Translation of document originally issued in Polish

Information on capital adequacy of the Capital Group of Bank Handlowy w Warszawie S.A. as at 31 December 2016

INTRODUCTION

This document has been laid down to execute The Disclosure Policy of Bank Handlowy w Warszawie S.A. on capital adequacy[1], to meet the disclosure requirements of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, as well as of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC ("CRD").

The objective of the document is presenting to the third parties, especially customers of the Capital Group of Bank Handlowy w Warszawie S.A. (hereinafter referred to as: Group) and financial market participants, the Group's risk management strategy and processes, information on the capital structure, exposure to risk and capital adequacy, which enable thorough assessment of the Group's financial stability. This document complements information included in the Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A for the financial year ended 31 December 2016 and refers to it wherever it is relevant.

Pursuant to 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, Bank publishes disclosures on capital adequacy on the basis of consolidated data as of 31 December 2016. the Report on Activities of the Capital Group of Bank Handlowy w Warszawie S.A. for 2016.

When the disclosures required by the Regulation (EU) No 575/2013 of the European Parliament and of the Council are published in the Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A for the financial year ended 31 December 2016, this document refers to the number of explanatory note, which discloses required information.

The terms used in the document shall mean the following:

Regulation No. 575/2013 / CRR - 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 with amendments;

Commission Implementing Regulation (EU) No. 1423/2013 of 20 December 2013 laying down implementing technical standards with regard to disclosure of own funds requirements for institutions according to Regulation (EU) No. 575/2013 of the European Parliament and of the Council;

Commission Delegated Regulation (EU) No. 183/2013 of 20 December 2013 supplementing Regulation (EU) No. 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, with regard to regulatory technical standards for specifying the calculation of specific and general credit risk adjustments;

Resolution on the risk management - Resolution No. 258/2011 of the Polish Financial Supervision Authority of October 4 2011 on risk management and internal control policy and determining the rules of internal capital estimation, supervision of the internal capital calculation and maintenance process and determining variable remuneration policy of the Bank's management staff (KNF Official Journal from 2011, No. 11, item 42);

Commission Delegated Regulation (EU) No. 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to

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

qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile.

Commission Implementing Regulation (EU) No. 2016/200 of 15 February 2016 laying down implementing technical standards with regard to disclosure of the leverage ratio for institutions, according to Regulation (EU) No. 575/2013 of the European Parliament and of the Council.

Commission Implementing Regulation (EU) No. 2015/1555 of 28 May 2015 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for the disclosure of information in relation to the compliance of institutions with the requirement for a countercyclical capital buffer in accordance with Article 440.

The law on macro-prudential oversight - The law of 5 August 2015 on macro-prudential oversight of the financial system and crisis management in the financial system (Official Journal from 2015, item 1513).

I. Risk management objectives and policies

The risk management process is consistent within the Group, including Bank Handlowy in Warsaw S.A. and its Subsidiaries (Dom Maklerski Banku Handlowego S.A., Handlowy Leasing Sp. z o.o.), and exclude special purpose vehicles, companies in the process of liquidation, as well as units not conducting current, statutory activity.

The aim of the risk management strategy of the Bank is to take a balanced risk with shared responsibility, without forsaking individual accountability. Taking a balanced risk means proper identification, measurement and risk aggregation, and the establishment of limits with full understanding of both the macroeconomic environment, the profile of the Group's activity, requirement to meet regulatory standards, as well as strategic and business objectives within available resources, capital and liquidity, maximizing return on capital employed.

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

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

The Management Boards of the Group entities ensures that risk Group’s management structure reflects Risk Profile and the functions of risk valuation monitoring and control are separated from activity associated with risk-taking.

Risk management is implemented based on the strategies, policies and procedures relating to taking, monitoring and limiting the risk, standards for the identification, valuation, acceptance, control, monitoring and reporting of risk to which the Group is or may be exposed to.

Risk management strategies, policies and procedures are regularly reviewed to ensure compliance with applicable laws, regulations, supervisory institutions and regulatory recommendations, internal regulations, business and market practices and the adequacy of the scale, nature and complexity of the Group's operations.

Strategies and processes of risk management, as well as the structure and organization of units managing the appropriate risks and solutions used by the Group on measurement and reporting of those risks are presented in details in the note 48 „Risk management” to the Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016.

Ensuring the adequacy of risk management arrangements of the Group and confirmation that the risk management systems used are appropriate from the institution profile and strategy point of view, takes place within the annual capital planning process.

As per the current „Principles of prudent and stable risk management in the Capital Group of Bank Handlowy w Warszawie S.A.” Risk and Capital Management Committee performs not less frequently than once a year, within the process of internal capital assessment and maintenance, an adequacy assessment of the solutions to the actual size and complexity of the Group, including its profile and strategy. The conclusions of such review are submitted to the Management Board for approval.

The Management Board has confirmed that the process of internal capital assessment and maintenance and risk management systems in the Group are appropriate to the nature, scale and complexity of its activities.

As part of the annual capital planning process, the overall risk profile of the Group is determined, including the business model, the assumptions related to business strategy and current and expected (so-called forward looking) macroeconomic/business environment. The Risk Profile is defined as list of risk identified on the inherent basis which includes the description of mitigation mechanisms that allow the risk assessment on the residual level.

The process of the Group risk profile determination includes in particular:

- identification of risks in the Group's operations, based on the experience, expertise, analysis of the macroeconomic environment, regulatory and competitive position of the Group, taking into account the profile and internal procedures;
- for identified risks: determination of the risk owner, processes and controls mitigating these risks and defining of quantitative measures for these types of risks for which it is possible;
- determination of significant risks for the Group for the year by the Board.

The Group manages all types of risk that are identified in its activities, while some of them considering as significant.
For measurable risks considered as significant, the Group estimates and allocates capital. The Group may decide to create capital buffers for significant, difficult to measure risks.

Within the risk profile assessment in 2016 the following risks were identified as significant:

- Credit risk – risk of potential losses arising from a client event of default or insolvency taking into account risk mitigation techniques applied to a product or individual credit.
- Counterparty Risk - the risk of potential losses arising from changes in market prices that occur when the client is unable to meet its contractual obligations. This risk is part of credit risk generated on such activities as derivative transactions.
- Market Risk - risk of loss resulting from potential fluctuations in the market value of the exposure as a result of the changes in underlying market risk factors. The key factors are: interest rates, FX rates, securities' prices, commodities' prices and their volatilities.
- Interest rate risk in banking book – risk of potential negative impact of the changes in market risk factors on the Group's interest income.
- Liquidity Risk - risk of a Group inability to meet its obligations in due time and without incurring financial losses, which occurs due to cash flow mismatches (cash flow gap), limited asset marketability or systematic market changes.
- Operational Risk - risk of loss resulting from inadequate or failed internal processes, human factors, or technical systems, or from external events. Operational Risk includes franchise risks associated with business practices or market conduct and reputation risk. It also includes the risk of failing to comply with applicable laws and internal regulations (as defined below). Operational Risk does not cover strategic risks or the risk of loss resulting solely from authorized judgments made with respect to taking credit, market.
- Compliance risk – risk of legal or regulatory sanctions, financial losses or reputational damage (reliability for counterparties), which the Group may be exposed at due to obeying the law, regulatory recommendations, internal Group's regulations and conduct standards accepted by the Group. Compliance risk may lead to income deterioration or capital utilization due to potential risk of additional costs associated with applied penalties, suffered damage or cancelled contracts.

The risks identified within the Group's profile as significant are the basis for the risk appetite setting for the Group and for the individual business lines. As a result, implementing a specific strategy within the Group's business model, decisions are considered not only for the business purposes, defined in Group's Strategy but also the return on capital employed. Appropriate measures of overall risk level and sets of limits were introduced to ensure that the risk is within the tolerance level.

Additionally the Group manages inter alia the following risks:

- Technological and technical risk – risk of disruption of entity's activity due to technology infrastructure and telecommunications systems failure;
- Outsourcing risk – risk of negative impact of external party on continuation, integrity and quality of entity's activity, its property or employees;
- Misappropriation risk – risk connected with willful act to the detriment of entity by its employees or third parties;
- Money Laundering risk – risk of losses due to involvement in money laundering activity conducted by customers, intermediaries or employees;

- Information Security risk – risk of disruption of entity's activity or financial losses due to insufficient security of its resources and information;
- External Events risk (Continuity of Business) – risk of inability of activity continuation by an entity or risk of losses occurring due to extraordinary event, such as earthquake, fires, floods, terrorism, lack of access to the headquarters or media;
- Tax and Accounting risk – risk of negative economic effects due to improper accountancy records, reporting, mistaken calculation of tax obligations or their delayed payments;
- Product risk – risk connected with the sale of product (service), which doesn't meet customers' requirements and needs, is not compliant with the law and regulations, generates additional risks (for an entity and its customers), doesn't have adequate support of the employees and processes;
- Legal risk - risk of losses occurring due to instability of legal regulations, changes of law and regulations, improper structure of legal relationships, quality of legal documentation, unfavourable conclusions of courts or other bodies in disputed cases, conducted with other entities.
- Models' risk – potential loss, which Bank may be exposed at, following decision based on data generated by models utilized by the Bank, as a result of errors in models' development, implementation or utilization. Models risk covers reputational risk resulting out of errors in financial reporting or other documents disclosed officially by the Bank, generated out of erroneous data processed by the model.
- HR Risk -–risk connected with recruitment, availability and professional qualification of employees, their fluctuation, ability to adapt to changes in work environment, work culture, absenteeism, tiredness, overtime, lack of utilization of annual leave for a long time, inadequate or not adjusted to the scale and complexity organizational structures, connections of personnel whose responsibilities is crucial from the perspective of the risk occurring in the bank and similar factors, which may lead to operational losses connected with human factor, it also includes the specificity and diversity of conditions related to the management of human resources in different areas of activity.
- Concentration Risk - risk arising from excessive concentration from exposures to clients, groups of connected clients, customers operating in the same economic sector, geographic region, carrying out the same economic activity or trading with similar commodities, entities belonging to Bank capital's group (both cross-border and local), exposures denominated in the same currency or indexed to the same currency, used credit risk mitigation techniques as well as large indirect credit exposures such as a single issuer of the security, with the potential to generate losses large enough to imperil bank's financial condition or financial ability to maintain its core operations or lead to a significant change in the risk Group's profile
- Conduct Risk – risk that Bank employees or service providers, selling Group's products – intentionally or due to negligence – cause harm to clients, financial markets integrity or Group's integrity.

