polish Standard) and Katedra Zarządzania Jakością Uniwersytetu Ekonomicznego in Kraków (Department of Quality Management in Cracow University of Economics).

**Euromoney: Bank Pekao S.A. for the consecutive time Best Trade Finance Provider in Poland**

Bank Pekao S.A. was awarded with the title of the "Best Trade Finance Provider in Poland 2016" according to the survey organized by prestigious Euromoney magazine.

Over 2 thousand international companies selected three banks in which they use trade finance products. Bank Pekao S.A. received the most votes among banks operating in Poland.

**Panattoni Europe: award for Bank Pekao S.A. in the category of the Best Financial Institution 2016**

Panattoni Europe, the recognised developer and the undisputed leader in industrial real estate in Europe, honoured Bank Pekao S.A. with the title of the Best Financial Institution 2016 for its professional approach and confidence over many years.

**BANK Financial Magazine: three awards for Bank Pekao S.A.**
Bank Pekao S.A. received three awards in the rankings organized by BANK Financial Magazine. In the main ranking, which takes into account assets, liabilities, volume of loans, number of outlets as well as traditional and online bank accounts, the Bank took the second position. The Bank took also the second position in the ranking of consumer banks, where absolute value of consumer loans portfolio and growth of these loans were factored and in the ranking of banks financing real estate, where current development achievements such as growth of loans portfolio, increase in sales of loans and the position of a given bank on the market were particularly factored.

**Global Finance: Private Banking of Bank Pekao S.A. recognized as the best in Poland**
Private Banking offered by Bank Pekao S.A. was recognized as the best in Poland by prestigious magazine Global Finance in the second edition of World's Best Private Banks Awards competition.

World's Best Private Banks Awards are granted to institutions, which offer the private banking customers the best customer service and the highest value and level of services. Experts from Global Finance magazine selected winners based on applications provided by these institutions, market analysis, opinions of analysts, top managers and private banking customers.

**Forbes: the best 5-star score for Private Banking of Bank Pekao S.A.**
Private Banking of Bank Pekao S.A. received, for the first time, the highest score in the sixth edition of private banking services competition organized by Forbes magazine. This distinction confirms high quality of private banking services and solutions that meet the needs of extremely demanding group of customers.

Evaluation of quality of private banking offer is conducted by a representative group using private banking services with a particular focus on solutions corresponding to market trends. The reason underlying the high position of Private Banking of Bank Pekao S.A. included the fact that the Bank has the right to distribute in Poland Goldman Sachs funds, which is a unique asset and a competitive advantage in the segment.

**Forum Biznesu: title Highest Quality Services QI SERVICES for Private Banking investment advisory of Bank Pekao S.A.**

Investment advisory, offered to the Private Banking clients was honored the title of the Highest Quality Services in QI Services category by the Quality International Program 2016 organized by Forum Biznesu and held under the patronage of the Polish Agency for Entrepreneurship Development and the Polish Committee for Standardization.

**Bankier.pl: MasterCard Debit of Bank Pekao S.A. recognized as Financial Innovation in the competition Złoty Bankier**

Multicurrency debit card MasterCard Debit of Bank Pekao S.A. was recognized as Financial Innovation in the competition Złoty Bankier organized by the Internet portal Bankier.pl with the cooperation of "Puls Biznesu" daily. The Bank was awarded with the statuette of Złoty Bankier in this category for the third time. Bankier.pl experts and the journalists of Puls Biznesu appreciated multicurrency card of Bank Pekao S.A. which meets requirements of the product defining trends in the banking sector in the coming years.
Multicurrency debit card is one of the most advanced products on the market that enables execution of transactions in PLN as well as in selected foreign currencies without FX conversion thanks to card's connection with corresponding currency accounts.

**„Produkt Roku IT@BANK 2016" for the PeoPay mobile application**


At an annual conference dedicated modern technologies in banking IT, the PeoPay mobile application of Bank Pekao S.A. was awarded with the title of „Produkt Roku IT@BANK 2016".

System of mobile payments PeoPay allows payments execution in terminals accepting contactless payments in Poland and abroad as well as payments, not only in majority of shops and online but also in public administration offices.

**XI Edycja Kongresu Gospodarki Elektronicznej: Bank Pekao S.A. awarded for PeoPay system**
PeopPay, the first in the world system of contactless mobile payments on Windows 10 Mobile won the top prize in the category Project of the Year 2015 in the XI Edycja Kongresu Gospodarki Elektronicznej (the XI Edition of the Congress of Electronic Economy). The Chapter of the competition appreciated innovation of the solution, among others, the ability to pay even if the phone is in offline mode, as well as to make payments up to PLN 50 without necessity to switch the application on.

The PeoPay application allows the Bank's customers to make fast payments between users (using the phone number), contactless payments execution in shops and service points cooperating with the Bank and online payments. Currently, thanks to PeoPay application it is possible to make payments in 425 thousand of POS terminals in Poland (ca. 85% of total number of POS) as well as in terminals accepting contactless payments abroad (nearly 4 million of terminals).

**Contactless Intelligence: KULkarta of Bank Pekao S.A won in the competition Contactless Intelligence 2016**

KULkarta of Bank Pekao S.A. won in the prestigious, international competition Contactless Intelligence 2016 in the category ID&Authorisation. Student card with the functionality of debit card and additionally library card is one of the first products of this type in Poland, which is in the Bank's offer is since October 2015. The card is addressed to the students of Katolicki Uniwersytet Lubelski (The Catholic University of Lublin).

During this year's 10th edition of the competition Contactless Intelligence that promotes most advanced technological solutions in the area of contactless payments, the prizes were awarded in 9 categories, which include, among others, the most innovative payment product, security of transaction, "mobile wallet", the best loyalty product, ID and authorization. The winners were selected by the jury of experts and the results of voting conducted among the Internet users.

**Izba Gospodarki Elektronicznej: Bank Pekao S.A. received distinction in the 4th edition of e-Commerce Polska awards 2016**

Tablet application „Pekao24 na tablety" of Bank Pekao S.A. received distinction in the category "The most digital bank" in competition E-commerce Polska awards 2016 organized by Izba Gospodarki Elektronicznej (Chamber of digital economy).

Bank Pekao S.A. presented the application „Pekao24 na tablety" which is dedicated to individual customers using tablets daily for banking operations. The applications combines functions of Pekao24 Internet service with a tool for analysis of personal finance and provides information on expenditures that are aggregated in categories such as: home, kids, travel.

Competition e-Commerce Polska awards 2016 is organized for four years and addressed to entities operating in e-commerce, banking and insurance market. In 2016, the competition received a record number of nearly 150 notifications.

**Polskie Stowarzyszenie Marketingu SMB: employees of Call Center of Bank Pekao S.A. won three main awards in the competition „Telemarketer Roku"**

Call Center employees of Bank Pekao S.A. won in the category of Customer Service, Help Desk and Other Projects in the competition „Telemarketer Roku" organized for the eighth time by Polskie Stowarzyszenie Marketingu SMB. In the competition attended nearly 180 consultants representing 30 companies, including over one third of companies from financial sector. 25 telemarketers participated in the final stage of the competition for three days presenting their skills in the field of sales and telephone service in the headquarter of Polskie Stowarzyszenie Marketingu SMB. The jury selected five winners.

The competition, apart from selection of the best telemarketers and call center employees in Poland, aims to promote the profession and to underline its influence on sales and marketing efficiency of the company.

The competition jury evaluated substantive preparation for the interview, the skill to make contact with the customer to collect the information and application of tools to control the conversation as well as correct language and voice handling. There was sought telemarketer who is able to combine sales efficiency with sensitivity towards customer and its needs.

# 5 Information for the Investors

## 5.1 The Bank's share capital and share ownership structure

As at December 31, 2016, the share capital of Bank Pekao S.A. amounted to PLN 262,470,034 and remained unchanged until the date of submitting the report. The share capital of the Bank consisted of 262,470,034 shares of the following series:

| | |
|---|---|
| 137,650,000 | Series A bearer shares with a par value of PLN 1 per share |
| 7,690,000 | Series B bearer shares with a par value of PLN 1 per share |
| 10,630,632 | Series C bearer shares with a par value of PLN 1 per share |
| 9,777,571 | Series D bearer shares with a par value of PLN 1 per share |
| 373,644 | Series E bearer shares with a par value of PLN 1 per share |
| 621,411 | Series F bearer shares with a par value of PLN 1 per share |
| 603,377 | Series G bearer shares with a par value of PLN 1 per share |
| 359,840 | Series H bearer shares with a par value of PLN 1 per share |
| 94,763,559 | Series I bearer shares with a par value of PLN 1 per share |

All the existing shares are ordinary bearer shares. There are no special preferences or limitations connected with the shares, or differences in the rights attached to them. The rights and obligations related to the shares are defined by the provisions of the Polish Commercial Companies Code and other applicable law.

Shareholders of Bank Pekao S.A., holding directly or indirectly, through subsidiaries, at least 5% of the total number of votes at the General Meeting of the Bank, are as follows:

| SHAREHOLDER'S NAME | NUMBER OF SHARES AND VOTES AT THE GENERAL MEETING | SHARE IN SHARE CAPITAL AND TOTAL NUMBER OF VOTES AT THE GENERAL MEETING | NUMBER OF SHARES AND VOTES AT THE GENERAL MEETING | SHARE IN SHARE CAPITAL AND TOTAL NUMBER OF VOTES AT THE GENERAL MEETING | NUMBER OF SHARES AND VOTES AT THE GENERAL MEETING | SHARE IN SHARE CAPITAL AND TOTAL NUMBER OF VOTES AT THE GENERAL MEETING |
|---|---|---|---|---|---|---|
| | AS AT THE DATE OF SUBMITTING THE REPORT | | AS AT DECEMBER 31, 2016 | | AS AT DECEMBER 31, 2015 | |
| UniCredit S.p.A. | 105,250,485 | 40.10% | 105,250,485 | 40.10% | 131,497,488 | 50.10% |
| Other shareholders (below 5%) | 157,219,549 | 59.90% | 157,219,549 | 59.90% | 130,972,546 | 49.90% |
| **Total** | **262,470,034** | **100.00%** | **262,470,034** | **100.00%** | **262,470,034** | **100.00%** |

In the current report No. 17/2016, the Management Board of Bank Pekao S.A. informed that on July 18, 2016 it received the notification from UniCredit S.p.A. according to which, UniCredit S.p.A. sold 26,247,003 shares of the Bank as a result of the execution on July 13, 2016 of the block trades concluded as a result of the accelerated book-building process. The transactions were settled on July 15, 2016.

Prior to the disposal, the UniCredit S.p.A. owned 131,497,488 shares in the Bank, constituting 50.10% of capital share of the Bank and corresponding to the same number and percentage share of votes at the General Meeting of the Bank.

After the transaction, the UniCredit S.p.A. holds 105,250,485 shares in the Bank, constituting 40.10% of capital share of the Bank and corresponding to the same number and percentage share of votes at the General Meeting of the Bank.

In the current report No. 30/2016, the Management Board of Bank Pekao S.A. informed that on December 8, 2016 UniCredit S.p.A. announced it has entered into an agreement for the disposal of a 32.8% stake in Bank Pekao S.A. to Powszechny Zakład Ubezpieczeń S.A. (PZU) and Polish Development Fund S.A. (PFR).

The Transaction is subject to the customary regulatory and antitrust approvals and is expected to be completed around mid-2017.

Moreover in the current report No. 31/2016 on December 8, 2016 the Bank informed that it had received communication from UniCredit S.p.A. concerning announcement on sale offer of 1,916 of certificates exchangeable for the Bank shares (equity linked certificates) of total reference value of approx. EUR 500 million, compulsorily settled in the Bank common shares no later than on December 15, 2019. Those certificates shall be used to sell the remaining 7.3% of the Bank shares belonging to UniCredit S.p.A. (after the conclusion of sale agreement mentioned above).

The Bank has not received any other notifications regarding changes in the ownership structure in accordance with par. 69 of the Act of July 29, 2005 on Public Offerings and Conditions Governing the Introduction of Financial Instruments to an Organized System of Trading, and on Public Companies.

Polish open-end pension funds (OFE) constitute to the group of financial investors holding significant equity interests in the Bank. Based on their publicly available financial reports, as at December 31, 2016 OFE held in aggregate 14.78% of the Bank's shares.

The Polish open-end pension funds' holdings in Bank Pekao S.A.:

| SHAREHOLDER | NUMBER OF SHARES AND VOTES AT GM | % OF SHARE CAPITAL AND TOTAL VOTE AT GM | NUMBER OF SHARES AND VOTES AT GM | % OF SHARE CAPITAL AND TOTAL VOTE AT GM |
|---|---|---|---|---|
| | DECEMBER 31, 2016 | | DECEMBER 31, 2015 | |
| Aviva OFE Aviva BZ WBK | 10,749,990 | 4.10% | 10,709,906 | 4.08% |
| Nationale-Nederlanden OFE | 6,254,975 | 2.38% | 4,715,432 | 1.80% |
| OFE PZU „Złota Jesień” | 5,291,194 | 2.02% | 5,836,563 | 2.22% |
| OFE MetLife | 3,644,584 | 1.39% | 2,801,190 | 1.07% |
| AXA OFE | 3,132,742 | 1.19% | 3,020,824 | 1.15% |
| Aegon OFE | 2,312,363 | 0.88% | 2,103,268 | 0.80% |
| Generali OFE | 2,165,755 | 0.83% | 1,852,089 | 0.71% |
| Allianz Polska OFE | 1,770,132 | 0.67% | 1,863,768 | 0.71% |
| Nordea OFE | 1,715,436 | 0.65% | 1,653,909 | 0.63% |
| PKO BP Bankowy OFE | 1,045,153 | 0.40% | 1,039,288 | 0.40% |
| OFE Pocztylion | 705,234 | 0.27% | 732,676 | 0.28% |
| **Total** | **38,787,558** | **14.78%** | **36,328,914** | **13.84%** |

Source: OFE Reports – annual structure of open-end pension funds assets; closing share price of Bank Pekao S.A. as at end of the period.

## 5.2 Performance of market valuation of Bank Pekao S.A.'s stock

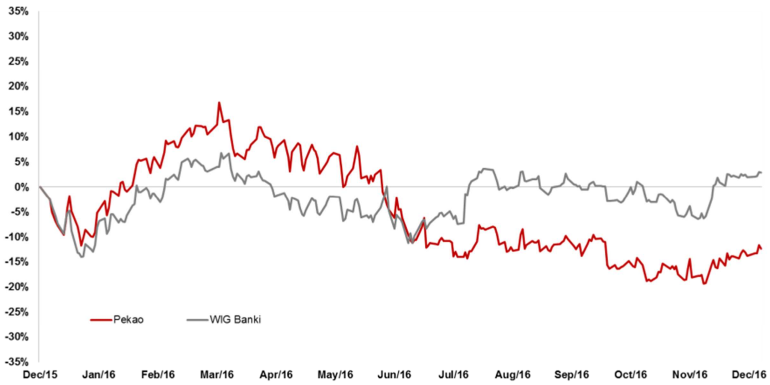
The shares of Bank Pekao S.A. have been listed on the WSE since June 1998 and they are one of the most liquid equities in Poland and Central and Eastern Europe. Since 2000, the Bank maintains Global Depositary Receipts (GDR) program. The Bank's GDRs are traded on London Stock Exchange and on the over the counter market in the USA.

The Bank's market capitalization as of December 31, 2016 amounted to PLN 33.0 billion and making the Bank one of the largest traded companies from Central Europe. Given the high capitalization and liquidity the Bank's shares are a part of many important stock indices maintained by domestic and foreign institutions including Polish blue chips index – WIG20 and sector index – WIGBanks. Since December 19, 2011, the shares of Bank Pekao S.A. are included in the CEERIUS Sustainability Index at Vienna Stock Exchange.

With the average daily turnover volume at the level of 640 thousand and the worth of trading at PLN 21.1 billion in 2016, the share of the Bank's stock in trading on the WSE amounted to 11.13%.

The share price of Bank Pekao S.A. reached to PLN 125.8 as at the end of December 2016 comparing to PLN 143.5 a year earlier. Share price drop in 2016 was driven by both introduction of regulatory changes, adversely affecting the profitability of the banking sector and uncertainty coming from the change of controlling entity.

Performance of Bank Pekao S.A.'s shares and WIGBanks in year 2016.




Source: the WSE

## 5.3 Dividend payment history

In 2016, the Bank paid dividend for 2015 in the amount of PLN 8.70 per share. Dividend yield amounted to 6.1%.

The dividend payments for the years from 2003 to 2015 are presented below:

| DATE | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Dividend for the year (in PLN million) | 748 | 1,065 | 1,234 | 1,504 | 2,517 | - | 761 | 1,785 | 1,412 | 2,202 | 2,614 | 2,625 | 2,283 |
| Dividend per 1 share (in PLN) | 4.50 | 6.40 | 7.40 | 9.00 | 9.60 | - | 2.90 | 6.80 | 5.38 | 8.39 | 9.96 | 10.00 | 8.70 |

## 5.4 Investor Relations

The Bank's activity in investor relations area is focused on providing transparent and active communication with the market through active co-operation with investors, analysts and rating agencies, as well as fulfilling disclosure requirements within the frameworks of applicable law regulations.

The Bank's representatives regularly hold a lot of meetings with investors in Poland and abroad, and take part in most of the regional and sector dedicated investors conferences. Financial results of Bank Pekao S.A. Group are presented quarterly at conferences that are simultaneously transmitted via the Internet.

The Bank's financial results and its activity are regularly monitored by analysts representing Polish and foreign brokerage entities. In 2016, 21 analysts published reports and recommendations on the Bank.

The main activity of the Bank's investor relations is to enable to make a reliable evaluation of the Bank's financial situation, its market position and business model effectiveness in the context of banking sector conditions and macroeconomic situation in the domestic economy as well as on international markets.

Relevant information for the investors about the Bank is available on the Bank's website http://www.pekao.com.pl/information_for_investors/. The Bank publishes also on-line annual report available on the Bank's website, where is also posted "Information Policy of Bank Polska Kasa Opieki Spółka Akcyjna regarding communication with investors, media and customers".

## 5.5 Bank Pekao S.A. financial credibility ratings

### 5.5.1 Bank Pekao S.A. financial credibility ratings

Bank Pekao S.A. co-operates with three leading credit rating agencies: Fitch Ratings, S&P Global Ratings, and Moody's Investors Service. In the case of the first two agencies, the ratings are provided on a solicited basis under relevant agreements, and with respect to Moody's Investors Service, the ratings are unsolicited and they are based on publicly available information and review meetings.

As of December 31, 2016, Bank Pekao S.A. had assigned following financial credibility ratings:

| FITCH RATINGS | BANK PEKAO S.A. | POLAND |
|---|---|---|
| Long-term rating (IDR) | A- | A- |
| Short-term rating | F2 | F2 |
| Viability rating | a- | - |
| Support rating | 2; credit watch negative | - |
| Outlook | Stable | Stable |
| **S&P GLOBAL RATINGS** | **BANK PEKAO S.A.** | **POLAND** |
| Long-term rating in foreign currencies | BBB+ | BBB+ |
| Long-term rating in domestic currency | - | A- |
| Short-term rating in foreign currencies | A-2 | A-2 |
| Short-term rating in domestic currency | - | A-2 |
| Stand-alone credit profile | bbb+ | - |
| Outlook | Stable | Stable |
| **MOODY'S INVESTORS SERVICE (UNSOLICITED RATING)** | **BANK PEKAO S.A.** | **POLAND** |
| Long-term foreign-currency deposit rating | A2 | A2 |
| Short-term deposit rating | Prime-1 | Prime-1 |
| Baseline Credit Assessment | baa1 | - |
| Long-term counterparty risk assessment | A1(cr) | - |
| Short-term counterparty risk assessment | Prime-1(cr) | - |
| Outlook | Stable / Negative(*) | Negative / Stable(**) |

(*) Stable for liabilities in domestic currency, Negative for liabilities in foreign currencies

(**) Negative for Polish economy, Stable for Polish banking sector

Among banks rated in Poland, Bank Pekao S.A. has the highest viability rating assigned by Fitch Ratings, the highest Stand-Alone Credit Profile rating assigned by S&P Global Ratings, the highest Baseline Credit Assessment as well as long- and short-term counterparty risk ratings assigned by Moody's Investors Service.

### 5.5.2 Pekao Bank Hipoteczny S.A. financial credibility ratings

Fitch Ratings agency assigned the "A" rating to the covered bonds issued by Pekao Bank Hipoteczny S.A., a 100% subsidiary of Bank Pekao S.A. The reasons underlying the Agency's decision included the high rating assigned to Pekao Bank Hipoteczny S.A. (A-), legal regulations pertaining to the covered bonds collateral register and the excess of collateral over the volume of bonds in issue, as declared by the bank.

The high rating assigned to the covered bonds confirms Pekao Bank Hipoteczny's ability to issue securities offering a high level of security and raise long-term capital to fund its lending activity. During the latest revision on December 20, 2016, outlook was change from Negative to Evolving. The national long-term rating of Pekao Bank Hipoteczny S.A. is AA+(pol) with a Stable outlook.

# 6 Activity of Bank Pekao S.A. Group

## 6.1 Important factors influencing the Group's activities and results

In 2016, the Group's activity was to a large extent determined by the macroeconomic situation in Poland and abroad as well as by the trends observed in the banking sector.

Polish economy achieved growth rate at the level of 2.8%, comparing to 3.9% in 2015. The slowdown was caused by decreased investments, which were lowered by 5.5% year on year. Private consumption remained as the main driver of growth supported by significant labour market improvement and growth of social transfers.

The Monetary Policy Council kept interest rates unchanged for the whole year 2016, what neutrally impacted loan demand and net interest margin in banking sector.

Household lending growth rate amounted to 5.1% year on year, compared to 6.6% year on year a year ago. The slowdown was mostly caused by lower mortgage loans growth, where customer's own contribution requirements had been increased.

Corporate loans increased by 4.9% year on year, compared to 8.6% year on year a year ago, what resulted from investments decrease and was connected with lower demand for loans.

Household deposits growth amounted to 9.1% year on year vs. 9.2% year on year in the previous year, mainly due to steady improvement of labour market. Interest in alternative forms of investing, including investment funds, still remained low. The large uncertainty on the stock exchange market due to growing geopolitical risks, volatile commodity prices and intervention of politicians in some sectors of the economy were neither supportive for stock market indices nor for demand for investment products. Corporate deposits growth was at the level of 7.8% year on year vs. 10.4% year on year in 2015, what confirms the good financial standing of enterprises.

The banking sector results were improved. However, it was largely a result of realization of one-off profits from sales of Visa Europe shares to Visa Inc., what increased banking sector gross profit by ca. PLN 2 billion.

Since February 2016, the banking sector was burdened with so called banking tax amounting to 44 b.p. (annualized) of assets decreased by deducting selected items, what significantly influenced profitability of banking sector in negative way.

Works on finding solutions of denominated and indexed FX mortgage loans problem have been continued for the whole year, what had significant influence on increasing listed on the WSE banks' shares price volatility.

The capital requirements for the banking sector were tightened due to the implementation of EU regulations. Among others, the KNF decided to increase the capital buffers, introducing requirements for other financial institutions of systemic importance.

Competition in the sector remained high, especially in the most attractive areas, what has limited sector capacity to improve margins.

Banks continued investments in innovative solutions and new technologies, including remote channels of contact, especially on the Internet and mobile banking as well as mobile payments.

Favourable economic conditions and improvement of labour market supported assets quality, which has been steadily improving.

## 6.2 Major sources of risk and threats

**Risk management**
Effective risk management is a prerequisite for maintaining a high level of security of the funds entrusted to the Group, and for achieving a sustainable and balanced profit growth within the risk appetite assumed by the Group.

The key risks material for the Group include credit risk, liquidity and market risks and operational risk. Moreover, business, real estate, financial investment, model, macroeconomic, reputation, compliance risks, the risk of excessive leverage and bancassurance risk are also recognized.

The Group has adopted a comprehensive and consolidated approach to risk management. It extends to all units of the Group. Risks are monitored and controlled with respect to profitability and the funds necessary to cover the exposure.

The Management Board is responsible for achieving the strategic risk management goals, while the Supervisory Board, supported by the Risk Committee, oversees whether the Group's policy of taking various risks is compliant with the overall strategy and financial plan. The Credit Committee plays an important role in the credit risk management, the Asset, Liability and Risk Committee and Liquidity and Market Risk Committee in market and liquidity risk management, and management of the operational risk falls within the scope of responsibility of the Operational Risk Committee.

The rules of managing each of the risks are defined in internal procedures and are subject to the assumptions of the credit and investment policies and the Operational Risk Strategy and Policy accepted annually by the Management Board and approved by the Supervisory Board.

Credit, liquidity, market and operational risk reports analyzing details of their development are presented to the Management Board and the Supervisory Board.

The rules and instruments of managing each of the risks and information on the risk exposure are included in Note 6 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on December 31, 2016 and in the document "Information in respect to capital adequacy of Bank Pekao S.A Group as at 31 December 2016" published on the Bank's website.

**Credit risk**
Managing credit risk and maintaining it at a safe level is vital for the Bank's financial performance. In order to minimize credit risk, special procedures have been established, pertaining in particular to the rules of assessing transaction risk, collateralization of loan and lease receivables, credit decision powers, and restrictions on lending to certain types of businesses.

Lending activities are subject to limits following both from the Banking Law and the Bank's internal standards, including limits concerning exposure concentration ratios for individual sectors of the economy, limit on the share of large exposures in the Bank's loan portfolio and limits of exposures to countries, foreign banks and domestic financial institutions.

The credit decision powers, lending restrictions as well as internal and external prudential standards, pertain to loans and guarantees as well as derivative transactions and debt instruments. The quality of the loan portfolio is also protected by periodic reviews and ongoing monitoring of the timely servicing of loans and the financial standing of customers.

The Bank has continued to work on further rationalization of the credit process with an aim to obtaining better efficiency and security, including in particular enhancement of the procedures and tools for risk measurement and monitoring.

***Credit risk concentration limits***
According to the Banking Law the total exposure of a bank to the risks associated with the single borrower or a group of borrowers in which entities are related by capital or management may not exceed 25% of a bank's equity. In 2016, the maximum exposure limits set forth in the Banking Law were not exceeded.

***Sector exposure concentration***

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

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

**Compliance risk**

Compliance risk is the risk resulting from breaching laws, internal regulations and market standards in the processes functioning within the Bank. Compliance risk can lead to criminal or administrative sanctions, material financial losses, diminished reputation, reduced brand value, reduced development potential and inability to perform contracts, as well as reduction or loss of business opportunities.

There is a separate unit for compliance matters functioning within the Bank, Compliance Department, organisationally and operationally independent and subordinated directly to the President of the Management Board. Compliance Department is the key element of ensuring compliance within the Bank.

The Bank ensures compliance through application of control mechanisms and compliance risk management process carried out by Compliance Department and encompassing identification, assessment, control and monitoring of compliance risk of the Bank's activity and presentation of reports in this scope. The reports on performance of tasks by Compliance Department together with the level of assessed compliance risk are presented to the Management Board and Supervisory Board. The oversight of compliance risk related to the activities of subsidiaries is performed in the Bank.

