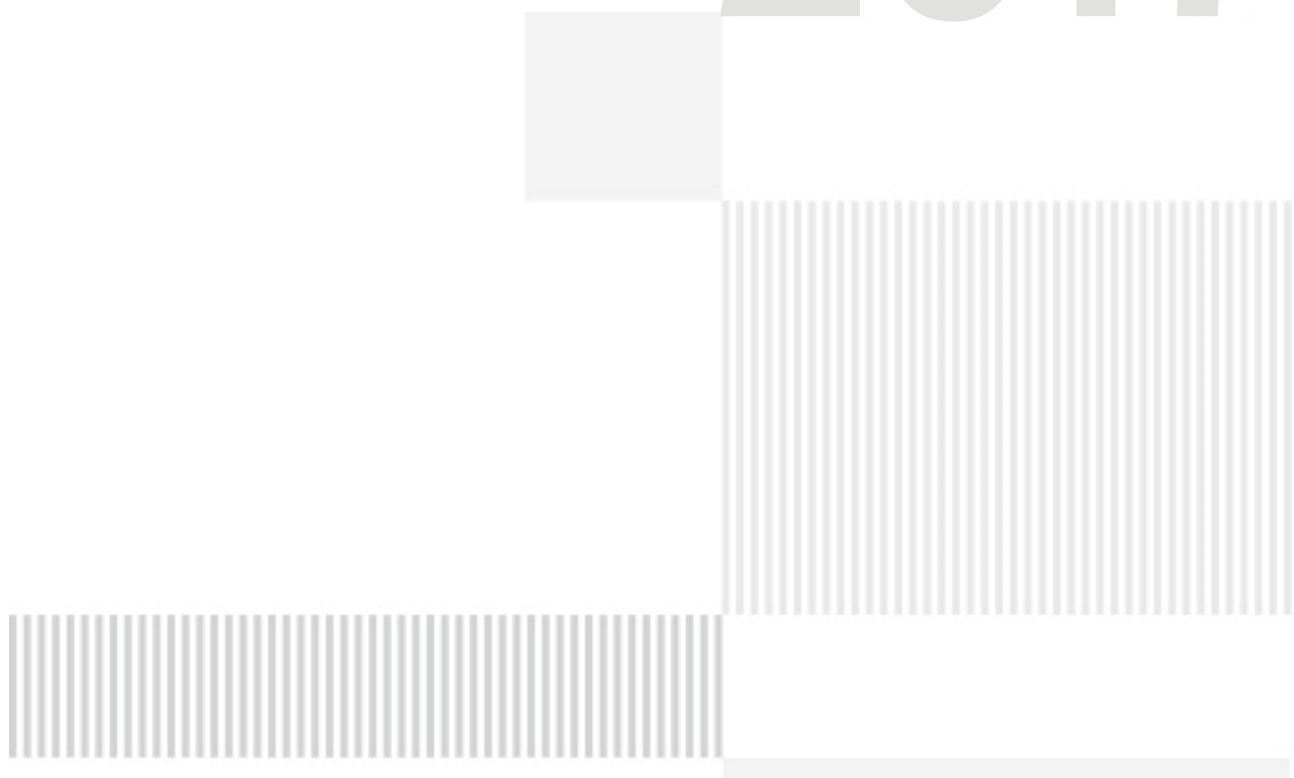


**INFORMATION ON
CAPITAL ADEQUACY
OF BANK ZACHODNI WBK GROUP
as at 31st December 2017**

2017



Bank Zachodni WBK

 Grupa Santander

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Bank Zachodni WBK

 **Grupa Santander**

1. Introduction

This document is issued under the Bank Zachodni WBK Group Disclosure Strategy formulated based on Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 which formed the legal basis of the reporting date i.e. 31 December 2017.

Starting from January 1st, 2014 by the decision of the European Parliament and of the Council the new regulations of the CRD IV/CRR package come into force. The CRD IV/CRR package consist of two parts, the CRD IV Regulation and CRR Directive. The regulation is directly applicable in all EU member states. The Act of 5 August 2015 on macroprudential supervision over the financial system and crisis management in the financial system transposes CRD IV into the Polish law.

Bank Zachodni WBK is the significant subsidiary of Banco Santander S.A. with its seat in Spain, which is the EU parent institution. Bank Zachodni WBK S.A. discloses information about the capital adequacy on a consolidated basis – at the highest local level of prudential consolidation – i.e. based on the data of Bank Zachodni WBK Group.

The purpose of the report is to present information about the capital adequacy of the Bank Zachodni WBK Group pursuant to the requirements laid down in Article 13 of CRR (i.e. disclosure of information laid down in Articles 437, 438, 440, 442, 450, 451 and 453 of CRR).

The data presented in the report were prepared as at 31 December 2017 and include:

- Risk management principles
- Own funds
- Value of Risk Weighted Assets
- Capital buffers
- Information on capital adequacy
- Remuneration policy for those categories of staff whose professional activities have a material impact on its risk profile
- Leverage ratio
- Encumbered assets and unencumbered assets.

Bank Zachodni WBK forms a Group with 14 subsidiaries which are consolidated in accordance with IFRS 10 and associates which are accounted for using the equity method.

The scope of consolidation used by Bank Zachodni WBK Group for the purpose of capital adequacy assessment in accordance with CRR is different than the scope of consolidation adopted for the published consolidated financial statements of the Group made in compliance with IFRS 10. The subsidiary Gieldokracja Sp. z o.o. is excluded from prudential consolidation.

As at 31 December 2017, Bank Zachodni WBK formed a Group with the following **subsidiaries**:

- Santander Consumer Bank S.A. (SCB S.A.)
- Santander Consumer Finanse Sp. z o.o. - a subsidiary of SCB S.A.
- Santander Consumer Multirent Sp. z o.o. – a subsidiary of SCB S.A.
- SC Poland Consumer 2015-1 Sp. z o.o. – a subsidiary of SCB S.A.
- SC Poland Consumer 2016-1 Sp. z o.o. – a subsidiary of SCB S.A.
- PSA Finance Polska Sp. z o.o. – a subsidiary of SCB S.A.
- PSA Consumer Finance Polska Sp. z o.o. – a subsidiary of PSA Finance Polska Sp. z o.o.
- BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A.
- BZ WBK Finanse Sp. z o.o.
- BZ WBK Faktor Sp. z o.o. – a subsidiary of BZ WBK Finanse Sp. z o.o.
- BZ WBK Leasing S.A. – a subsidiary of BZ WBK Finanse Sp. z o.o.
- BZ WBK F24 S.A. – a subsidiary of BZ WBK Finanse Sp. z o.o.
- BZ WBK Inwestycje Sp. z o.o.
- Gieldokracja Sp. z o.o in liquidation.*

Compared with 31 December 2016, the list of entities directly or indirectly controlled by Bank Zachodni WBK, and the structure of connections between them, changed as a result of the following:

* Company excluded from prudential consolidation in accordance with CRR

- Merger of BZ WBK Leasing and BZ WBK Lease

On 28 February 2017, BZ WBK Lease and BZ WBK Leasing were merged through the transfer of the total assets of the former company to the latter one. BZ WBK Leasing, an acquiring company, assumed all rights and obligations of BZ WBK Lease, an acquired company, which was removed from the court register. The objective of the transaction was to streamline the Group's lease business model.

- Liquidation of AKB Marketing Services and its removal from the National Court Register

The Extraordinary General Meeting of AKB Marketing Services held on 28 March 2017 approved the liquidation statements of the company as at 27 March 2017. The funds left after the liquidation of AKB Marketing Services were transferred on 28 March 2017 to an account of Santander Consumer Bank, the sole shareholder.

The liquidation of the company became effective after it had been struck off the National Court Register on 20 November 2017.

- Transformation of BZ WBK F24 (formerly BZ WBK Nieruchomości S.A.)

BZ WBK Nieruchomości was renamed BZ WBK F24 and the scope of its business was expanded to include lending activities. These changes became effective after they had been recorded in the National Court Register on 18 October 2017. The organisational and ownership structure of the company was modified in accordance with business changes. On 24 November 2017, Bank Zachodni WBK made an in-kind contribution of 7,499 shares of BZ WBK F24 to BZ WBK Finanse in exchange for new shares issued by BZ WBK Finanse as part of a share capital increase. On 28 November 2017, BZ WBK Finanse purchased an outstanding share of BZ WBK F24 from the bank in order to have full control over the company. The ownership changes were recorded in the National Court Register on 12 January 2018.

Approval of the liquidation of Gieldokracja by the company's Extraordinary General Meeting on 29 November 2017, which will become effective once it is recorded in the National Court Register.

In the consolidated financial statements of Bank Zachodni WBK for the 12 months ended 31 December 2017, the following companies are accounted for using the equity method in accordance with IAS 28:

- BZ WBK-Aviva Towarzystwo Ubezpieczeń Ogólnych S.A. (BZ WBK-Aviva TUO)
- BZ WBK-Aviva Towarzystwo Ubezpieczeń na Życie S.A. (BZ WBK-Aviva TUnŻ)
- POLFUND - Fundusz Poręczeń Kredytowych S.A.

Compared with 31 December 2016, the list of associates did not change.

Detailed information on the structure of Bank Zachodni WBK SA are presented in the Consolidated Financial Statements of Bank Zachodni WBK Group for the 2017 year.

On 14 December 2017, Bank Zachodni WBK and Banco Santander signed a transaction agreement with Deutsche Bank AG (DB AG) to purchase a part of Deutsche Bank Polska (DBPL) business, consisting of retail banking, private banking, SME banking and DB Securities. DBPL's corporate and investment banking business and foreign-currency mortgage portfolio are excluded from the transaction and will remain in DBPL (retained business).

On the same day, the bank signed a pre-demerger agreement with DBPL and DB AG setting out the terms of cooperation between the bank and DBPL to finalise the transaction.

Pursuant to the transaction agreement, DBPL's branch network and external sales channels (agents and intermediaries) are to be integrated with the bank's structures. Asset management contracts will also be transferred along with the carve-out, which will enable the transfer of open-ended investment funds.

The preliminary purchase price is PLN 1,289,799,000 and has been calculated on the basis of a capital requirement for carved-out risk weighted assets (excluding DB Securities' shares), determined using financial projections as at the date close to the execution of the transaction agreement. The portion of the preliminary purchase price related to the value of DB Securities' shares has been calculated on the basis of the company's net asset value.

The consideration for the transaction will be paid in:

- cash, through the payment of a price for the purchased shares (20% of the preliminary purchase price);

- newly issued shares of the bank representing approx. 2.7% of the bank's share capital (80% of the preliminary purchase price).

An estimated increase in risk weighted assets on account of the acquisition of a carve-out of DB Polska is PLN 14.5bn at the date of the agreement, which represents 12% of total risk weighted assets of BZ WBK Group amounting to PLN 119bn as at 31 December 2017.

Events after the balance sheet date

- International Financial Reporting Standard (IFRS) 9

On 24 July 2014, the International Accounting Standards Board published a new International Financial Reporting Standard (IFRS) 9, which was approved by virtue of Commission Regulation (EU) 2016/2067 of 22 November 2016 for application in the EU member states. The standard applies to financial statements for annual reporting periods beginning on or after 1 January 2018, except for insurers which may apply the standard starting from 1 January 2021. IFRS 9 supersedes IAS 39 Financial Instruments: Recognition and Measurement. However, it allows reporting entities an option to continue to use the hedge accounting provisions stipulated in IAS 39.

On 12 December 2017, the European Parliament and the Council adopted Regulation No 2017/2395 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any member state. This Regulation entered into force on the next day following its publication in the Official Journal of the European Union and has been applicable since 1 January 2018.

As a result of the adjustment of the regulatory capital requirements calculation, which include transitional arrangements for mitigating the impact of the introduction of IFRS 9 referred in the Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017, the Tier 1 capital ratio and total capital ratio on BZ WBK Group level decreased by 2 bps.

This estimation relates to the level of capital ratios as at 31 December 2017 and takes into account an amortisation rate of 0.95 applicable since 1 January 2018.



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Bank Zachodni WBK

 Grupa Santander

2. Risk Management

Bank Zachodni WBK Capital Group is exposed to a variety of risks in its ordinary business activities. The role of risk management is to ensure that BZ WBK Group continues to take risk in a controlled way in order to enhance shareholder value. Risk is a possibility that some events would materialise, which would impact the achievement of the BZ WBK Group's strategic goals.

Risk management policies are designed to identify and measure those risks, define the most profitable return within the accepted risk level (risk-reward), and to continually set appropriate risk limits, which restrict the risk exposure. BZ WBK Group continues to modify and enhance its risk management practices to reflect changes in Group's risk profile, economic environment, regulatory requirements and evolving best practice.

Management Board and Supervisory Board set the business direction and actively support the risk management strategies. This is achieved by approving the key risk management policies, participation of the Management Board Members in the risk management committees, reviewing and signing off on the key risks and risk reports.

Detailed principles, roles and responsibilities of the BZ WBK Group have been described in relevant internal policies on the management of the particular risks.

BZ WBK Group pays special attention to the consistency of risk management processes across the Group, which allows for adequate control of the risk exposure. The subsidiaries implement risk management policies and procedures reflecting the principles adopted by the BZ WBK Group.