The Group's risk profile, including quantitative indicators, current trends, and the utilization of capital limits, is monitored as a part of the regular, quarterly information provided to the Risk and Capital Management Committee of the Bank's Management Board and to the Risk and Capital Committee of the Supervisory Board. 4 meetings were held in 2016 in order to analyze abovementioned factors.

Group's risk profile is approved by the Management Board in the form of "Capital Group of Bank Handlowy w Warszawie S.A. Capital Management" document, and then submitted for the Supervisory Board approval by resolution in accordance with the document for 2016.

The Group's goal is to maintain current capital structure in order to address requirements of CRR/CRD on Common Equity Tier 1 regulatory capital. Group, as it is stated in the strategy, will continue to be adequately capitalized with diversified sources of income. Considering approved level of Overall Risk Appetite, the Group will maintain a target regulatory capital adequacy ratio (CAR) at the level of minimum 13,75%. In 2016 total CAR amounted to 17,4%.

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

Compliance, the Group's unit, supports the Bank's Management Board, Supervisory Board and business units. Compliance monitoring (Compliance) is comprehensive (systematic) ensuring compliance and the role of the

Compliance function is to ensure compliance (understood as one of the objectives of the internal control system) and the management of compliance risk. The risk management processes of non-compliance includes: identification, assessment, control, monitoring and testing, reporting, advisory and training in frame of compliance.

Compliance reviews and assesses the compliance risk management process on an annual basis as part of the Annual Compliance Plan, and submits relevant information to the Bank's Management and Supervisory Boards in the form of annual reports "Statement on the implementation of the functions of monitoring compliance and compliance risk management at Bank Handlowy w Warszawie S.A., taking into account the tasks to ensure the safety.

Information on the recruitment policy for the selection of members of the managing body and the actual state of their knowledge, skills and expertise

With respect to the institution's policy and practices relating to the selection of members of the managing body and the actual state of their knowledge, skills and expertise, in the Bank operates the Policy for the assessment of Management Board Members and Key Function Holders at Bank Handlowy w Warszawie S.A and a specific procedure to select the members of managing bodies who offer adequate guarantees of performance (in a prudent and sustainable manner) and have the necessary competences (understood as education and experience) to administer the business of a supervised institution, resulting from:

1) knowledge (arising from their education, completed training, professional titles and otherwise acquired in the course of their career),
2) experience (acquired when performing certain functions or occupying certain positions),
3) the necessary skills to perform their assigned functions.

The Supervisory Board identifies and selects qualified and experienced candidates to the Management Board. In the assessment of candidates, their experience is taken into account, considering:

(a) the character, magnitude and complexity of the Bank's operations and
(b) the responsibilities relevant to the role

Candidates to the managing body should, in each case, have an impeccable reputation, their activities to date should be transparent and lawful, and their employment history and track record should be related with jobs in financial institutions.

The Bank's Management Board is composed of five to nine members, including: the President of the Management Board of the Bank, Vice Presidents of the Management Board of the Bank, with the proviso that at least half of the Members of the Management Board should be Polish citizens.
Members of the Management Board of the Bank are appointed by the Supervisory Board on an individual term of three years, upon a motion of the President of the Management Board.
The motion contains in particular information:
- the business area within the responsibility of the prospective Member of the Management Board,
- professional experience with an overview of the career path to date as well as functions, responsibilities and achievements,
- education,
- a preliminary assessment of the candidate together with a recommendation on appointment of the candidate.

The Supervisory Board is composed of five to twelve members appointed by the General Meeting. Each Member of the Supervisory Board is appointed for a term of three years. At least half of the Members of the Supervisory Board, including its Chairperson, should be Polish citizens.
Members of the Supervisory Board of the Bank are selected from a list of candidates presented by shareholders represented in a General Meeting.

Number of directorships held by members of the management body understood as members of the Management Board: 7.

II. Information related to the use of prudential norms

Information related to the use of prudential norms concern Capital Group of Bank Handlowy w Warszawie S.A. ("Group").

Group is composed of Bank Handlowy w Warszawie S.A. ("Bank") as the parent company, as well as the following subsidiary companies: Dom Maklerski Banku Handlowego S.A., Handlowy Leasing Sp. z o.o., Handlowy Investments S.A., PPH Spomasz Sp. z o.o. w likwidacji, Handlowy-Inwestycje Sp. z o.o.

The following entities are fully consolidated:

- Dom Maklerski Banku Handlowego S.A. („DMBH"),
- Handlowy Leasing Sp. z o.o.,
- Handlowy Investments S.A.,
- PPH Spomasz Sp. z o.o. w likwidacji.

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

The Capital Group of Bank Handlowy w Warszawie S.A. provides leasing portfolio services until April 30th, 2013 through Handlowy Leasing Sp. z o.o. After this date, Handlowy Leasing – due to reducing its activity solely to execution of lease agreements signed before April 30th, 2013 - did not sign new contracts, continuing existing contracts service providing maintaining the quality of services and cost-efficiency of its operations. Leasing product remained in the Bank's offer and is offered in a form of so-called "open architecture", i.e. co-operation with the European Leasing Fund S.A. and CorpoFlota Sp. z o.o.

Handlowy Investments S.A. seated in Luxembourg, belongs to special purpose investment entities, through which the Bank and the Capital Group conduct capital transactions. The entity is a wholly-owned subsidiary of the Bank and its activities are financed with refundable additional capital contributions net profits earned. Due to intention to reduce the investment activities, Handlowy - Investments S.A. and similar holdings will be gradually sold or liquidated. As at 31 December 2016 Handlowy Investments S.A. had the portfolio composed of the following shares: Pol-Mot Holding S.A.

PPH Spomasz Sp. z o.o. under liquidation, seated in Warsaw, fully owned by the Bank is one of the holdings deemed for sale[2].

There are no proportionally consolidated entities within the Group.

Handlowy Inwestycje Sp. z o.o. is the entity accounted for under the equity. It seated in Warsaw is special purpose investment entity, through which the Bank conducts capital transactions. Handlowy Inwestycje Sp. z o.o. has in its portfolio shares of Handlowy Leasing Sp. z o.o. Activities of the entity is financed by refundable capital contributions as well as retained earnings. Handlowy Inwestycje Sp. z o.o. belongs to the portfolio of strategic entities.

There are no entities that are neither consolidated nor deducted. There are also no subsidiaries not included in the consolidation, for which there is a shortage of capital.

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

The scope of Group's consolidation, defined in accordance with the prudential regulations (CRR) matches the scope of consolidation applied for financial reporting.

[2] According to information in point IV.1.7 of this chapter, equity investments of the Capital Group of Bank Handlowy w Warszawie S.A. are classified into strategic portfolio and portfolio deemed for sale.

III. Information regarding own funds

Information about the components of equity are presented in details in supplementary note 35 „Capital and Reserves” to the Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016.

The structure of the Group's own funds (Table 1), reconciliation of the Group's own funds to the equity of the Group (Table 2), information on own funds in the interim period (Table 3) and detailed description of the capital instruments’ main characteristics (Table 4) are presented in the below tables:

Table 1: The structure of the Group's own funds

ID	Item	Amount in PLN'000
1	**OWN FUNDS**	**4 796 869**
1.1	TIER 1 CAPITAL	**4 796 869**
1.1.1	COMMON EQUITY TIER 1 CAPITAL	**4 796 869**
1.1.1.1	Capital instruments eligible as CET1 Capital	**3 008 172**
1.1.1.1.1	Paid up capital instruments	522 638
1.1.1.1.3	Share premium	2 485 534
1.1.1.2	Retained earnings	-7 051
1.1.1.2.1	Previous years retained earnings	-7 051
1.1.1.2.2.1	Profit or loss attributable to owners of the parent	601 580
1.1.1.2.2.2	(-) Part of interim or year-end profit not eligible	-601 580
1.1.1.3	Accumulated other comprehensive income	-214 906
1.1.1.4	Other reserves	2 873 657
1.1.1.5	Funds for general banking risk	529 000
1.1.1.9	Adjustments to CET1 due to prudential filters	**-24 286**
1.1.1.9.5	(-) Value adjustments due to the requirements for prudent valuation	-24 286
1.1.1.10	(-) Goodwill	**-1 245 976**
1.1.1.10.1	(-) Goodwill accounted for as intangible asset	-1 245 976
1.1.1.11	(-) Other intangible assets	**-104 885**
1.1.1.11.1	(-) Other intangible assets gross amount	-104 885
1.1.1.26	Other transitional adjustments to CET1 Capital	-3 678
1.1.1.28	CET1 capital elements or deductions - other	-13 178
1.1.2	ADDITIONAL TIER 1 CAPITAL	0
1.2	TIER 2 CAPITAL	0

Table 2: Reconciliation of the Group's own funds for the Group's equity

Reconciliation of the Group's own funds for the Group's equity	Amount in PLN'000
Share capital	522 638
Supplementary capital	3 003 082
Revaluation reserve	-214 843
Other reserves	2 885 045
Retained earnings	594 529
Total Equity	**6 790 451**
Goodwill & other intangible assets	-1 350 861
Adjustments to Equity Tier I in respect of prudential filters - value adjustments in respect of the requirements for the prudence	-24 286
Other adjustments in transition Common Equity Tier I	-16 856
Net profit for the Bank’s shareholders	-601 580
Total Deductions	**-1 993 583**
Total Own funds	**4 796 869**

Table 3: Own funds in the interim period (thousands PLN)

	Own Funds	(A) Amount at disclosure date	(C) Amounts subject to pre-Regulation(EU) No. 575/2013 treatment or prescribed residual amount of Regulation (EU) No. 575 / 201352 direct	(B) Regulation No. 575/2013 Article Reference
COMMON EQUITY TIER 1 CAPITAL: INSTRUMENTS AND RESERVES				
1	Capital instruments and the related share premium accounts	3 008 172	-	26 (1), 27, 28, 29, EBA list 26 (3)
	of which: Series A	*260 000*	-	EBA list 26 (3)
	of which: Series B	*112 000*	-	EBA list 26 (3)
	of which: Series C	*150 638*	-	EBA list 26 (3)
2	Retained earnings	-7 051	-	26 (1) (c)
3	Accumulated other comprehensive income (and other reserves)	2 658 750	-	26 (1)
3a	Funds for general banking risk	529 000	-	26 (1) (f)
6	**Common Equity Tier 1 (CET1) capital before regulatory adjustments**	**6 188 672**	-	
7	Additional value adjustments (negative amount)	-24 286	-	36 (1) (b), 37, 472 (4)
8	Intangible assets (net of related tax liability) (negative amount)	-1 350 861	-	26 (1), 27, 28, 29, EBA list 26 (3)
26	Regulatory adjustments relating to Common equity Tier 1 capital in terms of the amounts recognized before the adoption of the CRR.	**-3 678**	-	
26a	Regulatory adjustments relating to unrealised gains and losses pursuant to Article 467 and 468	-3 678	-	
	of which: 60% filter for unrealised profits on available for sale debt securities	*-2 802*	-	468
	of which: 60% filter for unrealised profits on available for sale equity securities	*-876*	-	468
26b	**The amount to be deducted from or added to the amount of core tier I capital for additional (liters and deductions required before the adoption of the CRR**	**-13 178**	-	480
28	**Total regulatory adjustment to Common Equity Tier 1 (CET1)**	**-1 392 003**	-	
29	**Common Equity Tier 1 (CET1) capital**	**4 796 869**	-	
ADJUSTMENTS ADDITIONAL TIER 1 (AT1) CAPITAL: INSTRUMENTS				
36	Additional Tier 1 (AT1) capital before regulatory adjustments		-	