Assumptions of compliance risk management process were defined in Bank Pekao S.A. Compliance Policy developed by the Management Board and approved by the Supervisory Board. There are following key elements supporting compliance risk management process:

– supervision of the Supervisory Board and responsibility of the Management Board for the effective management of compliance risk and observance of the Compliance Policy,
– responsibility of the Bank's employees for ensuring compliance within the scope of their duties,
– properly defined organisational structure including appropriate location of Compliance Department,
– internal regulations on compliance matters,
– training,
– regular cooperation of Compliance Department with Internal Audit Department and other internal control system units.

As part of compliance with laws, internal regulations and market standards each employee of the Bank applies appropriate control mechanisms and performs independent monitoring of adherence to control mechanisms, within the scope of duties assigned to him/her.

Implementation and application of the compliance risk management standards are key factors in creating the enterprise value, reinforcing and protecting the Bank's reputation, and winning public trust in the Bank's activities and its standing.

## 6.3 Capital adequacy

Capital ratios are the basic measures applied for the measurement of capital adequacy according to Regulation of the European Parliament and of the Council (EU) No 575/2013 of June 26, 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR Regulation), which entered into force since January 1, 2014 together with further amendments as well as Commission Implementing Regulations or Delegated Regulations (EU).

Capital ratios, capital requirements and own funds have been calculated in accordance with the CRR Regulation using national options defined in Banking Act, article 171a as well as recommendations of the Polish Financial Supervision Authority (KNF). In particular, this applies to the risk weights for claims secured by mortgages and number of ratios regulating method of own funds calculation.

The minimum value of capital ratios required by law is the sum of minimal capital requirement defined by CRR Regulation (equal to 8.0% for TCR and 6.0% for T1) and combined buffer requirement as defined in Act of 5 August 2015 on macroprudential supervision over the financial system and crisis management. On 4th October, 2016 KNF issued the Decision regarding the identification of Bank as the other systemically important institutions and imposed on Bank, on a consolidated and individual basis, capital buffer of the other systemically important institution in the amount of the equivalent to 0.75% of the total amount of the risk exposure.

According to recommendation of KNF total capital ratio of the Group, including combined buffer requirement (Capital conservation buffer of 1.25% and, Other Systemically Important Institution buffer of 0.75%) must be not less than 14.00% and Tier I capital ratio not less than 11.00%. Both levels are increased by additional capital requirement imposed by KNF[1].

At the end of December 2016 for Bank Pekao S.A. Group, total capital ratio amounted to 17.64% and was significantly higher than the minimum level required by the law and level recommended by the KNF.

The table below presents the basic data concerning Bank Pekao S.A. Group capital adequacy as of December 31, 2016, and December 31, 2015 according to regulation which were in force at those dates.

(in PLN thousand)

| CAPITAL REQUIREMENT | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Credit risk | 8,323,345 | 8,202,427 |
| Exceeding large exposure limits | - | - |
| Market risk | 44,022 | 63,578 |
| Counterparty credit risk including CVA | 187,820 | 325,240 |
| Operational risk | 493,557 | 564,787 |
| **Total capital requirement** | **9,048,744** | **9,156,032** |
| | | |
| **OWN FUNDS** | | |
| Common Equity Tier I Capital | 19,954,579 | 20,209,595 |
| **Own funds for total capital ratio** | **19,954,579** | **20,209,595** |
| | | |
| **Common Equity Tier I Capital ratio (%)** | **17.64%** | **17.66%** |
| **Total capital ratio (%)** | **17.64%** | **17.66%** |

Total capital ratio as at the end of 2016 compared with the end of 2015 decreased by 0.02 p.p. due to decrease in own funds by 1.3%, while decreasing the total capital requirement by 1.2%.

Total capital requirement decreased as at the end of December 2016 as a result of decrease of capital requirements for counterparty risk including CVA. operational risk and market risk.

[1] In case of Bank Pekao S.A. Group, additional capital requirement imposed by the KNF on total capital ratio is equal to 0.01 p.p. and for Tier I capital 0.0075 p.p.

## 6.4 Bank Pekao S.A. on the Polish banking market

Bank Pekao S.A. is a universal commercial bank providing a full range of banking services to individual and institutional clients mainly in Poland. Bank Pekao S.A. Group includes financial institutions operating in banking, asset management, pension funds, brokerage services, transactional advisory, leasing and factoring markets.

**Distribution channels**
The Bank offers to its clients a broad distribution network with ATMs and outlets conveniently located throughout Poland.

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Total number of outlets | 928 | 975 |
| Total number of own ATMs | 1,761 | 1,759 |

The Bank's clients can also make commission-free cash withdrawals from the European network of the UniCredit Group ATMs.

As at the end of December 2016, the Bank maintained 5,480.1 thousand PLN-denominated current accounts, 328.1 thousand mortgage loan accounts and 572.1 thousand "Pożyczka Ekspresowa" (Express Loan) loan accounts.

(in thousand)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Total number of PLN current accounts(*) | 5,480.1 | 5,314.4 |
| of which packages | 4,053.9 | 3,961.1 |
| Number of mortgage loans accounts(**) | 328.1 | 309.9 |
| of which PLN mortgage loans accounts | 293.6 | 273.8 |
| Number of "Pożyczka Ekspresowa" loan accounts(***) | 572.1 | 576.0 |

(*) Number of accounts including accounts of pre-paid cards.

(**) Retail customers accounts.

(***) "Pożyczka Ekspresowa", Pożyczka Ekspresowa Biznes.

### 6.4.1 Individual clients

In 2016, Bank Pekao S.A. consequently realized the strategy of growth in retail customer segment providing services for individual clients and small and micro enterprises.

The total value of new key loans for individual customers, including cash and PLN mortgage loans in 2016 amounted to over PLN 14.5 billion and was higher by 4.3% in comparison to 2015.

The value of deposits of individual clients and small and micro enterprises placed in the Bank increased by PLN 7.4 billion during the last 12 months which resulted in an increase in the total balance of retail deposits by 10.7% in comparison to 2015.

Bank Pekao S.A. is one of the leaders in electronic banking in Poland. In terms of electronic banking, the Bank offers to its clients wide range of solutions such as: Internet and mobile service, mobile application on phones and tablets as well as PeoPay mobile transfers.

Thanks to the PeoPay application the Banks' clients have the opportunity to make fast transfers between the application users, non-cash payments in POS terminals (425 thousand of terminals in Poland and nearly 4 million abroad) and online (in majority of online shops in Poland and in 250 thousand online shops abroad with Masterpass logo). In March 2016, Bank Pekao S.A., as the first bank in the world, allowed users of mobile phones with Windows 10 Mobile system to make contactless payments in HCE technology via the PeoPay application. In October, Bank Pekao S.A., as the first in Poland, provided the opportunity to make mobile payments in selected public administration offices in Poland, so that the customers can pay faster and more convenient for, among others, issue of driving license or vehicle registration directly at the office. Furthermore, the PeoPay mobile payments system was enriched with the opportunity to make contactless transactions in off-line mode and opportunity to top-up mobile phones on prepaid card.

Another innovative product offered by Bank Pekao S.A. on the Polish market is Elektroniczna Legitymacja Studencka (Electronic Student Card), which combines functionality of student and payment card with the opportunity to combine another services such as library card or public transport ticket. In 2016, the Bank issued Electronic Student Cards in the next five Polish universities.

As part of the government Family 500 plus Program realization, Bank Pekao S.A., as one of the first banks in Poland, allowed customers of the Pekao24 Internet banking system to submit applications. Additionally, there was prepared website for the government Family 500 plus Program and a dedicated offer for a family.

**Lending products**

The Bank offers to its individual clients a wide range of lending products, including first of all PLN mortgage loans and consumer loans Express Loan (Pożyczka Ekspresowa). In 2016, the Bank consequently realized the strategy of strengthening its position on housing and consumer goods financing market.

***Mortgage loans***

In 2016, the Bank maintained its strong market position in the area of mortgage loans, granting the loans in the amount of PLN 6.9 billion what translated into 9.3% of increase of PLN mortgage loans volume year on year and secured the market share at the level of ca.18% as at the end of 2016.

The Bank takes also a leading position in mortgage loans granting under the government program "Mieszkanie dla Młodych" ("Apartment for the Young") supporting the persons aged up to 35 in acquisition of the first new apartment. The Bank conducted also local and country-wide promotional activities of mortgage loans, including promotional campaigns on the Internet and internal channels of marketing communication as well as participated on a regular basis in real estate fairs organized all over the country.

***Consumer lending***

In 2016, the value of cash loans granted amounted to PLN 7.7 billion, an increase by 18.3% in comparison to 2015. Cash loans portfolio for individual clients increased in 2016 by 13.6%.

In 2016, the Bank continued the activities aiming at ensuring the clients transparent offer of Express Loan concentrating on strengthening the relationship with customers, among others, through preparation of individual loan offers with the use of CRM tools as well as electronic channels including website dedicated to consumer loans, the Pekao24 system and mobile application.

Within the framework of loan granting process „na klik" ("by click"), the Bank offered also fast and fully automated cash loan granting process in the Internet service and mobile applications on smartphones and tablets. In the offer "Klik Gotówka" ("Cash Click"), loan disbursement is automatically processed after approval of agreement in the Pekao24 system.

The Bank conducted also promotional campaign of Express Loan in the main TV channels with the largest coverage and thematic channels as well as on the Internet portals, including YouTube and Facebook.

**Payment cards**

In 2016, the Bank focused on promotion of the latest card products introduced to its offer in 2015. Multicurrency debit card and Flexia credit card became the most popular products chosen by the Bank's customers.

Multicurrency debit card is one of the most innovative products on the market that enables execution of transactions in PLN as well as selected foreign currencies without FX rate conversion thanks to card's connection with corresponding currency accounts. The Bank's multicurrency debit card is used abroad most frequently for transactions in EUR realized in the European Union countries. In 2016, the Bank conducted multicurrency debit card promotion on popular Internet portals as well as through posting in magazines cyclical newsletters „Pieniądze na wakacje" ("Money for holiday"), where the issue related to effective cash management during travel was discussed.

Flexia credit card is an innovative solution, that combines the advantages of a credit card with the ability to reschedule selected payments for purchases. Growing share of Flexia cards in total number of credit cards issuance confirms that this card meets the customer's expectations in terms of financing of expenditures and cheap and easy access to additional funds.

Within the framework of payment cards promotion, there were conducted marketing campaigns mainly on the Internet and radio. The Bank's payment cards were also promoted by bloggers who used them while shopping or travelling abroad and published opinion on their websites.

The Bank provides to customers the ability to customize image of payment card by selecting from proposals of 72 images available in the catalogue. More than half of newly issued debit cards are cards with selected image from the catalogue.

The effectiveness of the Bank is confirmed by increasing number of payment cards in circulation, higher by 224.6 thousand (6.6%) as compared to the end of 2015, of which the credit card number increased by 64.9 thousand (11.8%).

**Savings and investment products**

Thanks to a wide range of deposit products of the Bank, during the last 12 months deposits volume of individual customers increased by 11.0% in comparison to the end of 2015.

An important support for increase of savings volume were regular inflows to the accounts of the Bank's individual customers as well as term deposits placed in electronic channels and PLN negotiated deposits. In addition, there was an increase in volumes on saving accounts Mój Skarb dedicated to children.

The Bank continued activities to increase, among the customers, knowledge about the idea of regular saving in retirement programs. Focus of such activities among selected groups of customers translated directly into further increase in the number of new IKE and IKZE accounts as well as an increase in the level of payments realized by the customers who possessed these products before.

In 2016, the Bank continued development of the Premium Personal Banking and introduced to its offer a new Kontakt Premium (Contact Premium) service. The service allows customers, among others, to purchase the majority of products from the Bank's offer during a phone conversation with a dedicated Personal Advisor. Kontakt Premium service increases significantly customer service standards in the area of affluent client. Currently, the service is available in several largest cities.

In order to provide customers with more opportunities in terms of products selection and access to new markets, in 2016, the Bank introduced to its offer new investment funds and structured products which ensures 100% capital protection at the end of investment:

- Pioneer Strategii Globalnej – konserwatywny with a lower investment risk level (equity part of the portfolio accounts for 30% of its assets), at the same time IKE and PAK offer was expanded by new investment fund,
- Pioneer Dochodu USD – mixed fund of a global nature investing in different types of assets with opportunity to invest in USD as well as in PLN, at the same time PAK offer was expanded by this investment fund,
- IKE offer was expanded by Pioneer Pieniężny Plus and IKZE offer was expanded by Pioneer Strategii Globalnej and Pioneer Strategii Globalnej- konserwatywny funds,
- program of regular savings Moja Perspektywa was also expanded by new portfolios: Portfel obligacyjny Rodzina Plus and Portfel konserwatywny Rodzina Plus,
- in the scope of the structured products, three certificates based on EUR/PLN exchange rate and one certificate based on a basket of European companies were issued.

**Brokerage activity**

Bank Pekao S.A. Group offers a wide range of capital market products and services through retail brokerage entities: Dom Maklerski Pekao (Dom Maklerski), a subsidiary Centralny Dom Maklerski Pekao S.A. (CDM) and associated entity Dom Inwestycyjny Xelion Sp. z o.o. (Xelion).

As at the end of December 2016, the retail brokerage entities of the Group maintained 340.0 thousand investment accounts. The Group's brokerage entities were serving 181.6 thousand accounts with an active access to services through remote channels.

As of December 31, 2016, the total value of assets deposited on investment accounts run by the Group's retail brokerage entities amounted to PLN 23.5 billion.

In 2016, activities of the Group's brokerage entities focused on acquisition of new customers as well as improving tools and the range of remote services.

In 2016, the brokerage entities of the Group participated in seven IPO's allowing individual customers access to over 70% of IPO and SPO offers on the Polish market.

CDM, as the first on the Polish market, introduced to offer Goldman Sachs Asset Management (GSAM) investment funds. Furthermore, CDM product offer was also expanded by Structured certificates with no capital protection, barrier reverse convertible on the shares of foreign companies: Daimler AG, Continental AG and Hugo Boss AG, issued by UniCredit Bank AG.

In the first half of 2016, CDM expanded its offer on foreign markets by pre-market orders. CDM is currently the only provider of this service in Poland offering customers access to pre-market on U.S. stock exchanges.

In 2016, Xelion implemented innovative paid service of investment advisory which is based on own automatic model of assets allocation.

In 2016, CDM and Dom Maklerski were among five the best-rated brokerage entities in Ogólnopolskie Badanie Inwestorów (National Survey of Investors) organized by Stowarzyszenie Inwestorów Indywidualnych (Association of Individual Investors).

**Private Banking**

Private Banking of Bank Pekao S.A. is the market leader in Private Banking area in terms of the value of assets. Client service model is based on cooperation with dedicated Relationship Managers, who provide customers with product solutions tailored to their individual needs and market situation. A group of Relationship Managers consists of experienced employees who hold certificates of European Financial Planning Association. Relationship Managers are supported by assistants and product specialists teams what, combined with a unique experience and knowledge of markets allows, to maintain high level of services and to develop an offer for the most demanding customer segment. Both the customers and experts appreciate Private Banking of Bank Pekao S.A. awarding prizes and high positions in rankings.

In 2016, the activity in the area of Private Banking covered, in particular, intensive development of the Bank's offer, including investment offer as well as initiatives aiming at new clients acquisition and strengthening existing relations.

In the first quarter of 2016, the customers were provided with opportunity to open and maintain Eurokonto Walutowe account on individual terms in 9 additional currencies: Norwegian krone (NOK), Swedish krona (SEK), Danish krone (DKK), Canadian dollar (CAD), Australian dollar (AUD), Russian ruble (RUB), Japanese yen (JPY), dirham of the United Arab Emirates (AED) and Chinese yuan (CNY).

Since June 2016, Private Banking customers can benefit from the offer of investment funds managed by Goldman Sachs Asset Management (GSAM), which is the part of The Goldman Sachs Group, one of the largest investment banks in the world. From this moment for a period of eighteen months, Bank Pekao S.A. Group will be the exclusive distributor of GSAM solutions in Poland. Private Banking clients have a choice of nine selected funds from the GSAM offer available through the CDM. The offer on the Polish market consists of 3 debt funds, one alternative fund and 5 equity funds. In 2016, the co-operation with GSAM translated into investing of over PLN 100 million of assets in investment solutions offered to Private Banking customers.

Investment Advisory was very popular among customers – this service covered clients assets with total value amounting to over PLN 2.4 billion as at the end of 2016.

In the third quarter of 2016, investment offer was enriched with a new product group - structured certificates without capital protection. This innovative solution, the result of which is dependent on carefully selected base instrument and adopted formula of profit payment, was addressed to Private Banking clients accepting higher level of risk. The issuer of certificates is German UniCredit Bank AG, one of the leaders of the European market for structured products. Experts from UniCredit Bank AG as well as from Global Investment Strategy Department of Bank Pekao S.A. and Biuro Analiz of CDM determine base instrument and basic parameters of the product, ensuring the highest probability of expected profit, which may significantly exceed bank deposits interest rates.

In 2016, subscriptions of Indeks na Zysk deposits were conducted, including deposits based on the average exchange rate of foreign currencies (USD/PLN, EUR/PLN). The offer of investment funds was further expanded with selected solutions in the area of opened-end investment funds offered by Pioneer TFI and insurance capital funds offered by TU Allianz as well as by 9 new products for the most wealthiest clients in the area of closed-ended investment funds, including also products based on absolute return strategy. These products respond to the clients interest in such types of solutions resulting from high volatility on financial markets.

Within the scope of prestigious credit cards offer, special regulations of credit limits agreements and credit cards were implemented with Private Banking customers to support distribution of these products.

In 2016, a series of investment meetings were organized in the largest Polish cities, during which experts from the Bank and selected Investment Funds were presenting to the customers the directions and trends in the financial markets.

In 2016, Private Banking customers also had the opportunity to participate in events sponsored by the Bank, such as the Champions League and the European League, Paszporty Polityki (Passports of the Polityka magazine) awards ceremony, Film and Art Festival Dwa Brzegi and Pekao Szczecin Open Tennis Tournament as well as at prestigious meeting associated with publication of a List of 100 Polish billionaires 2016 of the Forbes magazine. The Bank was also a partner of the Congress CFO of the Year organized by Rzeczpospolita magazine and the Silesian Gala of Business Center Club and the Official International Showjumping Competition CSIO 5* and gala of the Jan Wejchert award of the Polish Business Roundtable. These meetings were designed to strengthen customers relationship and establish new business contacts.

**Electronic banking for individuals**

The Bank's individual clients are provided with system that enables remotely to realize almost all operations available in the Bank's outlet. The mobile application, which is one of the most advanced application on the market, allows to execute majority of operations available in the Internet system and access to additional functionalities such as geo-location of ATMs, branches and rebate points as well as to track market information.

The Pekao24 electronic banking system and mobile application additionally allow the individual clients to manage funds on brokerage accounts held by Dom Maklerski. In addition, clients of CDM and Xelion may use dedicated systems CDM24 and Xelion Internet platform for service of accounts held by these entities.

Individual clients may also use innovative mobile application dedicated for tablets – "Pekao24 na tablety". The application, apart from main transactional functions known from the Pekao24 Internet system was equipped with a tool of financial analysis that helps clients to overview revenue and expenditure on their account. A new, simplified form of transfer and advanced search transactions history facilitate day-to-day usage of bank account. The "Pekao24 na tablety" application is available on devices with Android and iOS operating systems. The functionality of the new application "Pekao24 na tablety" is systematically developed. In 2016, the application users were provided with ability to display operations register in the Pekao24 electronic banking. They were also provided with an opportunity to manage access to the Pekao24 services, SMS notifications and credit cards (i.e. automatic repayment, download statement).

The Bank regularly expands the scope of functions available for execution through remote access channels. In 2016, the possibility of fast and convenient activation of electronic banking through delivery of PIN via SMS was introduced.

In 2016, the Bank implemented also improvements in foreign transfers processing, providing a new, simplified form adapted to requirements of Sepa End Date and mechanism of automatically determined SWIFT / BIC code of recipient's bank based on account number.

In the Pekao24 Internet system, the Bank provided the customers with opportunity to convert investment fund units and recurrent money transfers on Indywidualne Konto Emerytalne as well as direct payments and recurrent money transfers on Indywidualne Konto Zabezpieczenia Emerytalnego.

The Bank offers to its clients convenient and secure system of mobile payments PeoPay that allows, among others, payments execution in terminals accepting contactless payments in Poland and abroad, immediate payments to system users to telephone number and cash withdrawal from the Bank's ATMs without payment card.

As at the end of December 2016, the number of individual users with an access to the Pekao24 system amounted to 3,176.9 thousand and was higher by 277.5 thousand as compared to the end of December 2015. In the fourth quarter of 2016, 1,708.6 thousand individual users logged in to the electronic banking services.

As at the end of December 2016, the number of individual users with an access to mobile banking amounted to 1,495.7 thousand and was higher by 481.1 thousand as compared to the end of December 2015. In the fourth quarter of 2016, 672.3 thousand of individual users logged in to the mobile service m.pekao24.pl, the Pekao24 mobile banking application (on phone or tablet) and the PeoPay application.

(in thousand)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Number of individual users with an access to electronic banking Pekao24 as at the end of period | 3,176.9 | 2,899.4 |
| Number of individual users actively using electronic banking Pekao24 (*) | 1,708.6 | 1,576.8 |
| Number of individual users with an access to mobile banking as at the end of period (**) | 1,495.7 | 1,014.6 |
| Number of individual users actively using mobile banking (***) | 672.3 | 509.2 |

(*) User actively using electronic banking is a user who logged in to the system at least once during the last quarter.

(**) User actively using at least one of the following mobile solutions: the mobile service m.pekao24.pl, the Pekao24 mobile banking application or the PeoPay application.

(***) User actively using mobile banking is a user who logged in to the mobile service m.pekao24.pl or the Pekao24 mobile banking application or the PeoPay application at least once during the last quarter.

### 6.4.2 Small and micro enterprises (SME)

In 2016, the Bank continued activities aimed at enrichment and promotion of products offer, acquisition of new customers, and, as a consequence, further strengthening its market position in the area of small and micro enterprises.

In 2016, the Bank extended offer of Pożyczka Ekspresowa Biznes (Business Express Loan) for customers with simplified form of accounting, and introduced also loan for the customers with annual sales revenue exceeding PLN 1.5 million. Entrepreneurs can be granted with a loan in the amount of up to PLN 100 thousand for the period of five years. Thanks to this offer the enterprises get access to an additional source of financing, which can use for any purpose associated with their business activity, among others, financing of current activity, purchase of small machines and devices without need to document expenditures.

In 2016, there were launched promotional campaigns of loans which supported granting process of Business Express Loan, Pożyczka Ekspresowa Agro (Agro Express Loan) and loans offered to individual farmers under the Agromania project.

The Bank focused also its activity on long-term financing through campaigns addressed to the Bank's clients with positive credit history.

The Bank continued special promotional campaigns of loans „SLK - szybko dostępny limit kredytowy" ("SLK – quickly available credit limit") addressed to the selected customers with dedicated short term loans offer and credit and charge cards limits available in simplified loans granting process. SLK offer was very popular among the customers, the almost three times more customers used this offer in comparison to 2015.

One of the supporting instruments of loans granting process were the portfolio guarantees of Bank Gospodarstwa Krajowego (BGK) and Europejski Fundusz Inwestycyjny (EFI). As at the end of 2016, Bank Pekao S.A. granted 14 thousand de minimis guarantees in the amount of PLN 3.4 billion. In October 2016, it was completed the realization of EU program Konkurencyjność i Innowacja (Competitiveness and Innovation) under which the Bank offered investment and operating loans (also for start-up's) with free of charge guarantee of EFI.

Small and micro enterprises were provided also with preferential investment financing within the credit line form of Bank Rozwoju Rady Europy (Council of Europe Development Bank) in June 2015. So far, small and micro enterprises were granted with 1.2 thousand loans with the value of almost PLN 500 million.

Within the payment cards product offer development, the Bank implemented a new credit card MasterCard Business DUO Komfort for SME customers with the ability to reschedule the whole or a part of debt due to purchases. Additional advantage of the card is the ability to choose graphics of payment card by selecting from the catalogue, which consists of 72 images, tailored to needs and expectations of the customers.

In 2016, the Bank provided to its business clients an opportunity to place negotiated deposits through the PekaoBiznes24 Internet banking system. Within this functionality, there are available deposits in PLN, USD and GBP. Interest rate depends on deposit amount, deposit period and current deposit rate on the market.

In the first quarter of 2016, the Bank presented the sixth edition of report "Raport o sytuacji mikro i małych firm" (Report on the situation of SME clients) during dedicated conference held in Warsaw. The report has been prepared based on 7 thousand interviews conducted with the enterprises' owners. The main theme of this edition was the start-up businesses. Outcomes of this report were also presented at conferences organized in each voivodeships.

In October 2016, at the VI Europejski Kongres Małych i Średnich Przedsiębiorstw (the 6th European Congress of SME) in Katowice, Bank Pekao S.A. was honored with the title and statue „Ambasadora MŚP".

Thanks to offer development and activities supporting card products distribution in 2016, the number of cards offered by the Bank to business clients increased by 15.7%.

As a result of product offer development (including possibility of transaction realization of Dynamic Currency Conversion and Cash Back service) and thanks to increased activities of business customer advisors in the area of payment cards acceptance, there was an increase by over 30% in portfolio of SME customers using the Bank's terminals.

**Electronic banking for SME customers**
SME customers of the Bank use the PekaoBiznes24 system (with extensive Internet banking and fully transactional mobile application) while the Pekao24 dla firm system (the Pekao24 system for entrepreneurs) is dedicated to self-employed customers. Both systems are an integral part of Pakiety Mój Biznes (My Business Packages).

In 2016, the mobile offer for business customers using the Pekao24 dla firm system was implemented within m.pekao24.pl service, which is adapted to browsers on mobile devices.

Customers using the PekaoBiznes24 system were provided with new, simplified form of credit transfer adapted to requirements of Sepa End Date.

As at the end of December 2016, 254.7 thousand business users had an access to the electronic banking systems, of which 169.3 thousand were active users. The number of business users with an access to the electronic banking systems increased by 7.1 thousand compared to the end of December 2015.

(in thousand)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Number of business users (SME) with an access to the electronic banking systems as at the end of period | 254.7 | 247.6 |
| Number of business users (SME) actively using electronic banking systems (*) | 169.3 | 164.6 |

(*) User actively using electronic banking is a user who logged in to the systems at least once during the last quarter.

As at the end of December 2016, 21.8 thousand business users had an access to the mobile banking application, of which 12.0 thousand were active users. The number of business users with an access to the mobile banking application increased by 4.0 thousand compared to the end of December 2015.

(in thousand)

| | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Number of business users (SME) with an access to the mobile banking as at the end of period | 21.8 | 17.8 |
| Number of business users (SME) actively using the mobile banking (*) | 12.0 | 10.7 |

(*) User actively using mobile banking is a user who logged in to the system at least once during the last quarter.

#### 6.4.3 Corporate customers

Bank Pekao S.A. is the largest corporate bank in Poland financing major strategic projects. A wide range of products, innovative solutions and an individual approach provide comprehensive financial services to enterprises, institutions and budgetary units.

The Bank is available to clients at every stage of the business activity, from support for the processes of financial management of the production and sales network to automation of service processes, financing the development of the product and service offer, as well as advisory services and the provision of funds for investments and international expansion.