Acting under the applicable law, the Bank exercises oversight over risk management in Santander Consumer Bank (SCB) in line with the same oversight rules as applied to other Bank Zachodni WBK Group companies. Bank Zachodni WBK Management Board Members in charge of the Risk Management Division and Retail Banking Division (respectively) sit on the Supervisory Board of SCB. Pursuant to the "BZ WBK strategy of investments in capital market instruments", they are responsible for supervision over SCB and they ensure, together with the SCB Supervisory Board, that the company operates in line with adopted plans and operational security procedures. The Bank monitors the profile and level of SCB risk via BZ WBK risk management committees.

Details about managing different risk types, the structure of corporate governance and roles of selected units in risk management oversight are presented in **Note 4** of the Consolidated Financial Statements of Bank Zachodni WBK Group for 2017.

2.1. Credit risk

BZ WBK Group's credit activities focus on growing a high quality loan book with a good quality, a good yield and customer satisfaction.

Credit activity includes all products subject to credit risk (credit facilities), originated by the Bank or its leasing and factoring subsidiaries.

Credit risk is defined as the possibility of suffering a loss as a result that a borrower will fail to meet its credit obligation, including interest and fees. Credit risk arises from the impairment of credit assets and contingent liabilities, resulting from worsening of the borrower's credit quality. Credit risk measurement is based on the estimation of credit risk weighted assets, with the relevant risk weights representing both the probability of default and the potential loss given default of the borrower.

Credit risk in BZ WBK Group arises mainly from lending activities on the retail, corporate and interbank markets. This risk is managed as part of the policy approved by the Management Board on the basis of the adopted credit procedures as well as on the basis of discretionary limits allocated to individual credit officers based on their knowledge and experience. The Group's internal system of credit grading and monitoring allows for an early identification of likely defaults that might impair the loan book. Additionally the Group uses large set of credit risk mitigation tools, both collaterals (financial and non-financial) and specific credit provisions and clauses (covenants).

The Group continues to develop and implement risk based methods of grading loans, allocating capital and measuring returns. Risk valuation models are used for all credit portfolios.

The Group also continues to review processes and procedures of managing and monitoring of credit portfolio risk adjusting them to the revised regulatory requirements, especially to Recommendations of KNF.

The Group is closely looking at the macroeconomic environment and analysing its credit exposure to particular customer segments and economic sectors to respond with an adequate and prompt action and adjust its credit policy parameters accordingly. The year 2017 in this respect was fairly stable and the introduced changes only modified Group's policy.

One of the Group's priorities in 2017 was close monitoring of foreign currency housing loan portfolio. In response to the numerous legislative proposals the Group conducted multivariate analyzes and actively participated in the consultation processes. The Group pays particular attention to credit risk on these portfolios.

Risk Management Forum

The credit risk oversight in BZ WBK Group is performed by Credit Policy Panel (CPP) operating within the Risk Management Forum. Its key responsibilities include development and approval of the best sectoral practice, industry analyses, credit policies as well as implementation of grading and assessment systems aimed at ensuring sustainable growth of the credit portfolio. To align the Group's management processes with the current strategic goals, three sub-committees were established within the CPP with a responsibility for the key customer segments: retail segment, SME segment and the business/corporate segment. The oversight over the credit risk models is the responsibility of the Models and Methodology Panel.

Risk Management Division

The Risk Management Division is responsible for a consolidated credit risk management process, including management and supervision of credit delivery, defining credit policies, providing decision-making tools and credit risk measurement tools, quality assurance of the credit portfolio and provision of reliable management information on the credit portfolio.

Credit Policies

Credit policies refer to particular business segments, loan portfolios and banking products. They contain guidelines for the identification of the areas where specific types of risks manifest themselves, specifying the methods of their measurement and mitigation to the level acceptable to the bank (e.g. "Loan-to-Value" ratios, FX risk in the case of foreign currency loans).

The Group reviews and updates its credit policies on a regular basis, aiming to bring them in line with the Group's strategy, current macroeconomic situation, legal developments and changes in regulatory requirements.

Credit Decision Making Process

The credit decision-making process as a part of the risk management policy is based upon Individual Credit Discretions vested in credit officers, commensurate with their knowledge and experience within the business segments. Credit exposures in excess of PLN 25m are referred to the Credit Committee composed of senior management and top executives. Transactions above PLN 187.5m are additionally ratified by Risk Management Sub-Committee.

The BZ WBK Group continually strives to ensure best quality credit service while satisfying the borrowers' expectations and ensuring security of the credit portfolio. To this end, the credit risk approval function has been segregated from the sales function.

Credit Grading

Intensive work has been undertaken to further develop credit risk assessment tools to conform to the recommendations of the Polish Financial Supervision Authority, the International Accounting Standards/International Financial Reporting Standards and the best practice in the market.

The BZ WBK Group uses credit risk grading models for its key credit portfolios, including corporate customers, SMEs, home loans, property loan, cash loans, credit cards and personal overdrafts.

The Group regularly monitors its credit grading using the rules specified in its Lending Manuals. Additionally, for selected models, automated process of credit grade verification is carried out based on the number of overdue days or an analysis of the customer's behavioural data. Credit grade is also verified at subsequent credit assessments.

Credit Reviews

The Group performs regular reviews to determine the actual quality of the credit portfolio, confirm that adequate credit grading and provisioning processes are in place, verify compliance with the procedures and credit decisions and to objectively assess

professionalism in credit management. The reviews are performed by the two specialised units: Credit Review Department and the Control & Quality Assessment Department, which are independent of the risk-taking units.

Collateral

In the Group's security model, the Collateral and Credit Agreements Department is the central unit responsible for creation and maintenance of securities. The Security Manual as a procedure describing legal standards for the application of collateral security is managed by the Legal and Compliance Division. The Collateral and Credit Agreements Department is the owner of the security contract templates.

The role of the department is to ensure that security covers are duly established and held effective in line with the lending policy for all business segments. The unit is also responsible for developing standardised internal procedures with respect to perfecting and maintaining validity of collateral as well as ensuring that establishment, monitoring and release of security covers is duly effected.

Furthermore, the Collateral and Credit Agreements Department provides assistance to credit units in credit decision making and development of credit policies with respect to collateral. The unit gathers data on collateral and ensures appropriate management information.

The tables below show types of collateral that can be used to secure loans and advances to customers from non-banking sector.

Retail customers

Type of loan/receivables	Type of collateral
Cash loan	bills, guarantees, credit insurance
Credit on liquid assets	guaranty deposit, amounts frozen on account, investment funds
Student loan	sureties
Housing loan	mortgage, credit insurance, transfer of claim
Leasing	bills, guarantees, transfer of rights to bank's account; court registered pledge on movables; transfer of ownership, open mortgage, obligation of the leased asset supplier to buy the asset back (buy-back guarantee)

Business customers

Type of loan/receivables	Type of collateral
Commercial credit	guaranty deposit, registered pledge, bills
Revolving credit	assignment of credit, bills, guarantees, registered pledge
Building credit	mortgage
Investment credit	mortgage, sureties, warranty
Granted and with supplements	guarantees, warranty
Leasing	bills, guarantees, transfer of rights to bank's account; court registered pledge on movables; transfer of ownership, open mortgage, obligation of the leased asset supplier to buy the asset back (buy-back guarantee)

Collateral management process

Before a credit decision is approved, in the situations provided for in internal regulations, the Collateral and Credit Agreements Department assesses the collateral quality, a process that includes:

- verification of the security valuation prepared by external valuers, and assessment of the security value,
- assessment of the legal status of the security,
- assessment of the investment process for the properties,
- seeking legal advises on the proposed securities.

The Collateral and Credit Agreements Department actively participates in credit processes, executing tasks including:

- providing draft credit documentation in the SME and corporate segments,
- verification and assessment of the signed credit documentation, and checking compliance with formal and legal conditions for loan disbursement in the corporate segment;
- verification of the data in information systems,
- collateral monitoring and reporting,
- releasing of the security.

In managing its receivables, BZ WBK Group carries out the process of collateral execution. Selection of proper action towards execution of specific collateral depends on the type of the collateral (personal or tangible). In principle the Group aims at voluntary proceedings in the course of collateral execution. When there is no evidence of cooperation with a collateral provider, the Group's rights are fulfilled in compliance with the law and internal regulations in the bankruptcy and enforcement proceedings.

Financial effect of the collateral

The financial effect of the collateral accepted was calculated as a change in the credit loss allowance as a result of exclusion of the cash flow from collateral (non-performing exposures are assessed on a case-by-case basis). For mortgage, SME and corporate loans, this effect was calculated by adjusting the LGD parameter from the provisions model.

Credit risk stress testing

Stress testing is a part of the credit risk management process used to evaluate potential effects of specific events or movement of a set of financial and macroeconomic variables or change in risk profile on BZ WBK Group's condition. Stress tests are composed of assessment of potential changes in credit portfolio quality when faced with adverse conditions. The process also delivers management information about adequacy of agreed limit and internal capital allocation.

Calculation of Impairment

In BZ WBK Group, charges updating impairment are recognised in accordance with the International Accounting Standards (IAS 39). The charges reflect credit impairment, which is recognised if the Group presents objective evidence that such amounts cannot be recovered in line with the signed loan, lease or factoring agreement. Objective evidences of impairment were defined in accordance with recommendation of Basel Committee, with the International Accounting Standards (IAS 39) and Recommendation R.

The impairment is calculated on the basis of the estimated recoverable amount. Impairments are analysed using both the individual (for individually significant exposures with objectively evidenced impairment) and collective approach (individually insignificant exposures with objectively evidenced impairment, and exposures of incurred but not reported losses).

Twice a year, the Group compares the assumptions and parameters used for loss calculations with the actual situation. The comparison includes changes of economic conditions, amendments to Group's credit policies and recovery process. The process provides assurance that impairments are recognized correctly. The responsibility for adequate level of charges rests with the Provisions Committee.

Details about impairment charges are presented in **Note 4** of the Consolidated Financial Statements of Bank Zachodni WBK Group for 2017.

Industry concentration

The credit policy of Bank Zachodni WBK Group assumes diversification of credit exposures. Risk of particular industry affects value of the exposure limit. In order to ensure adequate portfolio diversification and control the risk of overexposure to a single industry, the Group provides funding to sectors and groups or capital units representing a variety of industries.

As at 31.12.2017, the highest concentration level was recorded in the "distribution" sector (13% of the BZ WBK Group exposure), "manufacturing" (10%) and "property" (7%).

Forbearance Policy

Pursuant to the definition set out in the draft Implementing Technical Standards of the European Banking Authority, a forbearance measure (i.e. customer debt restructuring) consists of a concession towards a debtor facing financial difficulties or prospect difficulties which threaten the repayment of debt towards BZ WBK Group on the existing contractual terms. The concession may involve a modification of the previous terms and conditions of a debt contract or its total or partial refinancing. The purpose of debt restructuring is to better align repayment terms with the current and projected financial standing of the customer, minimise default risk and/or maximise recovery.

Restructuring does not refer to a technical or operational modification of contractual terms, or changes attributable to other factors than payment difficulties (business or market conditions).

The decision on granting a concession towards a customer with insufficient debt service ability is based on an analysis of its financial standing, assessment of repayment capacity under the new terms, analysis of existing collateral, assessment of the willingness to repay and the relationship history. The concessions depend on the results of the assessment and may involve in particular: moratorium on payments, modification of repayment schedule (reduced payments), interest capitalisation, extension of maturity etc. Such solutions may be applied to both personal and business customers.

Each concession (debt restructuring) is adequately reflected in the systems to allow for identification of debt portfolio under restructuring. Debt/customer is classified as under restructuring throughout the restructuring period, i.e. until the Bank establishes that the customer circumstances are sustainable, restructuring conditions have been met, there are no overdue payments above 30 days and the customer has a satisfactory repayment capacity. In accordance with a prudent approach, customers are reported as “subject to restructuring” for the minimum period of two years.

There are specialised units at the bank whose objective is to ensure a better quality of the credit portfolio through early restructuring and facilitation of debt repayment by customers. The effectiveness of actions taken by the above units and the portfolio subject to restructuring are regularly monitored by relevant Committees.

Accounting principles applicable to financial assets subject to forbearance are the same as in the case of other performing or non-performing assets in the Bank, that is loans and receivables are measured at amortised cost using the effective interest method. If the terms of a loan, receivable or held-to-maturity investment are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, the exposure is measured using the original effective interest rate before the modification of terms (in accordance with IAS 39 AG 84).

Mortgage loans – currency analysis

Mortgage portfolio of Bank Zachodni consist credit exposures denominated both in PLN and foreign currencies. From the perspective of exposure to currency risk the most important category of retail FX loans are loans denominated in CHF.

Risk profile of CHF-indexed/denominated loans

CHF gross mortgage loans as at 31.12.2017	Gross amount	Impairment losses	Coverage ratio
Performing loans	10 595 020	51 774	0,49%
Non-performing loans	176 839	77 549	43,85%
Total	10 771 859	129 323	

CHF gross mortgage loans as at 31.12.2016	Gross amount	Impairment losses	Coverage ratio
Performing loans	13 273 975	84 051	0,63%
Non-performing loans	184 191	87 338	47,42%
Total	13 458 166	171 389	

Leasing and factoring

Bank Zachodni WBK Group has **leasing operations** that specialise in leasing machines, computer hardware and office equipment for business customers. The Group's leasing companies also finance vehicles for both business and retail customers. The Group's **factoring operations** are conducted by BZ WBK Faktor Sp. z o.o. Factoring is a short-term finance for the companies that provide trade credit (i.e. supply goods or services on extended payment terms) to their counterparties.