ADDITIONAL TIER 1 (AT1) CAPITAL: REGULATORY ADJUSTMENTS		-		
43	Total regulatory adjustments to Additional Tier 1 (AT1) capital		-	
44	Additional Tier 1 (AT1) capital		-	
45	Tier 1 capital (T1= CET1+AT1)	**4 796 869**	-	
ADJUSTMENTSTIER 2 (T2) CAPITAL: INSTRUMENTS AND PROVISIONS				
51	**Tier 2 (T2) capital before regulatory adjustments**	-	-	
TIER 2 (T2) CAPITAL: REGULATORY ADJUSTMENTS				
57	**Total regulatory adjustments to Tier 2 (T2) capital**	-	-	
58	**Tier 2 (T2) capital**	-	-	
59	**Total capital (TC=T1+T2**	**4 796 869**	-	
60	**Total risk weighted assets**	**27 499 029**	-	
CAPITAL RATIOS AND BUFFERS				
61	Common Equity Tier 1 (as a percentage of risk exposure amount)	**17,4%**	-	92 (2) (a), 465
62	Tier 1 (as a percentage of risk exposure amount)	**17,4%**	-	92 (2) (b), 465
63	Total capital (as a percentage of risk exposure amount)	**17,4%**	-	92 (2) (c)
APPLICABLE CAPS ON THE INCLUSION OF PROVISIONS IN TIER 2				
72	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	**20 395**	-	36 (1) (h), 45, 46, 472 (10), 56 (c), 59, 60, 475 (4), 66 (c), 69, 70, 477 (4)
73	Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	**10 471**	-	36 (1) (i), 45, 48, 470, 472 (11)
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)	**198 382**	-	36 (1) (c), 38, 48, 470, 472 (5)

Group did not make deductions from own funds for significant investment in the financial sector entities and assets for deferred income tax.

Table 4: The table below presents capital instruments main characteristics

Series/emission	A	B	B	B	B	B	C
1 Issuer	Bank Handlowy w Warszawie S.A.	Bank Handlowy w Warszawie S.A.	Bank Handlowy w Warszawie S.A.	Bank Handlowy w Warszawie S.A.	Bank Handlowy w Warszawie S.A.	Bank Handlowy w Warszawie S.A.	Bank Handlowy w Warszawie S.A.
2 Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement)	ISIN: PLBH00000012	ISIN: PLBH00000012	ISIN: PLBH00000012	ISIN: PLBH00000012	ISIN: PLBH00000012	ISIN: PLBH00000012	ISIN: PLBH00000012
3 Governing law(s) of the instrument	Polish law	Polish law	Polish law	Polish law	Polish law	Polish law	Polish law
Regulatory treatment							
4 Transitional CRR rules	Common equity Tier 1 capital	Common equity Tier 1 capital	Common equity Tier 1 capital	Common equity Tier 1 capital	Common equity Tier 1 capital	Common equity Tier 1 capital	Common equity Tier 1 capital
5 Post-transitional CRR rules	Common equity Tier 1 capital	Common equity Tier 1 capital	Common equity Tier 1 capital	Common equity Tier 1 capital	Common equity Tier 1 capital	Common equity Tier 1 capital	Common equity Tier 1 capital
6 Eligible at solo/(sub-)consolidated / solo & (sub-)consolidated	Solo / Consolidated	Solo / Consolidated	Solo / Consolidated	Solo / Consolidated	Solo / Consolidated	Solo / Consolidated	Solo / Consolidated
7 Instrument type (types to be specified by each jurisdiction)	Ordinary shares	Ordinary shares	Ordinary shares	Ordinary shares	Ordinary shares	Ordinary shares	Ordinary shares
8 Amount recognised in regulatory capital (currency in million, as of most recent reporting date)	PLN 260.000.000	PLN 4.480.000	PLN 6.230.000	PLN 8.960.000	PLN 70.594.000	PLN 21.736.000	PLN 150.638.000
9 Nominal amount of instrument	PLN 4	PLN 4	PLN 4	PLN 4	PLN 4	PLN 4	PLN 4
9a Issue price							
9b Redemption price	-	-	-	-	-	-	-
10 Accounting classification	Equity	Equity	Equity	Equity	Equity	Equity	Equity
11 Original date of issuance	27.03.97	27.10.98	25.06.99	16.11.99	24.05.02	16.06.03	28.02.01
12 Perpetual or dated	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual
13 Original maturity date	Without maturity	Without maturity	Without maturity	Without maturity	Without maturity	Without maturity	Without maturity
14 Issuer call subject to prior supervisory approval	No	No	No	No	No	No	No
15 Optional call date, contingent call dates and redemption amount	-	-	-	-	-	-	-
16 Subsequent call dates, if applicable	-	-	-	-	-	-	-

Coupons / dividends							
17 Fixed or floating dividend/coupon	Floating rate	Floating rate	Floating rate	Floating rate	Floating rate	Floating rate	Floating rate
18 Coupon rate and any related index	-	-	-	-	-	-	-
19 Existence of a dividend stopper	No	No	No	No	No	No	No
20a Fully discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary
20b Fully discretionary, partially discretionary or mandatory (in terms of amount)	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary
21 Existence of step up or other incentive to redeem	No	No	No	No	No	No	No
22 Noncumulative or cumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative
23 Convertible or non-convertible	Nonconvertible	Nonconvertible	Nonconvertible	Nonconvertible	Nonconvertible	Nonconvertible	Nonconvertible
24 If convertible, conversion trigger(s)	-	-	-	-	-	-	-
25 If convertible, fully or partially	-	-	-	-	-	-	-
26 If convertible, conversion rate	-	-	-	-	-	-	-
27 If convertible, mandatory or optional conversion	-	-	-	-	-	-	-
28 If convertible, specify instrument type convertible into	-	-	-	-	-	-	-
29 If convertible, specify issuer of instrument it converts into	-	-	-	-	-	-	-
30 Write-down features	No	No	No	No	No	No	No
31 If write-down, write-down trigger(s)	-	-	-	-	-	-	-
32 If write-down, full or partial	-	-	-	-	-	-	-
33 If write-down, permanent or temporary	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
34 If temporary write-down, description of write-up mechanism	-	-	-	-	-	-	-
35 Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	-	-	-	-	-	-	-
36 Non-compliant transitioned features	-	-	-	-	-	-	-
37 If yes, specify non-compliant features	-	-	-	-	-	-	-

IV. Capital Adequacy

Capital requirement in relation to Own Funds of Group is calculated according to the Regulation No. 575/2013

The table below presents capital requirements in relations to Own Fund:

Table 5: Regulatory capital requirement in relations to Own Funds

Capital Requirements	**Requirement value in PLN '000**
credit risk	1 687 217
counterparty credit risk	65 908
credit valuation adjustment risk	63 927
dilution risk	0
free deliveries	0
settlement / delivery risk in trading book	0
traded debt instruments risk:	62 913
debt instruments prices specific risk	8
general risk of interest rates	62 905
equity securities price risk	90
commodities risk	0
foreign-exchange risk	11 355
operational risk	306 721
large exposure in trading book risk	1 792
Total Capital Requirement	**2 199 922**
Own Funds / Tier I Capital / Common Equity Tier I	**4 796 869**
Common Equity Tier 1 capital ratio	**17,4%**
Tier 1 capital ratio	**17,4%**
Total capital ratio	**17,4%**

Table 6: Capital requirement for credit and counterparty credit risk broken down by exposure classes

Exposure classes	Capital requirements in PLN '000
exposures to central governments or central banks	1 927
exposures to regional governments or local authorities	741
exposures to public sector entities	1 246
exposures to multilateral development banks	0
exposures to international organisations	0
exposures to institutions	51 879
exposures to corporates	1 055 463
retail exposures	311 892
exposures secured by mortgages on immovable property	156 362
exposures in default	13 921
exposures associated with particularly high risk	170
exposures in the form of covered bonds	0
items representing securitisation positions	75 986
exposures to institutions and corporates with a short-term credit assessment	0
exposures in the form of units or shares in collective investment undertakings ('CIUs')	0
equity exposures	3 808
other items	79 730
Total	**1 753 125**

V. Information regarding capital requirements

1.1. Credit risk

The accounting definitions of past due and impaired exposures

The impairment (exposure value is higher than the projected cash flows) occurs if there is an objective evidence of impairment as a result of the following defined objective evidence of impairment, i.e.:

- significant financial difficulties of the client, which are described in detail in Credit Procedures,
- breach of contract conditions, e.g. delay in interest or principal payments,
- occurrence of economic or legal reasons related to the borrower's financial difficulties and granting to the borrower a concession to financial conditions that the lender would not otherwise consider,
- high probability of a client's insolvency or obtainment of information on the opening of insolvency proceedings,
- domestic or local economic conditions that may be related to the default of exposures,
- the delay in payment,
- significant deterioration in customer rating,
- request of the Bank to initiate enforcement proceedings against the client,
- reduction of the client credit rating by an accepted by the Bank External Credit,

and other loss events could have impact on the estimated future cash flows from the financial asset that can be reliably estimated. Expected losses resulted from future events are not recognized regardless of the probability of future events occurrence and expected losses resulted from events that occurred before the initial recognition of the exposure in the Bank books.

The exposures of clients that the objective evidence of impairment was identified are treated as impaired exposures.

For the purpose of determining regulatory capital for credit risk, impaired exposures are classified to the class of exposures in default. All exposures assigned to the class of exposures in default are impaired exposures.

A description of the approaches and methods adopted for determining value adjustments and provisions

Detailed information on the management of exposures of impaired are presented in the Annual Financial Statements of the Bank Handlowy w Warszawie SA for the year ended 31 December 2016 in explanatory note no. 48 "Risk Management" in the section "Credit risk".