“Tailor-made” solutions of Bank Pekao S.A. for corporate banking are recognized both in Poland and internationally. The safety and convenience of on-line services, trading in Treasury securities, custodian business, trade finance and cash management are areas of corporate banking appreciated by clients and a group of independent, national and international, experts. The market also recognizes the solutions used by the Bank to improve the service and to support relations with clients, such as the Digital Gate – Pekao General Agreement.

Participation in the most difficult and most prestigious transactions, strong position in the corporate banking market and numerous awards are a proof of confidence in the expertise and experience of the Bank’s specialists and the value that the Bank creates for the clients.

**Transactional services**

The Bank holds a leading market position in the comprehensive range of services and transactional products and the prizes awarded by independent institutions confirm the high quality of services offered.

In the area of transaction banking, in 2016, the Bank continued activities to simplify the procedures, processes and improve the safety and convenience of corporate clients.

Key achievements in the area of transaction banking in 2016 include:

- expanding the offer to include the Digital Gate – Pekao General Agreement, which makes the handling of the current account simpler, faster and more comfortable. Under a single General Agreement, the client gains access to a basic set of most frequently used products, and may activate other products using simple applications,
- introduction in the offer for the public sector of opłatomat - a device for making payments to Municipal Offices without necessity to visit the Bank’s branch. Charges for the operations performed by the offices and taxes on their behalf may be made in cash or by card,
- introduction of a number of changes arising from the Regulation 260/2012 of March 14, 2012 of the European Parliament and the Council of the European Union, which establishes technical and trade requirements in connection with credit transfers and direct debits in EUR. These changes implement, among others, the obligation to make SEPA payments in a format compatible with the XML standard, based on ISO 20022,
- the possibility of making other non-SEPA payment orders compatible with the XML standard and offering additional facilities for clients using foreign orders in the electronic banking system,
- providing the fastest international settlements using the TARGET-2 system, which enable settlement with the contractual partner in ca. 1.5 hours,
- implementation in electronic banking, new, more efficient and open application architecture for the PekaoBiznes24 system, which provides easier management of the optimized infrastructure, unified software development model, resulting in shorter Time to Market time, more efficient and more stable performance and better application scalability.

The strengthening of the position of market leader in transaction banking in 2016 is confirmed by:

- a 15% increase year on year of the number of issued corporate credit cards, including new card products for corporate clients, i.e. multicurrency card and credit card,
- a 34% increase year on year in the number of domestic transfers,
- an increase in the number of foreign outgoing transfers, incoming transfers and SEPA transfers, by respectively over 16%, over 14% and nearly 28% year on year,
- the number of available solutions integrating financial systems of corporates with the Bank and the volume of transactions performed via these channels. In 2016, a total of over 23 million orders were completed through alternative channels (Pekao Connect, PekaoInMail, web service), which means a 7-fold increase as compared to 2015.

**Electronic banking**

The Bank provides corporate clients with easy and quick access to financial products and services through electronic channels. Electronic banking is constantly developing in terms of user convenience and improvements in the settlements.

In 2016, the most important changes in this area included:

- introduction of order confirmation, a tool providing automated information on the execution of payment and improving the flow of information inside the company and with its counterparties and notifications - a tool automatically sending information to the client concerning, among others, the security of the system and transactions,
- introduction of additional functions parametrization of corporate payment cards. Thereby, the clients gained tools for flexible cards management, i.e. the possibility of establishing limits for non-cash transactions for MasterCard Corporate Debit FX Pekao card,
- access to a universal, dynamic "Foreign transfer" form dedicated to, among others, the handling of SEPA transfers (foreign and currency transfers) to Poland, enabling a wider range of user interaction, dynamic determination of modes and available options, additional guidance and simplifying order entry. Users gained, among others, automatic identification of the SWIFT BIC code of the beneficiary's bank on the basis of the IBAN account for all accounts in this format and more effective verification of the correctness of the entered data,
- an access to a proprietary solution to convert the electronic form of a statement taken from the PekaoBiznes24 to a single structure (JPK) required by law, under the obligation imposed under the Tax Code. The solution prepared by the Bank eliminates the need for costly customization of financial and accounting systems of the clients to the required structure and allows to convert a statement from any period specified by the client.

The effect of the introduced changes and facilities includes increased automation and quicker service of the PekaoBiznes24 users. Clients, to a greater extent, make use of the management of the rights to the PekaoBiznes24 through electronic applications, appreciating the convenience, speed, accuracy and cost savings. Owing to this, the ratio of applications submitted electronically and applications submitted in paper form stands, as at the end of the year, at 70/30.

In the second half of the year, the use of a marketing tool, which allows for profiled campaigns encouraging users to remotely and easily activate new products and additional services, was intensified. Wider use of the functionality offered to clients by the PekaoBiznes24 system leads to increase in revenues from additional services and increases customer loyalty to Bank Pekao S.A.

**Trade finance**
In the area of financing of domestic and foreign trade, the Bank continued to strengthen its leading position in product solutions.

In co-operation with the Pekao Factoring, the Bank introduced a new hybrid model of debt financing of corporate clients co-operating with the Group. An effective model of sale and implementation of products financing receivables was initiated within the project, which provided clients with access to the offer using elements of the Bank's products and Pekao Factoring. The entire financing is structured by one transaction specialist. The objectives of the sales team, as well as performance monitoring, is conducted on a portfolio of all products serving the receivables of the Group regardless of product and operations structure.

The most important projects realized in 2016, in the area of trade finance included, among others,:

- introduction of a new monitoring process for the product Kredyt Zaliczka (Loan Advance) and transfer of service to the new trading system that influence on increasing of the client's transactions security,
- implementation of a number of hardware and regulatory adjustments for the systems that support document products in connection with the recommendations of the KNF,
- launching of the "Trade Finance Infoline" for clients and companies potentially interested in trade finance products supported by experts in the field,
- implementation of new IT hardware infrastructure ensuring more stable operation, service efficiency and scalability of products,
- providing clients with new reporting and analytical tools in the electronic access channels.

Trade Finance Team conducted systematic training and workshops for employees of the Bank, which ensured that customer advisors had actual knowledge of the products offered and the market situation.

**Depositary services**
In 2016, the Bank realized the project to adapt to the new, expanded responsibilities of the depositary bank, under the amended Act on Investment Funds and Managing Alternative Investment Funds.

**Cooperation with international clients**
In 2016, the Bank continued the realisation of the UniCredit Group project "Internationalisation" aimed at using to the fullest extent the potential of the Unicredit Group, based on its position in the European countries. Under the project, the Bank strengthened relations with existing international clients of the Group, and attracted new customers, in close co-operation with the Group advisors, senior bankers and employees of international outlets of the banks, being members of the Unicredit Group.

The Bank implemented new procedures aimed at developing international co-operation, such as the procedure for intra-group guarantees, the terms and conditions for cross-border lending activities within the UniCredit Group and the documentation of the Single Bank Account Agreement in the UniCredit Group.

The Bank's International Customer Office, along with the Polish-Italian Chamber of Commerce, the Italian Institute for Foreign Trade and the Italian Embassy, co-organized events enhancing the Bank's image as a partner for foreign companies operating in Poland under the patronage of key customers such as: Macfrut, SIAD and ANCE.

**Investment banking, structured finance and commercial real estates**
The Bank consistently supports the development of enterprises and infrastructure through financing, organising and securing the transactions. It offers to clients a wide range of services in the field of project financing, structured financing and commercial real estate project financing.

In 2016, the Bank's strong position in the area of financing was confirmed by, among others: the issue of medium-term bonds for a total amount of PLN 2.8 billion, the organization of the largest transactions in 2016 in the market of mergers and acquisitions in the amount of over PLN 1 billion (advisor/investor of this transaction was a subsidiary of the Bank - Pekao Investment Banking S.A.), participation in the largest merger and acquisition transaction carried out on the Polish market in the amount of USD 3.25 billion, and financing of housing developers in the amount of PLN 663 million.

The Bank participated also in the following investment projects of the institutional clients:

- financing the production of an enterprise in the biofuel sector in the amount of over PLN 400 million,
- financing the investment needs of a leading enterprise in the food industry in the amount of over PLN 300 million,
- participation in syndicated loan in automotive sector in the amount of over PLN 300 million,
- financing of a new industrial plant for one of the leaders in the energy industry in the amount of over PLN 280 million,
- financing of enterprise operating in agri sector in the amount of PLN 250 million.

Within the scope of commercial real estate financing, the Bank participated in the following transactions:

- refinancing of shopping centre in the amount of over PLN 550 million,
- financing the construction of a modern complex of varied purposes in the amount of over PLN 400 million,
- financing a residential and retail complex located in Warsaw in the amount of over PLN 160 million.

**Financial market and commercial debt instruments**
In the area of organization and management of commercial debt securities, Bank Pekao S.A. has nearly 20% market share (2nd place), as at 30 November 2016 (data based on the Rating&Market bulletin published by Fitch Polska). In the segment of medium-term corporate bonds, the Bank has 1st place with nearly 25% of market share.

In 2016, medium-term debt securities of enterprises and banks were issued through the Bank for a total amount of ca. PLN 4.5 billion, among which the following transactions deserve special attention:

- issue of four series with a 5- and 7-year maturity of unsecured bonds denominated in EUR and PLN for a leading manufacturer of packaging for a total amount equivalent to ca. PLN 1.1 billion,
- issues of medium-term debt securities (maturity period of 2-4 years) for commercial banks operating in Poland, in the total amount of nearly PLN 700 million,
- placing on the market several series of 5-year bonds for stock exchange listed companies from the construction industry for a total amount of PLN 400 million,
- organizing the issue of 5-year public bonds secured by mortgage in the amount of PLN 200 million for the largest hotel group in Eastern Europe.

Bank Pekao S.A. was among 14 dealers of treasury securities (TSD), who were selected for 2016 by the Ministry of Finance.

Bank Pekao S.A. belongs also to the group of 13 dealers of money market (DRP), who were selected for 2016 by the Polish National Bank.

**Comprehensive services for the public finance sector**

The Bank continues the strategy for maintaining a substantial share in the financing of Polish local government authorities and provides a full range of services designed to support their budgets.

In 2016, the Bank participated in the financing of the following local government infrastructure projects:

- a pioneering project for organizing the financing for the revitalization of urban infrastructure,
- financing the modernization of Łódzkie zoo and its expansion with a modern orientarium in the form of a bond issue program,
- increased the financing for medical investment projects in the Łódzkie voivodeship,
- financing, in the form of a bond issue program for the Municipal Sports and Recreation Centre in Radom Sp. z o.o. to build a new football stadium, a new sports hall, tennis courts and a modern system of city bikes,
- a long-term loan to finance the expenses associated with the expansion of the tram network in one of the Polish cities,
- financing, in the form of the issuance of bonds, the expansion and modernization of the municipal heating network in Lublin,
- a bond issue program in the amount of PLN 30 million to finance the preparatory process of building a thermal waste incineration plant.

In addition, the Bank was the sole organizer and agent of the issue of municipal bonds of the City of Kraków, with a total value of PLN 200 million. It is the largest single municipal bond issue in 2016 with 10-year maturity and a fixed rate.

The Bank also signed an agreement with the City of Gdańsk, including support for the budget of the city and all of its budgetary units in the years 2016-2021 and granted one year overdraft facility to one of the voivodeships.

In the second half of 2016, the Bank signed contracts with two other voivodeship towns, covering the support for the budgets of these towns and all their organizational units for the next five years.

**Cooperation with international and domestic financial institutions**

Bank Pekao S.A. maintains correspondent relations with 1.6 thousand Polish and foreign banks (according to the number of swift keys).

As at the end of 2016, the Bank maintains 71 nostro accounts in 48 banks in 26 countries; it runs 223 loro accounts for 208 foreign clients (banks and other financial institutions) from 48 countries and 42 current accounts for 40 foreign financial institutions.

The Bank also intermediates in the execution of transactions on behalf of clients of other domestic banks, running 33 loro accounts for 12 Polish banks and keeping 6 nostro accounts in one Polish bank, used for settlement of securities transactions and other custodian operations.

The Bank renders also services for Polish banks and branches of foreign banks in Poland in terms of purchase and sale of foreign and domestic currency.

In 2016, the Bank enhanced its product offer for clients of correspondent banking and clearing services for banks, for which it runs Loro accounts and acquired 10 new banks for cooperation and service in the field of clearing in PLN and foreign currencies.

The Bank maintains a high level of STP transactions (straight through processing) rate amounting for 98% of outgoing client and interbank transactions.

In accordance with the requirements of Basel III, the Bank introduced modifications for formatting MT910 messages (Confirmation of Credit), which allow clients for effective reporting of transactions and liquidity management.

## 6.5 Major areas of activities of the Group's subsidiaries

Bank Pekao S.A. is one of the leading providers of banking services and groups together a number of financial institutions active in the asset management, pension funds, brokerage services, transactional advisory, leasing and factoring markets.

Dom Maklerski, CDM and Xelion render brokerage services within the Group providing retail customers with a wide range of products and services on the capital markets. For detailed description of the brokerage activity refer to the point 6.4.1.

Below are described the areas of operations of the Group's key companies from the financial sector.

### 6.5.1 Banking activity

***Pekao Bank Hipoteczny S.A. – Pekao Bank Hipoteczny***

In 2016, Pekao Bank Hipoteczny, as a specialized mortgage bank, continued to pursue its strategy focused on the creation of a secure loans portfolio, strived to maintain competitive position on the market of commercial properties, as well as loans for purchase, construction, refurbishment or modernization of housing loans to individuals.

As at the end of 2016, net value of loans portfolio of Pekao Bank Hipoteczny amounted to PLN 2,024.2 million, a decrease by PLN 39.3 million, i.e. 1.9% in comparison to 2015. Loans granted to corporates and local governments represent 54.0% and loans granted to individual clients represent 46.0% of loan portfolio structure.

In 2016, within the framework of a strategy focused on co-operation with Bank Pekao S.A., the volume of new commercial real estate loans accounted for 65.5% of total new loans.

In 2016, within the second Program of Covered Bonds to bearer, bank successfully conducted one public issuance of covered bonds. The total value of liabilities due to covered bonds amounted to PLN 1,282.7 million as of December 31, 2016.

### 6.5.2 Assets management

***Pioneer Pekao Investment Management S.A. – PPIM***

As of December 31, 2016, the net asset value of investment funds of Pioneer Pekao TFI S.A. (a subsidiary of Pioneer Pekao Investment Management S.A, in which the Bank holds a 49% share) amounted to PLN 16,793.9 million, an increase of PLN 91.4 million, i.e. 0.5% as compared to the end of 2015. In August 2016, Pioneer Pekao TFI S.A. received license for customer portfolios management and after transfer of operational activities within the scope of management of financial instruments portfolios started to manage of the assets from October 1, 2016. Value of these assets as at the end of 2016 amounted to PLN 1,450.7 million.

***Pekao Pioneer Powszechne Towarzystwo Emerytalne S.A. - Pekao Pioneer PTE***

Pekao Pioneer PTE activity is the management of an open-end pension fund Pekao OFE, in which pension contributions are pooled and invested with the aim of their distribution to unit holders after they reach retirement age and voluntary pension fund Pekao DFE which allows collecting of additional funds with a number of advantages of this form of saving.

As at the end of 2016, the value of the pension fund's net assets was PLN 2,262.6 million and Pekao OFE held 1.5% share in the market of open-end pension funds, i.e. on the similar level in comparison to 2015.

### 6.5.3 Leasing activity

***Pekao Leasing Sp. z o.o. – Pekao Leasing***

Pekao Leasing provides financial services supporting purchases and sale of fixed assets, i.e. vehicles, plant and equipment, and office space, both in the form of operating and finance leases.

In 2016, the Company concluded 10,451 new agreements. The value of leased assets increased in comparison to 2015 by 14.5% and amounted to PLN 2,161.7 million, of which 62.4% were vehicles, 31.6% - plant and equipment, 1.9% - real estates and 4.1% - others.

Under the program of co-operation between Pekao Leasing and Bank Pekao S.A. in the area of sale, the value of assets leased via the Bank's branches amounted to PLN 1,484.9 million and increased by 12.5% in comparison to 2015.

### 6.5.4 Factoring activity

***Pekao Faktoring Sp. z o.o. - Pekao Faktoring***

The Company, besides the full range of factoring services (recourse and non-recourse factoring), offers additional services, such as collecting information on debtors' standing, payments collection, debt recovery, settlements accounting and monitoring of payments on an ongoing basis. Additionally, the Company offers settlement of mass transactions, financial advisory and consulting services regarding selection of business financing methods, as well as extending factoring-related loans. The Company co-operates with Bank Pekao S.A. in developing new sales channels and enhancing sales through the existing ones.

The Company is ranked the fifth on the Polish factoring market, with 8.7% of market share.

### 6.5.5 Transactional advisory

***Pekao Investment Banking S.A. - PIB***

PIB operates as brokerage house, focusing on institutional and corporate clients service. The scope of services provided by PIB include in particular receiving and transferring financial instruments to buy or sell orders, execution of these orders on the account of orders provider, offering financial instruments, advisory for corporates within capital structure, corporate strategy or other issues related to such structure or strategy. PIB offers also advisory and other services related to mergers, demergers and corporates acquisition.

PIB acts also as an animator both on equities as well as on derivative instruments market, being one of the most active animators. As at the end of 2016, PIB was the animator for 22 companies.

In 2016, PIB acted as an intermediary entity in tender offer for the sale of the shares and in obligatory redemption of shares of two companies listed on the WSE, acted as a global coordinator and serves as a bookrunner for shares of non-banking sector company, which was the largest transaction of this type on the WSE in 2016 and successfully completed the first IPO of the company on the WSE.

PIB acted as entity offering retail bonds issued by a leading developer of commercial real estate in Poland (eight series of bonds were issued for retail investors and one series for institutions, which were introduced to trading on the regulated market). PIB successfully provided its advisory in processes of disposal/acquiring of the companies (including, among others, disposal of a company operating in waste utilization sector, and acquiring of a company operating in retail sector), in process of strategic options review, acquiring a strategic investor for a company from financial services sector and acquisition of companies (among others from packaging industry).

### 6.5.6 Other financial services

***Centrum Bankowości Bezpośredniej Sp. z o.o. – CBB***

CBB offers services of a financial intermediary, as well as comprehensive services through alternative channels of communication for clients from non-banking sector.

CBB supports Bank Pekao S.A., as a major customer, in the use of online banking, cards and call center products. The company in its operations serves customers through alternative channels of communication, including, above all, by phone and mailing (both traditional way and electronic). The main channel of communication are the phone calls - in 2016, CBB handled 15.6 million calls (an increase of 23% compared to 2015).

The company runs with the Bank a number of projects aimed at developing communication with customers of Bank Pekao S.A. using mobile banking.

***Pekao Financial Services Sp. o.o. – PFS***

PFS outsourcing services to financial institutions in the field of operational solutions and technology, use of fund participants, as well as independent distribution of the funds. Operational and technological solutions are focused on providing customers with services of the highest quality and safety. PFS specialises in registers of participants in mutual and pension funds.

Among the clients served by the PFS there are companies with established market position. As at the end of December 2016, the company maintained its leading position in the OFE funds serving using the services of external Transfer Agent.

***Centrum Kart S.A. - CK S.A.***

The Company renders comprehensive services that include, among others, maintenance of payment card management systems, authorization of transactions and card personalization.

In 2016, CK S.A. continued realization of important IT projects allowing the extension of a range of products offered by Bank Pekao S.A.

The main projects realized in 2016 included the implementation of mobile phones top-ups services in two distribution channels: the Pekao24 and the PeoPay application as well as development in the area of personalized image of payment cards.

## 6.6 Investing in human capital

**Human Capital as a key asset**
The principles of the Bank's policy in the area of Human Resources (HR) development are set by its mission and values considered as a key for the Bank sustainable growth.

The Bank invests in training, professional development of employees (in line with their preferences and abilities), creation of a friendly work environment and conducts questionnaire surveys on employees opinion and satisfaction. Significant area of the Bank's personnel policy is outstanding talents spotting within the organization and investing in development of their skills.

In 2016, these priorities were accompanied by a particular emphasis on promoting preferential values of corporate culture shared across the Bank and UniCredit Group.

**Training and professional development**
The Bank creates learning opportunities and provides access to various forms of training for its employees. Key educational activities focus on realization of in-class training programs, on-the-job learning, coaching and Virtual Class system allowing for distance learning in form of Webinars. In 2016, the Bank continued also structured rotation program allowing for direct exchange of professional knowledge between experts.

In 2016, the main training priorities of the Bank were as follows:

- reinforcement of product and sales knowledge of the Bank's personnel,
- professional knowledge development of the Bank's employees,
- education of middle and top managers,
- realization of mandatory training required under internal and external regulations.

***Reinforcement of product and sales knowledge of the Bank's personnel***
The Bank realized training projects supporting personnel in proper distribution of banking products, including products from bancassurance area. In co-operation with the NBP, it was implemented cascade training system for cashiers in scope of new securities of banknotes as well as it was initiated training program for the years 2016 and 2017 on introducing into circulation the new 500 PLN banknote. Training programs were also developed for the staff responsible for acquisition of new customers and personnel dealing with current clients.

***Professional knowledge development of the Bank's employees***
The Bank continued also realization of training projects aimed at reinforcement of risk culture and training regarding introduction of new business strategies. Training activities were concentrated on support of high potential employees and employees servicing SME clients.

In 2016, the Bank delivered (in form of class room and e-learning as well as virtual sessions) more than 375 thousands of training hours, in which attended over 15 thousands of employees (ca. 99% of all employed persons) confirming the Bank's determination in efficient implementation of required regulations and customer care.

**Development programs and initiatives**
In 2016, development programs and initiatives were provided for the Bank employees, aimed at providing support in the development of managerial and interpersonal skills.

**Development processes**
The priority of development programs in the Bank is identification, review, verification and development of current and future leaders of the Bank.

In order to achieve this goal, the Bank currently operates four main processes:

- Executive Development Plan (EDP) - annual appraisal process of managers as well as planning and realization of development activities. In 2016, 613 persons took part in the EDP,
- Talent Management Review (TMR) - annual process of the professional development, potential and performance assessment, used to manage and develop talents in the Bank and UniCredit Group, which was attended by 137 people, identified as part of the recruitment process, addressed to all employees of the Bank,
- Succession Plans, which are the key outcomes of the EDP and the TMR processes - Succession Plans are crucial for ensuring continuous employment on strategic positions, continuity of long-term projects and minimizing operational risk,
- Annual Employee Appraisal System – process of evaluation of the Bank's employees which comprises appraisal of competencies, potential, personal development planning and business goals appraisal. In 2016, 14,383 employees took part in the process.

Furthermore, the Bank offers the following development:

- Assessment Centre/Development Centre session, survey of individual performance style and communication and 180/360 Feedback - diagnostic tools for identification of strengths and development areas of the employees.
- Mentoring and Coaching – dedicated for selected employees to give them broader business perspectives and an opportunity to gain new experience.
- International development programs realized at the level of UniCredit Group (international training for the higher level managerial staff in the range of Leadership Curriculum Program and Master in CIB).
- Career Navigator tool supporting career development planning of the Bank's employees.

**Internship and trainee programs**
One of the annual objectives of the Bank is to obtain a certain number of graduates of the best universities in Poland, offering them career development within the organization: the network of branches and units of the Head Office of the Bank.

The following programs are implemented in order to realize the above mentioned objective:

- UniChallenge – a two year-long internship program, addressed to talented last-year MA students and graduates. The UniChallenge Program is used to spot high-potential candidates for employees.
- The apprenticeship programs addressed to students. The apprenticeship possibility is offered for 2 weeks to 3 months in order to give participants an opportunity to gain experience in different areas of banking, in all of the Bank's units.

**Increasing engagement of employees**
In 2016, a number of activities were undertaken in order to increase the employees' satisfaction and engagement. It was launched the Intranet website 'We support diversity' and there was conducted a series of workshops for more than 400 managers and the Bank's employees within the scope of the friendly workplace and effective management of an own energy. Moreover, 'Team's climate' project was continued, which is realized within the teams and is aimed at strengthening the employees' engagement through implementation of the activities that improve the work atmosphere. In 2016, more than 1,000 employees from the 30 Bank's organizational units were covered by this project.

**Compensation policy**

On October 11, 2016, as a result of yearly reviews of remuneration rules, the Supervisory Board of Bank Pekao S.A. approved the updated Compensation Policy of the Bank (hereinafter referred to as "the Policy"), reflecting the mission and values of the Bank's approach to remuneration systems, which:

- defines basics of remuneration, structure management, corporate and organizational processes,
- confirms compliance requirements of the adopted remuneration system with generally binding law,
- defines the rules for monitoring of market practices and the approach to remuneration systems, which ensure sustainability of the Bank.

General framework of the Policy is aimed at providing consistency of components and strategy of remuneration by maintaining compliance with risk management and long-term strategies.

The main principle of the Policy is to guarantee competitive level of remunerations and their efficiency, correctness in scope of acting and achieved results as well as transparency and internal justice.

In 2016, the main elements and assumptions of the Policy were not changed. The Bank's policy implemented in this area takes into account the regulations of the parent company, supplemented by provisions ensuring its compliance with the applicable provisions of the Polish law and the recommendations of regulators and supervisory authorities.

In 2016, in the Policy were included provisions to increase the role of the risk management function in the Bank in designing the compensation policy, incentive system and compensation processes, as well as defining the objectives and evaluating the results, the introduction of those responsible within the Bank's control functions maximum threshold, which the bonus pool of variable remuneration can be gradually reduced and the advantage the share of fixed remuneration in the total remuneration.

The compensation strategy was developed in line with the business standards and values underlying the Bank's mission and reflected in the Policy provisions as well as it constitutes the basis for enhancing and protecting the Bank's reputation and creating long term value for all the stakeholders. Moreover, the Policy presents provisions regarding variable compensation elements of persons in key managerial positions of the Bank. It is aimed at reinforcement of long-term value increase for shareholders and company stability. The conducted internal control concerning implementation of the Policy provisions regarding variable compensation elements confirmed execution of the above assumptions of the Policy at a good level.

Assessment report of functioning of the Policy in the Bank in 2015, according to the provisions of the Supervisory Board of Bank Pekao S.A. Regulation was presented for the General Meeting of Shareholders on June 16, 2016. After considering the report, the General Meeting of Shareholders estimated that the functioning of the Bank's Compensation Policy in 2015 contributed to the development and security of the Bank's activities.

Information regarding remuneration value of each Member of the Management and the Supervisory Board is presented in the section of Remuneration of the Management Board and the Supervisory Board.

***Incentive systems***

In the Bank, there are three main incentive systems: a System based on Management by Objectives (MBO), a System based on provisions of Corporate Collective Labour Agreement, which is based on quarterly bonuses and incentive reward, and Executive Variable Compensation System.

Executive Variable Compensation System is dedicated to people holding managerial positions, who have significant influence on the risk profile of the Bank. The aim of the System is to support the execution of the Bank's operational strategy and to mitigate excessive risk conflicts of interest. Participant covered by the system may receive a variable compensation based on a bonus pool approach providing for a comprehensive performance measurement at individual level, level of his/her organizational unit and results of the entire Bank, as well as verification of the participant's compliant behaviour with respect to law provisions and standards adopted by the Bank. In accordance with the system parameters, for reinforcement of care for long-term welfare of the Bank, at least 50% of variable remuneration is provided in phantom shares based on the value of the Bank shares and at least 40% of the bonus is deferrable and paid after the end of the evaluation period it is payable for. In case of the Management Board Members, deferral refers to 60% of the variable remuneration component. Variable remuneration payable for a particular year, is paid within 6 years by considering economic cycle and the risk resulting from conducted activity.