Details about credit risk are presented in **Note 4** of the Consolidated Financial Statements of Bank Zachodni WBK Group for 2017.

2.2. Market risk

Market risk is defined as an adverse earnings impact of changes in interest rates, FX rates, share quotations, stock exchange indices, etc. It arises in trading activity as well as in the ordinary course of transacting business (exchange rate products, interest rate products, equity linked trackers).

BZ WBK Group is exposed to market risk arising from its activity on money and capital markets and services provided to customers. Additionally the Group undertakes the market risk related to the active management of balance sheet structure (assets and liabilities management).

The activity and strategies on market risk management are directly supervised by the Risk Management Forum.

General principles of market risk management

The key objective of the market risk policy pursued by the Group is to reduce the impact of interest and FX rate changes on the Group's profitability and market value as well as to grow income within the strictly defined risk limits while ensuring the Group's liquidity.

BZ WBK Group's market risk policies establish a number of measurement and risk limitation parameters in the form of limits, mandatory and monitoring ratios. Risk limits are periodically reviewed to align them with the Group's strategy and the current objectives of the Group.

Interest rate and FX risks linked to the banking business is managed centrally by the Financial Management Division. The Division is also responsible for acquiring funding, managing liquidity and making transactions on behalf of ALCO. This activity is controlled by the measures and limits approved from time to time by the Risk Management Forum, the bank's Management Board and the Supervisory Board.

The debt securities and the interest rate derivatives portfolio is managed by ALCO, which takes all decisions on the portfolio's value and structure.

The market risk on the trading portfolio is managed by the Global Corporate Banking Division, which is also responsible for the activities of the Brokerage Services Office. The Group's trading activity is subject to a system of measures and limits, including Value at Risk, stop loss, position limits and sensitivity limits. This limits are approved by the Risk Management Forum, the bank's Management Board and the Supervisory Board.

The Financial Risk Department within the Risk Management Division is responsible for ongoing assessment of the current risk, implementation of control procedures and risk monitoring and reporting. The Department is also responsible for shaping the market risk policy, proposing risk assessment methodologies and ensuring consistency of the risk management process across the Group. Owing to the fact that the Department is a part of the Risk Management Division, the risk assessment and monitoring processes are separate from the risk-taking units.

The market risk of equity instruments held by Brokerage Office (shares, index-linked securities) is managed by the Brokerage Office itself and supervised by BZ WBK Risk Management Forum.

Assessment methods

BZ WBK Group uses several methods to assess its market risk exposure. The methods employed for the banking portfolio are the MVE and Nil sensitivity measures, while the methods used for the trading portfolio include: Value at Risk (VaR), stop loss, sensitivity measures (PV01) and stress tests. The risk assessment methodology is subject to an independent initial and periodic validation, the results of which are presented for approval to the Models and Methodology Panel (part of the Risk Management Forum).

VaR in the trading portfolio is determined by means of a statistical modelling process as a difference between the mark-to-market value of positions and the market values based on the most severe movements in market rates from a determined observation window. VaR is calculated separately for interest rate risk, FX risk and the repricing risk of the equity instruments portfolio of Brokerage Office.

Due to the limitations of the VaR methodology, the Group augments it by stress tests and by sensitivity measurement that shows how position value changes in reaction to price/profitability movements.

VaR in the banking portfolio is calculated separately as a combined effect of EaR (Earnings-at-Risk) and EVE VaR (value at risk of the economic value of equity).

Interest rate risk in the banking book

The interest rate risk in the banking book is the risk of adverse impact of interest rate changes on the Group's income and the value of its assets and liabilities. The main source of interest rate risk are transactions entered in the bank's branches and in the business and corporate centres, as well as the transactions made in the money market by the Financial Management Division. Additionally, interest rate

risk can be generated by transactions concluded by other units, e.g. through acquisition of municipal/commercial bonds, or the bank's borrowings from the interbank market. However, all positions that generate a repricing risk are transferred for management to the Financial Management Division, responsible for shaping the balance sheet structure of the Bank by entering into transactions in the interbank markets so as to manage the overall interest rate risk profile according to the approved risk strategy and in compliance with the allocated risk limits.

The bank's subsidiaries also mitigate their exposure to the interest rate risk. If there is a mismatch between the repricing of assets and liabilities, the company enters into appropriate transactions via the standard bank accounts held with the Bank or makes derivative transactions with the bank, which from the transaction date manages the risk as part of the global limit of BZ WBK Group.

The interest rate risk in the banking book is managed based on the following limits:

- NII sensitivity limit (i.e. sensitivity of the net interest income to a parallel shift of the yield curve by 100 bp);
- MVE sensitivity limit (i.e. sensitivity of the market value of equity to a parallel shift of the yield curve by 100 bp).

In 2017, the global NII and MVE limits for the banking book were not exceeded.

Interest rate risk in the trading book

The trading book contains securities and derivatives held by the Global Corporate Banking Division for trading purposes. The instruments are marked to market each day, and any changes in their value are reflected in the profit and loss.

The key methods of measurement of the interest rate risk in the banking books include the VaR methodology, stop loss, PV01 sensitivity measurement and stress tests.

The VaR is calculated for the open positions of the Global Corporate Banking by establishing the difference between the market valuation of the interest rate transactions based on the current yield curves, and the valuation based on the "worst case" yield curve, which is calculated based on the fluctuations in the interest rates.

The "stop-loss" mechanism is used for managing the risk of losses on the items covered by the rules of fair valuation through profit and loss.

Stress tests are used in addition to these measures by providing an estimate of the potential losses in the event of materialisation of the stressed conditions in the market. The assumptions of stress scenarios are based on sensitivity reports and on extreme market rate movement scenarios set using the highest daily and monthly changes in interest rates.

In 2017, the VaR limit for the interest rate risk has not been exceeded.

FX risk

FX risk is the risk that adverse movements in foreign exchange rates will have an impact on results (and result in losses). This risk is managed by the VaR limit for the open currency positions in the Group's trading portfolio and by Brokerage Office which has been granted an FX VaR limit, used for managing the open positions linked to the market maker activity. Stress tests are used in addition to this measure by providing an estimate of the potential losses in the event of materialisation of the stressed conditions in the market. Stress tests use the currency exposure and the scenarios of extreme movements in currency rates based on historical data. Furthermore, the stop loss mechanism is used for managing the risk of losses on the trading positions.

In accordance with its policy, the Group does not maintain open positions on currency options. Transactions made with clients are immediately closed in the wholesale market thus limiting the bank's exposure to the market risk on the currency options portfolio.

Open positions of subsidiaries are negligible and are not included in the daily risk assessment.

In 2017, the VAR limit for the FX risk has not been exceeded.

FX Balance Sheet

In 2017, the share of assets in foreign currencies in the bank's balance sheet decreased further compared to the level observed in previous periods. A slight decrease fall in amounts receivable in EUR and in amounts receivable in CHF were observed as a result of continued amortisation of mortgage loans. A decrease in amounts due from customers in EUR and a decrease in amounts due from customers in CHF were observed as a result of the continuing amortisation of the mortgage loan portfolio.

The above decrease, together with the increase in financing in the form of a subordinated loan, significantly reduced the gap between EUR assets and liabilities.

The resulting funding gap was closed by entering into a swap transaction in the FX market.

Equity investment risk

The unit responsible for equity (listed on active markets) price risk management is Brokerage Office which now operates within the Financial Markets Area. The source of this risk are transactions conducted on Brokerage Office own account via stock exchanges and MS CTO (shares, futures).

This risk is measured using a Value at Risk model based on the historical method.

The market risk management in Brokerage Office is supervised by BZ WBK Risk Management Forum. The Forum sets the VaR limit for the Brokerage Office, approves changes in the risk measurement methodology and oversees the risk management process.

In 2017, the VaR limit for equity risk was not exceeded.

Details about market risk are presented in **Note 4** of the Consolidated Financial Statements of Bank Zachodni WBK Group for 2017.

2.3. Liquidity risk

Liquidity risk is the risk that the bank fails to meet its contingent and non-contingent obligations towards customers and counterparties as a result of a mismatch of financial cash flows.

Liquidity Risk Management

The BZ WBK Group Liquidity Risk Policy is designed to:

- ensure the ability to finance assets and satisfy claims, both current and future, in a timely manner and at an economic price;
- manage the maturity mismatch between assets and liabilities;
- set a scale of the liquidity risk in the form of various internal limits;
- ensure proper organization of the liquidity management process within the Group;
- prepare the organization for emergence of adverse factors, either external or internal;
- ensure compliance with regulatory requirements, both qualitative and quantitative.

The general principle adopted by the Group in its liquidity management process is that all expected outflows occurring within 1 month in respect of deposits, current funds, loan drawdowns, guarantee payments and transaction settlements should be at least fully covered by the anticipated inflows or available High Quality Liquid Assets (HQLA) assuming normal or predictable conditions for the bank's operations. The QLA category includes: cash on hand, cash deposited with NBP (National Bank of Poland), securities which may be sold or pledged under repo transactions or NBP lombard loans. As at 31 December 2017, the value of easy resalable assets buffer amounted to PLN 27,8 b.

The purpose of the policy is also to ensure an adequate structure of funding the growing scale of Bank Zachodni WBK's business by maintaining structural liquidity ratios at pre-defined levels.

The Bank uses a suite of additional watch limits and indicators with respect to the following:

- loan-to-deposit ratio;
- structural funding ratio, which measures the amount of long-term funding relative to non-liquid assets;
- ratios of reliance on wholesale funding, which are used to assess the concentration of foreign currency funding from the wholesale market;
- concentration of deposit funding;
- regulatory liquidity ratios calculated in accordance with KNF Resolution no. 386/2008;
- ratios laid down in CRD IV/CRR - LCR and NSFR;
- survival horizon under stressed conditions.

As at 31 December 2017, LCR ratio for the Group was at 169% and as at 31 December 2016 - 176%.

The internal liquidity limits, including the limits established in the Risk Appetite Statement, are set on the basis of both historical values of the selected liquidity ratios as well as their future values which are estimated against a financial plan. The limits also take into account the results of stress tests.

Management Process

The responsibility for supervision over the liquidity risk management process rests on the Assets and Liabilities Committee (ALCO), which also provides advice to the Management Board. ALCO prepares management strategies and recommends to the Management Board appropriate actions with regard to strategic liquidity management, including strategies of Bank's activity's financing.

Day-to-day management of liquidity is delegated to the Financial Management Division. The Assets and Liabilities Management Department, which is a part of the Division, is responsible for developing and updating the relevant liquidity management strategies.

The Group has a scenario-based contingency plan approved by the Management and Supervisory Board to cater for unexpected liquidity problems, whether caused by external or internal factors. The plan also contains stress test with system and idiosyncratic scenarios. ALCO supervises liquidity risk management process in subsidiaries.

Risk Measurement and Reporting

The responsibility for assessment and reporting of the liquidity risk rests on the Risk Management Division, specifically the Financial Risk Department. The role of the Department is to draft liquidity management policies, carry out stress tests and to measure and report on risk. Liquidity is measured by means of the modified liquidity gap, which is designed separately for the PLN and currency positions. The reported contract positions are subject to modifications based on: statistical analyses of the deposit and credit base behaviour, evaluation of the possibility to liquidate State Treasury securities by selling or pledging them in repo transactions or using liquidity supporting instruments in NBP, evaluation of transaction rolling in the interbank market.

When measuring liquidity risk, the bank additionally analyses the degree of liquidity outflows arising from potential margin calls due to changes in the value of derivatives transactions and collateral needs related to secured financing transactions resulting from the downgrade of the bank's credit rating, among other things.

Concurrently, liquidity was measured in accordance with binding at 31 December 2017 -KNF Resolution no. 386/2008 on setting liquidity standards for banks, and with the requirements laid down in CRD IV / CRR package together with related implementing acts.

The results of liquidity risk measurement are reported on a daily basis to persons in charge of operational management of the bank's liquidity and to persons responsible for liquidity risk management (information about intraday and current liquidity, including FX funding ratios and LCR) and - on a monthly basis - to senior executives (other liquidity ratios, including regulatory ratios).

In 2017 and in the comparable period, all key supervisory measures applicable to the Group were maintained at the required levels.

Details about liquidity risk are presented in **Note 4** of the Consolidated Financial Statements of Bank Zachodni WBK Group for 2017.

2.4. Operational risk

Bank Zachodni WBK Group adopted the operational risk definition of the Basel Committee on Banking Supervision, which says that **operational risk** is the risk of a loss resulting from inadequate or failed internal processes, people and systems or from external events[†].

The objective of the **operational risk management** is to minimize the likelihood and/or reduce the impact of unexpected and adverse events.

Bank Zachodni WBK Group has implemented an integrated risk management framework to ensure that all risks which have a significant impact on Bank Zachodni WBK business are identified, measured, monitored and controlled. Operational risk management in Bank Zachodni WBK Group involves employees at all levels of the organization and consists of a number of interrelated components.