Clients for which impairment criteria were fulfilled

Impairment losses / provisions are made depending on the approach to credit risk management:

- for individually significant receivables: based on the present value of projected cash flows (discounted using the appropriate effective interest rate) if it is lower than the total gross exposure value,
- for individually insignificant receivables: based on the portfolio assessment estimated on the basis of historical losses on assets with similar risk profiles.

Clients for which impairment criteria were not fulfilled

The IBNR provision is calculated based on loss norm that is a combination of probability of default and loss given default.

Exposures that are grouped to these parameters are homogeneous due to the risk assessment and characteristics.

Detailed information regarding the gross value of impaired exposures and provisions are presented in the Annual Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016, in explanatory note no. 48 "Risk Management", in the section "Credit risk", in the table "Commitment due to customers in terms of credit risk".

The reconciliation of adjustments and provisions regarding exposures impaired is provided in the Annual Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016, in explanatory notes no. 18 “Amounts due from banks” & note no. 24 “Amounts due from customers”, in parts on impairment of loans and advances.

The following tables provide information regarding the Group's exposure broken down by exposure classes (Table 7), geographical distribution (Table 8), the counterparty type (Table 9) and broken down by residual maturity (Table 10).

These tables provide a breakdown of the total exposure to credit risk and counterparty credit risk. In terms of exposure to credit risk table presents information on all exposures of the Group, i.e. the individual assets of the Group. In terms of exposure to the counterparty credit risk exposures to counterparty risk are presented, according to the definition of Regulation No. 575/2013, as described in more detail in Chapter 1.2. Information regarding the credit risk of the counterparty.

Table 7: The total amount of exposures according to balance-sheet valuation (after accounting offsets) and without taking into account the effects of credit risk mitigation, and the average amount of the exposures over the period broken down by different types of exposure classes

Exposure classes	Net exposures after adjustments and provisions* in PLN '000	Average exposure after adjustments and provisions** in PLN '000
exposures to central governments or central banks	19 291 632	19 329 717
exposures to regional governments or local authorities	51 911	492 764
exposures to public sector entities	36 914	79 366
exposures to multilateral development banks	2	15 067
exposures to international organisations	0	0
exposures to institutions	3 033 691	3 315 284
exposures to corporates	20 180 277	21 352 548
retail exposures	11 301 665	11 021 342
exposures secured by mortgages on immovable property	2 809 942	2 677 599
exposures in default	161 377	170 199
exposures associated with particularly high risk	1 420	1 719
exposures in the form of covered bonds	0	0
items representing securitisation positions	1 199 611	700 055
exposures to institutions and corporates with a short-term credit assessment	0	0
exposures in the form of units or shares in collective investment undertakings ('CIUs')	0	0
equity exposures	31 892	41 681
other items***	2 430 677	2 563 988
Total	**60 531 007**	**61 761 329**

* *Out of which PLN* 16.881.951 *due to contingent liabilities.*
** *Arithmetical average calculated on quarterly balances in 2016.*
*** *Including due to Assets arising from off-balance sheet transactions valuation, Intangible assets, Tangible fixed assets, Cash in hand, Income tax asset.*
The above table includes both exposures to credit risk and counterparty credit risk.

Table 8: The geographic distribution of the exposures, broken down into significant areas by material exposure classes, and further detailed if appropriate

Country	Net exposures after adjustments and provisions* in PLN '000
Belgium	5 005
France	5 150
Netherlands	304 929
India	37 760
Ireland	202 358
Canada	8 037
Luxembourg	200 894
Germany	106 677
Norway	162 231
Peru	1 861
Poland	55 969 455
Romania	62 647
USA	1 626 246
Switzerland	63 155
Sweden	46 424
Hungary	20 948
Great Britain	1 705 018
Other	2 213
Total	**60 531 007**

Table 9: The structure of balance sheet exposures and off balance sheet liabilities granted broken down by counterparty type and exposure class is presented below.

Counterparty type	Exposure class	Net value in PLN '000
Banks	exposure to institutions - banks	3 033 691
Budget sector	exposures to governments or central banks	19 291 632
	exposures to regional governments or local authorities	51 911
	exposures to public sector entities	36 914
Corporations	retail exposures	1 155 846
	of which: SME	131 816
	exposures to corporates	20 380 727
	of which: SME	2 627 958
	exposures secured on real estate property	1 537 207
	of which: SME	727 106
	exposures in default	66 485
	of which: SME	22 177
	items belonging to regulatory high-risk categories	1 420
Retail clients	exposure to retail	11 144 980
	exposure to secured on real estate property	1 272 736
	exposures in default	94 892
Other assets	equity exposures	31 892
	other items	2 430 672
Total		**60 531 007**

Table 10: The residual maturity breakdown of all the exposures, broken down by exposure classes

Exposure class	<= 1 month	> 1 month <= 3 months	> 3 months <= 6 months	> 6 months <= 1 year	> 1 year <= 2 years	> 2 years <= 5 year	> 5 year	Unknown maturity	Total in PLN '000
exposures to central governments or central banks	2 524 725	0	0	252	2 762 253	12 368 609	1 635 793	0	**19 291 632**
exposures to regional governments or local authorities	999	77	8 415	339	6 475	25 506	10 099	1	**51 911**
exposures to public sector entities	4	3 008	0	3 176	13 716	17 009	0	0	**36 914**
exposures to institutions	738 780	247 401	22 463	1 473 161	126 813	127 111	170 573	127 390	**3 033 691**
exposures to corporates	8 409 084	1 704 504	1 341 098	2 144 510	1 278 247	3 745 132	1 542 261	15 439	**20 180 277**
retail exposures	7 775 687	22 992	42 068	113 104	160 552	2 207 404	954 994	24 864	**11 301 665**
exposures secured by mortgages on immovable property	453 965	117 842	72 990	71 310	164 577	307 934	1 621 325	0	**2 809 942**
exposures in default	102 579	5 365	1 678	2 838	10 199	31 964	6 755	0	**161 377**
exposures to multilateral development banks	2	0	0	0	0	0	0	0	**2**
exposures associated with particularly high risk	0	0	0	0	0	0	0	1 420	**1 420**
items representing securitisation positions	0	0	0	0	0	1 199 611	0	0	**1 199 611**
equity exposures	0	0	0	0	0	0	0	31 892	**31 892**
other items	0	0	0	0	0	0	0	2 430 672	**2 430 672**
Total	**20 005 827**	**2 101 188**	**1 488 712**	**3 808 690**	**4 522 832**	**20 030 279**	**5 941 799**	**2 631 678**	**60 531 007**

1.2. Counterparty credit risk

Counterparty risk is incurred from derivative transactions and capital market transactions. For purposes of risk management the Group defines it as pre-settlement risk and settlement risk.
Pre-settlement exposure is defined by PSE measure (Pre-Settlement Exposure, „PSE"), reflecting future potential exposure of the counterparty. PSE reflects maximum expected exposure of the counterparty during the life of the transaction (or transaction portfolio) at the specified confidence level. The distribution of the market value (Mark-to-market) and PSE amount are dependent on market factors determining the values for particular transaction in the customer portfolio. In case there is no sufficient data, to simulate the value of the transactions' portfolio more simplified method are used, same as for the purpose of capital requirement calculation.

Pre-settlement risk exposure is managed and reduced through the initial or variation margin deposits as well as conducting transactions using clearing houses.
Moreover, the exposure arising from pre-settlement risk is continuously monitored and is also limited at the aggregate level broken down by product group.

Settlement risk arises when the Group exchanges cash payments to counterparty on a value date and is unable to verify that payments have been received in exchange. The exposure in this case equals the nominal transaction value.

A description of the methodology used to assign internal capital and credit limits for counterparty credit exposures

Internal capital related to counterparty risk related is calculated as 8% of the value of total risk weighted exposures in the trading portfolio, in which internal capital for the following exposure classes: institutions, corporates, regional governments and local authorities administrative bodies and non-commercial undertakings, was estimated according to advanced approach based on internal ratings. For exposures different than mentioned above internal capital requirements were estimated according to standardized approach specified in the Regulation No. 575/2013. The Group estimates also the level of exposures resulting from counterparty risk in stress scenario.

Furthermore pre-settlement & settlement risks are managed by the Group by setting appropriate limits (pre-settlement and settlement) as an integral part of credit approval process. Pre-settlement limits for counterparty specify, among others, tenors and product families and depend on the customer creditworthiness, his financial standing as well as on the level of customer's knowledge and experience in derivative transactions, forecasted currency position/ other position which requires hedging and related product needs and on the level of derivative transactions already concluded with other banks.

The level of settlement limit which may be approved is determined by the customer's risk rating. For a vast majority of transactions the Group adopted 'delivery versus payment' (DVP) principle which mitigate settlement risk through not paying the counterparty until Group confirms receipt of the payment or delivery of an instrument by a client.
The internal settlement limits are availed in specific and justified cases.

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

The Group's policies for securing collateral vary according to the counterparty business segment. Most common form of collateral accepted to mitigate credit risk of counterparty, with whom the derivate transactions ("transactions") are entered, is financial securing in the form of transfer of the rights to cash or security deposit according to Art. 102 of Banking Act (cash deposit). The amount of security depends on the difference of the current Mark to Market value of a transaction and a limit agreed. In principle, margining in the form of cash due to its nature does not expose the Group to the risk of unfavourable changes in collateral value. Generally the transactions are provided under frame agreements, which in case of breach by counterparty allow for an early termination of transaction by the other party and settlement the positive and negative values of transactions covered by given frame agreement in one net amount. The exposure resulting from counterparty risk together with other exposures is included in the periodical credit analysis of a customer.

The Group applies credit value adjustment to the market value of a derivative contract to take into account the credit risk of the counterparty. All Commercial and Corporate Banking Subsector customers are taken into account for derivatives assessment correction calculation
The Group differentiates the valuation of counterparty risk due to the availability of CDS quotations:

a) Credit Risk of Counterparties, for which there is active market of CDS. It is considered that CDS quotations reflect market valuation of credit risk.
b) Credit Risk of Counterparties, for which there isn't active market of CDS. Based on credit rating (external or internal, if external isn't available) and economic sector, in which client is operating, CDS index value, which reflects market valuation of risk, is attributed to the counterparty.

The negative correlation risk is not taken into account while calculating regulatory capital requirement due to applying standard methodology. The Group does not estimate α ratio, because it does not determine specific correlation risk.

The Group does not enter into agreements, which would require providing additional collateral in case of lowering its credit ratings.