MBO system covers employees employed under the management contract and refers in particular to the positions in the front-office sales and to the managerial positions, which play a significant role in achieving the Bank's commercial goals. The employees covered by the MBO system receive individual goals resulting from the strategy and activity directions of the Bank approved for a particular year; the annual bonus value is conditioned by completion level of those tasks.

A system based on the provisions of the Corporate Collective Labour Agreement (CCLA) applies to all employees who are subject to it. According to the provisions of the CCLA the basis of the system is a quarterly bonus which is discretionary and depends on evaluation of employee's performance and the level of commitment and an incentive bonus, which is granted for outstanding work achievements and the Bank's results in a given year.

***Retention Plans***

In 2016, the Long-Term Incentive Plans of UniCredit Group (edition 2007 and 2008 within the scope of stock options) addressed to the top management was carried out.

***Additional benefits for employees***

Within the scope of remuneration system, the Bank's employees are offered non-wage benefits allowing fair treatment and consistency of remuneration system.

In 2016, Employee Share Ownership Plan (ESOP) was continued, under which the Bank offers to all employees the opportunity to invest in the shares of UniCredit S.p.A under at favourable conditions by obtaining Free Shares measured on the basis of the Investment Shares purchased by each Participant. Detailed information on Employee Share Ownership Plan is included in the Note 46 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

Moreover, the Bank provides its employees with additional medical care in domestic network of private medical clinic.

***Suitability Assessment Policy***

The Bank adopted the Policy of the suitability assessment of the proposed and appointed Members of the Management and the Supervisory Board and Key Function Holders in Bank Pekao S.A. In 2016, the Bank assessed the suitability of the candidates for function of Member of the Supervisory and the Management Board including an assessment of their qualifications, reputation, and additional criteria for management according to mentioned policy. The suitability assessment is performed by the Supervisory Board of the Bank with the support of the Nomination and Remuneration Committee.

***Diversity policy***
On February, 4, 2016, the Supervisory Board of Bank Pekao S.A. approved the resolution "Diversity policy in reference to Supervisory Board Members, Management Board Members and Key Function Holders in the Bank", which defines the strategy of the Bank in scope of diversity management, including diversity in reference to appointment, the Supervisory Board Members, the Management Board Members and the Key Function Holders in the Bank.

The purpose of diversity strategy of the Bank is to provide high quality of tasks execution by its governing bodies, through selection of qualified people to hold function in the Supervisory Board, the Management Board and Key Function Holders in the Bank, using as the first objective criteria and taking into account the benefits of diversity in scope of knowledge, skills and work experience, as well as educational background, geographical origin and nationality, gender and age. An integral element of Diversity policy is the Gender Equality Policy of the Bank, which provides the Bank's employees career opportunities, success and performance evaluation based on individual merit, regardless of gender.

**Corporate values**
The Bank implements a project "System of Values" which defines the corporate values to be cherished by the Bank's employees in their daily relations at work. The Bank's values defined in the Integrity Charter are: respect, reciprocity, transparency, fairness, confidence, and freedom (to act). These values provide a reference system for routine work and for problem situations which are not always addressed by external and internal regulations.

The foundation of this "System of Values" is the work of Integrity Charter Ombudsmen who are independent, experienced, retired managers to whom the employees may report behaviours which clash with the corporate values. The Ombudsmen use the available tools (meetings, notices) when they undertake measures to restore respect for the corporate values in relations among employees wherever they have been disrupted. Their work directly supports the Bank's internal communication and defines certain standards of conduct and communication patterns for all the employees to follow. In 2016, the Integrity Charter Ombudsmen continue meetings with employees at the Bank in order to familiarize them with the "System of Values" and with the Ombudsmen's service. Furthermore, the Ombudsmen also meet with individual employees and they speak by telephone indicates the ability to solve problems.

**Relations with Trade Union Organisations**
In 2016, the co-operation between the Bank and the trade unions in the fields of consultation, negotiation, and agreements was carried out according to the rules and procedures defined by the Labour Law and with respect to the interest of the parties and the principles of social dialogue. There were 14 meetings between the Bank and the Unions in that period.

**Relations with the Works Council**
A Works Council of Bank Pekao S.A. Employees operates in the Bank. The Council is a representative of the workforce, authorized to get information and carry out consultation with the employees on matters defined by the Worker Information and Consultation Act of April 7, 2006. In 2016, the discussions with the Employee Council concerned issues covered by the relevant legal regulations and co-operation with the Works Council progressed with respect to the mutual rights of the parties involved. Reports on agreements made with the Employer are published on the Intranet available to the all Bank's employees.

**Workforce in number**
As at the end of December 2016, the Group employed 17,757 employees (in the Bank and the companies consolidated under full consolidation method) as compared to 18,327 employees as at the end of 2015.

As at the end of December 2016, the Bank employed 15,882 employees as compared to 16,387 employees as at the end of 2015. The average age of the employees was 46.7 years, 64.7% of the employees are university graduates (64.1% in 2015), women represent 79.3% of the total workforce.

## 6.7 Sponsorship and charity policy

The Bank's policy within the scope of sponsoring and charitable activity aims at strengthening the Bank's image as an open and modern institution, close to customers and communities in which the Bank operates.

Upon selecting initiatives, the Bank withdraws from activity based on single donations and reactive responding to requests for support, in favor of long-term social commitment based on partnership with selected organizations. In particular, the Bank supports selected organizations and institutions that execute projects in the scope of the following areas: high culture, sport, aiding children in need, environmental protection, responsible development of the economy.

Charitable activity of Bank Pekao S.A. are carried out mainly through Marian Kanton Foundation of Bank Pekao S.A., which was established in 1997. Each year, about one-third of the Foundation's financial resources are allocated to finance summer and winter holidays for children from poor families and rehabilitation camps for ill and disabled children and teenagers. Owing to such aid, the Foundation is able to improve the quality of their lives and ensure equal opportunities for them. In addition, the Foundation provides financial and material assistance to schools and libraries in villages and small towns, and supports sports clubs for children and teenagers, usually located in schools or in community centers. In line with the Founder's intention, the Foundation's Board also allocates funds for scholarships for talented pupils and students from socially disadvantaged families.

The Bank cooperates also with Foundation of the Great Orchestra of Christmas Charity (Wielka Orkiestra Świątecznej Pomocy – WOŚP), supporting selected projects of the Foundation, including the annual Grand Finale, educational program "Ratujemy i uczymy ratować", and since 2014 the Bank acts also as the Patron of the Academy of Fine Arts at Woodstock Festival Poland (Festiwal Przystanek Woodstock).

Bank Pekao S.A. is one of the titular sponsor of the Pekao Szczecin Open Tournament, the biggest and the most important men's tennis tournament in Poland. The Bank is continuously present at the Tournament since 1993, i.e. since its very beginning. Additionally, in 2015, the Bank launched educational program "Road to Pekao Szczecin Open" (Droga do Pekao Szczecin Open). The program is to promote sport among children and their parents, thus making it possible to select new talented tennis players, who will have a chance to win the Challenger tournament in Szczecin in the future.

The majority of projects, in which the Bank is engaged, are the high culture projects. In this area, the sponsoring activities of the Bank are carried out at two levels: the national level, at which the Bank sponsors strategic events with an undisputed impact on the Polish culture, and the local level, at which smaller projects of great significance to local communities are supported. One of the most important cultural projects supported by the Bank is Bank Pekao Project Room conducted in cooperation with the Center of Contemporary Art – Ujazdowski Castle in Warsaw, where young artists may develop their artistic projects in a special exhibition room in the Castle. In 2016, the Bank supports, among others,: POLITYKA Passports, The Gdańsk Shakespeare Festival, Film and Art Festival Dwa Brzegi, International Festival and Competition of Musical Personalities TANSMAN in Łódź, the Polish Theater in Wrocław, Polish PEN Club Association, Grape-Harvest Theater Meetings in Zielona Góra.

Significant element of the Bank's activities is to support important economic initiatives. Bank Pekao S.A. is the co-organizer of the European Financial Congress and the Corporate Banking Congress which supports both financially and substantively. In 2016, the Bank supported also the European Forum for New Ideas in Sopot and the European Congress of Small and Medium-Size Enterprises in Katowice.

For many years, the Bank is committed to the protection of the Polish bisons, a unique and endangered species. The Bank's financial support is to help ensure the diversification and growth of the bison population, herds care, and the co-financing of scientific and educational projects.

# 7 Statement of Financial Position and Financial Results

Consolidated income statement containing cumulated items for the period from 1 January to 31 December, 2016 and 2015 respectively is presented in the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

The Report on activities of Bank Pekao S.A. Group for 2016 includes statement of financial position in a short form and income statement in a presentation form as well as the key, selected items from these statements are discussed.

**The Bank's share in transaction of acquisition of Visa Europe Ltd. by Visa Inc.**
In accordance with an agreement signed between Visa Europe Ltd. and Visa Inc. on November 2, 2015, on takeover of Visa Europe Ltd. by Visa Inc., in the second quarter of 2016, Bank Pekao S.A. as one of the beneficiaries of the transaction received payment resulting from the transaction settlement in the amount of EUR 43.6 million and 15,818 preferred shares series C of Visa Inc. After three years of completion of the transaction, the Bank will receive deferred payment in cash.

More detailed information on the Bank's share in transaction of acquisition of Visa Europe Ltd. by Visa Inc. is included in the Note 31 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

## 7.1 Structure of the consolidated statement of financial position – short form

The balance sheet of Bank Pekao S.A. determines the amount of total assets in balance sheet and the structure of the assets and liabilities of the Group. As at the end of December 2016, the total assets of Bank Pekao S.A. constitutes 98.1% of the total assets of the whole Group.

The table below presents the Group's statement of financial position – short form.

| ASSETS | 31.12.2016 | | 31.12.2015 | | CHANGE |
|---|---|---|---|---|---|
| | PLN MILLION | STRUCTURE | PLN MILLION | STRUCTURE | |
| Cash and due from Central Bank | 5,872.9 | 3.4% | 7,881.6 | 4.7% | (25.5%) |
| Loans and advances to banks(*) | 3,258.5 | 1.9% | 7,319.0 | 4.3% | (55.5%) |
| Loans and advances to customers(**) | 122,663.2 | 70.4% | 117,299.4 | 69.5% | 4.6% |
| Reverse repo transactions | - | x | 4,755.5 | 2.8% | x |
| Securities(***) | 35,853.1 | 20.6% | 22,308.5 | 13.2% | 60.7% |
| Investments in associates | 136.2 | 0.1% | 149.0 | 0.1% | (8.6%) |
| Property, plant and equipment and intangible assets | 2,019.1 | 1.2% | 2,097.4 | 1.2% | (3.7%) |
| Other assets | 4,411.9 | 2.4% | 6,975.2 | 4.2% | (36.7%) |
| **Total assets** | **174,214.9** | **100.0%** | **168,785.6** | **100.0%** | **3.2%** |

(*) Including net investments in financial leases to banks.

(**) Including debt securities eligible for rediscounting at Central Bank and net investments in financial leases to customers.

(***) Including financial assets held for trading and other financial instruments at fair value through profit and loss.

| EQUITY AND LIABILITIES | 31.12.2016 | | 31.12.2015 | | CHANGE |
|---|---|---|---|---|---|
| | PLN MILLION | STRUCTURE | PLN MILLION | STRUCTURE | |
| Amounts due to Central Bank | 6.1 | 0.0% | 0.9 | 0.0% | > 100% |
| Amounts due to other banks | 4,823.4 | 2.8% | 5,958.4 | 3.5% | (19.0%) |
| Amounts due to customers | 136,379.7 | 78.3% | 124,398.8 | 73.7% | 9.6% |
| Debt securities issued | 1,523.0 | 0.9% | 2,903.2 | 1.7% | (47.5%) |
| Repo transactions | 1,436.2 | 0.8% | 4,468.9 | 2.6% | (67.9%) |
| Other liabilities | 7,134.6 | 4.0% | 7,631.2 | 4.5% | (6.5%) |
| Total equity, including | 22,911.9 | 13.2% | 23,424.2 | 13.9% | (2.2%) |
| non-controlling interests | 14.9 | 0.0% | 16.0 | 0.0% | (6.9%) |
| **Total equity and liabilities** | **174,214.9** | **100.0%** | **168,785.6** | **100.0%** | **3.2%** |

### 7.1.1 Assets

**Changes in the structure of assets**

Loans and advances to customers and securities represent items of the largest value under assets. As at the end of 2016, they accounted for 70.4% and 20.6% of the total assets respectively in comparison with 69.5% and 13.2% respectively as at the end of 2015.

***Cash and due from Central Bank***

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| **Cash and due from Central Bank, including:** | **5,872.9** | **7,881.6** | **(25.5%)** |
| Cash | 2,639.5 | 2,951.4 | (10.6%) |
| Current account at Central Bank | 1,713.3 | 4,930.0 | (65.2%) |
| Other | 1,520.1 | 0.2 | > 100% |

**Customers' Financing**

***Customer structure of loans and advances***

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| **Loans and advances at nominal value(*)** | **127,421.6** | **122,363.1** | **4.1%** |
| Loans(**) | 115,020.0 | 110,026.2 | 4.5% |
| Retail | 58,109.9 | 53,944.6 | 7.7% |
| Corporate | 56,910.1 | 56,081.6 | 1.5% |
| Non- quoted securities | 12,401.6 | 12,336.9 | 0.5% |
| Other(***) | 647.0 | 534.5 | 21.0% |
| Nominal value adjustment | 304.2 | 244.1 | 24.6% |
| **Impairment losses** | **(5,709.6)** | **(5,842.3)** | **(2.3%)** |
| **Total net receivables** | **122,663.2** | **117,299.4** | **4.6%** |
| Securities issued by non-monetary entities(****) | 882.7 | 892.3 | (1.1%) |
| Reverse repo transactions | - | 4,753.2 | x |
| **Total customers' financing (*****)** | **128,304.3** | **128,008.6** | **0.2%** |
| **Total customers' financing excluding reverse repo transactions** | **128,304.3** | **123,255.4** | **4.1%** |

(*) Excluding reverse repo transactions.

(**) Including debt securities eligible for rediscounting at Central Bank and net investments in financial leases to customers.

(***) Including interest and receivables in transit.

(****) Securities issued by non-monetary entities being loans equivalents.

(*****) Total customers' financing includes loans and advances at nominal value, securities issued by non-monetary entities and reverse repo transactions.

As at the end of December 2016, loans and advances at nominal value and securities issued by non-monetary entities amounted to PLN 128,304.3 million, an increase of PLN 5,048.9 million, i.e. 4.1% in comparison to the end of December 2015 with significant growth in key strategic areas.

As at the end of December 2016, the volume of retail loans amounted to PLN 58,109.9 million, an increase of PLN 4,165.3 million, i.e. 7.7% in comparison to the end of December 2015.

The volume of corporate loans, non-quoted securities and securities issued by non-monetary entities amounted to PLN 70,194.4 million as at the end of December 2016, an increase of PLN 883.6 million, i.e. 1.3% as compared to the end of December 2015.

As at the end of December 2016, there were no reverse repo transactions. As of December 31, 2015, reverse repo transactions amounted to PLN 4,753.2 million.

***Receivables and impairment losses***

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| **Gross receivables(*)** | **127,815.4** | **122,677.8** | **4.2%** |
| Not impaired | 120,154.8 | 114,705.8 | 4.8% |
| Impaired | 7,660.6 | 7,972.0 | (3.9%) |
| Impairment losses | (5,709.6) | (5,842.3) | (2.3%) |
| Interest | 557.4 | 463.9 | 20.2% |
| **Total net receivables** | **122,663.2** | **117,299.4** | **4.6%** |

(*) Including debt securities eligible for rediscounting at Central Bank, net investments in financial leases to customers, non-quoted securities and excluding reverse repo transactions.

As of December 31, 2016, the ratio of impaired receivables to total receivables excluding reverse repo transactions amounted to 6.0% as compared to 6.5% as at the end of December 2015.

Impairment losses as at the end of December 2016 amounted to PLN 5,709.6 million.

***Loans and advances to customers by currency(*)***

| | 31.12.2016 | | 31.12.2015 | | CHANGE |
|---|---|---|---|---|---|
| | PLN MILLION | STRUCTURE | PLN MILLION | STRUCTURE | |
| Denominated in PLN | 103,891.3 | 80.9% | 100,977.2 | 82.0% | 2.9% |
| Denominated in foreign currencies(**) | 24,481.5 | 19.1% | 22,164.5 | 18.0% | 10.5% |
| **Total** | **128,372.8** | **100.0%** | **123,141.7** | **100.0%** | **4.2%** |
| Impairment losses | (5,709.6) | x | (5,842.3) | x | (2.3%) |
| **Total net** | **122,663.2** | **x** | **117,299.4** | **x** | **4.6%** |

(*) Including interest and receivables in transit and excluding reverse repo transactions.

(**) Including indexed loans.

The currency structure of loans and advances to customers is dominated by amounts expressed in the Polish złoty; as at the end of December 2016, their share was 80.9%. The largest portion of foreign currency loans and advances to customers were represented by those denominated in EUR (64.9%), CHF (19.4%) and USD (14.9%).

***Loans and advances to customers by contractual maturities*** [(*)]

| | 31.12.2016 | | 31.12.2015 | | CHANGE |
|---|---|---|---|---|---|
| | PLN MILLION | STRUCTURE | PLN MILLION | STRUCTURE | |
| Current and up to 1 month | 15,047.9 | 11.7% | 12,651.3 | 10.3% | 18.9% |
| 1 to 3 months | 3,271.3 | 2.5% | 4,363.2 | 3.5% | (25.0%) |
| 3 months to 1 year | 13,330.4 | 10.4% | 13,375.8 | 10.9% | (0.3%) |
| 1 to 5 years | 39,666.9 | 30.9% | 39,562.3 | 32.1% | 0.3% |
| Over 5 years | 56,409.3 | 43.9% | 52,654.6 | 42.8% | 7.1% |
| Other | 647.0 | 0.6% | 534.5 | 0.4% | 21.0% |
| **Total** | **128,372.8** | **100.0%** | **123,141.7** | **100.0%** | **4.2%** |
| Impairment losses | (5,709.6) | x | (5,842.3) | x | (2.3%) |
| **Total net** | **122,663.2** | **x** | **117,299.4** | **x** | **4.6%** |

(*) Including interest and receivables in transit and excluding reverse repo transactions.

As at the end of December 2016, loans and advances with maturity over 5 years represents 43.9% of total loans and advances (mainly attributed to mortgage loans and receivables for which the maturity date already passed).

Information on loan concentration is included in the Note 28 and 29 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on December 31, 2016.

***Credit exposures towards Ukraine***
In 2016, the Group exposure towards Ukraine in the form of interbank placements were repaid in full.

As at December 31, 2016, the net balance sheet value of remaining exposures towards Ukraine amounted to PLN 111 million (which constitutes 0.1% of total Group exposures), less by PLN 481 million in comparison to the end of December 2015.

### 7.1.2 Liabilities

**Changes in the structure of liabilities**
Amounts due to customers were the main item under the Group’s liabilities and equity. As at the end of 2016, amounts due to customers and debt securities issued totaled PLN 137,902.7 million, and their share in the total assets was 79.2%, compared with 75.4% as at the end of 2015. The share of total shareholder’s equity in the total assets was 13.2% as at the end of 2016, compared with 13.9% as at the end of 2015.

**External sources of financing**

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| Amounts due to Central Bank | 6.1 | 0.9 | > 100% |
| Amounts due to other banks | 4,823.4 | 5,958.4 | (19.0%) |
| Amounts due to customers | 136,379.7 | 124,398.8 | 9.6% |
| Debt securities issued | 1,523.0 | 2,903.2 | (47.5%) |
| Repo transactions | 1,436.2 | 4,468.9 | (67.9%) |
| **Total external sources of financing** | **144,168.4** | **137,730.2** | **4.7%** |

The deposit base is widely diversified and the deposits sourced from retail and corporate customers. In addition, the Group uses also funds borrowed on the interbank market. The Group is not dependent on any single customer nor group of customers.

As at the end of 2016, the geographical structure of deposits acquired through the Bank's domestic branches was as follows:

| REGION | % OF TOTAL DEPOSITS |
|---|---|
| Warszawski | 29.4% |
| Mazowiecki | 20.6% |
| Małopolski | 10.4% |
| Centralny | 9.5% |
| Południowo-Wschodni | 8.6% |
| Wielkopolski | 4.7% |
| Pomorski | 4.3% |
| Śląski | 4.3% |
| Dolnośląski | 4.1% |
| Zachodni | 4.1% |
| **Total** | **100.0%** |

### *Total customer savings*

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| **Corporate deposits** | **65,764.5** | **60,738.8** | **8.3%** |
| Non-financial entities | 48,932.4 | 47,225.8 | 3.6% |
| Non-banking financial entities | 9,024.7 | 7,903.2 | 14.2% |
| Budget entities | 7,807.4 | 5,609.8 | 39.2% |
| **Retail deposits** | **70,183.2** | **63,254.4** | **11.0%** |
| Other (*) | 432.0 | 405.6 | 6.5% |
| **Amounts due to customers(**)** | **136,379.7** | **124,398.8** | **9.6%** |
| **Debt securities issued, of which** | **1,523.0** | **2,903.2** | **(47.5%)** |
| Structured Certificates of Deposit (SCD) | 168.9 | 257.7 | (34.5%) |
| Certificates of Deposit | 130.0 | 1,393.1 | (90.7%) |
| Pekao Bank Hipoteczny S.A. covered bonds | 1,214.8 | 1,227.4 | (1.0%) |
| Interest | 9.3 | 25.0 | (62.8%) |
| **Amounts due to customers and debt securities issued, total(**)** | **137,902.7** | **127,302.0** | **8.3%** |
| Repo transactions | 1,436.2 | 4,468.9 | (67.9%) |
| **Investment funds of Pioneer Pekao TFI** | **16,793.9** | **16,702.5** | **0.5%** |
| Bond and money market funds | 12,108.2 | 11,366.4 | 6.5% |
| Balanced funds | 2,418.1 | 2,780.5 | (13.0%) |
| Equity funds | 2,267.6 | 2,555.6 | (11.3%) |
| including distributed through the Group's network | 16,470.2 | 16,363.6 | 0.7% |

(*) Other item includes interest and funds in transit.
(**) Excluding repo transactions.

As at the end of December 2016, the total amounts due to the Group's customers and debt securities issued amounted to PLN 137,902.7 million, an increase of PLN 10,600.7 million, i.e. 8.3% in comparison to the end of December 2015.

The total volume of retail customers deposits, Structured Certificates of Deposit and other amounted to PLN 70,724.8 million as at the end of December 2016, an increase of PLN 6,859.5 million, i.e. 10.7% in comparison to the end of December 2015.

The total volume of corporate deposits, Certificates of Deposit, Pekao Bank Hipoteczny S.A. covered bonds, interest and other amounted to PLN 67,177.9 million as at the end of December 2016, an increase of PLN 3,741.2 million, i.e. 5.9% as compared to the end of December 2015 while continuing selective pricing approach and focus on securing liquidity needs of the Group.

Repo transactions amounted to PLN 1,436.2 million as at the end of December 2016, a decrease by PLN 3,032.7 million, i.e. 67.9% in comparison to the end of December 2015.

The value of net assets of investment funds managed by Pioneer Pekao TFI S.A. amounted to PLN 16,793.9 million as at the end of December 2016, an increase of PLN 91.4 million, i.e. 0.5% in comparison to the end of December 2015.

***Amounts due to customers by currency*** (*)

| | 31.12.2016 | | 31.12.2015 | | CHANGE |
|---|---|---|---|---|---|
| | PLN MILLION | STRUCTURE | PLN MILLION | STRUCTURE | |
| Denominated in PLN | 113,654.0 | 83.3% | 102,079.2 | 82.1% | 11.3% |
| Denominated in foreign currencies | 22,725.7 | 16.7% | 22,319.6 | 17.9% | 1.8% |
| **Total** | **136,379.7** | **100.0%** | **124,398.8** | **100.0%** | **9.6%** |

(*) Including interest and amounts due in transit and excluding repo transactions.

The bulk of the amounts due to customers are denominated in the Polish currency and its share as at the end of December 2016 amounted to 83.3%. The majority of amounts due to customers denominated in foreign currencies were in EUR (59.0%) and USD (32.9%).

***Amounts due to customers by contractual maturities*** (*)

| | 31.12.2016 | | 31.12.2015 | | CHANGE |
|---|---|---|---|---|---|
| | PLN MILLION | STRUCTURE | PLN MILLION | STRUCTURE | |
| Current accounts and overnight deposits | 79,090.1 | 58.2% | 67,564.5 | 54.5% | 17.1% |
| Term deposits | 56,857.6 | 41.8% | 56,428.7 | 45.5% | 0.8% |
| **Total deposits** | **135,947.7** | **100.0%** | **123,993.2** | **100.0%** | **9.6%** |
| Interest accrued | 198.5 | x | 219.0 | x | (9.4%) |
| Funds in transit | 233.5 | x | 186.6 | x | 25.1% |
| **Total** | **136,379.7** | **x** | **124,398.8** | **x** | **9.6%** |

(*) Excluding repo transactions.

### 7.1.3 Off–balance sheet items

**Statement of Off-balance sheet items**

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| Contingent liabilities granted and received | 54,592.2 | 56,968.3 | (4.2%) |
| Liabilities granted: | 43,564.2 | 45,008.7 | (3.2%) |
| financial | 32,304.3 | 30,935.9 | 4.4% |
| guarantees | 11,259.9 | 14,072.8 | (20.0%) |
| Liabilities received: | 11,028.0 | 11,959.6 | (7.8%) |
| financial | 209.1 | 285.1 | (26.7%) |
| guarantees | 10,818.9 | 11,674.5 | (7.3%) |
| Derivative financial instruments | 196,569.9 | 226,692.6 | (13.3%) |
| interest rate transactions | 96,486.1 | 133,104.3 | (27.5%) |
| transactions in foreign currency and in gold | 99,253.8 | 92,934.2 | 6.8% |
| transactions based on commodities and equity securities | 830.0 | 654.1 | 26.9% |
| **Total off-balance sheet items** | **251,162.1** | **283,660.9** | **(11.5%)** |

More detailed information on off-balance-sheet items is included in the Notes 27 and 48 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

## 7.2 The structure of the net profit

The structure of the net profit of the Group is presented in the table below:

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| **Net profit of Bank Pekao S.A.** | **2,278.4** | **2,290.4** | **(0.5%)** |
| **Entities consolidated under full method** | | | |
| Pekao Leasing Sp. z o.o. | 40.0 | 53.9 | (25.8%) |
| Centralny Dom Maklerski Pekao S.A. | 25.3 | 44.2 | (42.8%) |
| Pekao Investment Banking S.A. | 24.4 | 6.8 | > 100% |
| Pekao Faktoring Sp. z o.o. | 9.7 | 9.3 | 4.3% |
| Pekao Bank Hipoteczny S.A. | 8.7 | 5.0 | 74.0% |
| Pekao Financial Services Sp. z o.o. | 7.5 | 8.0 | (6.3%) |
| Centrum Bankowości Bezpośredniej Sp. z o.o. | 3.4 | 2.7 | 25.9% |
| Pekao Pioneer PTE S.A. | 1.4 | 2.9 | (51.7%) |
| Pekao Leasing Holding S.A. w likwidacji(*) | 0.4 | 61.4 | (99.3%) |
| Centrum Kart S.A. | 0.3 | 0.6 | (50.0%) |
| Pekao Fundusz Kapitałowy Sp. z o.o. | 0.3 | 0.2 | 50.0% |
| FPB "Media" Sp. z o.o. | (0.2) | 0.2 | x |
| Pekao Property S.A. | (0.3) | (0.2) | 50.0% |
| **Entities valued under the equity method** | | | |
| Pioneer Pekao Investment Management S.A. | 36.4 | 44.6 | (18.4%) |
| Dom Inwestycyjny Xelion Sp. z o.o. | 2.2 | 2.0 | 10.0% |
| Krajowa Izba Rozliczeniowa S.A. (**) | - | 5.5 | x |
| **Exclusions and consolidation adjustments(***)** | **(158.6)** | **(245.0)** | **(35.3%)** |
| **Net profit of the Group attributable to equity holders of the Bank** | **2,279.3** | **2,292.5** | **(0.6%)** |

(*) On September 20, 2016 Pekao Leasing Holding S.A. w likwidacji was removed from the National Court Register. The result of Pekao Leasing Holding S.A. w likwidacji for 2015 includes mainly the dividend received from Pekao Leasing Sp. z o.o.