[†] This definition includes legal risk but excludes strategic and reputation Risk.

Operational risk is inherent in all the Group's business processes, including the outsourced functions or services delivered in cooperation with third parties.

Bank Zachodni WBK Group has defined the **Operational Risk Management Strategy**. In addition, detailed politics, procedures and guidelines are used to define how risks are identified, estimated, monitored and mitigated.

The **Operational Risk Management Committee (ORMCo)** established by the Management Board is responsible for setting operational risk management standards for Bank Zachodni WBK Capital Group. ORMCo is the main forum for discussions on operational risk. It sets out the strategic direction for operational risk management, determines and monitors objectives for managing operational risk, including business continuity, information security, outsourcing / insourcing and crime preventing in all business areas of Bank Zachodni WBK. Within ORMCo, there are two Forums working, which are dedicated to specific aspects of Operational Risk – Fraud Prevention Forum and Insurance Forum. The ORMCo working results are passed on to the Risk Control Committee.

Taking into account the increasing influence of cyber risk the Committee of Cyber Risk was appointed. The committee is the forum of direct cooperation and communication of all business units which are involved into the cyber security processes. The committee is supervising the performance of cyber security strategy in Bank Zachodni WBK S.A.

Bank Zachodni WBK Group uses the following **tools** in operational risk management:

- Identification and assessment of operational risk

The basic tool to identify and assess operational risk is self-assessment. In the self-assessment process, Bank Zachodni WBK Group identifies the risks it may be exposed to when delivering its functions, assesses inherent and residual risks in terms of their likelihood and impact, and evaluates the construction and the control environment functioning.

Moreover, in the area of technological risk a special self-assessment is conducted which aims to ensure that for every technology risk process BZ WBK is able to identify and assess the level of vulnerability on every of related risks (including cybernetic risks) by frequency and loss due to non-performance obligation and is able to identify and assess the level of protections basing on implemented controls mechanism.

Additionally, the operational risk identification and assessment process is supported by other tools, e.g. scenario analysis, business impact analysis (BIA), risk analysis in new initiatives.

- Reporting

Each organizational unit is required to report operational incidents identified in its area of activity. A quick communication path to higher management is prepared for key operational incidents. The Bank and the Group runs a database of operational incidents identified across the whole organization. The collected data is used to analyze the root causes and consequences of the incidents, define lessons to be learned and take preventive and corrective measures.

Operational incidents in Bank Zachodni WBK Group in 2017
gross losses (PLN k)[‡]

Operational event class			
Event types	Event category	PLN k	%
1 Internal fraud	1.1. Unauthorised activity	0	0,01%
	1.2. Theft and fraud	0	0,00%
2 External fraud	2.1. Theft and fraud	6 277	12,42%
	2.2. Security of systems	1 273	2,52%
3 Occupational safety and health, employment practices	3.1. Labour relations	0	0,00%
	3.2 Safety and health in the workplace	0	0,00%
	3.3. Diversity and discrimination	0	0,00%
4 Customers, products and operating practices	4.1. Adaptation, disclosure of information and trust	205	0,41%
	4.2. Inappropriate business or market practices	25 014	49,49%
	4.3. Defective products	664	1,31%
	4.4. Selection, Sponsorship and Risks	38	0,08%
	4.5. Advisory Activities	0	0,00%
5 Damage to tangible assets	5.1. Natural disasters and other incidents	4 049	8,01%
6. Business interruption and system errors	6.1. Systems	81	0,16%
	7.1. Reception, execution , execution and maintenance of transactions	1 913	3,78%
	7.2. Monitoring and presentation of reports	44	0,09%
	7.3. Acceptance of customers and documentation	168	0,34%
	7.4. Customer account management	7 335	14,51%
	7.5. Trade counterparties other than the Bank's clients (e.g. clearing chambers)	3 340	6,61%
	7.6. Distributors and suppliers	145	0,29%
7 Execution of transactions, delivery and management of operating processes	7.1. Reception, execution , execution and maintenance of transactions	1 913	3,78%
	7.2. Monitoring and presentation of reports	44	0,09%
	7.3. Acceptance of customers and documentation	168	0,34%
	7.4. Customer account management	7 335	14,51%
	7.5. Trade counterparties other than the Bank's clients (e.g. clearing chambers)	3 340	6,61%
	7.6. Distributors and suppliers	145	0,29%

In 2017 the level of losses in category „Inappropriate Business or Market Practices” (4.2) was affected mainly by legal provisions for customers' claims regarding abusive clauses in exchange rate credit agreements (mainly CHF) with amount of PLN 18.8m. The claims concern mainly credits given between years 2006 and 2008 by Kredyt Bank[§]. The currently existing credit process is basing on the best market practices.

The level of the losses in category “Customer account management” (7.4) was also affected mainly by one customer legal claim. The customer is claiming the settlement for blocking the financial instruments at the security account. The provision was made for the event (PLN 7.3m). It is worth to mention that the valuation of the claim is based on the subjective opinion of probable prices of the prices of financial instruments.

In 2017 the increase of losses in category “Theft and fraud” (2.1) was observed which was the effect of increased number of ATMs burglars by the organized crime group (up PLN 2.3m). Bank took a lot of actions to improve ATMs safety.

The level of the losses in category 5.1 “Natural disasters and other incidents” is affected mainly by car damages which are recovered almost in 90%.

The Group also belongs to the external database of operational incidents conducted by The Polish Bank Association (ZBP) and uses other sources of information concerning the operational incidents. The analysis of the collected data enables to carry out benchmark and define lessons to be learned regarding the incidents materialized out of the Group.

- Risk indicators analysis

The BZ WBK S.A. Capital Group is monitoring the risk indicators. Monitoring is based on financial, operational and technological indicators. The indicators provide early warning of emerging threats and support observation of the risk placed in the Bank and in the Group.

- Mitigating actions defining

The process of mitigating action management is to eliminate or reduce operational risk. The analysis conducted with the help of the operational risk tools (like operation events database, risk indicators, risk self assessment) are the basis to define risk mitigating actions.

[‡] Do not include credit boundary events.

[§] The merger of Bank Zachodni WBK and Kredyt Bank took place on 4th of January 2013.

- **Business continuity management (BCM)**

Each organisation unit is required to develop and update its business continuity management plans to prevent from interrupting the critical business processes in case of unplanned disruption. BCM plans are tested on a regular basis to provide assurance to Bank Zachodni WBK Group that critical business processes are able to be restored at the required service level and within the agreed timeframe. The Bank and the Group has backup solutions to execute critical processes which makes it able to restore activity in case of any crisis takes place.

- **Information security**

Ensuring an adequate level of information security and ICT environment security is the key aspect of Bank's activity. In BZ WBK the Security Information Management System exists, it has the certificate of conformity with the standard ISO/IEC 27001:2013. The Security Information Management contains the supervision of information security cases in business environment of BZ WBK and the assessment of specific requirements of information and IT systems security.

- **Insurance**

For the purpose of operational risk mitigation, BZ WBK S.A. Capital Group has an insurance scheme which covers particular financial risks, motor, property and professional indemnity insurance.

- **Reporting for Risk Management Committee and Supervisory Board**

The aim of operational risk reporting is to provide up-to-date and adequate information to the management. Operational risk reports cover, inter alia: operational risk incidents and losses, information security and business continuity incidents, risk indicators and risk mitigants.

2.5. Compliance risk

As an universal bank providing a wide array of financial services to retail and business customers, a parent company in a capital group providing a number of additional specialised financial services, and as an important member of the Polish banking system, BZ WBK Group is exposed to the compliance risk mainly in the following areas:

- domestic and international regulations concerning the type of offered products and service delivery methods applied by the bank and the BZ WBK Group (in particular: the legislation on consumer and competition protection, capital markets, financial markets etc.);
- good practice codes and other regulations implemented by the Group, including in connection with membership in domestic or international trade associations ;
- generally applicable laws regarding the employment law, health and safety at work, taxes, accounting, personal data protection etc. which are binding for all enterprises operating in Poland;
- domestic and international (mainly: EU) trade regulations in the area of reporting, prudential standards, functioning on capital and investment market, prevention of money laundering and terrorist financing etc.;

Compliance risk is defined as the risk of legal or regulatory sanctions, significant financial loss or negative impact on reputation that the Bank may suffer due to its failure to comply with the law, internal regulations and market standards. Compliance risk consists of the following risk categories.

- regulatory risk,
- conduct risk,
- money laundering and terrorism financing risk,
- reputational risk.

The Bank attaches particular importance to compliance delivered through management and control of compliance risk in the form of controls, independent monitoring and reporting.

The control function is rendered by the so-called three lines of defence. The first line of defence is the operational risk management, the second line consists in on-going vertical verification and vertical testing, while the internal audit units provide the third line of defence.

Compliance duties of the second line of defence in the Bank are rendered by the Compliance Unit (understood as the Compliance Area and the Anti-Money Laundering Department) and other organisational units operating under internal regulations, in particular:

- compliance with employment law – HR Division;

- compliance with company law – Corporate Governance unit;
- compliance with health and safety regulations – the Business Partnership Division;
- compliance with taxation law and reporting requirements – Financial Accounting and Control Division;
- compliance with prudential regulations – Risk Management Division.

In July 2017 The Bank's Management Board adopted an amended policy statement on compliance with legal and regulatory obligations, which was approved by the Supervisory Board.

The policy provides the Compliance Area together with Anti-Money Laundering Department forms Compliance Unit operating within the Legal and Compliance Division, with the relevant mandate to support senior managers in effective management of the compliance risk. The Compliance Area escalates all issues to the Risk Management Committee and Audit and Compliance Committee of the Supervisory Board. Both Committees ensure compliance with regulatory obligations and approve internal control rules and the Policy framework as well as provide necessary resources for the Compliance Unit, so that the Compliance Unit may operate independently from business units and has relevant resources to perform its tasks.

The Audit and Compliance Committee regularly reviews key compliance issues identified by the Compliance Area as well as Anti-Money Laundering Department:

- as part of monitoring of new products;
- as part of compliance monitoring;
- as part of the monitoring of proprietary transactions effected by employees;
- based on the information on regulators' activity;
- as part of the review of upcoming legislative initiatives;
- as part of the review of anti-money laundering initiatives;
- as part of the review of ethical issues;
- as part of the review of customers' complaints.

The Compliance Unit's tasks are delivered through:

- independent identification, assessment and monitoring of compliance risk that the Group is exposed to (with the focus on new products and services, prevention of money laundering and terrorist financing, protection of confidential information, conflicts of interest or private account shares dealing by employees);
- prevention of using the financial system for money laundering and terrorist financing;
- providing advice and reporting to the Risk Management Committee, bank's Management Board and Audit and Compliance Committee on the effectiveness of the processes established to ensure compliance with laws and regulations within its area of responsibility;
- publication of policies and procedures, providing the management and staff with guidance on compliance risk and adequate risk management policies and procedures;
- centralisation of contacts with market regulators (KNF, UOKiK, GIIF, GIODO);
- centralisation of the approval of new products;
- coordination and support for compliance processes regarding the model of sale of investment products and MiFID Directive;
- strengthening of the principles regarding ethical business conduct
- cooperation with compliance units within the Group and with central compliance unit in Santander Group.

Apart from the aforementioned activities, the Compliance Unit actively cooperates with the Communications, Marketing and Quality Management Area in terms of managing of the reputational risk defined as the risk of deterioration of the Bank's and Santander Group's image perceived by the Bank's and Group's customers, shareholders and communities arising from materialisation of other risks, including individual types of compliance risk.

BZ WBK Group also has specialised committees supporting the management of the compliance risk in specific areas. These committees consist of the representatives of key business units and risk management units who are competent and duly authorised to make informed decisions and provide high-quality advice. The Compliance Area together with Anti-Money Laundering Department coordinate and support the work of individual committees which are chaired by the Management Board member in charge of the Legal and Compliance Division. These committees include:

- Compliance Committee;
- Product Marketing and Monitoring Committee;
- Volcker Local Steering Committee;
- Anti-Money Laundering and Terrorism Financing Committee;

- Business Ethics Commission.

In 2017, the Compliance Unit worked on adapting the Bank to the Regulation of the Minister of Development and Finance of 6 March 2017 on the risk management system and the internal control system, remuneration policy and detailed method of internal capital estimation in banks and KNF Recommendation H issued in April 2017.



- 1. Introduction**
- 2. Risk Management**
 - 2.1. Credit risk
 - 2.2. Market risk
 - 2.3. Liquidity risk
 - 2.4. Operational risk
 - 2.5. Compliance risk
- 3. Own funds**
 - 3.1. Tier I capital
 - 3.2. Tier II capital
- 4. Capital requirements**
 - 4.1. Capital requirements for individual risk types
 - 4.2. Exposure structure
 - 4.3. Allocating risk weights to the credit portfolio
- 5. Capital buffers**
- 6. Capital adequacy**
 - 6.1. Capital adequacy management
 - 6.2. Regulatory capital adequacy
 - 6.3. Internal capital adequacy
- 7. Securitisation**
- 8. Policy of variable components of remuneration**
- 9. Leverage ratio**
- 10. Encumbered assets and unencumbered assets**

Bank Zachodni WBK

 Grupa Santander

3. Own funds

The level of own funds of the Bank Zachodni WBK Group is adjusted to the Group's business. Own funds are calculated in accordance with the Banking Law and legislative package of CRDIV/CRR:

According to CRR, own funds of the Group are a sum of:

- Tier I capital
- Tier II capital

Tier I capital consists of:

- Common Equity Tier I capital, which is a sum of items of Common Equity Tier I capital items after adjustments, deductions and inclusions
- Additional Tier I capital

Tier II capital includes items of Tier II capital after deductions.