Table 11: Gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held and net derivatives credit exposure. Net derivatives credit exposure is the credit exposure on derivatives transactions after considering both the benefits from legally enforceable netting agreements and collateral arrangements

	in PLN '000
Gross positive fair value	**1 179 378**
Netting benefits (change in value of balance sheet equivalent)	**2 007 381**
Net value of credit exposure (value of balance sheet equivalent)	**2 018 342**
Current credit exposure*	**2 445 150**

* Current credit exposure calculated as the sum of balance equivalent of derivatives and the exposure value of repo and reverse repo transactions (before application of credit risk mitigation techniques).

The Group measures exposures of derivative transactions using methods of market valuation in compliance with the Regulation No. 575/2013. According to the method mentioned above, the balance sheet equivalent of off-balance sheet transactions is calculated as the sum of the replacement cost and potential future credit exposure. The cost of a replacement shall be the market value of the transaction - if it is positive, or zero - when the aforementioned market value is negative or equal to zero. Potential future credit exposure is calculated as the product of the nominal amount of off-balance sheet transactions (or its equivalent delta values for options) and product risk weight assigned to the transaction.

The Group does not use credit derivative hedges.

1.3. Information regarding credit risk mitigation techniques

For the purpose of calculating the balance sheet equivalent of derivative transactions within capital requirements calculation the Group recognizes contractual compensation ("close-out netting") with respect to off-balance sheet derivative transactions provided by the Bank under relevant frame agreement, when fulfils all legal and formal terms as per the Regulation No. 575/2013, which must be met in order to consider the contractual compensation as risk mitigant.

In particular the Group has a process to monitor regulations in terms of compensation in order to ensure proper monitoring of changes in current regulations in regards to requirements set in the above mentioned resolution.

Information regarding the policies for collateral management and main types of accepted collateral are presented in supplementary note 48 „Risk Management" to the Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016.

The value of collateral is calculated on the basis of estimates provided by the property valuation experts, valuations provided by industry analysts, borrowers' accounting records, deposit certificates, information from external databases, etc. The Group defines and applies appropriate loan to value ratios for different collateral types in the process of estimating collateral amounts.

The Group reviews in detail the amount of taken collateral at least annually and by the renewal or change in conditions of the transaction.

Additionally the Group monitors if there are shortages in received collateral. Monitoring is performed by the unit independent of sales units and its frequency depends on collateral type (monthly, quarterly or annually).

In order to diversify risk associated with collateral, the Group accepts various types and forms of collateral:

- In the Consumer the most common type of collateral is residential real estate,
- In the Corporate and Commercial Banking primarily the following types of collateral are accepted:
    - guarantees and warranties,
    - financial security,
    - collateral.

Detailed procedures defining types of collateral acceptable by the Bank, rules on collateral establishment and value determination as well as creation of specialized independent risk unit responsible for collaterals evaluation allowed to develop adequate standards for this process, including e.g.

- Collateral acceptance and appraisal criteria,
- Standardized documentation,
- Rules of collateral monitoring process (including inspections).

Commercial Bank credit procedures describe ratio of the value of the loan to collateral value for each type of security.

The Group periodically monitors if the actual structure of the collateral portfolio in Commercial Bank is compliant with the structure assumed and if the collateral amount is sufficient.

In Corporate Bank expected Loan-to-Value relations are determined each time in credit decision. These relations are also monitored on the on-going basis.

For Retail Banking Sector the basic collateral for mortgage loans is mortgage on Real Estate. Due to time gap between loans disbursement and setting legally effective mortgage the bridge collateral is used.
The valuation of collateral is performed each time based on real estate appraisal requested by the Group. Collateral appraisals are verified by an independent valuation team in accordance with the valuation guidelines of real estate

being collateral for real estate loans for retail customers in Retail Banking Sector. The quality of the appraisal team's work is monitored.

In the field of the funded credit protection the Group considers cash collateral and real estates in case of credit risk mitigation of retail exposures in accordance with the principles set in the Regulation No. 575/2013.
Currently only guarantees issued by the Treasury and BGK are recognized by the Group as unfunded credit risk mitigation techniques for capital adequacy calculation.

The Group enters into reverse repo transactions secured entirely by highly liquid debt securities (mainly issued by the Treasury). These transactions are characterized by low market risk level and therefore low market risk concentration due to short maturities.

Table 12: Total exposure value covered by eligible financial collateral or other eligible collateral by exposure classes after the application of volatility adjustments (in PLN '000)

Exposure type / Exposure class	Security collateral	Unfunded credit protection-guarantees	Cash collateral	Total collateral amount
On-balance sheet exposures & financial and guarantees liabilities granted				
retail exposures	0	15 764	1 389	17 154
exposures to institutions	167 783	186 979	0	354 762
exposures to corporates	0	31 802	42 847	74 649
exposures in default	0	1 308	30	1 338
Repo-style transactions* and derivatives				
exposures to institutions	192 793	103 102	497 717	793 611
exposures to corporates	0	0	39	39
retail exposures	0	0	1 092	1 092
Total	**360 575**	**338 955**	**543 113**	**1 242 644**

* repo and reverse-repo transactions

The total value of exposures secured by the guarantee is presented in in column: Unfunded credit protection - guarantees.

1.4. Information regarding application of standardised approach to calculate risk-weighted exposure amounts

The Regulation No. 575/2013 on banks' capital adequacy and Bank's internal policies describe the use of the Group's external ratings and identify external credit assessment institutions whose ratings can be used for the application of the standard method. Currently there are Moody's and Standard & Poors as well as Fitch. Ratings from this three mentioned agencies are used in calculation and reporting process of Capital Requirements for Credit Risk and Counterparty Risk according to standardize method. Currently Group does not use ratings issued by Export Credit Agencies.

Exposure classes for which Bank uses external ratings granted by approved external agency:
1) exposures or contingent exposures to central governments and central banks;
2) exposures or contingent exposures to local governments and local authorities;
3) exposures or contingent exposures to public sector entities;
4) exposures or contingent exposures to multilateral development banks;
5) exposures or contingent exposures to institutions;
6) exposures or contingent exposures to corporates
7) items representing securitisation positions.

Group applies issuer and issue credit assessment according to rules set forth in The Regulation No. 575/2013 on banks' capital adequacy. Consequently for given exposure where a credit assessment exists for a specific issuing programme or facility to which the exposure belongs, this credit assessment is used to determine the risk weight, which is then assigned to that exposure. Otherwise, Group uses a credit assessment that exists for a specific issuing programme or facility to which the exposure does not belong or a general credit assessment that exists for this issuer, provided that it produces a higher risk weight than that which would be applied to exposures without a credit assessment.

Table 13: The exposure values before and after credit risk mitigation associated with each credit quality step as set for the standardised approach as well as items deducted from own funds

Credit quality step	Exposure values before credit risk mitigation in PLN '000	Exposure values after credit risk mitigation in PLN '000
1	1 595 007	1 595 007
2	20 328 953	19 609 515
3	3 048 359	3 005 359
4	629 652	598 852
5	7 957	7 957
6	0	0
no rating	34 921 078	34 810 628
Total	**60 531 007**	**59 627 318**

The Group complies with the standard way to assign credit ratings shown in the resolution on the rating takes into account the principles set out in The Regulation No. 575/2013.

1.5. Information regarding exposure to securitisation positions

Securitization activities are one of the areas of business, which recently gained in importance. Group decided to invest in securities based on economic calculation, measuring return on investment against the potential risks. Securitization is now a standard and widely used product in global markets. Its importance also increases on the Polish market. The Group intends to be an active participant in this market segment.

At the end of 2016 year the total item constituting securitization exposures amounted PLN 1,2 MM Securities purchased by the Group are not traded on the market. The Group intends to maintain investments until the maturity date. The Group classifies securitization's assets as loans and receivables in accordance with IAS 39 and value them at amortized cost. The expected maturity date of the securities is July 2020.

The Group has no positions in the resecuritization.

The Group has procedures for defining the processes of approval and monitoring of securitization exposures, which include, in particular:
- Analysis of the originator including the processes of credit and debt collection, qualitative and quantitative analysis, the condition of maintaining a material net economic interest, reputation, data related to the quality of previous securitization,

- Risk analysis of the exposure underlying the securitization position i.e. the quality, concentration, delays in repayment and the level of losses, the level of recovery rates
- The terms and structure of the transaction reducing identified risks and defining the division into tranches, level of support and security, payment streams, events of default and default indicators, - Monitoring including, among others, verification of the quality of the exposures underlying the securitization position, timeliness of payments and service, compliance with the transactions conditions, the financial situation of the institutions participating in the transaction, etc.
Existing Group's commitment in securitized assets is not exposed to market risk due to the accounting treatment applied.

The Group does not use any additional collateral (other than arising from the transaction's structure) and unfunded protection of securitization positions

The main risk of securitisation transactions is credit risk. Other important risks of the transaction are *inter alia* the risk of early repayment and the risk of partial prepayment (limited by discounting).

Given the above risks, the Group's credit procedures ensure conducting quality monitoring of securitization portfolio on a quarterly basis.

For the assessment of the securitized portfolio, the Group applies internal rating methodology that is based largely on Fitch's methodology.

Risk weighted exposure for securitization portfolio is determined in accordance with the Regulation No 575/2013.

The Group uses agencies' ratings agencies in a consistent and continuous way with respect to all exposures in order to determine the risk weights for exposures. For exposures that are securitization positions to assign risk weight at least two credit ratings assigned by recognized external credit assessment institutions are required.

Risk weights are assigned to securitization exposures according to the below table:

Quality level	Risk weight
1	20%
2	50%
3	100%
4	350% (only for credit assessments other than short-term credit assessments)
All other credit quality steps without two ratings	1250%

If the Bank at any time knows the composition of unrated pool of securitized exposures, it is possible to apply the risk weight calculated in accordance with the following formula, i.e.

RW= average-weighted risk weight (calculated in accordance with the standardized method) x concentration factor

whereby:

- average-weighted risk weight is the risk weight that would be applied by the Group, if it had exposure to the securitized exposures,
- concentration factor = sum of the nominal amounts of all the tranches divided by the sum of the nominal amounts of the tranches junior to or *pari passu* with the tranche in which the position is held including that tranche itself.

Table 14: The total amount of exposure and capital requirement for securitization exposures held

Exposure class	The total amount of exposure in 000'PLN	Capital requirement in 000'PLN
Items representing securitisation positions	1 199 611	75 986

1.6. Market risk

The amount of capital requirements by types of market risk:

- fx risk,
- general and specific equity risk,
- specific risk for debt securities,
- general interest rate risk

is presented in p. IV of this report in table No 5.