(**) Krajowa Izba Rozliczeniowa S.A. was consolidated till June 30, 2015. On July 15, 2015 the Bank sold 3,125 shares of Krajowa Izba Rozliczeniowa S.A. As a result of the transaction, the Bank's share in the share capital and the votes in the General Meeting of the Company was reduced from 34.44% to 5.74%.

(***) Includes, among others, transactions within the Group (including dividends from subsidiaries for the previous year) and net profit attributable to non-controlling interest.

**The results of Bank Pekao S.A.**

The main items from the Bank's income statement in presentation form are as follows:

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Net interest income | 4,266.9 | 4,039.6 | 5.6% |
| Dividend income | 132.8 | 210.6 | (36.9%) |
| Total net interest income and dividend income | 4,399.7 | 4,250.2 | 3.5% |
| Net non-interest income | 2,636.3 | 2,541.8 | 3.7% |
| **Operating income** | **7,036.0** | **6,792.0** | **3.6%** |
| **Operating costs** | **(2,991.4)** | **(2,992.6)** | **(0.0%)** |
| **Gross operating profit** | **4,044.6** | **3,799.4** | **6.5%** |
| Net impairment losses on loans and off-balance sheet commitments | (491.4) | (514.0) | (4.4%) |
| **Net operating profit** | **3,553.2** | **3,285.4** | **8.2%** |
| Net result on other provisions | (15.5) | (28.6) | (45.8%) |
| Guarantee funds charges | (260.3) | (273.1) | (4.7%) |
| One-off charges in favour of the Bank Guarantee Fund and contribution to Borrowers Support Fund (*) | (16.6) | (256.0) | (93.5%) |
| Tax on certain financial institutions | (449.5) | - | x |
| Net result on investment activities | 51.9 | 63.9 | (18.8%) |
| **Profit before tax** | **2,863.2** | **2,791.6** | **2.6%** |
| **Net profit** | **2,278.4** | **2,290.4** | **(0.5%)** |

(*) One-off charges in favour of the Bank Guarantee Fund and contribution to Borrowers Support Fund include:

- in 2016 - charge related to bankruptcy of Bank Spółdzielczy in Nadarzyn,
- in 2015 - charge related to bankruptcy of SBRiR in Wołomin and contribution to Borrowers Support Fund.

In 2016, the Bank's net profit amounted to PLN 2,278.4 million, a decrease of PLN 12.0 million, i.e. 0.5% in comparison to 2015.

Underlying net profit of Bank Pekao S.A. i.e. excluding net impact of significant extraordinary charges and one-off non-recurring items in 2016 would amount to PLN 2,366.9 million and would be higher by PLN 187.1 million, i.e. 8.6% than comparable net profit achieved in 2015.

The main Bank's financial information are as follows:

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| **STATEMENT OF FINANCIAL POSITION – SELECTED ITEMS** *(in PLN million)* | | | |
| Loans and advances at nominal value(*) | 123,660.5 | 118,662.9 | 4.2% |
| Securities issued by non-monetary entities(**) | 882.7 | 892.3 | (1.1%) |
| Reverse repo transactions | - | 4,753.2 | x |
| Amounts due to customers | 136,629.9 | 124,788.0 | 9.5% |
| Structured Certificates of Deposit | 168.9 | 257.7 | (34.5%) |
| Certificates of Deposit | 130.0 | 1,393.1 | (90.7%) |
| Repo transactions | 1,436.2 | 4,468.9 | (67.9%) |
| Total assets | 170,988.9 | 165,760.7 | 3.2% |
| Investment funds distributed through the Bank's network | 15,583.6 | 15,388.9 | 1.3% |
| **SELECTED RATIOS** | | | |
| Impaired receivables to total receivables in %(***) | 5.8% | 6.3% | (0.5) p.p. |
| TCR (Basel III) in % | 18.2% | 18.2% | 0.0 p.p. |

(*) Including loans and non-quoted securities.

(**) Securities issued by non-monetary entities being loans equivalents.

(***) Excluding reverse repo transactions.

As at the end of December 2016, loans and advances at nominal value and securities issued by non-monetary entities amounted to PLN 124,543.2 million, an increase of PLN 4,988.0 million, i.e. 4.2% in comparison to the end of December 2015. As at the end of December 2016, the volume of retail loans amounted to PLN 57,176.3 million and the volume of corporate loans, non-quoted securities and securities issued by non-monetary entities amounted to PLN 67,366.9 million.

As at the end of December 2016, the amounts due to the customers, Structured Certificates of Deposit and Certificates of Deposit amounted to PLN 136,928.8 million, an increase of PLN 10,490.0 million, i.e. 8.3% in comparison to the end of December 2015 with improved structure of liabilities thanks to growth of share of retail customers deposits.

The value of net assets of investment funds managed by Pioneer Pekao TFI S.A. distributed through the Bank's network amounted to PLN 15,583.6 million as at the end of December 2016, an increase of PLN 194.7 million, i.e. 1.3% in comparison to the end of December 2015.

**Results of the Bank's major related entities**

***Pioneer Pekao Investment Management S.A. – PPIM***
In 2016, consolidated net profit of PPIM amounted to PLN 74.3 million compared with PLN 91.1 million in 2015. The Bank's share in the company's profit was **PLN 36.4 million**. The result of 2016 was influenced by situation on capital markets and change of customers' preferences in terms of the level of acceptable risk.

***Pekao Leasing Sp. z o.o. – Pekao Leasing***
In 2016, Pekao Leasing reported a net profit of **PLN 40.0 million** compared with PLN 53.9 million in 2015. Pekao Leasing result for 2015 included positive impact of VAT related settlements.

***Centralny Dom Maklerski Pekao S.A. – CDM***
In 2016, net profit of CDM amounted to **PLN 25.3 million** compared with PLN 44.2 million profit earned in 2015, influenced by situation on capital markets, lower turnover on the WSE and lower revenues on mutual funds.

***Pekao Investment Banking S.A. – PIB***
In 2016, PIB reported net profit of **PLN 24.4** million compared with PLN 6.8 million in 2015 mainly thanks to completion of several transactions within the scope of advisory in processes of acquiring and disposal of companies, shares and bonds offering as well as realization on behalf of a customer the tender offer for the sale of shares of the company listed on the WSE.

***Pekao Faktoring Sp. z o.o. – Pekao Faktoring***
In 2016, Pekao Faktoring reported a net profit of **PLN 9.7 million** and it was at a similar level to the net profit achieved in 2015.

***Pekao Bank Hipoteczny S.A. – Pekao Bank Hipoteczny***
In 2016, Pekao Bank Hipoteczny reported a net profit of **PLN 8.7 million** compared with PLN 5.0 million in 2015. The 2015 results was under negative influence of external conditions, higher charges in favour of the BFG (including the contribution to the BFG for the purpose of payments of the funds guaranteed to the depositors of the bankrupt Spółdzielczy Bank Rzemiosła i Rolnictwa in Wołomin) and the cost of provision for Borrowers Support Fund.

***Pekao Financial Services Sp. z o.o. – PFS***
In 2016, PFS reported a net profit in the amount of **PLN 7.5 million** compared with PLN 8.0 million in 2015.

## 7.3 The consolidated income statement – presentation form

Net profit of Bank Pekao S.A. Group attributable to equity holders for 2016 amounted to PLN 2,279.3 million after tax on certain financial institutions in the amount of PLN 449.5 million and the extraordinary one-off charge of PLN 16.6 million to the Bank Guarantee Fund in relation to bankruptcy of Bank Spółdzielczy in Nadarzyn. Strong contribution to the results was brought by a substantial growth of loan and deposit volumes in key strategic areas, further progress in cost optimization and lower cost of risk, also thanks to successful recoveries from vindication activity.

Underlying net profit of Bank Pekao S.A. Group i.e. excluding net impact of significant extraordinary charges and one-off non-recurring items in 2016 would amount to PLN 2,367.8 million and would be higher by PLN 185.9 million, i.e. 8.5% than comparable net profit achieved in 2015.

Thanks to the effective commercial activity of the Group in 2016 a significant growth in loan volumes was reported in the area of retail loans (an increase of 7.7% year on year) and a 1.3% year on year growth in the area of corporate loans and non-quoted securities. Such increase in lending was financed by higher volumes of retail deposits growing 11.0% year on year.

The solid liquidity structure of Bank Pekao S.A. Group is reflected by net loans to deposits ratio at 88.9% as at the end of December 2016. This, together with high equity level reflected by total capital ratio (Basel III) amounting to 17.6%, enables for further sound and stable development of the Group's activities.

**The consolidated income statement – presentation form**

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Net interest income | 4,382.0 | 4,166.6 | 5.2% |
| Dividend income and income from equity investments | 55.4 | 65.7 | (15.7%) |
| **Total net interest income, dividend income and other income from equity investments** | **4,437.4** | **4,232.3** | **4.8%** |
| Net fee and commission income | 1,959.0 | 2,005.5 | (2.3%) |
| Trading result | 763.1 | 662.7 | 15.2% |
| Net other operating income and expenses | 187.7 | 158.1 | 18.7% |
| **Net non-interest income** | **2,909.8** | **2,826.3** | **3.0%** |
| **Operating income** | **7,347.2** | **7,058.6** | **4.1%** |
| **Operating costs** | **(3,211.9)** | **(3,219.7)** | **(0.2%)** |
| **Gross operating profit** | **4,135.3** | **3,838.9** | **7.7%** |
| Net impairment losses on loans and off-balance sheet commitments | (500.6) | (517.5) | (3.3%) |
| **Net operating profit** | **3,634.7** | **3,321.4** | **9.4%** |
| Net result on other provisions | (14.5) | (28.8) | (49.7%) |
| Guarantee funds charges | (262.9) | (274.4) | (4.2%) |
| One-off charges in favour of the Bank Guarantee Fund and contribution to Borrowers Support Fund (*) | (16.6) | (260.5) | (93.6%) |
| Tax on certain financial institutions | (449.5) | - | x |
| Net result on investment activities | 5.3 | 73.4 | (92.8%) |
| **Profit before tax** | **2,896.5** | **2,831.1** | **2.3%** |
| Income tax expense | (616.7) | (537.6) | 14.7% |
| **Net profit** | **2,279.8** | **2,293.5** | **(0.6%)** |
| **Attributable to equity holders of the Bank** | **2,279.3** | **2,292.5** | **(0.6%)** |
| Attributable to non-controlling interest | 0.5 | 1.0 | (50.0%) |

(*) One-off charges in favour of the Bank Guarantee Fund and contribution to Borrowers Support Fund include:
- in 2016 - charge related to bankruptcy of Bank Spółdzielczy in Nadarzyn,
- in 2015 - charge related to bankruptcy of SBRiR in Wołomin and contribution to Borrowers Support Fund.

**Operating income**

In 2016, the Group's operating income amounted to PLN 7,347.2 million, an increase of PLN 288.6 million, i.e. 4.1% in comparison to 2015 thanks to both higher net interest income, dividend income and income from equity investment and higher net non-interest income.

**Total net interest income, dividend income and income from equity investments**

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Interest income | 5,448.5 | 5,456.4 | (0.1%) |
| Interest expense | (1,066.5) | (1,289.8) | (17.3%) |
| **Net interest income** | **4,382.0** | **4,166.6** | **5.2%** |
| Dividend income | 16.8 | 13.6 | 23.5% |
| Income from equity investments | 38.6 | 52.1 | (25.9%) |
| **Total net interest income, dividend income and income from equity investments** | **4,437.4** | **4,232.3** | **4.8%** |

Total net interest income, dividend income and income from equity investments in 2016 amounted to PLN 4,437.4 million and was higher by PLN 205.1 million, i.e. 4.8% compared to 2015 driven by higher volumes.

**Net non-interest income**

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Fee and commission income | 2,252.1 | 2,388.5 | (5.7%) |
| Fee and commission expense | (293.1) | (383.0) | (23.5%) |
| **Net fee and commission income** | **1,959.0** | **2,005.5** | **(2.3%)** |
| Trading result | 763.1 | 662.7 | 15.2% |
| of which gains on disposal of AFS assets | 276.5 | 229.6 | 20.4% |
| Net other operating income and expense | 187.7 | 158.1 | 18.7% |
| **Net non-interest income** | **2,909.8** | **2,826.3** | **3.0%** |

Net non-interest income in 2016 amounted to PLN 2,909.8 million, higher by PLN 83.5 million, i.e. 3.0% in comparison with 2015 thanks to higher trading result supported also by gains on settlement of the transaction of the acquisition of Visa Europe Limited by Visa Inc. and by higher net other operating income supported by disposal of loans, with net fee and commission income lower by 2.3% compared to 2015 mainly due to some pressure observed on capital market related fees.

The Group's net fee and commission income in 2016 amounted to PLN 1,959.0 million and was lower by PLN 46.5 million, i.e. 2.3% in comparison with 2015 mainly due to lower net fee and commission income on mutual funds.

The table below presents the Group's net fee and commission income divided according to the main areas of the activity.

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| **Net fee and commission income** | **1,959.0** | **2,005.5** | **(2.3%)** |
| on loans | 524.5 | 486.2 | 7.9% |
| on cards | 380.2 | 370.7 | 2.6% |
| on mutual funds | 248.1 | 298.0 | (16.7%) |
| other | 806.2 | 850.6 | (5.2%) |

**Operating costs**

The operating costs amounted to PLN 3,211.9 million in 2016. They were lower by PLN 7.8 million, i.e. 0.2% as compared with 2015.

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Personnel expenses | (1,896.8) | (1,908.5) | (0.6%) |
| Other administrative expenses | (974.2) | (979.7) | (0.6%) |
| Depreciation and amortization | (340.9) | (331.5) | 2.8% |
| **Operating costs** | **(3,211.9)** | **(3,219.7)** | **(0.2%)** |

In 2016, cost / income ratio amounted to 43.7% in comparison with 45.6% in 2015.

As of December 31, 2016, the Group employed 17,757 employees (in the Bank and the companies consolidated under full consolidation method) as compared to 18,327 employees as at the end of December 2015.

As of December 31, 2016, the Bank employed 15,882 employees as compared to 16,387 employees as at the end of December 2015.

**Guarantee funds charges**

Guarantee funds charges in 2016, amounted to PLN 262.9 million, a decrease of PLN 11.5 million, i.e. 4.2% in comparison with 2015.

**Tax on certain financial institutions**

On February 1, 2016 tax on certain financial institutions under the Act on tax on certain financial institutions was introduced. In 2016, it amounted to PLN 449.5 million.

**One-off charges related to bankruptcy of Bank Spółdzielczy in Nadarzyn**

In 2016, the Group additionally incurred one-off charges in the amount of PLN 16.6 million related to the contribution to the BGF for the purpose of payments of the funds guaranteed to the depositors of the bankrupt Bank Spółdzielczy in Nadarzyn.

**Net impairment losses**

(in PLN million)

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Impairment losses on loans | (401.4) | (500.3) | (19.8%) |
| Impairment losses on off-balance sheet commitments | (99.2) | (17.2) | > 100% |
| **Total** | **(500.6)** | **(517.5)** | **(3.3%)** |

The Group's net impairment losses on loans and off-balance sheet commitments amounted to PLN 500.6 million in 2016, a decrease of PLN 16.9 million, i.e. 3.3% as compared with 2015.

**Provisions, deferred tax assets and liabilities**

(in PLN million)

| | 31.12.2016 | 31.12.2015 | CHANGE |
|---|---|---|---|
| **Total provisions** | **560.4** | **425.4** | **31.7%** |
| of which: | | | |
| provisions for off-balance sheet commitments | 221.0 | 120.8 | 82.9% |
| provisions for liabilities to employees | 316.7 | 293.4 | 7.9% |
| other provisions | 22.7 | 11.2 | > 100% |
| **Deferred tax liabilities** | **4.9** | **4.9** | **0.0%** |
| **Deferred tax assets** | **1,003.4** | **915.2** | **9.6%** |

## 7.4 Quarterly Income Statement

### 7.4.1 Consolidated income statement – long form

**Consolidated income statement for 2016** - Provided for comparability purposes.

(in PLN thousand)

| | Q4 2016 | Q3 2016 | Q2 2016 | Q1 2016 |
|---|---|---|---|---|
| Interest income | 1,374,829 | 1,382,257 | 1,338,188 | 1,353,216 |
| Interest expense | (262,018) | (264,806) | (256,183) | (283,478) |
| **Net interest income** | **1,112,811** | **1,117,451** | **1,082,005** | **1,069,738** |
| Fee and commission income | 578,725 | 559,541 | 575,789 | 538,030 |
| Fee and commission expense | (78,191) | (69,592) | (70,648) | (74,690) |
| **Net fee and commission income** | **500,534** | **489,949** | **505,141** | **463,340** |
| **Dividend income** | **236** | **151** | **16,410** | **1** |
| **Result on financial assets and liabilities held for trading** | **121,861** | **117,300** | **125,406** | **120,842** |
| **Result on fair value hedge accounting** | **5,265** | **1,449** | **(2,533)** | **(2,868)** |
| **Net result on other financial instruments at fair value through profit and loss** | **-** | **-** | **-** | **-** |
| **Gains (losses) on disposal of:** | **4,209** | **7,811** | **273,500** | **150,383** |
| loans and other financial receivables | 3,773 | - | 5,796 | 149,924 |
| available for sale financial assets and held to maturity investments | 460 | 7,862 | 267,707 | 464 |
| financial liabilities | (24) | (51) | (3) | (5) |
| **Operating income** | **1,744,916** | **1,734,111** | **1,999,929** | **1,801,436** |
| **Net impairment losses on financial assets and off-balance sheet commitments:** | **(106,179)** | **(133,882)** | **(131,179)** | **(129,389)** |
| loans and other financial receivables | (68,911) | (131,532) | (72,740) | (128,226) |
| off-balance sheet commitments | (37,268) | (2,350) | (58,439) | (1,163) |
| **Net result on financial activity** | **1,638,737** | **1,600,229** | **1,868,750** | **1,672,047** |
| **Administrative expenses** | **(920,340)** | **(895,948)** | **(911,446)** | **(874,590)** |
| personnel expenses | (482,836) | (469,837) | (472,983) | (471,180) |
| other administrative expenses(*) | (437,504) | (426,111) | (438,463) | (403,410) |
| **Depreciation and amortization** | **(84,359)** | **(85,037)** | **(85,677)** | **(85,793)** |
| **Net result on other provisions** | **(4,994)** | **(6,628)** | **(2,024)** | **(829)** |
| **Net other operating income and expenses** | **8,006** | **12,010** | **3,971** | **6,541** |
| **Operating costs** | **(1,001,687)** | **(975,603)** | **(995,176)** | **(954,671)** |
| **Gains (losses) on subsidiaries and associates** | **8,908** | **9,862** | **9,788** | **10,003** |
| **Gains (losses) on disposal of property, plant and equipment, and intangible assets** | **98** | **3,617** | **363** | **1,281** |
| **Profit before income tax** | **646,056** | **638,105** | **883,725** | **728,660** |
| Income tax expense | (151,172) | (117,330) | (193,098) | (155,182) |
| **Net profit for the period** | **494,884** | **520,775** | **690,627** | **573,478** |
| **Attributable to equity holders of the Bank** | **494,712** | **520,654** | **690,513** | **573,396** |
| Attributable to non-controlling interest | 172 | 121 | 114 | 82 |

(*) Including one-off charge to the Bank Guarantee Fund in relation to bankruptcy of Bank Spółdzielczy in Nadarzyn, tax on certain financial institutions and guarantee funds charges.

**Consolidated income statement for 2015** - Provided for comparability purposes.

(in PLN thousand)

| | Q4 2015 | Q3 2015 | Q2 2015 | Q1 2015 |
|---|---|---|---|---|
| Interest income | 1,369,470 | 1,365,004 | 1,323,599 | 1,398,296 |
| Interest expense | (308,959) | (317,370) | (308,104) | (355,366) |
| **Net interest income** | **1,060,511** | **1,047,634** | **1,015,495** | **1,042,930** |
| Fee and commission income | 582,260 | 606,051 | 616,307 | 583,905 |
| Fee and commission expense | (78,351) | (98,251) | (103,057) | (103,338) |
| **Net fee and commission income** | **503,909** | **507,800** | **513,250** | **480,567** |
| **Dividend income** | **1** | **297** | **13,336** | **1** |
| **Result on financial assets and liabilities held for trading** | **124,074** | **103,916** | **94,931** | **105,127** |
| **Result on fair value hedge accounting** | **529** | **(223)** | **3,007** | **2,234** |
| **Net result on other financial instruments at fair value through profit and loss** | **-** | **-** | **-** | **-** |
| **Gains (losses) on disposal of:** | **58,476** | **16,162** | **2,019** | **152,944** |
| loans and other financial receivables | 132 | - | 58 | 344 |
| available for sale financial assets and held to maturity investments | 58,486 | 16,350 | 2,089 | 152,626 |
| financial liabilities | (142) | (188) | (128) | (26) |
| **Operating income** | **1,747,500** | **1,675,586** | **1,642,038** | **1,783,803** |
| **Net impairment losses on financial assets and off-balance sheet commitments:** | **(120,277)** | **(130,067)** | **(130,082)** | **(137,132)** |
| loans and other financial receivables | (117,113) | (147,171) | (89,181) | (146,890) |
| off-balance sheet commitments | (3,164) | 17,104 | (40,901) | 9,758 |
| **Net result on financial activity** | **1,627,223** | **1,545,519** | **1,511,956** | **1,646,671** |
| **Administrative expenses** | **(1,043,824)** | **(795,962)** | **(797,373)** | **(789,433)** |
| personnel expenses | (471,865) | (484,565) | (480,167) | (471,922) |
| other administrative expenses (*) | (571,959) | (311,397) | (317,206) | (317,511) |
| **Depreciation and amortization** | **(84,808)** | **(81,888)** | **(83,031)** | **(81,738)** |
| **Net result on other provisions** | **1,587** | **(3,714)** | **(767)** | **(25,872)** |
| **Net other operating income and expenses** | **10,635** | **22,843** | **117,895** | **9,623** |
| **Operating costs** | **(1,116,410)** | **(858,721)** | **(763,276)** | **(887,420)** |
| **Gains (losses) on subsidiaries and associates** | **10,622** | **72,426** | **14,599** | **15,556** |
| **Gains (losses) on disposal of property, plant and equipment, and intangible assets** | **11,171** | **628** | **(54)** | **628** |
| **Profit before income tax** | **532,606** | **759,852** | **763,225** | **775,435** |
| Income tax expense | (93,960) | (149,008) | (143,806) | (150,866) |
| **Net profit for the period** | **438,646** | **610,844** | **619,419** | **624,569** |
| **Attributable to equity holders of the Bank** | **438,364** | **610,469** | **619,209** | **624,417** |
| Attributable to non-controlling interest | 282 | 375 | 210 | 152 |

(*) Including one-off charge to the Bank Guarantee Fund in relation to bankruptcy of SBRiR in Wołomin, contribution to the Borrowers Support Fund and guarantee funds charges.

### 7.4.2 Consolidated statement of comprehensive income

### Consolidated statement of comprehensive income for 2016

(in PLN thousand)

| | Q4 2016 | Q3 2016 | Q2 2016 | Q1 2016 |
|---|---|---|---|---|
| **Net profit** | **494,884** | **520,775** | **690,627** | **573,478** |
| **Attributable to equity holders of the Bank** | **494,712** | **520,654** | **690,513** | **573,396** |
| Attributable to non-controlling interest | 172 | 121 | 114 | 82 |
| **Other comprehensive income** | | | | |
| ***Items that are or may be reclassified subsequently to profit or loss:*** | | | | |
| Foreign currency translation differences | - | - | - | - |
| Change in fair value of available-for-sale financial assets | (342,128) | 17,670 | (313,460) | 29,099 |
| Change in fair value of cash flow hedges | (44,063) | 4,712 | (6,281) | 40,075 |
| Income tax expense on other comprehensive income | 73,376 | (4,253) | 60,751 | (13,143) |
| ***Items that will never be reclassified to profit or loss:*** | | | | |
| Re-measurements of the defined benefit liabilities | (11,560) | - | - | - |
| Share in re-measurements of the defined benefit liabilities of associates | 18 | - | - | - |
| Tax on items that will never be reclassified to profit or loss | 2,196 | - | - | - |
| **Other comprehensive income (net)** | **(322,161)** | **18,129** | **(258,990)** | **56,031** |
| **Total comprehensive income** | **172,723** | **538,904** | **431,637** | **629,509** |
| **Attributable to equity holders of the Bank** | **172,551** | **538,783** | **431,523** | **629,427** |
| Attributable to non-controlling interest | 172 | 121 | 114 | 82 |

Note: Net profit includs one-off charge to the Bank Guarantee Fund in relation to bankruptcy of Bank Spółdzielczy in Nadarzyn and tax on certain financial institutions.

### Consolidated statement of comprehensive income for 2015

(in PLN thousand)

| | Q4 2015 | Q3 2015 | Q2 2015 | Q1 2015 |
|---|---|---|---|---|
| **Net profit** | **438,646** | **610,844** | **619,419** | **624,569** |
| **Attributable to equity holders of the Bank** | **438,364** | **610,469** | **619,209** | **624,417** |
| Attributable to non-controlling interest | 282 | 375 | 210 | 152 |
| **Other comprehensive income** | | | | |
| ***Items that are or may be reclassified subsequently to profit or loss:*** | | | | |
| Foreign currency translation differences | (1,146) | (10) | (19) | 6 |
| Change in fair value of available-for-sale financial assets | 98,833 | 191,550 | (441,980) | (85,527) |
| Change in fair value of cash flow hedges | 41,738 | (26,197) | (52,662) | (56,220) |
| Income tax expense on other comprehensive income | (26,708) | (31,417) | 93,982 | 26,932 |
| ***Items that will never be reclassified to profit or loss:*** | | | | |
| Re-measurements of the defined benefit liabilities | 12,900 | - | - | - |
| Share in re-measurements of the defined benefit liabilities of associates | 18 | - | - | - |
| Tax on items that will never be reclassified to profit or loss | (2,451) | - | - | - |
| **Other comprehensive income (net)** | **123,184** | **133,926** | **(400,679)** | **(114,809)** |
| **Total comprehensive income** | **561,830** | **744,770** | **218,740** | **509,760** |
| **Attributable to equity holders of the Bank** | **561,548** | **744,395** | **218,530** | **509,608** |
| Attributable to non-controlling interest | 282 | 375 | 210 | 152 |

Note: Net profit includs one-off charge to the Bank Guarantee Fund in relation to bankruptcy of SBRiR in Wołomin and contribution to the Borrowers Support Fund.