Common Equity Tier I consists of:

- 1) Share capital, fully paid and registered at its nominal value
- 2) Emission premium
- 3) Supplementary capital
- 4) Profit or loss eligible– pursuant to Art. 26 of CRR, the non-audited profit for the current period or the annual profit may be included in Common Equity Tier I capital, as long as the Bank is granted approval from a relevant authority (KNF in this case). Relevant authority shall issue the approval on conditions that:
 - a) Profits have been verified by institution-independent persons responsible for analysing financial statements of the institution
 - b) The institution has satisfactorily proved that the profit amount has been reduced by all foreseeable encumbrances and dividends
- 5) Accumulated other comprehensive income
- 6) Other reserves
- 7) Funds for general banking risk
- 8) Minority interest recognised in Common Equity Tier I capital – calculated in line with the standards indicated in Art. 84 of CRR
- 9) Adjustment and deductions from Common Equity Tier I items:
 - a) Additional value adjustments due to the requirements of prudent valuation – acc. to Article 34 and 105 of CRR
 - b) Goodwill arising on acquisition
 - c) Other intangible assets
 - d) Surplus of deferred tax assets or liabilities exceeding 10% of Tier I - according to EBA's interpretation re. inclusion of assets and reserves under deferred tax, in line with the answer Q&A 2014_980, the Bank nets deferred tax assets and deferred tax liabilities in order to determine the threshold value necessary to calculate the deductible amount
 - e) Surplus of material exposure in financial sector institutions exceeding 10% of Tier I
 - f) Portion of deferred income tax assets depending on future profitability and arising from temporary differences, as well as direct and indirect holdings in Common Equity Tier I instruments, where the institution has invested a considerable amount of funds, which shall be deducted
 - g) Unrealised gains and losses related to assets or liabilities measured at fair value and recognised in balance sheet – disclosure in interim period in accordance with Article 467 (1) and 468 (1) of CRR
 - h) Defined benefit pension fund assets

Tier II capital includes eligible subordinated loans of the bank and instruments issued by subsidiaries that are given recognition in Tier II Capital.

Reconciliation between balance sheet items used to calculate own funds and regulatory own funds, according to methodology described in Annex I to Commission Implementing Regulation (EU) No 1423/2013 and according to article 437 (1)(a) of CRR, is presented in the table below.

**Differences in own funds items of Bank Zachodni WBK Group
due to different scope of accounting and prudential consolidation as at 31.12.2017
(Disclosure according to Article 2 of Commission Implementing Regulation (EU) No 1423/2013) – in PLN k**

ITEMS OF CONSOLIDATED STATEMENT OF FINANCIAL POSITION USED FOR CALCULATION OF OWN FUNDS	as at 31.12.2017	Adjustments for companies that are not covered by prudential consolidation	filters	Part of year-end profit, not eligible	Issue of series M shares	BALANCE SHEET ITEMS IMPACTING REGULATORY OWN FUNDS	item no. in the table 2
Assets							
Investments in subsidiaries, associates and joint ventures, and investment financial assets :	29 305 184	-	-	-	-		
- including significant investments into financial sector entities – amount not exceeding the threshold set in Article 48(1)(b)	909 380	-	-	-	-	909 380	73
Intangible fixed assets	490 327	-	-	-	-	490 327	8
Goodwill	1 712 056	-	-	-	-	1 712 056	8
Deferred tax assets (net)	1 414 227	128 409	-	-	-	1 542 636	
- including assets that do not exceed the threshold set in Article 48(1)(a)	1 414 227	128 409	-	-	-	1 542 636	75
Liabilities							
Subordinated obligations	1 488 602	-	-	-	-		
- including loans eligible as instruments under Tier II	1 489 428	-	-	-	-	1 489 428	46
Equity attributable to shareholders of BZ WBK S.A. including:							
Share capital	993 335	-	-	-	- 989	992 345	1
Other capital items:	16 920 130	-	-	-	-		
- share premium	7 035 424	-	-	-	-	7 035 424	1
- general banking risk fund	649 810	-	-	-	-	649 810	3a
- reserve capital	8 296 942	-357 631	-	-	-	7 939 311	3
- supplementary capital	937 954	9 477	-	-	-	947 431	3
Revaluation reserve:	714 466	-	-	-	-	714 466	3
- including unrealised gains on debt instruments	325 549	-	-130 219	-	-	195 329	26a
- including unrealised gains on equity instruments	698 962	-	-74 683	-	-	624 280	26a
Current year profit	2 213 054	117	-	-1 693 306	-	519 865	5a

*Bank submitted to the Polish Financial Supervision Authority the request for permission to classify capital instruments, ie M series shares to Common Equity Tier I capital

Table 1

As at 31 December 2017, the total own funds of the Bank Zachodni WBK Group amounted to PLN **19 860 478k**.

The amounts and nature of their specific items are presented in Table 2. The disclosure uses the template presented in Annex 6 to article 5 of Commission Implementing Regulation (EU) No 1423/2013, which states the disclosure requirement of own funds items during the transitional period. The table is limited to lines relevant for Bank Zachodni WBK Group.

References in the last column of Table 1 allow the mapping between individual elements of own funds with balance sheet items used for their calculation.

The nature and amounts of specific items on own funds of Bank Zachodni WBK Group during the interim period - as at 31.12.2017 (Disclosure according to Article 5 of Commission Implementing Regulation (EU) No 1423/2013) – in PLN k

	(A) AMOUNT AT DISCLOSURE DATE (PLN k)	(B) REGULATION (EU) No 575/2013 ARTICLE REFERENCE	(C) AMOUNTS SUBJECT TO PRE- REGULATION (EU) No 575/2013 TREATMENT OR PRESCRIBED RESIDUAL AMOUNT OF REGULATION (EU) 575/2013
Common Equity Tier 1 capital: instruments and reserves			
1	Capital instruments and the related share premium accounts	8 027 769	26 (1), 27, 28, 29, EBA list 26 (3)
	of which: shares	8 027 769	EBA list 26 (3)
2	Retained earnings	1 040 860	26 (1) (c)
3	Accumulated other comprehensive income (and any other reserves)	9 601 207	26 (1)
3a	Funds for general banking risk	649 810	26 (1) (f)
5	Minority interests (amount allowed in consolidated CET1)	792 756	84, 479, 480
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	519 865	26 (2)
6	Common Equity Tier 1 (CET1) capital before regulatory	20 632 267	
Common Equity Tier 1 (CET1) capital: regulatory adjustments			
7	Additional value adjustments (negative amount)	-46 366	34, 105
8	Intangible assets (net of related tax liability) (negative amount)	-2 202 383	36 (1) (b), 37, 472 (4)
15	Defined-benefit pension fund assets (negative amount)	-437	36 (1) (e), 41, 472 (7)
26a	Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468	-204 902	
	of which: filter for unrealised gains on debt instruments	-130 219	468
	of which: filter for unrealised gains on equity instruments	-74 683	468
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	-2 454 088	
29	Common Equity Tier 1 (CET1) capital	18 178 179	
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)	18 178 179	
Tier 2 (T2) capital: instruments and provisions			
46	Capital instruments and the related share premium accounts	1 489 428	62, 63
48	Qualifying own funds instruments included in consolidated T2 capital (including minority interest and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third party	192 871	87, 88, 480
51	Tier 2 (T2) capital before regulatory adjustment	1 682 299	
Tier 2 (T2) capital: regulatory adjustments			
57	Total regulatory adjustments to Tier 2 (T2) capital	-	
58	Tier 2 (T2) capital	1 682 299	
59	Total capital (TC = T1 + T2)	19 860 478	
59a	Risk weighted assets in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amount)	6 130 040	
60	Total risk-weighted assets	119 003 114	
Capital ratios and buffers			
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	15,28%	92 (2) (a), 465
62	Tier 1 (as a percentage of total risk exposure amount)	15,28%	92 (2) (b), 465
63	Total capital (as a percentage of total risk exposure amount)	16,69%	92 (2) (c)
Amounts below the thresholds for deduction (before risk-weighting)			
73	Direct and indirect holdings 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)	909 380	36 (1) (i), 45, 48, 470, 472 (11)
75	Deferred tax assets arising from temporary difference (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)	1 542 636	36 (1) (c), 38, 48, 470, 472 (5)

Table 2

3.1. Tier I

Common Equity Tier I

Share capital in accordance with the Bank's Statutes and the entry to the Court Register as at 31 December 2017 amounted to PLN **993 335k**.

In relation to the resolution of BZ WBK Annual General Meeting of 17 May 2017 amending the bank's statutes, as confirmed by a relevant entry made to the National Court Register by the District Court for Wrocław-Fabryczna on 3 August 2017, the bank's share capital was increased by PLN 990k from PLN 992,345k to PLN 993,335k. All the newly issued shares were paid up. The share capital was increased through the private placement of series M ordinary bearer shares without pre-emptive rights, which were taken up by the participants of the 5th Incentive Programme.

For capital adequacy purposes, the bank requested consent from the KNF to allocate these equity instruments to the Common Equity Tier 1 capital.

As at the date of this report, the bank did not receive the consent referred to above.

Detailed information about prices of the above instruments, including Tier 1 capital, are presented in Table 3.

Supplementary capital is created from profit allocations and from share premium. By the Bank's Statutes, the supplementary capital is created from net profit allocations. Its purpose is to cover any balance sheet losses. The value of the allocations is determined by the General Meeting of Shareholders. As at 31 December 2017, the supplementary capital in own funds was PLN **7 982 854k**, incl. share premium of PLN **7 035 424k**.

Other reserves are created from net profit allocations in an amount approved by the General Meeting of Shareholders. Other reserve are used to cover balance sheet losses if they are greater than the supplementary capital. The decision to resort to the reserve capital is taken by the General Meeting of Shareholders. As at 31 December 2017, after including prudential consolidation adjustments, the other reserves in own funds was PLN **7 939 311k**.

Funds for general banking risk for unidentified banking business risk are created from net profit allocations in an amount approved by the General Meeting of Shareholders. The funds for general banking risk are used to cover costs and losses connected with unidentified banking risks that were not separately provided for. As at 31 December 2017, the general risk fund earmarked for unidentified risks of the banking business was PLN **649 810k**.

Net profit of Bank Zachodni WBK Group for year 2017 totaled PLN **2 518 514k**, including PLN 305 460k of profit attributable to shareholders who do not exercise control. As at 31 December 2017, according to article 26 CRR and based on the consent received from Polish Financial Supervision Authority, Bank Zachodni WBK included the amount of PLN **519 865k** of current year profit on own funds elements.

In May 2017, the General Meeting of Bank Zachodni WBK Shareholders agreed on the distribution of the net profit of **PLN 2 081 720k** for the accounting year from 1 January 2016 to 31 December 2016 as follows:

- PLN 1 040 860k was allocated to capital reserves;
- PLN 1 040 860k was left undistributed.

Furthermore, the AGM decided to distribute the retained net profit of PLN **540 707k** in respect of:

- 1) the accounting year from 1 January 2014 to 31 December 2014 and
- 2) the accounting year from 1 January 2015 to 31 December 2015.

as follows:

PLN 535 866k was allocated to dividend for shareholders;

PLN 4 841k was allocated to reserve capital.

The dividend was **PLN 5.40** per share.

Minority interests

As at 31 December 2017, the minority interests recognised in the consolidated Tier 1 capital totalled PLN **792 756k** and were attributed to the sub-consolidation of SCB Group.

Minority interest are no longer included in own funds based on the balance sheet value, but are calculated according to article 84 of CRR.

Adjustment and deductions from Common Equity Tier I

Bank Zachodni WBK Group has calculated the additional value adjustments due to the requirements for prudent valuation according to articles 34 and 105 of CRR. It amounted to PLN **(46 366)k**.

As at 31 December 2017, the adjustment of the Common Equity Tier 1 capital due to goodwill amounted to PLN **(1,712,056)k**, including:

- 1 PLN 1,688,516 – goodwill arising from the merger of Bank Zachodni WBK and Kredyt Bank on 4 January 2013. The goodwill recognised as at the date of the merger between Bank Zachodni WBK and Kredyt Bank represents a control premium and arises from the possibility to generate additional benefits from the expected synergies, increase in revenues and market share, combination of staff competencies and an increase in the effectiveness of processes, in relation to the fair value of the acquired net assets.
- PLN 23,540k – goodwill arising from the fact that Bank Zachodni WBK holds 60% shares of Santander Consumer Bank, which, in turn, has a 50% stake in PSA Finance Polska. Bank Zachodni WBK disclosed non-controlling interests representing 70% of share capital and voting power at the General Meetings of PSA Finance Polska and, indirectly, PSA Consumer Finance Polska (for more information, see Note 50 to the Consolidated Financial Statements of Bank Zachodni WBK Group for 2017).

As at 31 December 2017, deduction from Common Equity Tier I regarding other intangible assets amounted to PLN **(490 327)k**.