The information regarding the exposure to interest rate risk on positions not included in the trading book are disclosed in explanatory note 48 “Risk Management” to the Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016.

The interest rate risk is measured on a daily basis.

The Group does not use internal ratings-based approach.

1.7. Information regarding the exposures in equities not included in the trading book

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

Detailed information on how the Group’s equity investment portfolio is broken down based on purchase reasons are described in chapter V point No 8 „Equity investments” of the Report on Activities of the Capital Group of Bank Handlowy w Warszawie S.A. for 2016.
A description of accounting techniques applied as well as capital commitments valuation methodologies is in explanatory note 2 „Significant accounting policies” to the Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016.

Information on balance sheet value and the fair value of capital expositions not included in the trading book is in explanatory note 39 „Fair value information” to the Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016.

The value of equity exposures, broken down into listed equity exposures and portfolios of securities not admitted to trading in the regulated equity market is provided in explanatory note 22 „Equity investments valued at the equity method” and note 23 „Equity investments available for sale” to the Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016.

The value of liquidations of equity investments not included in Bank’s trading portfolio is provided in explanatory note 22 “Equity investments valued at equity method” to the Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016.

1.8. Operational risk

Operational risk is the risk of loss resulting from inadequate or deficient internal processes, people, technical systems, or from external events (including technological and technical risk, outsourcing risk, misappropriation risk, money laundering risk, information security risk, external events risk (business continuity), tax and accounting risk, product risk, compliance risk, legal risk, models risk, staffing risk, concentration risk and (conduct risk).

Operational risk includes reputation and franchise risks associated with operational risk events and business practices or market conduct. It also includes legal and compliance risks.

Operational risk does not cover strategic risk or the risk of loss resulting solely from authorized judgments made with respect to taking credit, market, liquidity or insurance risk.

Group applies standardised methodology (STA) for calculation of capital requirement for operational risk, defined in Regulation No. 575/2013.

The Group doesn’t apply advanced methodologies for calculation of capital requirement for operational risk.

Information regarding operational risk, as specified in the paragraph 17.3 of Recommendation M on the management of operational risk in banks

With regard to losses impacting financial results, for Retail Banking and Leasing all events are reported and for the other areas of Group losses exceeding equivalent of USD 1 thousand are reported.

Total operational risk gross losses in Group (absolute value, including gains, excluding recoveries) recorded in the year 2016, split by operational risk event types and categories (in accordance with appendix 1 to Recommendation M) are presented in the table 14. Table contains events impacting financial results, including boundary events.

Table 15: Total operational risk gross losses by types of events

Types and categories of events	in PLN '000
External Theft and Fraud	**2 733**
Credit Card Fraud	2 026
Debit/ATM Card Fraud	585
Other External Theft and Fraud	105
Electronic Banking and Internet Fraud	6
Virus, Malware and other Cyber Attacks	5
Theft of Cash, Assets and Property; Theft of Inventory and Other Assets	3
Account Takeover / ID Theft - Non Card Related	3
Execution, Delivery & Process Management	**617**
Transaction Capture, Execution & Maintenance	604
Customer / Client Account Management	11
Monitoring and Reporting	2
Clients, Products & Business Practices	**42**
Business Practices or Market Conduct	42
Internal Theft and Fraud	**1**
Incentive Abuse - Falsifying performance metrics to receive unearned financial incentives	1
Systems & Technology	**2**
Other Systems & Technology	2
Total	**3 394**

Gross value of operational losses by date of occurrence amounted to PLN 3394 thousand. Relation of net losses to Group revenues amounts to 1,6%. The total amount of losses consists of almost 400 registered events (including homogenous events with financial effects not exceeding USD 10 thousand aggregated on a monthly basis). In terms of severity, in the year 2016 Group didn't record any event in the bucket >USD 100M and 8 events in the bucket >USD 20M and <USD 100M. The remaining events didn't exceed USD 20M.

The significant events affecting the total amount of 2016 losses include credit and debit cards frauds (including skimming and internet frauds) in amount of PLN 2612 M – 77% of gross loss amount.

Operational risk events exceeding set tolerance thresholds are analyzed by independent control units in view of root causes and corrective actions. Corrective actions are monitored by management to avoid repetitive losses. The Group undertakes series of actions aiming at operational risk mitigation. The following actions were undertaken in 2016: verification of adequacy of applied controls, enhancements to control processes in areas of identified weaknesses, enhancements of fraud detection systems, revision of limits mitigating risk exposure, strengthening of independent verifications, enhancements to maker/checker controls, automations, revision of vendor management principles and staff training. Members of the Management Board approval is required for all losses exceeding established threshold, in view of analyses of causes of the losses and adequacy of corrective actions. Set 2016 appetite thresholds were not exceeded.

The information regarding the operational risk is disclosed in explanatory note 48 “Risk Management” to the Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016.

VI. Internal Capital Adequacy Assessment

The Group identifies and manages all types of risks in its activity while some of them considering as significant. For all measurable risks that are considered as significant in the Group’s activity, the Group estimates and allocates capital. For this purpose the Group implemented process of estimation and allocation of the internal capital covering significant risk in which assessment of capital adequacy is performed (process ICAAP). The Group annually sets Overall Risk Appetite approved by the Management Board and Supervisory Board. Adopted Overall Risk Appetite clearly and consistently communicate the types and levels of risk the Bank is willing to take, within the context of the Bank’s articulated business strategies.

The result of the ICAAP is to determine the capital plan which is consistent with approved by the Board and the Supervisory Board financial plan and risk appetite. It specifies the Group's capital needs and goals. Internal Capital is estimated for significant types of risk. The Group allocates internal capital to the particular business units. Risk and Capital Management Committee is responsible for the annual capital planning and ongoing monitoring of capital usage according to established limits.

Overall Risk Appetite is defined as the aggregated level of expected and unexpected losses, that Group is willing to assume to achieve its strategic objectives while maintaining target regulatory capital adequacy ratio Management Board on the basis of risk appetite decides on the level of aggregated limits on particular business units and sub-limits on measurable risks treated as significant.

Below we present the specific, measurable risks identified as significant in the Group in 2016:

- credit risk,
- counterparty credit risk,
- operational risk,
- market risk in the trading book,
- interest rate risk in the banking book,
- liquidity risk,
- compliance risk.

The Group assesses the internal capital for a base case and a downside scenario, which is a basis for the stress tests’ analysis.
Scenarios are defined on the basis of the set of assumptions common to all risks analyzed. In addition, the Group analyzes a one in ten year’s scenario (1/10), which forms a basis for additional risk / return measure within a set risk appetite.

The internal capital requirements for credit and counterparty risk were estimated according to advanced approach based on internal ratings for the following exposure classes: exposures to institutions, corporates, regional governments and local authorities and public sector entities. For exposures different than mentioned above internal capital requirements were calculated according to standardized approach specified in the Regulation No. 575/2013.
Capital requirement for operational risk has been calculated using standardized methodology approach specified in the Regulation No. 575/2013. Calculated capital requirement, according with the accepted methodology, is increased by add-on, if stress tests show necessity to increase internal capital for operational risk.
Internal capital for market risk in trading book is based on an integrated measure, which takes into account both the value at risk (VaR), and the size of losses in stress scenarios, estimating unexpected loss on the trading portfolio with the probability of 99.9% in 1Y time horizon. In the case of banking book (accrual) portfolios quantification of internal capital, is based on a combination of potential maximum decrease in net interest income of the bank in the

perspective of one year in conjunction with the maximum negative impact of changes in interest rates on the economic value of the bank's capital, determined in stress scenarios with the probability of 99.9% in 1Y time horizon.
In the case of liquidity risk, the amount of internal capital allocation is based on current and projected elements of supervisory measures, taking into account the stress scenarios within the next 12 months.
The Group does not use diversification effect while aggregating estimated internal capital for significant risks.

The Group adopted proper methods for capital allocation to the business units.

The organisational units engaged in the process of assessment of internal capital are required to ensure adequate level of internal control in the capital calculation process for significant risks. Audit Department conducts independent review of the process of capital assessment and maintenance.

The Banks's capital adequacy assessment process in the form of "Capital Group of Bank Handlowy w Warszawie S.A. Capital Management" document is approved by the Management Board, and then submitted for the Supervisory Board's approval.

Risk and Capital Management Committee is responsible for ongoing capital adequacy assessment. The Committee supervises the compliance with Overall Risk Appetite established by the Supervisory Board and monitors capital adequacy taking into account the quantitative ratios and capital limits utilization as well as the forecasts related to capital adequacy.

Risk and Capital Committee of the Supervisory Board receives periodically report on assessment and utilizations of internal and regulatory capital.

If determined within the Overall Risk Appetite level of capital adequacy ratio falls below approved threshold or the Group does not have enough capital to cover internal capital allocation for significant risks, the contingency capital plan will be activated.

VII. Capital Buffers

The Group is obliged to maintain conservation capital buffer of 1,25 p.p. of total risk exposure amount in 2016.

On 4 October 2016, Polish Financial Supervision Authority identified the Group as Other Systemically Important Institution (O-SII) and imposed an additional capital buffer – O-SII capital buffer – of 0,25% of total risk exposure amount.

As of 31 December 2016, the countercyclical capital buffer ratio of 0% has been applied to credit exposures in Poland according to the Article 83 of the Law. The ratio shall be effective until it is changed by way of an ordinance of the Finance Minister.

The Group calculates the institution-specific countercyclical capital buffer in accordance with the provisions of the Act as the weighted average of the countercyclical buffer rates that apply in the countries where the relevant credit exposures of the Group are located.