### 7.4.3 Consolidated income statement – presentation form

**Consolidated income statement for 2016**

(in PLN thousand)

| | Q4 2016 | Q3 2016 | Q2 2016 | Q1 2016 |
|---|---|---|---|---|
| Net interest income | 1,112,811 | 1,117,451 | 1,082,005 | 1,069,738 |
| Dividend income and income from equity investments | 9,143 | 10,033 | 26,198 | 10,004 |
| **Total net interest income, dividend income and other income from equity investments** | **1,121,954** | **1,127,484** | **1,108,203** | **1,079,742** |
| Net fee and commission income | 500,534 | 489,949 | 505,141 | 463,340 |
| Trading result | 127,562 | 126,560 | 390,577 | 118,433 |
| Net other operating income and expenses | 11,470 | 11,351 | 9,095 | 155,823 |
| **Net non-interest income** | **639,566** | **627,860** | **904,813** | **737,596** |
| **Operating income** | **1,761,520** | **1,755,344** | **2,013,016** | **1,817,338** |
| **Operating costs** | **(793,808)** | **(793,841)** | **(812,143)** | **(812,115)** |
| **Gross operating profit** | **967,712** | **961,503** | **1,200,873** | **1,005,223** |
| Net impairment losses on loans and off-balance sheet commitments | (106,179) | (133,882) | (131,179) | (129,389) |
| **Net operating profit** | **861,533** | **827,621** | **1,069,694** | **875,834** |
| Net result on other provisions | (4,994) | (6,628) | (2,024) | (829) |
| Guarantee funds charges | (66,016) | (65,758) | (64,104) | (66,986) |
| One-off charge in favour of the Bank Guarantee Fund related to bankruptcy of Bank Spółdzielczy in Nadarzyn | (16,604) | - | - | - |
| Tax on certain financial institutions | (127,962) | (120,727) | (120,204) | (80,640) |
| Net result on investment activities | 99 | 3,597 | 363 | 1,281 |
| **Profit before income tax** | **646,056** | **638,105** | **883,725** | **728,660** |
| Income tax expense | (151,172) | (117,330) | (193,098) | (155,182) |
| **Net profit** | **494,884** | **520,775** | **690,627** | **573,478** |
| **Attributable to equity holders of the Bank** | **494,712** | **520,654** | **690,513** | **573,396** |
| Attributable to non-controlling interest | 172 | 121 | 114 | 82 |

**Consolidated income statement for 2015**

(in PLN thousand)

| | Q4 2015 | Q3 2015 | Q2 2015 | Q1 2015 |
|---|---|---|---|---|
| Net interest income | 1,060,511 | 1,047,634 | 1,015,495 | 1,042,930 |
| Dividend income and income from equity investments | 10,623 | 11,666 | 27,935 | 15,502 |
| **Total net interest income, dividend income and other income from equity investments** | **1,071,134** | **1,059,300** | **1,043,430** | **1,058,432** |
| Net fee and commission income | 503,909 | 507,800 | 513,250 | 480,567 |
| Trading result | 182,947 | 119,855 | 99,899 | 259,961 |
| Net other operating income and expenses | 9,784 | 21,814 | 117,369 | 9,131 |
| **Net non-interest income** | **696,640** | **649,469** | **730,518** | **749,659** |
| **Operating income** | **1,767,774** | **1,708,769** | **1,773,948** | **1,808,091** |
| **Operating costs** | **(798,613)** | **(808,475)** | **(811,221)** | **(801,363)** |
| **Gross operating profit** | **969,161** | **900,294** | **962,727** | **1,006,728** |
| Net impairment losses on loans and off-balance sheet commitments | (120,277) | (130,067) | (130,082) | (137,132) |
| **Net operating profit** | **848,884** | **770,227** | **832,645** | **869,596** |
| Net result on other provisions | 1,587 | (3,714) | (767) | (25,872) |
| Guarantee funds charges | (68,487) | (68,346) | (68,599) | (68,972) |
| One-off charges in favour of the Bank Guarantee Fund related to bankruptcy of SBRiR in Wołomin and contribution to Borrowers Support Fund | (260,549) | - | - | - |
| Net result on investment activities | 11,171 | 61,685 | (54) | 683 |
| **Profit before income tax** | **532,606** | **759,852** | **763,225** | **775,435** |
| Income tax expense | (93,960) | (149,008) | (143,806) | (150,866) |
| **Net profit** | **438,646** | **610,844** | **619,419** | **624,569** |
| **Attributable to equity holders of the Bank** | **438,364** | **610,469** | **619,209** | **624,417** |
| Attributable to non-controlling interest | 282 | 375 | 210 | 152 |

### 7.4.4 Reconciliation of income statement – presentation form and long form

**Consolidated income statement for 2016**

(in PLN thousand)

| INCOME STATEMENT – PRESENTATION FORM'S ITEMS | LONG FORM'S ITEMS RECLASSIFFIED TO PRESENTATION FORM | 2016 | COMMENTS |
|---|---|---|---|
| Net interest income | | 4,382,005 | |
| Dividend income and income from equity investments | | 55,378 | |
| | Dividend income | 16,798 | |
| | Gains (losses) on subsidiaries and associates | 38,580 | |
| **Total net interest income, dividend income and other income from equity investments** | | **4,437,383** | |
| Net fee and commission income | Net fee and commission income | 1,958,964 | |
| Trading result | | 763,132 | |
| | Result on financial assets and liabilities held for trading | 485,409 | |
| | Result on fair value hedge accounting | 1,313 | |
| | Net result on other financial instruments at fair value through profit and loss | - | |
| | Gains (losses) on disposal of available for sale financial assets and held to maturity investments | 276,493 | |
| | (Gains) losses on disposal of financial liabilities | (83) | |
| Net other operating income and expenses | | 187,739 | |
| | Net other operating income and expenses | 30,528 | |
| | *less* - Refunding of administrative expenses | (2,282) | /1 |
| | Gains (losses) on disposal of loans and other financial receivables | 159,493 | |
| **Net non-interest income** | | **2,909,835** | |
| **Operating income** | | **7,347,218** | |
| Operating costs | | (3,211,907) | |
| | Personnel expenses | (1,896,836) | |
| | Other administrative expenses | (1,705,488) | |
| | *less* –Guarantee funds charges | 262,864 | |
| | *less* – One-off charges related to bankruptcy of Bank Spółdzielczy in Nadarzyn | 16,604 | |
| | *less* – tax on certain financial institutions | 449,533 | |
| | Refunding of administrative expenses | 2,282 | /1 |
| | Depreciation and amortization | (340,866) | |
| **Gross operating profit** | | **4,135,311** | |
| Net impairment losses on loans and off-balance sheet commitments | | (500,629) | |
| | Net impairment losses on loans | (401,409) | |
| | Net impairment provision for off-balance sheet commitments | (99,220) | |
| **Net operating profit** | | **3,634,682** | |
| Net result on other provisions | Net result on other provisions | (14,475) | |
| Guarantee funds charges | Guarantee funds charges | (262,864) | |
| One-off charges related to bankruptcy of Bank Spółdzielczy in Nadarzyn | One-off charges related to bankruptcy of Bank Spółdzielczy in Nadarzyn | (16,604) | |
| Tax on certain financial institutions | Tax on certain financial institutions | (449,533) | |
| Net result on investment activities | | 5,340 | |
| | Gains ( losses) on disposal of property, plant and equipment and intangible assets. | 5,359 | |
| | Impairment losses on subsidiaries and associates | - | |
| | Gains (losses) on disposal of subsidiaries and associates | (19) | |
| **Profit before income tax** | | **2,896,546** | |
| Income tax expense | Income tax expense | (616,782) | |
| **Net profit for the period** | **Net profit for the period** | **2,279,764** | |
| **Attributable to equity holders of the Bank** | **Attributable to equity holders of the Bank** | **2,279,275** | |
| Attributable to non-controlling interest | Attributable to non-controlling interest | 489 | |

1/ In the long form the item "Refunding of administrative expenses" included in the item "Net other operating income/expenses", in a presentation form included in “Operating cost”.

## Consolidated income statement for 2015

(in PLN thousand)

| INCOME STATEMENT – PRESENTATION FORM'S ITEMS | LONG FORM'S ITEMS RECLASSIFFIED TO PRESENTATION FORM | 2015 | COMMENTS |
|---|---|---|---|
| Net interest income | | 4,166,570 | |
| Dividend income and income from equity investments | | 65,726 | |
| | Dividend income | 13,635 | |
| | Gains (losses) on subsidiaries and associates | 52,091 | |
| **Total net interest income, dividend income and other income from equity investments** | | **4,232,296** | |
| Net fee and commission income | Net fee and commission income | 2,005,526 | |
| Trading result | | 662,662 | |
| | Result on financial assets and liabilities held for trading | 428,048 | |
| | Result on fair value hedge accounting | 5,547 | |
| | Net result on other financial instruments at fair value through profit and loss | - | |
| | Gains (losses) on disposal of available for sale financial assets and held to maturity investments | 229,551 | |
| | (Gains) losses on disposal of financial liabilities | (484) | |
| Net other operating income and expenses | | 158,098 | |
| | Net other operating income and expenses | 160,996 | |
| | *less* - Refunding of administrative expenses | (3,432) | /1 |
| | Gains (losses) on disposal of loans and other financial receivables | 534 | |
| **Net non-interest income** | | **2,826,286** | |
| **Operating income** | | **7,058,582** | |
| Operating costs | | (3,219,672) | |
| | Personnel expenses | (1,908,519) | |
| | Other administrative expenses | (1,518,073) | |
| | *less* –Guarantee funds charges | 274,404 | |
| | *less* – One-off charges related to bankruptcy of SBRiR in Wołomin and contribution to Borrowers Support Fund | 260,549 | |
| | Refunding of administrative expenses | 3,432 | /1 |
| | Depreciation and amortization | (331,465) | |
| **Gross operating profit** | | **3,838,910** | |
| Net impairment losses on loans and off-balance sheet commitments | | (517,558) | |
| | Net impairment losses on loans | (500,355) | |
| | Net impairment provision for off-balance sheet commitments | (17,203) | |
| **Net operating profit** | | **3,321,352** | |
| Net result on other provisions | Net result on other provisions | (28,766) | |
| Guarantee funds charges | Guarantee funds charges | (274,404) | |
| One-off charges related to bankruptcy of SBRiR in Wołomin and contribution to Borrowers Support Fund | *less* – One-off charges related to bankruptcy of SBRiR in Wołomin and contribution to Borrowers Support Fund | (260,549) | |
| Net result on investment activities | | 73,485 | |
| | Gains ( losses) on disposal of property, plant and equipment and intangible assets. | 12,373 | |
| | Impairment losses on subsidiaries and associates | - | |
| | Gains (losses) on disposal of subsidiaries and associates | 61,112 | |
| **Profit before income tax** | | **2,831,118** | |
| Income tax expense | Income tax expense | (537,640) | |
| **Net profit for the period** | **Net profit for the period** | **2,293,478** | |
| **Attributable to equity holders of the Bank** | **Attributable to equity holders of the Bank** | **2,292,459** | |
| Attributable to non-controlling interest | Attributable to non-controlling interest | 1,019 | |

1/ In the long form the item "Refunding of administrative expenses" included in the item "Net other operating income/expenses", in a presentation form included in “Operating cost”.

# 8 Other Information

**Information required pursuant to Art. 111a of the Banking Law**
Bank Pekao S.A. is a universal commercial bank providing a full range of banking services to individual and institutional clients in Poland. Bank Pekao S.A. Group includes financial institutions operating in banking, asset management, pension funds, brokerage services, transactional advisory, leasing and factoring markets.

The Bank and all subsidiaries of the Bank, within a consolidated basis under article 4, section 1, point 48 of the Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, run its activities on territory of Poland.

As at the end of December 2016, the number of full-time jobs in the Group was 17,304 compared to 17,933 as at the end of 2015.

In 2016, the Group's operating income amounted to PLN 7,347.2 million, an increase of PLN 288.6 million, i.e. 4.1% in comparison to 2015 thanks to both higher net interest income, dividend income and income from equity investment and higher net non-interest income.

Profit before tax of Bank Pekao S.A. Group in 2016 amounted to PLN 2,896.5 million and was higher by PLN 65.4 million, i.e. 2.3% in comparison to 2015. Income tax expense in 2016 amounted to PLN 616.7 million vs. PLN 537.6 million in 2015 and was higher by 14.7%.

As at the end of December 2016, the return on assets (ROA) of the Group was 1.4% and was at the same level as at the end of December 2015.

In 2016, the Bank do not conclude any agreements according to article 141t, section 1 of the Banking Law Act.

**Management Board position regarding the possibility of achieving previously published forecasts**
The Bank has not published the forecast of the financial results for 2016.

**Management Board remunerations**

The amount of remunerations or benefits (in cash, payments in kind or in any form) paid or due to the Management Board Members in 2016(*).

Fix remuneration

(in PLN thousand)

| | BASE SALARY FOR 2016 |
|---|---|
| Luigi Lovaglio | 4,367 |
| Diego Biondo | 1,030 |
| Andrzej Kopyrski | 1,326 |
| Adam Niewiński | 839 |
| Grzegorz Piwowar | 1,286 |
| Stefano Santini | 645 |
| Marian Ważyński | 883 |

Variable remuneration

(in PLN thousand)

| VARIABLE REMUNERATION (CASH PART) PAID FOR | 2012 | 2014 | 2015 |
|---|---|---|---|
| Luigi Lovaglio | 793 | 1,189 | 1,842 |
| Diego Biondo | 112 | 168 | 231 |
| Andrzej Kopyrski | 179 | 215 | 320 |
| Adam Niewiński | 0 | 40 | 140 |
| Grzegorz Piwowar | 174 | 283 | 380 |
| Stefano Santini | 0 | 67 | 45 |
| Marian Ważyński | 87 | 107 | 150 |

Variable remuneration paid to the Management Board Members also includes phantom shares for 2011-2013 calculated base on the average share price PLN 149.80 (for the period from 16 May, 2016 to 15 June, 2016). Phantom shares relating the year 2011, 2012 and 2013 respectively: Mr. Luigi Lovaglio 5 611, 9 387, 8 985 shares, Mr. Diego Biondo 960, 1 460, 1 336 shares, Mr. Andrzej Kopyrski 1 415, 2 196, 1 932 shares, Mr. Adam Niewiński 0, 0, 431 shares, Mr. Grzegorz Piwowar 1 569, 2 130, 2 099 shares, Mr. Stefano Santini 0, 0, 672 shares, Mr. Marian Ważyński 613, 1 071, 857 shares.

Due portion of Members of the Management Board variable remuneration in phantom shares is 50,505 shares. The value of this portion of the variable remuneration will depend on the Bank's share price at the settlement date.

Other payments related to benefits received in 2016 for Management Board Members: Mr. Luigi Lovaglio PLN 149 thousand, Mr. Diego Biondo PLN 1 thousand, Mr. Andrzej Kopyrski PLN 112 thousand, Mr. Adam Niewiński PLN 81 thousand, Mr. Grzegorz Piwowar PLN 112 thousand, Mr. Stefano Santini PLN 1 thousand, Mr. Marian Ważyński PLN 31 thousand.

(*) the remuneration for expats is presented in pln rate valid for compensation payout on monthly basis

In 2016, the Management Board Members did not receive nor are due any compensation from subsidiaries and associated entities.

Additional payments related to secondment package in 2016 for Management Board Members: Mr. Luigi Lovaglio PLN 1,297 thousand, Mr. Diego Biondo PLN 1,056 thousand, Mr. Stefano Santini PLN 519 thousand.

**Supervisory Board remunerations**
The amount of remunerations or benefits (in cash, payments in kind or in any form) paid or due to the Supervisory Board Members in 2016:

(in PLN thousand)

| | TOTAL | NOTES |
|---|---|---|
| Jerzy Woźnicki | 233 | |
| Gianni Papa (from June 17, 2016) | - | Did not receive remuneration according to the Group's policy |
| Leszek Pawłowicz | 215 | |
| Alessandro Decio ( until June 16, 2016) | 86 | |
| Massimiliano Fossati (from June 17, 2016) | - | Did not receive remuneration according to the Group's policy |
| Dariusz Filar | 191 | |
| Katarzyna Majchrzak | 133 | |
| Roberto Nicastro ( until June 16, 2016) | 79 | |
| Laura Penna | - | Did not receive remuneration according to the Group's policy |
| Wioletta Rosołowska | 133 | |
| Doris Tomanek | - | Did not receive remuneration according to the Group's policy |

In 2016, the Supervisory Board Members did not receive nor are due any compensation from subsidiaries and associated entities.

**The Incentive Programs**
As at December 31, 2016, the following long-term incentive programs are realized in Bank Pekao S.A. Group:

– the Long-term UniCredit Group Incentive Program 2007 – in terms of the options 32 employees of Bank Pekao S.A. Group have been covered by the program, including 4 Members of the Management Board. The options expire in 2017,

– the Long-term UniCredit Group Incentive Program 2008 - in terms of the options 49 employees of Bank Pekao S.A. Group have been covered by the program, including 4 Members of the Management Board. The options expire in 2018.

**Shares in the Bank and related entities held by the Bank's Directors**

According to information available to the Bank as at December 31, 2016, the Members of the Bank's management and supervisory bodies held 73,535 shares of Bank Pekao S.A. with face value of PLN 73,535. The number of the Bank's shares held by the Members of the Bank's management and supervisory bodies and its face value remained unchanged as the date of submitting of this report.

The table below presents the number of shares held by the Management Board Members:

| | AS AT THE DATE OF SUBMITTING THE REPORT | | |
|---|---|---|---|
| | FOR THE YEAR 2016 | FOR THE THIRD QUARTER OF 2016 | FOR THE YEAR 2015 |
| Luigi Lovaglio | 64,035 | 64,035 | 64,035 |
| Diego Biondo | 9,500 | 9,500 | 9,500 |
| **Total** | **73,535** | **73,535** | **73,535** |

Moreover, as at December 31, 2016 UniCredit S.p.A. shares were held by: Mr. Luigi Lovaglio – 69,566 shares without nominal value, Mr. Diego Biondo – 5,033 shares without nominal value, Mr. Massimiliano Fossati – 37,335 shares without nominal value, Mr. Andrzej Kopyrski – 1,152 shares without nominal value, Mr. Gianni Papa – 139,470 shares without nominal value, Ms. Laura Penna – 11,187 shares without nominal value, Mr. Grzegorz Piwowar – 1,807 shares without nominal value, Mr. Stefano Santini – 45,786 shares without nominal value, Ms. Doris Tomanek – 56,684 shares without nominal value, Mr. Marian Ważyński - 827 shares without nominal value.

**Information regarding contracts for post termination benefits**

Employment agreements provide payment of compensation amounting to 18 times the value of the monthly base remuneration of the following Members of the Management Board of the Bank: Mr. Andrzej Kopyrski – Vice-president of the Management Board, Mr. Grzegorz Piwowar - Vice-president of the Management Board, Mr. Marian Ważyński - Vice-president of the Management Board, however, in case of Mr. Adam Niewiński - Vice-president of the Management Board, the employment contract provides payment of compensation amounting to 12 times of the monthly base remuneration for the last month. Payment of the compensation follows, among others, in the event of tenure expiration without appointment for the next tenure or dismissing from the function.

The above mentioned provisions do not apply in case of dismissal for reasons stipulated in art. 52 or art. 53 of the Labour Code or in case of, among others, failure to adequately execute responsibilities or infringement of the Bank Statute, resolutions of the Management Board and the Supervisory Board.

Moreover, the abovementioned Members of the Management Board have concluded non-competition agreements with the Bank, which define the rights and obligations of agreement parties in the scope covered by non-competition agreements during and after the employment period.

Employment contracts of the remaining Management Board Members do not provide compensations of this kind.

The Bank has no liabilities arising from pensions and similar benefits for former managers, supervisors or former members of the administrative bodies.

**Agreements with companies entitled to auditing of financial reports**
On the basis of the agreement concluded on June 17, 2013, Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. is the company appointed to audit and review the financial statements of Bank Pekao S.A. and Bank Pekao S.A. Group for the years 2013 – 2017.

Audit remuneration for services of Bank Pekao S.A. Group.

(in PLN thousand)

| | 2016 | 2015 |
|---|---|---|
| Fee for the audit of annual financial statements | 3,295 | 3,351 |
| Fee for other attestation services, including review of financial statements | 2,362 | 1,827 |

The amounts above do not include value added tax (VAT).

**Average interest rates in Bank Pekao S.A. in December 2016**
The average nominal interest rates for the basic types of PLN deposits for non-financial sector residents:

| | |
|---|---|
| PLN retail deposits | 0.8% p.a. |
| PLN corporate clients deposits | 0.8% p.a. |

The average nominal interest rates for the PLN loans for non-financial sector residents:

| | |
|---|---|
| Total retail loans | 4.3% p.a. |
| Mortgage | 3.4% p.a. |
| Consumption | 8.3% p.a. |
| Other | 5.6% p.a. |
| Corporate loans | 3.3% p.a. |

**Number and value of titles of execution and value of collaterals**
Bank Pekao S.A. has established specific policy with regard to collateral accepted to secure loans and guarantees. This policy is reflected under internal rules and regulations in the Bank. The type of collateral and its value are carefully analyzed and chosen regarding the particular risk of the secured transaction.

The Bank obeys the rule, according to which the value of collateral should relate directly to the value of secured liability, that is cash provided by the Bank to a client (capital or the amount of off-balance sheet commitments granted by the Bank) together with extraneous amounts due, for example, interest or commissions.

In order to hedge risk related to lending activities the Bank accepts legal collateral under the Civil Code, the law on bills of exchange or resulting from the habits adopted in domestic or foreign trade, i.e. bank guarantees, guarantee under the Civil Code, blank of promissory notes, aval, transfer of debts, mortgages, registered pledges, pledges, assignment as collateral, transfer of assets in bank account, blockade assets on client's account.

For corporate clients, the total value of the collateral for impaired transactions as at December 31, 2016 amounted to PLN 1,646.3 million. For retail clients, the total value of the collateral for impaired transactions as at December 31, 2016 amounted to PLN 595.0 million. In 2016, there were no titles of execution issued on behalf of the Bank.

**Pending litigations**
In 2016, the number of the legal proceedings pending before courts, arbitration bodies or public administration authorities in respect of the Group's liabilities was 666 with the total value amounting to PLN 1,091.6 million. The number of legal proceedings in respect of receivables was 18,524 with the total value of PLN 1,629.5 million.

In 2016, there were no legal proceedings relating to the liabilities and/or receivables of the Group in which asserted claims accounted for at least 10% of the Bank's own funds.

In the opinion of the Bank none of the individual pending proceedings before any courts, arbitration bodies or public administration authorities during the year 2016, nor the proceedings in aggregate pose any threat to the Bank's financial liquidity.

**Related party transactions**

In 2016, the Bank and its subsidiaries have not concluded any significant transactions (single or aggregate) with related entities other than those executed on arm's length.

In 2016, the Bank and its subsidiaries did not provide any sureties in respect of loans or advances or did not provide any guarantees for repayment of loans or advances to an entity or a subsidiary of such entity, as a result of which the total value of sureties and guarantees at the balance sheet date would have equaled or exceeded 10% of the Bank's equity.

Detailed information on related party transactions is included in Note 53 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

**Information on significant agreements**

In 2016, there have been no significant agreements concluded by the Bank, in particular the Bank has not concluded material agreements with central bank or the competent supervision authorities.

**Information on derivative financial instruments and hedge accounting**

Information on derivative financial instruments and hedge accounting is included in Note 27 and 30 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

**Accounting principles adopted in the preparation of the report**

Accounting principles adopted in the preparation of the report are described in Note 5 to the Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016.

**Issuance, redemption and repayment of debt securities**

***Structured Certificates of Deposit***

Structured Certificates of Deposit are investment products for the Bank's clients that form an alternative to traditional banks' deposits. The total value of the Bank's liabilities relating to these products amounted to PLN 168.9 million (principal value) as at the end of December 2016. There are 4 issues of Structured Certificates of Deposit open in PLN with the maturity date on February 05, 2018. Those liabilities that mature in 2017 and 2018 account for 48.3%, and 51.7% of its total value, respectively.

***Certificates of Deposit***

Certificates of Deposit are investment products denominated in PLN that guarantee 100% protection of invested funds also in case of termination before redemption date. The total value of the Bank's liabilities under these products amounted to PLN 130.0 million (principal value) as at the end of December 2016. There are 2 issues of Certificates of Deposit with the maturity date up to 3 months.

***Pekao Bank Hipoteczny S.A. covered bonds***

The total value of liabilities due to covered bonds amounted to PLN 1,282.7 million as at the end of December, 2016. The liabilities under covered bonds with maturity date up to 1 year account for 12.3%, with maturity date from 1 up to 3 years account for 21.3%, with maturity date from 3 up to 5 years account for 50.9% and with maturity date from 5 up to 10 years account for 15.5% of the total nominal value.

**Subsequent events**

On January 13, 2017, the Management Board of Bank Pekao S.A. informed, in the current report No. 2/2017, on resignations of Mr. Gianni Papa, Mr. Massimiliano Fossati, Ms. Laura Stefania Penna and Ms. Doris Tomanek from the positions of Members of the Supervisory Board of the Bank subject to the condition and with effect as of the date of: (i) the indirect sale by UniCredit S.p.A. of 52,494,007 shares in the Bank to Powszechny Zakład Ubezpieczeń S.A. and (ii) the direct sale by UniCredit S.p.A. of 26,247,003 shares in the Bank to Polski Fundusz Rozwoju S.A.

# 9 Prospects for Development

## 9.1 Factors which will affect the results of the Group

Bank Pekao S.A. and its subsidiaries operate predominantly on the territory of Poland. Therefore, the Bank's performance will be influenced mainly by the economic events in Poland and international outlooks that have an impact on the Polish economy.

The outlook for economic growth in 2017 is positive, with still dominating private consumption in the structure of the GDP growth, and good chances of acceleration of investments, both public as well as private ones. Consumption is propelled mostly thanks to the improvement in the labor market, which is characterized with increasing demand for labor force amid increasing - due to demographic reasons - shortages of supply. These factors are lowering the unemployment rate, at the same time propelling wages' growth – and these two combined are pushing consumer confidence indicators to record-highs. An additional factors are transfers within the Family 500 plus government program, which should dominate at least in the next one-two years, meaning favorable environment for, among others, banking business. It should be kept in mind, though, that the demographic challenges will intensify in the coming years, posing a challenge for the whole economy.