Unrealised gains related to assets or liabilities measured at fair value and recognised in balance sheet are excluded from own funds in the transitional period. In 2017, the Group deducted 20% of gains in the amount of PLN **(204 902)k**. Breakdown between debt and equity instruments is presented in Table 2.

Unrealised losses related to assets or liabilities measured at fair value and recognised in balance in sheet were fully excluded from Tier I capital in the amount of PLN **(33 691)k** according to Article 467(3) of CRR.

3.2. Tier II

Subordinated liabilities

Own funds of Bank Zachodni WBK Group:

- include funds raised through the issuance of variable-rate registered bonds which were taken up and paid up by the European Bank for Reconstruction and Development. In 2016, the bank amended the agreement under which subordinated registered bonds had been issued on 5 August 2010. The amendments included a maturity extension to 5 August 2025, among other things. Pursuant to the KNF decision of 18 May 2016 (letter No. DBK/DBK 2/7100/2/7/2016), the foregoing subordinated bonds of EUR 100m were allocated to Tier 2 capital.
- pursuant to the KNF decision of 24 February 2017 (letter No. DBK/DBK 2/7100/6/7/2016/2017), the subordinated bonds of EUR 120m issued by Bank Zachodni WBK on 2 December 2016, maturing on 3 December 2026 and taken up by investors, were allocated to Tier 2 capital.
- pursuant to the KNF decision of 19 October 2017 (letter No. DBK/DBK 2/7100/1/14/2017), the subordinated bonds of EUR 137.1m issued by Bank Zachodni WBK on 22 May 2017, maturing on 22 May 2027 and taken up by an investor, were allocated to Tier 2 capital.

Hence, as at 31 December 2017, own funds include subordinated liabilities of PLN **1 489 428k**.

**Subordinated liabilities of the Bank Zachodni WBK Group eligible as Tier II capital
as at 31 December 2017 (PLN k)**

Entity	Nominal value [k]	Currency	Amount included in own funds [k]	Redemption date	Start date of amortization	Subordinated liabilities included in own funds [PLN k]
European Bank for Reconstruction and Development	100 000	EUR	100 000 EUR	05.08.2025	05.08.2020	417 090
Other financial institution	120 000	EUR	120 000 EUR	03.12.2026	03.12.2021	500 508
International Finance Corporation (IFC green bonds)	137 100	EUR	137 100 EUR	22.05.2027	22.05.2022	571 830
						1 489 428

Instruments issued by subsidiaries that recognised in Tier II capital

Following the acquisition of control over Santander Consumer Bank in 2014, its qualifying own funds of PLN **192 871k**, calculated in accordance with Art. 88 of CRR as own funds of a subsidiary, represent another item of Tier II capital of Bank Zachodni WBK Group.

More details about the subordinated liabilities are presented in **Note 33** to the Consolidated Financial Statements of the Bank Zachodni WBK Group for 2017.

Detailed description of capital instruments' main features is presented in Table 3.

Description of main features of Common Equity Tier I and Tier II instruments of Bank Zachodni WBK S.A. (Disclosure according to Article 3 Commission Implementing Regulation (EU) No 1423/2013)

Capital Instruments' main features	Bank Zachodni WBK S.A.	Bank Zachodni WBK S.A.	Bank Zachodni WBK S.A.	Bank Zachodni WBK S.A.
1 Issuer	Bank Zachodni WBK S.A.	Bank Zachodni WBK S.A.	Bank Zachodni WBK S.A.	Bank Zachodni WBK S.A.
2 Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement)	PLB20000044	XSSG1310162	PLB200000226	not applicable
3 Governing law(s) of the instrument	polish	english/polish	polish	english
Regulatory treatment				
4 Transitional CRR rules	Common Equity Tier I	Tier II	Tier II	Tier II
5 Post-transitional CRR rules	Common Equity Tier I	Tier II	Tier II	Tier II
6 Eligible at solo/(sub-)consolidated/solo & (sub-)consolidated	solo and consolidated	solo and consolidated	solo and consolidated	solo and consolidated
7 Instrument type (types to be specified by each jurisdiction)	shares - Common Equity Tier I as published in Regulation (EU) No 575/2013 article 28	Tier II as published in Regulation (EU) No 575/2013 article 63	Tier II as published in Regulation (EU) No 575/2013 article 63	Tier II as published in Regulation (EU) No 575/2013 article 63
8 Amount recognised in regulatory capital (currency in million, as of most recent reporting date)	PLN 992,345 m	PLN 417,090 m	PLN 500,508 m	PLN 571,830 m
9 Nominal amount of instrument	10 PLN	100 000 000 EUR	120 000 000 EUR	137 100 000 EUR
	Series A: 10 PLN Series B: 10 PLN Series C: 10 PLN Series D: 102 PLN Series E: 102 PLN Series F: 40 PLN Series G: 10 PLN Series H: 10 PLN Series I: 212.60 PLN Series J: "Share Exchange Ratio" re. the merger of BZ WBK with Kredyt Bank, pursuant to Resolution no. 2 of the Extraordinary Meeting of BZ WBK Shareholders, dd. 30.07.2012 r. Series K: 10 PLN Series L: 400.53 PLN			
9a Issue price		100% of nominal value	100% of nominal value	100% of nominal value
9b Redemption price	N/A	100% of nominal value	100% of nominal value	100% of nominal value
10 Accounting classification	Shareholders' equity	Liability - amortised cost	Liability - amortised cost	Liability - amortised cost
	Series A: 08.11.1991 Series B: 21.12.1996 Series C: 31.12.1996 Series D: 25.10.1999 Series E: 17.05.2000 Series F: 30.11.2000 Series G: 13.06.2001 Series H: 10.07.2009 Series I: 09.08.2012 Series J: 04.01.2013 Series K: 11.07.2014 Series L: 18.07.2014			
11 Original date of issuance		05.08.2010	02.12.2016	22.05.2017
12 Perpetual or dated	N/A	Dated	Dated	dated
13 Original maturity date	No maturity	05.08.2025	03.12.2026	22.05.2027
14 Issuer call subject to prior supervisory approval	N/A	Yes	Yes	Yes
15 Optional call date, contingent call dates, and redemption amount	N/A	05.08.2020	03.12.2021	22.05.2022
16 Subsequent call dates, if applicable	N/A	each interest period, every 3 months	each interest period, every 6 months	each interest period, every 6 months (after five years)
Coupons / dividends				
17 Fixed or floating dividend/coupon	Floating	Floating	Floating	Floating
18 Coupon rate and any related index	N/A	above three-month EURIBOR for each interest period	above six-month EURIBOR for each interest period	above six-month EURIBOR for each interest period
19 Existence of a dividend stopper	No	Yes	No	Yes
20a Fully discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary	Mandatory	N/A	Partially discretionary
20b Fully discretionary, partially discretionary or mandatory (in terms of amount)	Fully discretionary	Mandatory	N/A	Partially discretionary
21 Existence of step up or other incentive to redeem	N/A	No	No	No
22 Noncumulative or cumulative	Noncumulative	Cumulative	N/A	N/A
23 Convertible or non-convertible	Nonconvertible	Nonconvertible	Nonconvertible	Convertible
				E: (1) The Bonds shall be converted into a senior loan at the price level agreed by both Parties. F: (1) there is a change in the regulatory classification of the Bonds that would be likely to result in their exclusion from the Issuer's own funds (as defined in the CRR) or reclassification as a lower quality form of own funds; or (2) Under BGF Act as defined in Terms and Conditions: Under the BGF Act, the Issuer's obligations under the Bonds may be subject to write-down or conversion on the terms set out in the BGF Act. By purchasing the Bonds, each Bondholder acknowledges the results of a decision the Bank Guarantee Fund may make on exercising its write-down or conversion powers with respect to the Bonds.
24 If convertible, conversion trigger (s)	N/A	N/A	N/A	fully
25 If convertible, fully or partially	N/A	N/A	N/A	fully
26 If convertible, conversion rate	N/A	N/A	N/A	The Bonds shall be converted into a senior loan at the price level agreed by both Parties.
27 If convertible, mandatory or optional conversion	N/A	N/A	N/A	mandatory
28 If convertible, specify instrument type convertible into	N/A	N/A	N/A	senior loan or any other financial instrument defined under BGF Act, as mentioned above.
29 If convertible, specify issuer of instrument it converts into	N/A	N/A	N/A	Bank Zachodni WBK S.A.
				Under the BGF Act, the Issuer's obligations under the Bonds may be subject to write-down or conversion on the terms set out in the BGF Act. By purchasing the Bonds, each Bondholder acknowledges the results of a decision the Bank Guarantee Fund may make on exercising its write-down or conversion powers with respect to the Bonds.
30 Write-down features	No	No	No	Bonds.
31 If write-down, write-down trigger (s)	N/A	N/A	N/A	as above
32 If write-down, full or partial	N/A	N/A	N/A	as above
33 If write-down, permanent or temporary	N/A	N/A	N/A	as above
34 If temporary write-down, description of write-up mechanism	N/A	N/A	N/A	as above
Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	N/A	the lowest priority of satisfaction and will rank only to the extent permitted by applicable laws relating to creditors' right	the lowest priority of satisfaction and will rank only to the extent permitted by applicable laws relating to creditors' right	the lowest priority of satisfaction and will rank only to the extent permitted by applicable laws relating to creditors' right
35 Non-compliant transitional features	No	No	No	No
37 If yes, specify non-compliant features	N/A	N/A	N/A	N/A

(1) 'N/A' inserted if the question is not applicable

Table 3



1. Introduction
2. Risk Management
 - 2.1. Credit risk
 - 2.2. Market risk
 - 2.3. Liquidity risk
 - 2.4. Operational risk
 - 2.5. Compliance risk
3. Own funds
 - 3.1. Tier I capital
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4. Capital requirements
 - 4.1. Capital requirements for individual risk types
 - 4.2. Exposure structure
 - 4.3. Allocating risk weights to the credit portfolio
5. Capital buffers
6. Capital adequacy
 - 6.1. Capital adequacy management
 - 6.2. Regulatory capital adequacy
 - 6.3. Internal capital adequacy
7. Securitization
8. Policy of variable components of remuneration
9. Leverage ratio
10. Encumbered assets and unencumbered assets

Bank Zachodni WBK

 Grupa Santander

4. Capital requirements

The capital requirements of Bank Zachodni WBK Group are set in accordance with part III 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 ("CRR"), which was the official legal basis as at 31 December 2017.

In 2017, Bank Zachodni WBK applied the standardised approach to the calculation of capital requirement for credit, market and operational risk. Under this approach the total capital requirement for credit risk is calculated as a sum of risk-weighted assets multiplied by 8%. To calculate risk-weighted exposures, risk weights are allocated to all exposures in accordance with the CRR. The Group measures its balance sheet assets and liabilities in accordance with International Accounting Standards and International Financial Reporting Standards.

The Bank calculates and monitors capital requirements for all key risks, including:

- capital requirement for credit risk
- capital requirement for market risk, including:
 - capital requirement for positions risk, including:
 - specific and general risk of debt instruments
 - specific and general risk of equity instruments
 - capital requirement for FX risk
- capital requirement for the settlement, supplier and counterparty risk
- capital requirement for credit valuation adjustments
- capital requirement for the excess of large exposures limit
- capital requirement for the excess of capital concentration limit
- capital requirement for operational risk.

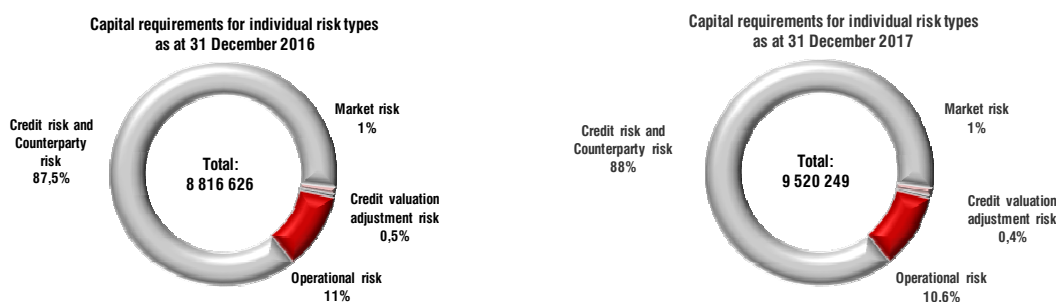
Bank Zachodni WBK Group calculates capital requirement separately for the exposures classified into the banking and trading book.

4.1. Capital requirements for individual risk types

As at 31 December 2017, the total capital requirements of Bank Zachodni WBK Group calculated in line with the CRR was PLN **9 520 249**, including:

- for credit risk and counterparty credit risk: PLN **8 361 481k**
- for market risk: PLN **107 752k**
- for credit valuation adjustment risk: PLN **42 400k**
- for operational risk: PLN **1 008 616k**.