Table 16: The amount of the institution-specific countercyclical capital buffer

	As of 31.12.2016
Total risk exposure amount (in PLN'000)	27 499 029
Institution-specific countercyclical capital buffer rate (%)	0,00010
Institution-specific countercyclical capital buffer requirement (in PLN'000)	2 868

Table 17: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer (in PLN'000)

	General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements					
Country	Exposure value for SA	Exposure value for IRB	Sum of long and short position of trading book exposure for SA	Value of trading book exposures for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total	Own funds requirements weights (%)	Countercyclical capital buffer rate (%)
Poland	23 452 081	0	544	0	999 161	0	1 582 103	43	59 950	1 642 096	96,74330	0,0000
Norway	138 225	0	0	0	0	0	11 058	0	0	11 058	0,65148	1,5000
Netherlands	69 375	0	0	0	0	0	5 550	0	0	5 550	0,32698	0,0000
Romania	62 039	0	0	0	0	0	4 963	0	0	4 963	0,29240	0,0000
Luxembourg	49 747	0	0	0	0	0	3 980	0	0	3 980	0,23447	0,0000
Switzerland	42 377	0	0	0	0	0	3 390	0	0	3 390	0,19973	0,0000
India	37 760	0	0	0	0	0	3 021	0	0	3 021	0,17797	-
United States	33 616	0	0	0	0	0	2 446	0	0	2 446	0,14412	0,0000
Germany	18 842	0	0	0	0	0	1 307	0	0	1 307	0,07702	0,0000
United Kingdom	17 120	0	0	0	0	0	1 370	0	0	1 370	0,08069	0,0000
Hungary	16 629	0	0	0	0	0	1 330	0	0	1 330	0,07838	0,0000
Sweden	9 290	0	0	0	0	0	743	0	0	743	0,04379	1,5000
Belgium	1 000	0	0	0	0	0	80	0	0	80	0,00471	0,0000
Czech Republic	30	0	0	0	0	0	2	0	0	2	0,00011	0,0000
Ireland	7	0	0	0	200 450	0	1	0	16 036	16 037	0,94479	0,0000
Canada	7	0	0	0	0	0	1	0	0	1	0,00003	0,0000
Austria	5	0	0	0	0	0	0	0	0	0	0,00002	0,0000
South Korea	2	0	0	0	0	0	0	0	0	0	0,00001	0,0000
Hongkong	2	0	0	0	0	0	0	0	0	0	0,00001	0,6250
Italy	1	0	0	0	0	0	0	0	0	0	0,00001	0,0000
Total	**23 948 156**	**0**	**544**	**0**	**1 199 611**	**0**	**1 621 346**	**43**	**75 986**	**1 697 375**	**100**	

VIII. Information regarding the remuneration policy

Remuneration policy for the key Persons at Bank Handlowy w Warszawie S.A. (Bank) and at Dom Maklerski Banku Handlowego S.A. (DMBH) – subsidiary of the Bank – were adopted by the resolution of the Supervisory Board of the Bank dated 3 December 2015 and the resolution of DMBH Supervisory Board dated 28 December 2015 (hereinafter referred to as the Remuneration Policy). Remuneration Policy sets out the principles for remunerating the Management Board Members and other persons holding key functions, including persons who have a material impact on the risk profile of the Bank and DMBH. This Policy implements requirements of the provisions of law, Rules of Corporate Governance for Supervised Institutions adopted by the Polish Financial Supervision Authority.

Principles for variable remuneration in the Bank and DMBH are described in details in the "Variable Remuneration Components Policy for Persons Holding Managerial Positions in Bank Handlowy w Warszawie S.A." which was adopted by the Management Board and approved by the Supervisory Board on 26 September 2012 along with further modifications and the "Variable Remuneration Components Policy for Persons Holding Managerial Positions in DMBH" which was adopted by the Management Board and approved by the Supervisory Board on 29 March 2012 along with further modifications (hereinafter referred to as "the Variable Remuneration Policy")

In the work on preparation and implementation of both polices mentioned above were involved:

- the members of the Bank's Remuneration Committee,
- the Bank's and DMBH Management Board,
- the head of the Banks's Legal Department and DMBH Legal Team,
- the head of the Banks's Human Resources Department,
- the Bank's and DMBH manager of the Compensation & Benefits Department,
- and, as an external Bank's and DMBH consultant, the law firm "Clifford Chance Janicka, Krużewski, Namiotkiewicz i wspólnicy spółka komandytowa".

Variable remuneration for Bank's Management Board Members is granted by the Supervisory Board and for other employees covered by the "Variable Remuneration Components Policy for Persons Holding Managerial Positions in Bank Handlowy w Warszawie S.A." by the Management Board. It should be noted that the Remuneration Committee of the Supervisory Board was established in the Bank. It provides recommendations and opinions on the levels and conditions of variable remuneration of employees covered by the Variable Remuneration Policy. The Remuneration Committee gives opinions and monitors the variable remuneration of staff under the Variable Remuneration Policy connected with risk management, compliance and internal audit.

Additionally, each time, in case of the change of the Variable Remuneration Policy the Remuneration Committee gives its opinion on the changes, including the amounts and components of remuneration, taking into account a cautious and stable risk, capital and liquidity management, and paying special attention to long-term interests of the Bank, the interest of the Bank's shareholders and investors. In 2016 there were five meetings of the Remuneration Committee.

As at December 31, 2016 the Remuneration Committee was composed of:

1. Andrzej Olechowski – Chairman of the Committee
2. Jenny Grey – Vice Chairman of the Committee
3. Zdenek Turek – Member of the Committee
4. Stanisław Sołtysiński – Member of the Committee

In DMBH decisions related to Management Board Members' remuneration and grant of variable remuneration are made by the Supervisory Board and for other employees covered by the "Variable Remuneration Components Policy for Persons Holding Managerial Positions in Dom Maklerski Banku Handlowego S.A." by the Management

Board. Implementation of this policy is subject to at least annual review performed by the function responsible for internal control and risk management. Written report covering the assessment of implementation of Variable Remuneration Policy is presented to DMBH Supervisory Board.

Each time, in case of the change of the Variable Remuneration Policy DMBH Supervisory Board gives its opinion on the changes, including the amounts and components of remuneration, taking into account a cautious and stable risk, capital and liquidity management, and paying special attention to long-term interests of DMBH, the interest of the Bank's shareholders and investors. In 2016 there were two meetings of the Supervisory Board related to the Variable Remuneration Policy.

In 2016 the Bank and DMBH analyzed the roles and the responsibilities of their employees in relation to the key manageable risks in the Bank and DMBH as well as quantitative and qualitative criteria described in Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile and on this basis set the list of management staff, approved by the Supervisory Board of the Bank and DMBH, which has a material impact on the risk profile of the Bank or DMBH accordingly and therefore should be the subject to the provisions of the Variable Remuneration Policy. The list of the employees under the Variable Remuneration Policy includes:

- President, Vice-Presidents and the Members of the Management Board of the Bank and DMBH,
- the members of the Risk and Capital Management Committee,
- the members of the Asset-Liability Committee,
- the heads of business lines,
- management staff responsible for control functions in the Bank, i.e. the head of internal audit, the head of compliance division and the heads of risk management, human resources and legal departments,
- other supervisors, whose actions significantly impact assets and liabilities of the Group and which directly influence entering into or changing the contracts and their conditions by the Group,
- other employees who met at least one criterion described in Commission Delegated Regulation.

The philosophy of awarding the persons under the Variable Remuneration Policy, adopted by the Group, implies the wage differentiation of particular employees based on the financial and non-financial criteria, such as attitude to take risk and assurance of compliance to reflect their current and future contribution and to supplement mechanisms of efficient risk control by limiting the motivation for taking unreasonable risk impacting the Group and its activities and by rewarding the proper balance between risk and rate of return. According to this philosophy, the payment of variable remuneration to staff under the Variable Remuneration Policy depends on both the short-term and long-term evaluation of the individual performance and the financial results of the Bank or DMBH or specific organizational unit, whereby the persons responsible for control functions are not assessed for the financial results. The assessment of the Bank's results or results of DMBH is based on the data from three financial years, which takes into account the business cycle of the Bank and risk of its economic activities. In case of staff employed less for than 3 years when evaluating the Bank's results and results of DMBH the data includes the span of time from the establishing working relationship. The variable remuneration for 2016, granted January 16, 2017, was divided into non-deferred and deferred portions. The deferred portion was divided into short-term part which vests after 6-month period and long-term one consisting of three tranches, to be paid in years 2018, 2019 and 2020, subject to conditions provided for in the Variable Remuneration Policy. Information on adopted solutions was given in Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016 in the explanatory note 47 "Employee benefits".

Vesting of particular tranches requires to be approved each time by the Supervisory Board in relation to remuneration of the Management Board Members and the Management Board in the relation to remuneration of other employees.

The amount of deferral depends on the amount of the awarded variable remuneration and is as follows:

- less than PLN 100 thousand – no deferrals

- between PLN 100 thousand and equivalent EUR 500 thousand (in DMBH up to the equivalent of 1 million euro) – deferral over 3 years equal to 40% of the variable remuneration with 6 months retention period for each bonus tranche,
- above the equivalent EUR 500 thousand (in DMBH above the equivalent of 1 million euro) – deferral over 3 years equal to 60% of the variable remuneration with 6 months retention period for each bonus tranche.

The variable remuneration for adopted Remuneration Policy's and Variable Remuneration Policy's purposes is understood as – in case of the members of the Management Board – discretionary bonus granted by the individual decision of the Supervisory Board, and in case of other Identified Staff – the annual bonus.
At least 50% of the variable remuneration should be awarded in the form of non-cash instruments whose value highly depends on the financial results of the Bank or DMBH accordingly. This condition is fulfilled by the phantom shares applied by the Group, whose value will fluctuate depending on the market value of the Bank's shares. The remaining part of the variable remuneration is a cash award, whereby the interests for the period from awarding to payment the given part of remuneration will be accrued to the given tranche of the deferred variable remuneration. After two years from granting the deferred cash award the accrued interest will be credited to the capital of unpaid tranches of this award and will be subject to interest until it becomes payable after the retention period.

During the deferral period, employees who are rewarded in phantom shares are entitled to dividend equivalent payments in respect of any dividends that are declared and paid to ordinary holders of BHW stock, in accordance with the Variable Remuneration Policy.

Regardless of changes of the deferred variable remuneration's value associated with the fluctuation of the Bank's share price or accrued interest, the amount of paid deferred portion of bonus may be lowered or completely reduced if the Supervisory Board or accordingly the Management Board decides that:

- the Identified Staff have received the variable remuneration based on significantly incorrect financial statements of the Bank or DMBH accordingly; or
- the Identified Staff have been knowingly taking part in disseminating the significantly incorrect information on the financial statements of the Bank or DMBH accordingly; or
- the Identified Staff have significantly violated any risk limits, established or corrected by the senior management staff or risk management staff; or
- the Identified Staff have flagrantly breached their employee duties; or
- there has been a significant decrease of the financial performance of the Bank or DMBH accordingly or significant mistake in risk management.

The acquisition of the right to each tranche of deferred variable remuneration will depend on the Bank's results or DMBH results accordingly in the calendar year directly preceding the date of awarding of the right to given tranche ("Year Concerning the Results").