When it comes to investments, year 2017 should bring the beginning of implementation of investments within the EU financial perspective 2014-2020. However, many factors suggest this will happen in the second half of the year, and a sizeable "jump" in the level of the funds utilized will happen in 2018. Regarding private sector investments, the key factor will be limiting of the regulatory uncertainty, as many other factors (such as: high level of capacity utilization, good current financial results of the enterprises, sizeable accumulated profits, an exchange rate favorable for exporters, high level of amortization of existing productive assets, necessity to substitute labor with capital due to demographic challenges etc.) suggest the need or even necessity to invest by the private sector. It is anticipated gradual improvement with regard to private investments.

The forecast assumes ca. 3.0% of the GDP growth in 2017, after 2.8% in 2016.

In 2017, tax and regulatory environment is still going to have significant influence on banks' business and earnings, including in particular:

– Tax on certain financial institutions in force – this so-called bank levy was introduced in February 2016. In case of banks, the tax base is assets value (net of selected items). According to available information, in 2017 the tax is going to be charged according to the same rules as in previous year,
– growing requirements concerning the level of banks own capital,
– burdens related to the functioning of the BFG. In 2017, certain rules concerning calculation of the contribution are subject to change. As a result the burden for individual banks is going to be, to a higher extent than before, dependent on their risk profile. Moreover, in addition to pre-defined yearly contributions, an ad-hoc need for financing of the BFG may arise, as it did in previous years.

Strict tax and regulatory environment will continue to constrain banks' credit expansion.

It is hard to expect in 2017 a positive one-off event in the type of the one in 2016, when banks' shares in Visa Europe were sold to Visa Inc. It cannot be ruled out, however, that an opposite event may occur, namely an unexpected one-off burden for the sectors' earnings.

In 2017, it should be expected maintaining of the relatively high pace of growth of households' deposits. It is associated with favorable situation on labour market (growing employment and wages), as well as social programs carried out by the government. In case of the enterprises, the fall in deposits' interest rates led to higher attractiveness of other forms of funds placement. In addition, in case of international groups it also caused lower propensity to locate financial surplus in Poland. Such situation may lead to lower growth of corporate deposits in 2017.

As for loans, in 2017 limited growth is to be expected, both in households and corporate portfolio. In case of enterprises, a low propensity to invest is visible (which is connected with uncertainty generated on global and local level). In turn for households, a low growth pace of loans portfolio is being influenced by, among others, growing requirements with regard to a down-payment (from 2017, requirement account for 20%) and growing scale of repayments of principal installments from loans taken out in the past.

In 2017, monetary policy may be among important factors influencing bank results. A rebound of inflation in Poland as at the end of last year with an outlook to maintain such a trend in 2017 greatly decreased the risk of another interest rate cuts. At the same time, if the CPI growth is higher than current expectations, the probability will rise for the Monetary Policy Council to start the cycle of rates hike in the second half of 2017. This would benefit the banks' net interest income.

In the Parliament works are conducted concerning the project of law on returns for some of the loans agreements. It assumes, that in case of FX loans, banks will have to return to the clients the difference between acceptable spread (the difference between the rate of buying and selling of the currency set by the law) and the one actually charged. Estimates point out, that if the law is passed the cost for the banking sector may amount to couple of billions of the złoty. The new law also provided space for introducing supervisory actions that are meant to induce banks to propose to their clients a conversion of FX loans on conditions beneficial to customers. Works are currently being held over specific actions in this case and eventual solutions may have strong, negative impact on banks' financial results in 2017. However, taking into account the relatively minor share of these loans in the total assets of the Bank (almost entirely acquired as a result of the merger of the spun-off part of Bank BPH S.A. in 2007), the Bank assesses that potentially taken solutions should not materially affect the financial standing of the Group.

## 9.2 Directions of the activities and business priorities

Bank Pekao S.A. is a universal commercial bank focused on conducting business activity on the Polish market. The strategic objective of the Bank is further business development and stable growth thanks to its strong capital and liquidity position while maintaining the highest standards of risk management and further improvement of cost efficiency. The Bank aims to maintain sustainable flow of income and increase its share in the sector income through strengthening its market position in the areas with the largest value creation potential and by effective margin management.

The Bank's philosophy is based on the customer-centric approach, adjusting its products offer and operational model to the changing clients' needs. The Bank aims to build long-term relationships with clients, allowing to ensure sustainable business growth.

The Bank's business model is based on customer segmentation identifying the following groups of customers:

– individual customers – embracing retail, affluent and private banking clients. Segmentation is based on monthly inflows or assets under management. Each segment has its own business model adjusted to the clients' needs,

– small and micro enterprises (SME) – customers are served by dedicated advisors with the support of product specialists. Service is carried out in retail branches as well as in specialized Business Customer Hubs. Customers are offered professional products and services adjusted to individual clients' needs,

– corporate customers – embracing medium and large companies. Segmentation takes into account the turnover value, sector, type of ownership (public/private, domestic/international, etc.). Customers are served by dedicated advisors with the support of product specialists enabling to optimize service level and cost. Customer advisors are focused on providing high-quality and effective service, using the best practices and integrated sales management tools.

The Bank offers competitive products and services on the Polish market, high service quality and nationwide, well-developed and easily accessible network of branches and ATMs as well as professional call center and a competitive Internet and mobile banking platform for individuals, corporate, small and micro enterprises.

Thanks to the scale of operations, strong capital and liquidity structure and balance sheet strength with a high level of solvency ratio and high surplus of deposits in relation to granted loans, the Bank has competitive advantages that allow effectively compete on the market.

**Directions of the activities and business priorities for the year 2017**

The Bank’s will continue the activities conducted in the previous years. Favourable macroeconomic scenario and strong Bank’s fundamentals support the continuation of determined directions, despite still growing regulatory pressure, and introduction of significant additional banking sector financial burdens made last year.

In 2017, the Bank's priority will continue to be further business development and reinforcement of market position in selected areas while maintaining the highest standards of risk management, effective margin management and further operational efficiency improvement, keeping the liquidity and capital position at safe levels, while striving to ensure sustainable and attractive dividends. The Bank will aim to gradual improvement of business profitability by improving the structure and the level of achieved incomes as well as by further cost efficiency enhancement.

It is expected acceleration of high economic growth to the level of 3%, what allow to maintain the demand for loans in the sector at a level of 3%, similar to the level reached in 2016. At the same time a deposit growth at the level of 7% is expected, which will surpass loans dynamics for consecutive year and lead to further lowering loans to deposits ratio in the sector. The Bank, thanks to its competitive advantages, among others, strong capital position aims to continue its strategy of increasing lending activity and strengthening its market position in strategic areas that provide the largest value creation potential.

The Bank's goal is to build the position of the most recognizable bank in Poland thanks to the professionalism of its activities and value creation for the customer. The Bank's activities will be focused on increasing customer satisfaction with provided services through meeting the customer’s needs, improvement of service quality and delivering the best on the market solutions that enable clients to reach their financial goals.

In the individual customer segment, the Bank will continue to grant consumer loans and mortgage loans denominated in PLN leveraging on long-term experience in selling these products and proved business model focused on effective and efficient adaptation of the offer to the clients’ needs, while maintaining ethical principles in lending and reasonable risk level. In order to adopt best offer to the changing clients’ preferences, the Bank will continue to upgrade CRM system and multi-module analytical tools and algorithms while developing sales of products via remote channels and automating and simplifying processes. Thinking about the future of clients, the Bank intends to continue the development of product offer proposing the best and proven savings and insurance solutions, building long-term relationships with the clients.

In the business customer segment, the Bank’s focus is to reinforce its leading position in the corporate lending, transactional banking services as well as organisation and servicing of corporate bonds issuance. The Bank, leveraging on its experience, aims to support the clients in utilizing 2014-2020 EU funds assigned for building a modern and competitive economy. In addition, the Bank will continue the development of cooperation with customers from the agri-food sector.

In order to ensure the highest service quality for corporate as well as small and micro enterprises (SME), the Bank will continue working on the best adoption of its business model to the changing clients’ requirements by simplifying business procedures, which should improve client satisfaction, and providing innovative financial solutions.

The Bank will continue acquisition of new clients consistently working on the number of customers increase in all segments. Investments in innovative products and solutions will be one of the elements that increase the attractiveness of the Bank's offer and allow to increase the number of customers served. The Bank will continue the development of remote distribution channels (multichannels / omnichannel), including the Internet and mobile banking exploring innovative solutions available on the market, allowing the customer to use the banking services on multiple devices, among others, computer, mobile/smartphone, tablet. Providing ready-made solutions, tailored to the needs of given customer through the remote channels, without branch visit, making life of the Bank’s customers easier, remains one of the Bank’s key objectives. The Bank intends to further develop mobile payment system by combining it with banking mobile system in one application, which should enable further dynamic increasing the number of active users and transaction volumes.

The Bank will continue the activities aimed at improving operational efficiency focusing on processes optimisation, gradual adjustment of the distribution channels structure to the evolving customer needs and simplification of the organizational model.

## 10 Representations of the Bank's Management Board

The Management Board of Bank Pekao S.A. declares to the best of its knowledge that:

- Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016 and comparative figures have been prepared in accordance with the binding accounting policies and that they reflect in a true, fair and clear manner Bank Pekao S.A. Group financial position and their results,
- Report on the activities of Bank Pekao S.A. Group for the year 2016 provides the true picture of Bank Pekao S.A. Group development, achievements and situation, including the main threats and risks.

The Management Board of Bank Pekao S.A. declares that the registered audit company performing the review of Consolidated Financial Statements of Bank Pekao S.A. Group for the period ended on 31 December 2016 has been selected in line with the binding legal regulations. The company and the registered auditors performing the review meet the requirements indispensable for issuing an objective and independent report on the annual consolidated financial statement, in line with the binding provisions of the law and professional standards.

## 11 Statement of Bank Polska Kasa Opieki Spółka Akcyjna on application of Corporate Governance Standards in 2016

According to the ordinance of Minister of Finance dated February 19, 2009 *on current and periodic information published by issuers of securities and the conditions for recognition as equivalent the information required by the laws of a non-member state*[1], Bank Polska Kasa Opieki Spółka Akcyjna (the "Bank") states that it falls within the following set of corporate governance rules, including standards that issuer applies voluntarily and corporate governance practices used by issuer beyond the requirements of national law.[2]

General corporate governance rules i.e. a system of regulations and procedures defining guidelines for the activities of the Bank's governing bodies, including their relations with entities interested in the Bank's activities (stakeholders) result from laws regulations, especially from the Commercial Companies Code and the Banking Law, capital market regulations, as well as the rules laid down in: Code of Best Practice for WSE Listed Companies 2016, Corporate Governance Rules for the Supervised Institutions issued by the Financial Supervision Authority on July 22, 2014 and Code of Banking Ethics of Polish Bank Association.

In 2016, the Bank applied corporate governance rules laid down in the Code of Best Practice for WSE Listed Companies 2016[3] set by WSE Supervisory Board's Resolution No. 26/1413/2015 of October 13, 2015. Recommendation No. IV.R.2 did not apply to the Bank due to shareholder's structure, lack of notifications regarding shareholders expectations concerning mode of conducting General Meeting with the use of electronic communication means and lack of possibility to ensure technical infrastructure necessary to efficiently conduct General Meeting with the use of electronic communication means and to maintain relevant level of electronic communication security during General Meeting. The Bank ensured General Meeting transmission in real time via Internet.

In 2016, the Bank also applied Corporate Governance Rules for the Supervised Institutions issued by the Polish Financial Supervision Authority on July 22, 2014[4] with the exclusion of:

- chapter 9 of the Rules related to asset management at the client's risk, in view of the fact that the Bank does not pursue any activity in this area,
- § 49 section 4 and § 52 section 2 of the Rules in view of the fact that there is an audit unit and a compliance unit functioning in the Bank,
- § 45 section 2 of the Rules in terms of risk assessment concerning failure to achieve the objectives of the internal control system due to ongoing adjustment works.

Moreover, taking into account the lack of possibility for the Bank to ensure the technical conditions necessary to correctly identify shareholders and to ensure the appropriate level of security of electronic communication during the Ordinary General Meeting of the Bank for 2015, in particular during the process of voting at the General Meeting, the Management Board has resolved not to allow participation in this General Meeting with the use of electronic communication means and hence has decided not to apply § 8 section 4 of Corporate Governance Rules for the Supervised Institutions.

Information about not applying the above mentioned rule was published by the Bank on the website, in accordance with Corporate Governance Rules for the Supervised Institutions.

1 Journal of Laws 2014.133 unified text, as amended

2 Par. 91.5.4.a and b of the ordinance of the Minister of Finance of February 19, 2009

3 The document is publicly available on the WSE website: http://www.gpw.pl/dobre_praktyki_spolek_regulacje

4 The document is publicly accessible on the Polish Financial Supervision Authority web site: http://www.knf.gov.pl/regulacje/praktyka/index.html

In the announcement on convening the Ordinary General Meeting of the Bank published in the current report 5/2016 on May 12, 2016 the Bank informed that: "Considering the fact that the Shareholding of the Bank is characterized by a large number of shareholders, geographical and linguistic diversity, which means that for the Bank to meet the requirements necessary to identify the shareholders correctly and to ensure the appropriate level of security of electronic communication it is necessary for the Bank to provide highly advanced technical solutions which currently the Bank is not in possession of, in accordance with Art. $406^5$ § 2 of the Commercial Companies Code and § 8a sec. 2 of the Statute of the Bank, the Management Board of the Bank resolved not to allow participation with the use of electronic communication means in the Ordinary General Meeting of the Bank for the year 2015."

The Management Board of the Bank defines whether the participation in the General Meeting with the use of electronic communication means is possible if the Bank meets technical conditions necessary to participate in the General Meeting with the use of electronic communication means.

In 2016, the Bank applied corporate governance rules laid down in the Code of Banking Ethics of Polish Bank Association.[5]

Furthermore, the Bank applied corporate governance rules resulting from UniCredit Group Integrity Charter[6] as requirements beyond requirements under national law.

The activities undertaken by the Bank comply with the laws regulations, the Bank's Statute, internal Bank's regulations, supervisory and control bodies recommendations, good practices standards and ethic norms.

Acting in compliance with par. 91.5.4.c–k of above mentioned ordinance of Minister of Finance dated February 19, 2009, the Bank presents following information:

1) **The description of key features of the Bank's internal control and risk management systems related to the preparation of financial statements and consolidated financial statements**[7]

The Management Board of the Bank is responsible for developing and implementing of an adequate, effective and efficient internal control system and risk management system with respect to the preparation of financial statements.

The Supervisory Board oversees the functioning of the internal control system by assessing its adequacy, effectiveness and efficiency through the Audit Committee and the Internal Audit Department.

The internal control system within the process of financial statements preparation is aimed at ensuring reliable, complete and correct disclosure of all commercial transactions executed over a given period.

The accounting policy adopted by the Bank, which is compliant with the International Financial Reporting Standards (IFRS), the chart of accounts and reporting databases take into account the format and the extent of detail of the financial data disclosed in the financial statements, in accordance with the requirements and rules applied by the parent entity. The Bank maintains its accounting books in the form of separate IT resources in its IT systems, in line with the adopted business structure. The IT systems ensure access to intelligible and centralized data, separately for each system, which confirm the accounting records and make it possible to control records continuity and transfer account activity and balances, as well as draw up financial statements.

The accounting books are reconciled against reporting databases.

The responsibility for preparation of financial statements, periodic financial reporting and information management rests with the Financial Division supervised by the Vice President of the Bank's Management Board.

UniCredit S.p.A. as the parent company of the Bank is subject to the provisions of the Italian "Savings Act 262" (law 262/2005). Therefore in the Bank there has been implemented a verification process of its operational and audit procedures applied in the drawing up of the financial statements, in accordance with UniCredit S.p.A. guidelines arising from the above provisions.

5 The document is publicly accessible on the Polish Bank Association web site: http://zbp.pl/dla-bankow/zespoly-rady-i-komitety/dzialania-w-obszarze-legislacyjno-prawnym/komisja-etyki-bankowej

6 The document is publicly available on Bank Pekao S.A. website: http://www.pekao.com.pl/o_banku/misja/#tab2

7 Par. 91.5.4.c of the ordinance of the Minister of Finance of February 19, 2009

**2) Identification of shareholders owning directly or indirectly a significant block of shares together with identification of number of shares owned by those shareholders, percentage of shareholders share in share capital, number and percentage of votes at the Bank's General Meeting resulting from owned shares[8]**

UniCredit S.p.A. has been the Bank's major shareholder since August 1999. As a result of realization block trades in the mode of the accelerated bookbuilding, concluded on July 13, 2016, UniCredit S.p.A. has sold 26,247,003 of the Bank shares. Those transactions were settled on July 15, 2016.

Before the sale UniCredit S.p.A. held 131,497,488 of the Bank shares, which accounted for 50.10% of the Bank share capital and corresponded to the same amount of votes at the Bank General Meeting and the same percentage the total votes at the Bank's General Meeting of Shareholders accordingly.

After the transaction and as at December 31, 2016, UniCredit S.p.A. held 105,250,485 of the Bank shares, which accounted for 40.10% share in the Bank's share capital and the same percentage of the total votes at the Bank's General Meeting of Shareholders. The remaining shareholders held 59.90% share in the Bank's share capital and the same percentage of the total votes at the Bank's General Meeting of Shareholders.

Since none of the remaining shareholders held more than 5% of the total vote at the Bank's General Shareholders Meeting, they were not required to disclose acquisitions of the Bank's shares.

The shareholders of the Bank owning directly or indirectly through their subsidiaries at least 5% of the total number of voting rights at the Bank's General Shareholders Meeting are as follows:

| SHAREHOLDER'S NAME | NUMBER OF SHARES AND VOTES AT THE GENERAL MEETING | SHARE IN SHARE CAPITAL AND TOTAL NUMBER OF VOTES AT THE GENERAL MEETING | NUMBER OF SHARES AND VOTES AT THE GENERAL MEETING | SHARE IN SHARE CAPITAL AND TOTAL NUMBER OF VOTES AT THE GENERAL MEETING |
|---|---|---|---|---|
| | DECEMBER 31, 2016 | | DECEMBER 31, 2015 | |
| UniCredit S.p.A. | 105,250,485 | 40.10% | 131,497,488 | 50.10% |
| Other shareholders (below 5%) | 157,219,549 | 59.90% | 130,972,546 | 49.90% |
| **Total** | **262,470,034** | **100.00%** | **262,470,034** | **100.00%** |

In the current report No. 30/2016, the Management Board of Bank Pekao S.A. informed that on December 8, 2016 UniCredit S.p.A. announced it has entered into an agreement for the disposal of a 32.8% stake in Bank Pekao S.A. to Powszechny Zakład Ubezpieczeń S.A. (PZU) and Polish Development Fund S.A. (PFR).

The Transaction is subject to the customary regulatory and antitrust approvals and is expected to be completed around mid-2017.

Moreover in the current report No. 31/2016 on December 8, 2016 the Bank informed that it had received communication from UniCredit S.p.A. concerning announcement on sale offer of 1,916 of certificates exchangeable for the Bank shares (equity linked certificates) of total reference value of approx. EUR 500 million, compulsorily settled in the Bank common shares no later than on December 15, 2019. Those certificates shall be used to sell the remaining 7.3% of the Bank shares belonging to UniCredit S.p.A. (after the conclusion of sale agreement mentioned above).

8 Par. 91.5.4.d of the ordinance of the Minister of Finance of February 19, 2009

**3) Identification of holders of any securities with special control rights with description of those rights[9]**

According to the Bank's Statute all the existing shares are ordinary bearer shares. There are no special preferences or limitations connected with the shares, or differences in the rights attached to them. The rights and obligations related to the shares are defined by the provisions of the Polish Commercial Companies Code and other applicable laws.

Securities issued by the Bank do not give their holders any special control rights.

**4) Identification of any restrictions of voting rights, such as restriction of voting rights of holders of given number or percentage of votes, temporary restrictions of voting or provisions according to which, with co-operation of a company, rights resulting from securities are separated from the fact of holding those securities[10]**

According to the Bank's Statute there are no restrictions of voting rights.

**5) Identification of any restrictions of ownership transfer of securities issued by the Bank[11]**

According to the Bank's Statute there are no restrictions of ownership transfer of the Bank's shares.

**6) Description of rules governing appointment and dismissal of Members of managerial bodies and their rights, in particular right to decide whether to issue or repurchase shares[12]**

Management Board
As stated in the Bank's Statute the Management Board is composed of 5 to 9 Members. Members of the Management Board are appointed by the Supervisory Board for the common term, which shall last three years. The Management Board comprises the President of the Management Board of the Bank, Vice Presidents of the Management Board of the Bank and Members of the Management Board of the Bank. Vice Presidents and Members of the Management Board are appointed and removed on the motion of the President. Appointment of the President of the Management Board and the Member of the Management Board supervising significant risk management or entrusting this function to the appointed Member of the Management Board, is subject to approval by the Financial Supervision Authority. The body which applies to the Financial Supervision Authority for the approval is the Supervisory Board.

At least half of the Members of the Management Board, including its President, should possess a thorough knowledge of the Polish banking market, i.e. they should meet all of the following criteria:

- they have professional experience gained on the Polish market, relevant for the performance of a managerial function at the Bank,
- they are permanently domiciled in Poland,
- they have command of the Polish language.

The Management Board runs the business and represents the Bank. Each Member of the Bank's Management Board is obliged to undertake actions in Bank's interest. Members of the Management Board are prohibited from taking any decisions or actions that would lead to conflicts of interests or that would be incompatible with the Bank's interests or their official duties. A Management Board Member is obliged to notify the Management Board of the Bank of any situation in which a conflict of interests might occur or has occurred as well as refrain from participating in discussion and voting on resolution in case of which a conflict of interest has occurred.

Members of the Management Board shall have rights under the generally applicable law.

According to the Bank's Statute they have no right to decide whether to issue or purchase shares.

9 Par. 91.5.4.e of the ordinance of the Minister of Finance of February 19, 2009

10 Par. 91.5.4.f of the ordinance of the Minister of Finance of February 19, 2009

11 Par. 91.5.4.g of the ordinance of the Minister of Finance of February 19, 2009

12 Par. 91.5.4.h of the ordinance of the Minister of Finance of February 19, 2009

**7) Description of rules governing amendment of the Statute of the Bank[13]**

Amendment of the Bank's Statute requires adoption by way of resolution of the Bank's General Shareholders Meeting as well as registering the amendment in the National Court Register. Procedure of the General Shareholders Meeting of the Bank[14] defines detailed rules of conducting the Bank's General Shareholders Meetings and adopting resolutions. The Bank's General Shareholders Meetings resolutions concerning the amendments of the Bank's Statute are being adopted by the three-quarter majority, whereas according to the Bank's Status the Bank's General Shareholders Meeting is entitled to adopt resolutions only if at least 50% of shares plus one share is represented. Moreover, as stated in Par. 34.2 of the Banking Act, any amendment of the Statute of the Bank shall require the authorization of the Polish Financial Supervision Authority where such amendment relates to:

- the company name,
- the bank's registered office, objects and scope of activity taking into consideration activities defined in par. 69.2.1-7 of the Act on Trading in Financial Instruments of July 29, 2005 that the bank intends to perform according to Par. 70.2 of this Act,
- the statutory bodies and their competences, including particularly the competences of the members of the management board appointed with acceptance of the Polish Financial Supervision Authority and decision making standards, the basic organizational structure of the bank, the procedures applicable to making legally binding statements regarding property rights and obligations, the procedures for issuing internal regulations and the procedure for making decisions concerning the undertaking of commitments or disposal of assets whose total value with regard to a single entity exceeds 5% of the bank's own funds,
- the principles of functioning of the management system, including internal control system,
- the own funds and financial management principles, and
- voting preference or limitation attached to shares of a bank.

**8) Functioning of the General Shareholders Meeting and its key powers, as well as description of the rights of shareholders and the manner of exercising these rights, in particular rules resulting from Rules of Procedure for the General Shareholders Meeting, unless these rules result directly from generally applicable law**[15]

The operation of the Bank's General Shareholders Meeting is governed by the Rules of Procedure for the Bank's General Shareholders Meeting, adopted by way of Resolution No. 19 of April 8, 2003, amended by way of Resolution No. 41 of May 5, 2009 and Resolution No. 41 of June 1, 2012. The Regulation of Shareholders' Meetings of the Bank was amended by resolution No. 42 dated June 16, 2016 of the Ordinary General Meeting of the Bank which shall enter into force on the day following the next shareholder's General Meeting. The Regulation of Shareholders' Meetings of the Bank defines detailed rules of conducting General Shareholders Meetings and adopting resolutions. The Rules of Procedure are available to the public on the Bank's website[16].

Apart from powers and authorities mentioned in binding laws, in particular in the Code of Commercial Companies and the Banking Law Act, in the Regulators' recommendations and the Bank's Statute, the Bank's General Shareholders Meeting has the following powers and authority:

- to review and approve the report on the Bank's operations and the Bank's financial statements for the previous financial year,
- to adopt a resolution on profit distribution or coverage of loss,
- to review and approve the report on the activities of the Supervisory Board,

13 Par. 91.5.4.i of the ordinance of the Minister of Finance of February 19, 2009

14 Adopted by virtue of the Resolution of the General Shareholders Meeting No. 19 of April 8, 2003

15 Par. 91.5.4.j of the ordinance of the Minister of Finance of February 19, 2009

16 http://www.pekao.com.pl/informacje_dla_inwestorow/walne-zgromadzenia-banku/

- to grant discharge to Members of the Supervisory Board and Management Board in respect of their duties,
- to review and approve the report on the Group's operations and the Group's financial statements,
- to set the dividend record date and dividend payment date,
- to dispose of or lease a business or its organized part, and to encumber it with limited property rights,
- to amend the Bank's Statute and to draft its consolidated text,
- to increase or decrease the Bank's share capital,
- to issue convertible bonds, bonds with pre-emptive rights to acquire shares, and subscription warrants,
- to retire shares and to define the terms of retirement,
- to decide on the Bank's merger, demerger or liquidation,
- to create and release special accounts,
- to appoint and remove from office Members of the Supervisory Board, taking into account assessment of fulfilment of the suitability requirements,
- to define the remuneration rules for Members of the Supervisory Board,
- to conclude an agreement with a subsidiary which provides for the management of the subsidiary or for the transfer of profit by the subsidiary,
- to appoint the entity authorized to examine financial statements and review the financial statements,
- to deal with other matters falling within the scope of the Bank's activities which are submitted to the Bank's General Shareholders Meeting.

The Bank's General Shareholders Meeting is convened via the Bank's website and in a way determined for passing current information according to rules regarding public offer and conditions, under which the financial instruments are introduced to organized turnover system and to rules regarding public companies. The convocation have to take place at least twenty-six days before the Bank's General Shareholders Meeting.

The Ordinary General Shareholders Meeting should take place once a year, not later than in June. When determining the date of the Bank's General Shareholders Meeting, the Management Board seeks to enable as many shareholders as possible to participate in the Meeting.

The Statute allows the participation in the General Meeting with the use of electronic communication means if the Management Board adopts such decision. Management Board adopts decision mentioned in the previous sentence in the case of fulfilling by the Bank technical conditions necessary for participation in the General Meeting with the use of electronic communication means what covers in particular:

1) real-life broadcast of General Meeting,
2) real-time bilateral communication where shareholders may take the floor during a General Meeting from location other than the General Meeting,
3) exercising the rights to vote during a General Meeting either in person or through a plenipotentiary.