Percentage structure of the capital requirements in 2016 – 2017



**Capital requirements of the Bank Zachodni WBK Group
(PLN k)**

No.	CAPITAL REQUIREMENTS FOR INDIVIDUAL RISK TYPES	as at 31.12.2017	as at 31.12.2016
1.	Credit risk and Counterparty risk	8 361 481	7 713 572
2.	Risk of exceeding the exposure concentration limit and the large exposure limit	-	-
3.	Market risk including:	107 752	93 321
3.1	FX risk	-	-
3.2	commodity prices risk	-	-
3.3	risk of positions of equity instruments, including: :	2 441	1 409
3.3.1	specific risk	2 176	1 159
3.3.2	general risk	93	154
3.3.3	Specific approach to the risk of positions in collective investment undertakings (CIUs)	172	96
3.4	risk of debt instrument positions, including:	105 311	91 912
3.4.1	specific risk	364	107
3.4.2	general risk	104 947	91 805
4.	Supply settlement risk	-	-
5.	Credit valuation adjustment risk	42 400	42 739
6.	Operational risk	1 008 616	966 994
	TOTAL CAPITAL REQUIREMENT (items 1+2+3+4+5+6)	9 520 249	8 816 626

The biggest item is the total capital requirement of Bank Zachodni WBK Group is the capital requirement for credit risk, including counterparty credit risk, which on 31 December 2017 accounted for **87.83%** of the total capital requirement. Bank Zachodni WBK Group manages credit risk on a priority basis, using its internal rating systems, credit concentration limits and sectoral exposure limits, seeking to maintain the possible highest quality of the credit portfolio.

The BZ WBK uses contractual netting according to art. 295-298 of CRR.

The table below present a specification of the capital requirement for credit risk and counterparty credit risk by exposure classes, in accordance with the CRR.

**Capital requirement of Bank Zachodni WBK Group for credit risk and counterparty credit risk
as at 31.12.2017 (PLN k)**

No.	Exposure Class	Capital requirement for credit risk and counterparty risk
1.	Exposures to central governments or central banks	6 843
2.	Exposures to regional governments or local authorities	2 635
3.	Exposures to public sector entities	142
4.	Exposures to multilateral development banks	-
5.	Exposures to institutions*	139 168
6.	Exposures to corporates	1 562 939
7.	Retail exposures	2 195 714
8.	Exposures secured by mortgages on immovable property	3 506 353
9.	Exposures in default	235 999
10.	Exposures associated with particularly high risk	3 053
11.	Exposures in the form of units or shares in collective investment undertakings	-
12.	Equity exposures	251 918
13.	Other items	456 717
	Total exposures covered by the standardised approach	8 361 481
	of which: counterparty risk - trading portfolio	99 769

*including capital requirement for pre-funded contribution to the default fund of a qualifying central counterparty

4.2. Exposure structure

In the process of capital adequacy assessment, each type of exposure was classified in accordance with Article 112 of the CRR.

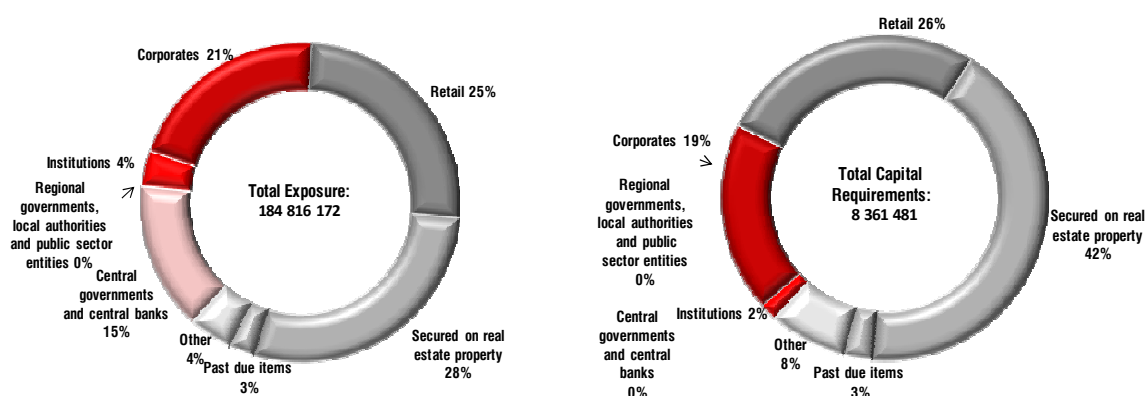
The original exposure before conversion factors represents the value of the exposure exclusive of value and provisioning adjustments, conversion factors and credit risk mitigation techniques.

**Credit risk and counterparty credit risk exposures
as at 31.12.2017 (PLN k)**

No.	Exposure Class	Original exposure before CCF	Average value of the exposure
1.	Exposures to central governments or central banks	27 393 370	26 691 787
2.	Exposures to regional governments or local authorities	174 181	171 766
3.	Exposures to public sector entities	8 909	5 796
4.	Exposures to multilateral development banks	104 786	79 402
5.	Exposures to institutions*	6 616 300	7 310 334
6.	Exposures to corporates	38 097 833	36 018 292
7.	Retail exposures	46 524 151	46 939 180
8.	Exposures secured by mortgages on immovable property	51 528 987	48 752 507
9.	Exposures in default	6 630 774	6 713 462
10.	Exposures associated with particularly high risk	25 440	25 431
11.	Exposures in the form of units or shares in collective investment undertakings	-	-
12.	Equity exposures	1 784 912	1 749 161
13.	Other items	5 926 529	5 908 373
	Total exposures covered by the standardised approach	184 816 172	180 365 491

*including exposure for pre-funded contribution to the default fund of a qualifying central counterparty

Percentage structure of exposures and the capital requirements of credit risk and counterparty credit risk by different asset classes in 2017



The structure of balance sheet and off-balance sheet exposures of the Bank Zachodni WBK Group by maturity is presented below. Exposures with residual maturity between 1-5 years represent the bulk of the exposures.

**Credit risk and counterparty credit risk exposures
by maturities
as at 31.12.2017 (PLN k)**

No.	Exposure Class	Residual Term to Maturity				total
		<1 year	1-5 years	>5 years	without residual term to maturity	
1.	Exposures to central governments or central banks	12,81%	49,61%	37,40%	0,18%	27 393 370
2.	Exposures to regional governments or local authorities	48,90%	38,62%	12,48%	-	174 181
3.	Exposures to public sector entities	56,13%	43,87%	0,00%	-	8 909
4.	Exposures to multilateral development banks	0,00%	2,50%	97,50%	-	104 786
5.	Exposures to institutions*	49,57%	36,42%	14,01%	-	6 616 300
6.	Exposures to corporates	35,87%	55,83%	8,30%	-	38 097 833
7.	Retail exposures	21,40%	47,75%	30,85%	-	46 524 151
8.	Exposures secured by mortgages on immovable property	12,77%	26,84%	60,39%	-	51 528 987
9.	Exposures in default	65,18%	19,89%	14,93%	-	6 630 773
10.	Other items	-	-	-	100,00%	7 736 882
	Total exposures covered by the standardised approach	22,40%	40,42%	32,97%	4,21%	184 816 172

*including exposure for pre-funded contribution to the default fund of a qualifying central counterparty

Credit risk concentration

Bank Zachodni WBK Group adheres to the standards provided for in the Banking Law with regard to the concentration of risk bearing exposures to a single entity or a group of entities connected in terms of capital or organisation.

As at 31.12.2017, pursuant to art. 71 of the Banking Law Act and art. 395 (1) CRR the maximum limits for the Group amounted to:

- PLN 4 965 120 k (25% of Group's own funds).

As at 31.12.2016, pursuant to art. 71 of the Banking Law Act and art. 395 (1) CRR the maximum limits for the Group amounted to:

- PLN 4 146 204k (25% of Group's own funds).

The policy pursued by the Group aims at minimising the credit concentration risk, by for example applying more rigorous than regulatory rules in this respect. The effect of this policy is maintenance of high level of diversification of exposures towards individual customers.

The analysis of the Group's exposures in terms of sector concentrations, proved that the Group does not have any exposures in excess of the limits imposed by the regulator in 2017.

**Credit risk and counterparty credit risk exposures
by sectors
as at 31.12.2017 (PLN k)**

No.	Exposure Class	Industry Analysis										Total	
		Public Sector	Detail (including mortgages)	Property	Manufacturing	Distribution	Construction	Agriculture	Transport	Financial	Energy		Other Sectors
1.	Exposures to central governments or central banks	27 393 370	-	-	-	-	-	-	-	-	-	-	27 393 370
2.	Exposures to regional governments or local authorities	174 181	-	-	-	-	-	-	-	-	-	-	174 181
3.	Exposures to public sector entities	8 909	-	-	-	-	-	-	-	-	-	-	8 909
4.	Exposures to multilateral development banks	-	-	-	-	-	-	-	104 786	-	-	-	104 786
5.	Exposures to institutions*	-	-	-	-	-	-	-	6 616 300	-	-	-	6 616 300
6.	Exposures to corporates	239	-	3 001 446	8 685 344	9 798 020	894 410	156 003	1 764 886	3 251 812	5 191 724	5 353 949	38 097 833
6.1.	of which: SME**	-	-	127 497	983 016	1 097 717	114 264	24 885	314 151	11 913	58 021	773 219	3 504 683
7.	Retail exposures	1 317	32 664 198	440 967	2 235 035	3 529 305	738 876	1 732 471	1 571 377	161 520	63 821	3 385 264	46 524 151
7.1.	of which: SME**	1 317	119	440 967	2 235 035	3 529 305	738 776	1 732 471	1 571 377	161 520	63 821	3 385 264	13 859 972
8.	Exposures secured by mortgages on immovable property	-	27 075 005	7 989 840	6 024 156	6 761 035	447 368	677 036	666 267	62 138	353 191	1 472 951	51 528 987
8.1.	of which: SME**	-	-	353 751	1 426 877	2 223 141	174 574	468 263	202 047	25 864	45 601	541 486	5 461 604
9.	Exposures in default	680	2 795 569	964 637	577 491	835 677	117 127	149 002	160 246	19 573	690 928	319 844	6 630 774
10.	Exposures associated with particularly high risk	-	-	-	-	-	-	-	-	-	-	25 440	25 440
11.	Exposures in the form of units or shares in collective investment undertakings	-	-	-	-	-	-	-	-	-	-	-	-
12.	Equity exposures	-	-	-	-	-	193	-	-	1 759 974	-	24 745	1 784 912
13.	Other items	-	-	-	-	-	-	-	-	-	-	5 926 529	5 926 529
	Total exposures covered by the standardised approach	27 578 696	62 534 772	12 396 890	17 522 026	20 924 037	2 197 974	2 714 512	4 162 776	11 976 103	6 299 664	16 508 722	184 816 172

*including exposure for pre-funded contribution to the default fund of a qualifying central counterparty

**of which: SME – subject to SME-supporting factor

**Credit risk and counterparty credit risk exposures
by countries
as at 31.12.2017 (PLN k)**

No.	Exposure Class	Geographic distribution*											Total	
		Poland	Spain	Luxembourg	France	Belgium	United Kingdom	Netherlands	Szwajcaria	Portugal	Germany	United States		Other countries
1.	Exposures to central governments or central banks	27 393 370	-	-	-	-	-	-	-	-	-	-	-	27 393 370
2.	Exposures to regional governments or local authorities	174 181	-	-	-	-	-	-	-	-	-	-	-	174 181
3.	Exposures to public sector entities	8 909	-	-	-	-	-	-	-	-	-	-	-	8 909
4.	Exposures to multilateral development banks	-	-	103 594	-	-	1 192	-	-	-	-	-	-	104 786
5.	Exposures to institutions	3 369 999	614 198	-	706 953	583 846	283 152	234 510	285 790	-	110 210	536	427 106	6 616 300
6.	Exposures to corporates	36 197 029	13 949	815 687	247 410	7 501	188 586	54 099	-	213 071	77 430	51 643	231 428	38 097 833
7.	Retail exposures	46 509 757	2 087	-	254	240	2 235	829	1	2	1 401	313	7 032	46 524 151
8.	Exposures secured by mortgages on immovable property	50 090 888	819 741	411 588	992	669	100 631	29 670	382	-	1 639	1 323	71 464	51 528 987
9.	Exposures in default	6 602 979	81	11	93	3	805	58	1	4	30	154	26 555	6 630 774
10.	Exposures associated with particularly high risk	-	-	-	-	-	-	25 440	-	-	-	-	-	25 440
11.	Exposures in the form of units or shares in collective investment undertakings	-	-	-	-	-	-	-	-	-	-	-	-	-
12.	Equity exposures	1 691 219	-	-	-	529	-	-	-	-	-	93 164	-	1 784 912
13.	Other items	5 921 594	-	-	-	-	-	-	-	-	-	596	4 339	5 926 529
	Total exposures covered by the standardised approach	177 959 925	1 450 056	1 330 880	955 702	592 788	576 601	344 606	286 174	213 077	190 710	147 729	767 924	184 816 172

* Distribution by the country of the borrower

Delinquent and impaired positions

An exposure is considered as delinquent if the obligor is in arrears with capital and/or interest payments. In such circumstances, the entire exposure is considered as delinquent, regardless of whether or not the payment delay relates to the whole exposure or a part thereof.

An exposure is considered as impaired, if the Group has objective evidence that it will not be able to recover the exposure in accordance with the underlying credit agreement. Objective indications of impairment were defined in accordance with recommendations of the Basel Committee and the International Accounting Standards (IAS 39) and Recommendation R.