If the Bank or DMBH accordingly suffers a loss calculated as a loss before tax for the Year Concerning the Results, then the Long-term Bonus in the Phantom Shares, to which the right may be earned during the calendar year following the end of the Year Concerning the Results, will be reduced (but not below zero) by a percentage defined as (i) the absolute value of the loss before tax suffered by the Bank or DMBH accordingly in the given Year Concerning the Results, divided by (ii) the absolute value of the highest profit before tax made by the Bank or DMBH accordingly in the period covering three calendar years before the proper Year Concerning the Results, but excluding all the periods ending before January 1-st, 2012 ("Measurement Period"). Irrespective of the above, if the Bank or DMBH accordingly suffers any loss calculated as the loss before tax for the Year Concerning the Results, the minimum percentage reduction of 20% will be applied.

- The amount of profit (or loss) before tax for each adequate Year Concerning the Results will be the total value of profit (loss) before income tax for the current operations of the Bank or DMBH accordingly. The results for the calendar year will be defined on a basis of the local IFRS statements, which will be covering the audited results for the first three quarters (in accordance with the report to WSE and adequate public authorities), and the last quarter of the year will consist of the actual results for the first two months of this quarter and the estimates for the last month. The estimates will be defined by the Financial Department of the Bank or DMBH accordingly and they will be final and binding regardless of the actual final results.

- If the absolute value of the loss before tax suffered by the Bank or DMBH accordingly for the Year Concerning the Results equals or exceeds the total value of the highest profit before tax in the Group's calendar year in the Measurement Period, then the Authorized Persons will not earn the rights to the given tranche.

Based on the above information and based on own judgment as well as after review by the Remuneration Committee when applicable, the Supervisory Board in relation to the members of the Management Board or the Management Board in relation to other Identified Staff takes final relevant decisions on the acquiring of right to a given tranche of Deferred Variable Remuneration.

Table 18: Annual Award for 2016 for employees covered by the Policy in 2016 [1]

(in PLN '000)

Category/Sector	Number of Employees[2]	Total fixed remunaration in 2016[3]	Total variable remunaration[4]	Cash Award for 2016 – Non deferred cash – Paid[5]	Cash Award for 2016 – Deferred cash award – Paid	Cash Award for 2016 – Deferred cash award – Accrued, unvested	Phantom shares of Bank Handlowy w Warszawie S.A. – Short term phantom shares award – Paid	Phantom shares of Bank Handlowy w Warszawie S.A. – Short term phantom shares award – Accrued, unvested	Phantom shares of Bank Handlowy w Warszawie S.A. – Long-term phantom shares award – Paid	Phantom shares of Bank Handlowy w Warszawie S.A. – Long-term phantom shares award – Accrued, unvested
Management Board	7	9 741	13 928	2 580	1 839	2 411	1 921	1 811	1 237	2 129
Consumer Bank Segment	6	4 241	1 554	453	23	225	405	381	27	41
Corporate Bank Segment	59	29 936	19 814	3 370	3 917	2 552	2 481	2 481	2 729	2 285
Total Bank	**72**	**43 919**	**35 297**	**6 402**	**5 780**	**5 188**	**4 807**	**4 673**	**3 993**	**4 454**
Brokerage house	8	3 373	1 741	301	217	260	297	300	144	223
Total Grupa	**80**	**47 292**	**37 038**	**6 704**	**5 997**	**5 448**	**5 104**	**4 972**	**4 136**	**4 677**

[1] Within the Group, there are separate Variable Remuneration Policies in the Bank and in the Brokerage House. The above table presents remuneration under those Policies.

[2] Including employees covered by the Variable Remuneration Policy in 2016, during whole 2016 there were 82 employees covered by the Variable Remuneration Policy in the Bank and 8 employees in Brokerage House.

[3] Represents fixed remuneration and covers gross amounts of base salary, benefits, insurance, payment in lieu of leave, benefits provided for in employment contracts of foreign employees.

[4] In addition in 2016 the Bank and Brokerage House paid out deferred cash award with interest and long-term phantom shares award with dividends to the employees who were not covered by the Variable Remuneration Policy in 2016. The full cost of the payouts of those awards in 2016 is included in financial statement.

[5] Paid out in 2017.

[6] Covers employees not being Members of the Management Board of the Bank and who are not employed in the Consumer Bank Segment.

The table above does not include the wages and benefits other than the fixed remuneration which were not under the Variable Remuneration Policy.

Information related to payments in 2016 associated with hiring of employees covered by the Variable Remuneration Policy.

- No. of employees: 0 employee,
- Payment amount: PLN 0 thousand.

Information related to 2016 severance payments for employees covered by the Variable Remuneration Policy.

- No. of employees: 3 employees,
- Payment amount: PLN 413,60 thousand,
- Highest such payment to a single person: PLN 180,91 thousand.

Number of individuals being remunerated in 2016 at least EUR 1 million:

- 2 persons in the pay band of EUR 1,0m – 1,5m.

Within the scope of the Variable Remuneration Policy, in the column “Non - deferred cash award” of the table above there is presented the non - deferred part, paid out in 2016. The remaining, deferred part – consisting of deferred cash award and award in the form of the Bank’s phantom shares – will be paid in three tranches in years 2018-2020 and is given in the values of the cost of 2016 in accordance with the Annual Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the financial year ended 31 December 2016.

There were no reductions of remuneration awarded under the Variable Remuneration Policy within the correction connected with the results.

IX. Unencumbered assets

Assets are encumbered, when they are pledged or used as collateral or as enhancement of transaction's credit quality and their transferability is restricted. As at 31 December 2016 the Group had encumbered assets due to securities sold under agreements to repurchase, negative valuation of derivative transactions and securities and received credit collateral.

Table 19: Encumbered & unencumbered assets are presented in table below:

	Carrying amount of encumbered assets in PLN '000	Carrying amount of non-encumbered assets in PLN '000
Loans on demand	0	287 175
Equity instruments	0	32 085
Debt securities, including:	365 745	23 025 612
issued by central government and regional governments	365 745	18 946 775
issued by financial insitutions	0	1 324 775
issued by non-financial corporations	0	514 347
Loans and fees other than loans on demand, including:	374 451	17 361 590
mortgage loans	0	2 063 302
Other assets	0	3 876 657
Total	**740 196**	**44 583 120**

X. Leverage ratio

Information on the leverage ratio at 31 December 2016: summary reconciliation of accounting assets and leverage ratio exposures, the calculation of the leverage ratio and the split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures) are presented in the following tables:

Table 20: Summary reconciliation of accounting assets and leverage ratio exposures

		Applicable Amounts in 000'PLN
1	Total assets as per published financial statements	45 209 916
2	Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	0
3	(Adjustment for fiduciary assets recognised on the balance sheet pursuant to the applicable accounting framework but excluded from the leverage ratio exposure measure in accordance with Article 429(13) of Regulation No. 575/2013 "CRR")	0
4	Adjustments for derivative financial instruments	838 964
5	Adjustments for securities financing transactions "SFTs"	214 447
6	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	4 363 796
6a	(Adjustment for intragroup exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (7) of Regulation No. 575/2013)	0
6b	(Adjustment for exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (14) of Regulation No. 575/2013)	0
7	Other adjustments	-27 964
8	**Total leverage ratio exposure**	**50 599 158**

Table 21: Leverage ratio common disclosure

		CRR leverage ratio exposures in 000'PLN
On-balance sheet exposures (excluding derivatives and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	43 612 316
2	(Asset amounts deducted in determining Tier 1 capital)	-1 322 897
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	42 289 420
Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	443 796
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	1 574 546
5a	Exposure determined under Original Exposure Method	0
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	0
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	0
8	(Exempted CCP leg of client-cleared trade exposures)	0
9	Adjusted effective Notional amount of written credit derivatives	0
10	(Adjusted effective Notional offsets and add-on deductions for written credit derivatives)	0
11	**Total derivative exposures (sum of lines 4 to 10)**	2 018 342
Securities financing transaction exposures		
12	Gross SFT assets (with No. recognition of netting), after adjusting for sales accounting transactions	632 669
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	0
14	Counterparty credit risk exposure for SFT assets	0
14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Article 429b (4) and 222 of Regulation No. 575/2013	0
15	Agent transaction exposures	0
15a	(Exempted CCP leg of client-cleared SFT exposure)	0
16	**Total securities financing transaction exposures (sum of lines 12 to 15a)**	632 669
Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross Notional amount	16 881 951
18	(Adjustments for conversion to credit equivalent amounts)	-12 518 155
19	**Other off-balance sheet exposures (sum of lines 17 to 18)**	4 363 796

Exempted exposures in accordance with CRR Article 429 (7) and (14) (on and off balance sheet)		
19a	(Exemption of intragroup exposures (solo basis) in accordance with Article 429(7) of Regulation No. 575/2013 (on and off balance sheet))	0
19b	(Exposures exempted in accordance with Article 429 (14) of Regulation No. 575/2013 (on and off balance sheet))	0
Capital and total exposures		
20	**Tier 1 capital**	4 796 869
21	**Total leverage ratio exposures (sum of lines 3, 11, 16, 19, 19a and 19b)**	49 304 226
Leverage ratio		
22	**Leverage ratio**	**9,7%**
Choice on transitional arrangements and amount of derecognised fiduciary items		
23	Choice on transitional arrangements for the definition of the capital measure	Transitional
24	Amount of derecognised fiduciary items in accordance with Article 429(11) of Regulation No. 575/2013	0

Table 22: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)

		CRR leverage ratio exposures in 000'PLN
1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	43 818 177
2	Trading book exposures	2 614 272
3	Banking book exposures, of which:	41 203 905
4	Covered bonds	0
5	Exposures treated as sovereigns	19 477 977
6	Exposures to regional governments, MDB, international organisations and PSE No.T treated as sovereigns	69 258
7	Institutions	514 791
8	Secured by mortgages of immovable properties	2 546 723
9	Retail exposures	5 145 220
10	Corporate	9 627 519
11	Exposures in default	158 822
12	Other exposures (e.g. equity, securitisations, and other Non-credit obligation assets)	3 663 595

The Group does not use exemptions specified in Articles 499. 2 and 3 of the CRR when calculating leverage ratio. Leverage ratio is calculated with regard to Tier 1 capital, as well as according to transitional definition of Tier 1 capital. The Group does not exempt amounts from total exposure on the basis of Article 429.11 of the CRR.
The main factor impacting the leverage ratio was decrease in on-balance assets and change in methodology of calculating off-balance exposures added to the denominator of the leverage ratio.

The level of leverage is monitored periodically. Information about the current ratio is regularly, on a quarterly basis, reported to the Risk and Capital Management Committee of the Bank’s Management Board and to the Risk and Capital Committee of the Supervisory Board.
The Group manages the risk of excessive leverage, among others, by establishing limits, their monitoring and the escalation process.

Signatures of Management Board Members

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