According to the Statute, in each case of convening the General Meeting, the Management Board of the Bank defines whether the participation in the General Meeting with the use of electronic communication means is possible and what are the requirements and limitations necessary to identify of shareholders and to ensure the safety of electronic communication. Detailed conditions of participation in the General Meeting with the use of electronic communication means are specified in regulation adopted by the General Meeting and notice of calling the General Meeting.

The Bank's Supervisory Board can convene Annual General Shareholders Meeting, if the Management Board does not convene it in due time stated in the Statute and the Extraordinary Shareholders Meeting, if necessary.

The full documentation which is to be presented to the Bank's General Meeting, together with the drafts of resolutions and information concerning the Bank's General Meeting are made available to persons entitled to participate in the Bank's General Meeting on the Bank's website and in paper form which is available in the Bank's Headquarters, Warsaw, Żwirki i Wigury Street 31. Information in this respect is covered by announcement about convening the General Meeting, in accordance with Art. $402^2$ of Code of Commercial Companies.

Official copies of the Bank's Management Board on the Bank's operations and financial statements as well as copies of the Supervisory Board's report and external auditor's opinion are issued to shareholders upon request no later than 15 days prior to the Bank's General Meeting date.

The rights of the Bank's shareholders include in particular:

– the right of shareholders holding at least a half of the share capital or at least a half of the votes to convene Extraordinary Meeting of Shareholders. In this case, the shareholders elect the chairman of the Bank's General Meeting,
– the right of shareholders holding at least the twentieth of share capital to demand that specific issues be placed on the agenda of the next Bank's General Shareholders Meeting. The demand should include the justification and the project of resolution's project concerning proposed issue and should be submitted to the Management Board no later than 21 days prior to the Meeting date. The Management Board is obliged to announce changes in the Meeting agenda introduced because of shareholder's demand as fast as possible and no later than 18 days prior to the Meeting date. The Announcement takes place according to the way proper for General Meeting convocation,
– the right of shareholders holding at least the twentieth of share capital to submit via electronic communication media projects of resolutions concerning issues introduced to the Bank's General Meeting agenda or issues, which are supposed to be introduced to the Meeting agenda before the date of holding the Bank's General Meeting. The Bank instantly announces projects of resolutions on the Bank's website,
– the right of every shareholder to submit projects of resolutions concerning issues introduced to the Meeting's agenda,
– the right of shareholders to participate in the Bank's General Shareholders Meeting personally or by proxy,
– the right of shareholders holding a tenth of the share capital represented at the Bank's General Shareholders Meeting to demand that the attendance list of the Bank's General Shareholders Meeting be checked by a committee appointed for that purpose and composed of at least three persons, including one person appointed by the parties making the demand,

- the right according to which the Bank's General Shareholders Meeting is not allowed to adopt a resolution to remove an item from the agenda or not to consider an issue which was placed on the agenda upon request of shareholders unless the shareholders express their consent to the same,
- the right according to which the Bank's General Shareholders Meeting may not be adjourned deliberately to obstruct the exercise of the shareholders rights,
- the right of each individual participant of the Bank's General Shareholders Meeting to nominate one or more candidates for membership on the Bank's Supervisory Board,
- the right of shareholders holding at least a fifth of the share capital to demand block voting on the appointment of the Supervisory Board; a relevant request should be submitted to the Management Board in writing at such time as to enable its placement on the agenda of the Bank's General Shareholders Meeting,
- the right to inspect the book of minutes and to receive copies of resolutions authenticated by the Management Board,
- the right according to which the Chairperson of the Bank's General Shareholders Meeting is obliged to ensure that the rights of minority shareholders are respected,
- the right of shareholders who raise an objection against a resolution to justify the objection in a concise manner.

All issues submitted to the Bank's General Shareholders Meeting have the recommendation of the Supervisory Board. According to Par. 9 of the Bank's Statute, issues submitted to the Bank's General Shareholders Meeting should be submitted to the Supervisory Board for consideration.

The Bank's General Shareholders Meetings are attended by Members of the Management Board and Supervisory Board in makeup that enables providing content-related answers to question in discussion. An auditor is present at the General Shareholders Meeting in particular Ordinary General Shareholders Meeting, if financial matters of the Bank are to be discussed at the Meeting.

The Bank's Management Board, as a body responsible for providing legal service to the Bank's General Shareholders Meeting, exerts every effort to ensure that resolutions are formulated in a clear and unambiguous manner.

The Rules of Procedure for the Bank's General Shareholders Meeting contain provisions (Par. 13.10–17) regarding block voting on the appointment of the Supervisory Board.

Any amendments to the Rules of Procedure for the Bank's General Shareholders Meeting take effect as of the date of the next General Shareholders Meeting.

In the course of performing their responsibilities, the Bank's governing bodies ensure that the interests of majority shareholders are served in such a way as not to prejudice the interests of the minority shareholders. The above principle finds its practical implementation in the proper composition of the Supervisory Board, which comprises representatives of both majority and minority shareholders. Thus, the interests of all shareholder groups are accounted for in carrying out the supervisory function. The principle of the majority rule is reflected in Par. 10.2 of the Bank's Statute, whereby the Bank's General Shareholders Meeting may adopt resolutions if at least 50% of the share capital plus one share is represented at the Meeting. The purpose of this provision is to guarantee that resolutions on matters most important to the Bank and its shareholders are adopted by the Bank's General Shareholders Meeting in the presence of shareholders representing jointly an absolute majority of the share capital. However, if a resolution is not adopted for lack of quorum, as defined above, the resolution may be adopted at the next Meeting with the same agenda, in the presence of shareholders representing at least 20% of the share capital.

The Chairperson of the Bank's General Shareholders Meeting is responsible for the orderly conduct of the meeting and ensures that the rights and interests of all shareholders are respected, that any abuse of rights by the participants is prevented, and that the rights of minority shareholders are observed.

Within the scope of their competence and to the extent necessary to resolve issues placed under discussion of the Bank's General Shareholders Meeting, Members of the Supervisory Board, Members of the Management Board and the auditor provide the participants with the required explanations and information concerning the Bank.

Voting on procedural matters may be carried out only on issues related to the conduct of the Meeting. This voting procedure cannot be applied to resolutions which may have impact on the exercise of the shareholders rights.

Removing an item from the agenda or a decision not to consider an issue placed on the agenda at the request of shareholders requires a resolution of the Bank's General Shareholders Meeting, adopted with a three-quarter majority of the votes, following approval by all the present shareholders who submitted such a request.

**9) Composition of the Bank's managerial, supervisory or administrative bodies and it's committees, and its changes that occurred during last financial year as well as rules of procedure[17]**

**Management Board**

As at January 1, 2016 the Management Board of the Bank was composed of the following persons:

| | |
|---|---|
| Luigi Lovaglio | President of the Management Board, CEO, |
| Diego Biondo | Vice President of the Management Board, |
| Andrzej Kopyrski | Vice President of the Management Board, |
| Adam Niewiński | Vice President of the Management Board, |
| Grzegorz Piwowar | Vice President of the Management Board, |
| Stefano Santini | Vice President of the Management Board, |
| Marian Ważyński | Vice President of the Management Board. |

With the effect from June 16, 2016 the mandates of Management Board Members expired. Therefore, on the meeting of June 6, 2016 the Supervisory Board, taking into account the assessment of fulfilment of the suitability requirements appointed the Management Board Members for three-year joint term, starting on June 17, 2016.

The following persons were appointed as members of the Management Board:

| | |
|---|---|
| Luigi Lovaglio | as the President of the Management Board, CEO, |
| Diego Biondo | as Vice President of the Management Board, supervising material risk management in the Bank's activity, |
| Andrzej Kopyrski | as Vice President of the Management Board, |
| Grzegorz Piwowar | as Vice President of the Management Board, |
| Stefano Santini | as Vice President of the Management Board, |
| Marian Ważyński | as Vice President of the Management Board, |
| Adam Niewiński | as Vice President of the Management Board. |

17 Par. 91.5.4.k of the ordinance of the Minister of Finance of February 19, 2009

As at December 31, 2016 the Management Board was composed of the following persons:

| | |
|---|---|
| Luigi Lovaglio | President of the Management Board, CEO, |
| Diego Biondo | Vice President of the Management Board, supervising material risk management in the Bank's activity, |
| Andrzej Kopyrski | Vice President of the Management Board, |
| Grzegorz Piwowar | Vice President of the Management Board, |
| Stefano Santini | Vice President of the Management Board, |
| Marian Ważyński | Vice President of the Management Board, |
| Adam Niewiński | Vice President of the Management Board. |

The Management Board of the Bank acts according to the Bank's Statute and the Rules of procedure adopted by virtue of its Resolution No. 480/XII/2014 of December 22, 2014. The previously binding Resolution of the Management Board No. 101/VI/03 of June 3, 2003 expired. The Rules of procedure shall in particular define the matters which require joint consideration by the Management Board, as well as the procedure for adopting a resolution in writing. The Rules of Procedure of the Management Board are available on the Bank's website[18]. The Members of the Management Board shall coordinate and supervise the activity of the Bank pursuant to the binding division of competence adopted by the Management Board and approved by the Supervisory Board.

According to the Bank's Statute, the Management Board shall conduct the matters of the Bank and represent the Bank. Issues not reserved by virtue of the provisions of the law or of the Statute to fall within the scope of competence of other Bank's statutory bodies, shall fall within the scope of competence of the Bank's Management Board. The Management Board of the Bank in the framework limited by the rules of the binding Polish law submits all required information and data to UniCredit S.p.A. as the parent company. The Management Board of the Bank, operating through the statutory bodies of the subsidiaries of the Bank, coordinates and affects their activities aimed at ensuring the stability of the Group.

Pursuant to the provisions of the Rules of procedure, the Bank's Management Board prepares the development strategy for the Bank and is responsible for the implementation and execution of that strategy. The Supervisory Board issues its opinions on the Bank's long-term development plans and annual financial plans, prepared by the Management Board. The Management Board ensures that the management system at the Bank is transparent and effective, and runs the Bank's affairs in compliance with applicable laws and Best Practices. The core values underlying the management of the Bank are professionalism, credibility and confidentiality, while customer relations are underpinned by reliability and integrity, as well as compliance with applicable laws, including the provisions on anti-money laundering and financing of terrorism.

Pursuing the principle of efficient and prudent management, the Management Board is responsible for initiation and implementation of programs aimed at increasing the Bank's value and rate of return for the shareholders, as well as protection of the employees' long-term interests. In its decisions, the Bank's Management Board makes every effort to ensure, to the maximum extent possible, the promotion of the interests of the shareholders, creditors, employees, as well as other entities and persons co-operating with the Bank in its business activity.

18 http://www.pekao.com.pl/o_banku/wladze_Banku/

**Supervisory Board**
As at January 1, 2016 the Supervisory Board of the Bank was composed of the following persons:

| | |
|---|---|
| Jerzy Woźnicki | Chairman of the Supervisory Board, |
| Roberto Nicastro | Deputy Chairman of the Supervisory Board, |
| Leszek Pawłowicz | Deputy Chairman of the Supervisory Board, |
| Alessandro Decio | Secretary of the Supervisory Board, |
| Dariusz Filar | Member of the Supervisory Board, |
| Katarzyna Majchrzak | Member of the Supervisory Board, |
| Laura Stefania Penna | Member of the Supervisory Board, |
| Wioletta Rosołowska | Member of the Supervisory Board, |
| Doris Tomanek | Member of the Supervisory Board. |

The Ordinary General Meeting of Shareholders of the Bank on June 16, 2016 appointed Members of the Supervisory Board of the Bank for three-year joint term starting on June 17, 2016.

The following persons were appointed as Members of the Supervisory Board: Dariusz Filar, Massimiliano Fossati, Katarzyna Majchrzak Giovanni Papa, Leszek Pawłowicz, Laura Stefania Penna, Wioletta Rosołowska, Doris Tomanek, Jerzy Woźnicki,

At the meeting on July 22, 2016 the Supervisory Board appointed:

| | |
|---|---|
| Jerzy Woźnicki | as Chairman of the Supervisory Board, |
| Gianni Papa | as Deputy Chairman of the Supervisory Board, |
| Leszek Pawłowicz | as Deputy Chairman of the Supervisory Board, |
| Massimiliano Fossati | as Secretary of the Supervisory Board, |

As at December 31, 2016 the Supervisory Board of the Bank was composed of the following persons:

| | |
|---|---|
| Jerzy Woźnicki | Chairman of the Supervisory Board, |
| Gianni Papa | Deputy Chairman of the Supervisory Board, |
| Leszek Pawłowicz | Deputy Chairman of the Supervisory Board, |
| Massimiliano Fossati | Secretary of the Supervisory Board, |
| Dariusz Filar | Member of the Supervisory Board, |
| Katarzyna Majchrzak | Member of the Supervisory Board, |
| Laura Stefania Penna | Member of the Supervisory Board, |
| Wioletta Rosołowska | Member of the Supervisory Board, |
| Doris Tomanek | Member of the Supervisory Board. |

Wioletta Rosołowska resigned from the position of the Member of the Supervisory Board as of the end of December 31, 2016.

On January 13, 2017 the Bank Management Board informed in the current report No. 2/2017 that Gianni Papa, Massimiliano Fossati, Laura Stefania Penna and Doris Tomanek resigned from the positions of members of the Supervisory Board of the Bank subject to the condition and with effect as of the date of: (i) the indirect sale by UniCredit S.p.A. of 52,494,007 (fifty-two million four hundred and ninety-four thousand and seven) shares in the Bank to Powszechny Zakład Ubezpieczeń S.A. and (ii) the direct sale by UniCredit S.p.A. of 26,247,003 (twenty-six million, two hundred and forty-seven thousand and three) shares in the Bank to Polski Fundusz Rozwoju S.A.

The Supervisory Board acts on the basis of the Rules of procedure adopted by virtue of its Resolution No. 10/15 of February 6, 2015. amended by the resolution No. 54/15 of the Supervisory Board of December 18, 2015. The Rules of procedure of the Supervisory Board are available on the Bank's website[19].

The role of the Supervisory Board is to exercise a general and permanent supervision over the Bank's activities, taking into consideration the Bank's function of a parent company regarding subsidiaries of the Bank. Apart from the competence defined in law, the Supervisory Board possesses competences stated in the Bank's Statute, the Supervisory Board in particular examines every matter submitted to the Bank's General Shareholders Meeting.

The Supervisory Board Members always act with due regard to the Bank's interests and take all actions necessary to ensure efficient functioning of the Supervisory Board. Moreover, Members of the Supervisory Board of the Bank are prohibited from taking any decisions or actions that would lead to conflicts of interests or that would be not in line with the Bank's best interest. About existing or potential conflict of interests the Member of the Supervisory Board informs the Supervisory Board and restrains from participating in a discussion and voting on resolution regarding issue in the case of which a conflict of interest occurred.

Each year, according to regulations in force, the Supervisory Board prepares and submits to the Bank's General Shareholders Meeting an assessment of the report on the activities of the Bank and the Group prepared by the Bank's Management Board, assessment of the Bank's financial statements and consolidated financial statements of the Group, assessment of motion concerning profit's division or losses coverage, as well as the Supervisory Board activities statements. The assessments prepared by the Supervisory Board are made available to the shareholders before the Bank's General Shareholders Meeting.

The Supervisory Board set up dedicated committees which deal with specific areas of the Bank's operations, including the Audit Committee, the Nomination and Remuneration Committee and the Financial Committee and Risk Committee . Reports of the committees set up by the Supervisory Board are stored at the Bank's Head Office. Annual reports of committees are annexed to and published with the Supervisory Board statement.

Audit Committee
As at January 1, 2016 the Audit Committee was composed of the following persons:

| | |
|---|---|
| Dariusz Filar | President of the Committee, |
| Alessandro Decio | Member of the Committee, |
| Leszek Pawłowicz | Member of the Committee, |
| Laura Stefania Penna | Member of the Committee, |
| Jerzy Woźnicki | Member of the Committee. |

Due to appointing a new composition of the Supervisory Board, the composition of the Audit Committee has changed.

19 http://www.pekao.com.pl/o_banku/wladze_Banku/#tab2

Since July 22, 2016 Audit Committee is composed of the following persons:

| | |
|---|---|
| Dariusz Filar | President of the Committee, |
| Massimiliano Fossati | Member of the Committee, |
| Leszek Pawłowicz | Member of the Committee, |
| Laura Stefania Penna | Member of the Committee, |
| Jerzy Woźnicki | Member of the Committee. |

and until December 31, 2016 it did not change.

The scope of the Audit Committee's competence has been determined by the Supervisory Board's Resolution No. 41/14 of December 12, 2014. Previously in force Supervisory Board's Resolution No. 9/12 of March 8, 2012 expired.

The Audit Committee supports the Supervisory Board in the performance of its duties, therein related to the adequacy and effectiveness of the Bank's internal control mechanisms, including identification, measurement and management of risk, compliance with applicable laws and procedures governing the Bank's operations, correct application of accounting rules in the process of drawing up financial statements, and ensuring independence of external auditors and the resources of the Internal Audit Department.

The Audit Committee is composed of five persons selected from among the Members of the Supervisory Board, and includes at least three independent Members. The Chairman of the Audit Committee is an independent Member of the Supervisory Board.

Meetings of the Audit Committee are held as need of Committee arises, but not less frequently than four times a year, and dates of these meetings coincide with key dates in the Bank's quarterly reporting cycle and the review of the annual audit plan presented by the Director of the Internal Audit Department.

<u>Nomination and Remuneration Committee</u>
As at January 1, 2016, in the Bank operated the Remuneration Committee, which was composed of the following persons:

Roberto Nicastro,

Wioletta Rosołowska,

Doris Tomanek,

Jerzy Woźnicki.

As a result of appointing new composition of the Supervisory Board, the composition of the Nomination and Remuneration Committee has changed.

Since July 22, 2016 Nomination and Remuneration Committee is composed of the following persons:

Dariusz Filar,

Gianni Papa,

Wioletta Rosołowska – until December 31, 2016.

Doris Tomanek,

Jerzy Woźnicki

and until December 31, 2016 it did not change.

The Committee operates on the basis of the Rules of Procedure of the Supervisory Board of the Bank which was adopted on April 27, 2015, amended by the resolution No. 75/16 dated October 11, 2016.

The aim of the Committee is to support the Supervisory Board in performing its duties by, among others:

a) submission of recommendations regarding conditions of agreements that regulate employment relationship or other legal relationship between Members of the Management Board and the Bank, including the amount of remuneration to be paid to Members of the Management Board, and regarding approval of the policy on variable components of the remuneration for persons holding managerial positions in the Bank according to separate regulations and in order to submit recommendations to the General Shareholders Meeting regarding the remuneration to be paid to Members of the Supervisory Board,

b) preparation of recommendations regarding fulfillment of suitability requirements for the purpose of appointment of Members of the Management Board and the Supervisory Board,

c) Preparation of report for the General Shareholders Meeting regarding assessment of functioning of the remuneration policy in the Bank.

Financial Committee

As at January 1, 2016, the Financial Committee was composed of the following persons:

Alessandro Decio,

Roberto Nicastro,

Laura Stefania Penna.

As a result of appointing new composition of the Supervisory Board, the composition of the Financial Committee has changed.

Since July 22, 2016 Financial Committee is composed of the following persons:

Massimiliano Fossati,

Gianni Papa,

Laura Stefania Penna

and until December 31, 2016 it did not change.

The Financial Committee operates on the basis of the Supervisory Board's resolution. Its role is to exercise supervision over the implementation of the Bank's financial objectives. Members of the Committee have the right to use services of advisers.

Risk Committee

Since July 22, 2016 Risk Committee was composed of the following persons:

Massimiliano Fossati,

Katarzyna Majchrzak

Leszek Pawłowicz

and until December 31, 2016 it did not change.

Risk Committee operates on the basis of "Rules of Procedure of the Risk Committee" set up by the Supervisory Board. Mission of the Committee is to support the Supervisory Board in fulfillment of its obligations concerning supervision over risk management system and assessment of the adequacy and effectiveness of the said system.

**10. Description of the Bank's diversity Policy applied to governing, managing and supervising bodies with respect to such factors as age, gender or education and professional experience, aims of the diversity policy, manner of its realisation and results in the given reporting period,[20]**

On December 22, 2015 Management Board of the Bank adopted by resolution and on February 4, 2016 Supervisory Board of the Bank accepted by resolution “Diversity policy in reference to Supervisory Board members, Management Board members and Key Function Holders in Bank Polska Kasa Opieki Spółka Akcyjna" (hereinafter referred to as "the Policy").

This Policy defines the strategy of the Bank in scope of diversity management, including diversity in reference to appointment the Supervisory Board members, Management Board members and Key Function Holders in the Bank.

The purpose of diversity strategy of the Bank is to provide high quality of tasks execution by its governing bodies, through selection of qualified people to hold function in the Supervisory Board, the Management Board and Key Function Holders in the Bank, using as the first objective criteria and taking into account the benefits of diversity.

The diversity strategy includes and uses to achieve the best outcome differences, which in addition to knowledge, skills and work experience result from educational background, geographical origin and nationality, gender and age. The diversity strategy is also conducted in the processes of selection, suitability assessment and succession.

Application of diversity strategy is accomplished also by the Gender Equality Policy of the Bank, which assumes striving to provide representatives of both genders in the following processes referring to Management Board members and Key Functions in the Bank: external selection, internal appointment, succession planning, taking into account provisions on equal treatment in the field of establishing an employment relationship.

In 2014-2016 the share of men and women the Management of the Bank was following.

| | DECEMBER 31, 2014 | | DECEMBER 31, 2015 | | DECEMBER 31, 2016 | |
|---|---|---|---|---|---|---|
| | No. of persons | % | No. of persons | % | No. of persons | % |
| Women | | 0% | | 0% | | 0% |
| Men | 6 | 100% | 7 | 100% | 7 | 100% |
| Sum | 6 | 100% | 7 | 100% | 7 | 100% |

In 2014-2016 the share of men and women the Supervisory Board of the Bank was following.

| | DECEMBER 31, 2014 | | DECEMBER 31, 2015 | | DECEMBER 31, 2016 | |
|---|---|---|---|---|---|---|
| | No. of persons | % | No. of persons | % | No. of persons | % |
| Women | 4 | 44% | 4 | 44% | 4 | 44% |
| Men | 5 | 56% | 5 | 56% | 5 | 56% |
| Sum | 9 | 100% | 9 | 100% | 9 | 100% |

[20] § 91, item 5, pt 4 l of the ordinance of the Minister of Finance of February 19, 2009

## Signatures of all Members of the Bank's Management Board

| Date | Name/Surname | Position/Function | Signature |
|---|---|---|---|
| 09.02.2017 | Luigi Lovaglio | President of the Management Board, CEO | |
| 09.02.2017 | Diego Biondo | Vice-President of the Management Board | |
| 09.02.2017 | Andrzej Kopyrski | Vice-President of the Management Board | |
| 09.02.2017 | Adam Niewiński | Vice-President of the Management Board | |
| 09.02.2017 | Grzegorz Piwowar | Vice-President of the Management Board | |
| 09.02.2017 | Stefano Santini | Vice-President of the Management Board | |
| 09.02.2017 | Marian Ważyński | Vice-President of the Management Board | |

# Selected consolidated financial data

| INCOME STATEMENT | | | | |
|---|---|---|---|---|
| | PLN thousand | | EUR thousand | |
| | **2016** | **2015** | **2016** | **2015** |
| Net interest income | 4 382 005 | 4 166 570 | 1 001 441 | 995 644 |
| Net fee and commission income | 1 958 964 | 2 005 526 | 447 692 | 479 241 |
| Profit before income tax | 2 896 546 | 2 831 118 | 661 962 | 676 524 |
| Net profit for the period | 2 279 764 | 2 293 478 | 521 006 | 548 050 |
| Net profit attributable to equity holders of the Bank | 2 279 275 | 2 292 459 | 520 894 | 547 806 |
| Net profit attributable to non-controlling interest | 489 | 1 019 | 112 | 244 |
| Basic earnings per share (in PLN\EUR) | 8.68 | 8.73 | 1.98 | 2.09 |
| Diluted earnings per share (in PLN\EUR) | 8.68 | 8.73 | 1.98 | 2.09 |
| Declared/paid dividend per share (in PLN\EUR) | 8.68 | 8.70 | 1.98 | 2.08 |
| **CASH FLOW STATEMENT** | | | | |
| | PLN thousand | | EUR thousand | |
| | **2016** | **2015** | **2016** | **2015** |
| Net cash flows from operating activities | 11 331 180 | (1 300 152) | 2 589 570 | (310 684) |
| Net cash flows from investing activities | (13 518 677) | 3 923 505 | (3 089 489) | 937 561 |
| Net cash flows from financing activities | (3 659 808) | (3 666 142) | (836 394) | (876 061) |
| Net change in cash and cash equivalents | (5 847 305) | (1 042 789) | (1 336 313) | (249 184) |
| **STATEMENT OF FINANCIAL POSITION** | | | | |
| | PLN thousand | | EUR thousand | |
| | **31.12.2016** | **31.12.2015** | **31.12.2016** | **31.12.2015** |
| Total assets | 174 214 943 | 168 785 567 | 39 379 508 | 39 607 079 |
| Amounts due to Central Bank | 6 091 | 914 | 1 377 | 214 |
| Amounts due to other banks | 4 823 440 | 5 958 449 | 1 090 289 | 1 398 205 |
| Amounts due to customers | 137 815 926 | 128 867 691 | 31 151 882 | 30 239 984 |
| Non-controlling interests | 14 924 | 15 964 | 3 373 | 3 746 |
| Equity attributable to equity holders of the Bank | 22 897 019 | 23 408 229 | 5 175 637 | 5 492 955 |
| Share capital | 262 470 | 262 470 | 59 329 | 61 591 |
| Number of shares | 262 470 034 | 262 470 034 | 262 470 034 | 262 470 034 |
| Book value per share (in PLN\EUR) | 87.24 | 89.18 | 19.72 | 20.93 |
| Diluted book value per share (in PLN\EUR) | 87.24 | 89.18 | 19.72 | 20.93 |
| **CAPITAL ADEQUACY** | | | | |
| | PLN thousand | | EUR thousand | |
| | **31.12.2015** | **31.12.2014** | **31.12.2015** | **31.12.2014** |
| Capital adequacy ratio (%) (Bazylea III) | 17.64 | 17.66 | 17.64 | 17.66 |
| Risk weighted assets | 113 109 296 | 114 450 402 | 25 567 201 | 26 856 835 |
| Core funds (Tier I) | 19 954 579 | 20 209 595 | 4 510 529 | 4 742 366 |
| Supplementary funds (Tier II) | - | - | - | - |

The following exchange rates were used in translation selected financial data from PLN to EUR:

- for balance sheet items – an exchange rate announced by the National Bank of Poland as at 31 December 2016 – 1 EUR = 4.240 PLN and an exchange rate announced by the National Bank of Poland and as at 31 December 2015 – 1 EUR = 4.2615 PLN,
- for profit and loss account items – an exchange rate calculated as the arithmetic mean of exchange rates announced by the National Bank of Poland as at theend of each month of 2016 and 2015: 1 EUR = 4.3757 PLN and 1 EUR 4.1848 PLN respectively,
- for cash flows items – an exchange rate used for profit and loss account items,
- for dividend calculation – an exchange rate used for income statement items calculation.