Impairment is calculated on the basis of the estimated recoverable amount. Impairment analysis is performed using both the individual (for individually significant exposures with objectively evidenced impairment) and collective approach (individually insignificant exposures with objectively evidenced impairment, and incurred but not reported losses).

Twice a year, to facilitate proper calculation of impairment, the Group compares the assumptions and parameters used for impairment calculations with the actual situation, taking into account changes of economic conditions, modifications in the Group's credit policies and recovery strategies to ensure adequacy of provisions. The responsibility for ensuring adequacy of the impairment charges rests with the Provisions Committee.

Impaired and delinquent exposures by industries as at 31.12.2017 (PLN k)

Industry structure	Impaired Original Exposures	Overdue original exposures	Adjustment for specific and general credit risk*	including: for impaired exposures*
Public sector	680	5 949	356	282
Retail (including mortgages)	2 795 569	5 582 490	2 432 771	1 916 073
Facilities management	964 637	869 917	443 399	415 579
Production sector	577 491	904 965	317 274	276 547
Distribution	835 677	1 156 450	568 625	515 556
Budownictwo	117 127	153 634	120 842	93 469
Agriculture	149 002	411 827	119 767	100 212
Transport	160 246	384 888	102 786	88 463
Financial sector	19 573	41 182	18 642	15 208
Energy sector	690 928	297 831	386 746	375 128
Other sectors	319 844	899 482	287 492	210 320
Total	6 630 774	10 708 615	4 798 700	4 006 837

*Pursuant to Commission Delegated Regulation (EU) No 183/2014 (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), in calculation of its capital adequacy the bank takes into account specific and general credit risk adjustments by which the bank's Common Equity Tier 1 capital has been reduced in order to reflect losses exclusively related to credit risk according to the applicable accounting framework and recognised as such in the profit or loss account, irrespective of whether they result from impairments, value adjustments or provisions for off-balance sheet items. After an independent overview of the financial statements as at 30 June 2017 and obtaining the necessary approval of the Bank included part of the profit of the current period in the amount of PLN 519 865k own funds. Accordingly, included in this report adjustments for specific and general credit risk are consistent with the date indicated above.

**Impaired and delinquent exposures
by countries
as at 31.12.2017 (PLN k)**

Country	Impaired Original Exposures	Overdue original exposures	Adjustment for specific and general credit risk*	including: for impaired exposures*
Poland	6 602 979	10 596 534	4 780 890	3 990 799
USA	154	52 894	176	82
Luxembourg	11	16 798	655	7
Ireland	7 292	16 627	4 272	4 102
Liechtenstein	16 301	16 301	9 205	9 205
United Kingdom	805	4 617	879	432
Sweden	1 616	1 618	1 612	1 611
Italy	8	788	56	2
Ukraine	414	771	114	90
Canada	510	511	267	267
Other countries	684	1 156	574	240
Total	6 630 774	10 708 615	4 798 700	4 006 837

*Pursuant to Commission Delegated Regulation (EU) No 183/2014 (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), in calculation of its capital adequacy the bank takes into account specific and general credit risk adjustments by which the bank's Common Equity Tier 1 capital has been reduced in order to reflect losses exclusively related to credit risk according to the applicable accounting framework and recognised as such in the profit or loss account, irrespective of whether they result from impairments, value adjustments or provisions for off-balance sheet items. After an independent overview of the financial statements as at 30 June 2017 and obtaining the necessary approval of the Bank included part of the profit of the current period in the amount of PLN 519 865k own funds. Accordingly, included in this report adjustments for specific and general credit risk are consistent with the date indicated above.

**Reconciliation of changes to adjustments for impaired exposures
as at 31.12.2017 (PLN k)**

As at 31.12.2016	Provision charge	Claw-backs and adjustments	As at 31.12.2017
4 602 318	2 017 027	-2 612 508	4 006 837

*calculation of the exposure takes into account only those adjustments connected with general and specific risk which were applied to Tier 1 capital to reflect losses related to credit risk, in accordance with the applicable accounting standards, and disclosed accordingly in the income statement, regardless of whether they arise from impairment, value adjustment or provisions for off-balance sheet items.

Return on assets

As at 31 December 2017 the ROA was 1.5%, calculated as profit attributable to shareholders of the parent for four consecutive quarters to the average value of assets (at the beginning and at the end of the current reporting period).

4.3. Allocating risk weights to the credit portfolio

The risk weights used in the calculation of capital requirement for credit risk in the standardised approach are based on the provision of Chapter 2, Title II, Part III of the CRR. Risk weights are allocated in line with the category of the exposure and the credit quality of the exposure/entity.

The Group uses credit risk mitigation techniques both for funded credit protection and for unfunded credit protection. In the latter case, borrowers protected by guarantees are allocated a risk grade that corresponds to the risk grade of the guarantor. Most providers of unfunded credit protection are banks, including Bank Gospodarstwa Krajowego (with its "de minimis" guarantee programme) and the Ministry of Finance as a State unit.

In the case of funded credit protection, Bank Zachodni WBK Group recognizes exposures secured by financial collateral.

Defaulted exposures have their risk weight allocated in accordance with the rules laid down in Article 127 of the CRR.

Pursuant to Article 125(2) of the CRR, Bank Zachodni WBK additionally assigns a preferential risk weight of 35% to a part of an exposure which is fully and completely secured by a mortgage on a residential property and whose value does not exceed 80% of the market value of the property in question. Bank Zachodni WBK has not identified exposures effectively secured by mortgage on a commercial property, to which preferential risk weights are applied in accordance with Article 126.

Pursuant to Regulation of the Minister of Economic Development and Finance of 25 May 2017 on a higher risk weight for exposures secured with mortgages on properties, for exposures secured by mortgages on a residential property, where the principal or interest instalment is linked to an exchange rate of a currency or currencies other than the currency of the debtor's revenue, the risk weight is set at 150%.

Pursuant to the KNF recommendation, Bank Zachodni WBK Group assigns a risk weight of 150% to exposures which are fully secured with a mortgage on a residential property which is or will be self-occupied or let out where a principal or interest instalment depends on changes in the exchange rate of currency or currencies other than the currency of the debtor's revenue. From the perspective of currency risk, the key category of foreign currency retail loans which are fully secured with a mortgage on a residential property are CHF-denominated loans. Bank Zachodni WBK Group actively manages the CHF position using derivative instruments (swaps) and direct funding in the form of loans and repo transactions.

According to the decision of the Financial Supervision Authority dated 15 December 2017 Bank Zachodni WBK S.A. Group keeps own funds in order to cover capital add-on requirements for the risk arising from foreign currency mortgages to households at 0.44 p.p. in excess of the total capital ratio, having the following composition: Tier 1 capital - no less than 75% (which corresponds to the capital requirement at 0.33 p.p. in excess of the Tier 1 capital ratio) and Common Equity Tier 1 capital - no less than 56% (which corresponds to the capital requirement at 0.25 p.p. in excess of Common Equity Tier 1).

As at 31 December 2017, the Group's debt instruments portfolio included PLN **1 955 039k** worth of bonds of Bank Gospodarstwa Krajowego, which were fully guaranteed by the State Treasury. They were allocated a preferential risk weight of 0%.

On 10 February 2017, Bank Zachodni WBK ("the Bank") signed a guarantee agreement ("Guarantee") with the European Investment Bank (EIB) providing for unfunded credit protection with respect to the portfolio of selected corporate loans of the bank in accordance with EU Regulation No 575/2013.

As at the date of the agreement, the value of the bank's loans portfolio secured by the guarantee was PLN 2,499m PLN. The coverage ratio is now 50%, which means that the maximum guarantee amount is PLN 1,249m PLN. The guarantee expires on 15 December 2034. The bank may terminate the guarantee before its expiry.

The guarantee coverage ratio depends on the volume of lending provided by the bank after the date of the guarantee agreement to SMEs which meet the definition set out in Commission Recommendation 2003/361/EC of 6 May 2003 and additional criteria stipulated in the guarantee agreement. As at the date of this report, the coverage ratio was 9.92%.

**Credit risk and counterparty credit risk exposures
by type of collateral
as at 31.12.2017 (PLN k)**

No.	Exposure Class	Exposures secured by financial collateral	Exposures secured by guarantees
1.	Exposures to central governments or central banks	-	-
2.	Exposures to regional governments or local authorities	-	-
3.	Exposures to public sector entities	-	-
4.	Exposures to multilateral development banks	-	-
5.	Exposures to institutions	509 485	1 955 039
6.	Exposures to corporates	1 547 834	676 729
7.	Retail exposures	25 169	776 509
8.	Exposures secured by mortgages on immovable property	141 639	1 125 060
9.	Exposures in default	869	19 086
10.	Exposures associated with particularly high risk	-	-
11.	Exposures in the form of units or shares in collective investment undertakings	-	-
12.	Equity exposures	-	-
13.	Other items	-	-
	Total exposures covered by the standardised approach	2 224 996	4 552 423

In each asset class, appropriate risk weight is allocated depending on the available credit rating of external rating institutions or export credit agencies. The Bank accepts ratings of the following agencies:

- Fitch Ratings;
- Moody's Investors Service;
- Standard and Poor's Ratings Services.

If two credit ratings are available for an exposure and the ratings are linked to different risk weight of the particular exposure, the Bank uses the higher risk weight. If for an exposure 3 or more credit ratings are available, the Bank uses two ratings with the lowest risk weights and if the two are different, the higher risk weight is applied.

**Credit risk and counterparty credit risk exposures
by risk weights
as at 31.12.2017 (PLN k)**

No.	Exposure Class	Risk Weightings								Total
		0-3%	20%	35%	50%	75%	100%	150%	250%	
1.	Exposures to central governments or central banks	26 965 679	427 691	-	-	-	-	-	-	27 393 370
2.	Exposures to regional governments or local authorities	-	174 181	-	-	-	-	-	-	174 181
3.	Exposures to public sector entities	-	36	-	8 873	-	-	-	-	8 909
4.	Exposures to multilateral development banks	104 786	-	-	-	-	-	-	-	104 786
5.	Exposures to institutions*	2 620 844	2 428 204	-	1 559 938	-	7 314	-	-	6 616 300
6.	Exposures to corporates	1 720 564	420 300	-	435 071	-	35 488 531	33 367	-	38 097 833
7.	Retail exposures	802 075	-	-	-	45 722 076	-	-	-	46 524 151
8.	Exposures secured by mortgages on immovable property	450 324	-	13 127 219	816 445	-	25 010 741	12 124 258	-	51 528 987
9.	Exposures in default	29 774	-	-	-	-	5 821 044	779 956	-	6 630 774
10.	Exposures associated with particularly high risk	-	-	-	-	-	-	25 440	-	25 440
11.	Exposures in the form of units or shares in collective investment undertakings	-	-	-	-	-	-	-	-	-
12.	Equity exposures	-	-	-	-	-	875 532	-	909 380	1 784 912
13.	Other items	2 265 259	142 701	-	-	-	1 975 933	-	1 542 636	5 926 529
	Total exposures covered by the standardised approach	34 959 305	3 593 113	13 127 219	2 820 327	45 722 076	69 179 095	12 963 021	2 452 016	184 816 172

*including exposure for pre-funded contribution to the default fund of a qualifying central counterparty

There are not many companies on the Polish market which have a credit rating from the agencies listed above. As a result, 82.87% of the exposures presented below do not have a credit quality rating.

**Credit risk and counterparty credit risk exposures
by credit rating
as at 31.12.2017 (PLN k)**

No.	Exposure Class	Credit quality step							Total
		1	2	3	4	5	6	N/A	
1.	Exposures to central governments or central banks	-	24 597 124	-	-	-	-	2 796 246	27 393 370
2.	Exposures to regional governments or local authorities	-	-	-	-	-	-	174 181	174 181
3.	Exposures to public sector entities	-	-	-	-	-	-	8 909	8 909
4.	Exposures to multilateral development banks	-	-	-	-	-	-	104 786	104 786
5.	Exposures to institutions*	490 156	5 212 137	383 650	145 591	13 517	-	371 249	6 616 300
6.	Exposures to corporates	350 000	-	3 499 000	931 758	33 367	-	33 283 708	38 097 833
7.	Retail exposures	-	-	-	-	-	-	46 524 151	46 524 151
8.	Exposures secured by mortgages on immovable property	-	93 436	-	1 504 843	-	-	49 930 708	51 528 987
9.	Exposures in default	-	-	-	-	-	-	6 630 774	6 630 774
10.	Exposures associated with particularly high risk	-	-	-	-	-	-	25 440	25 440
11.	Exposures in the form of units or shares in collective investment undertakings	-	-	-	-	-	-	-	-
12.	Equity exposures	-	-	-	-	-	-	1 784 912	1 784 912
13.	Other items	-	-	-	-	-	-	5 926 529	5 926 529
	Total exposures covered by the standardised approach	840 156	29 902 697	3 882 650	2 582 192	46 884	0	147 561 593	184 816 172

*including exposure for pre-funded contribution to the default fund of a qualifying central counterparty



- 1. Introduction**
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Bank Zachodni WBK

 Grupa Santander

5. Capital buffers

The Act of 5 August 2015 on macroprudential supervision over the financial system and crisis management in the financial system transposed CRD IV into the Polish law with regard to, among other things, additional capital buffers to be maintained by banks.

On 1 January 2016, the minimum capital ratios for the banking sector in Poland were increased by 1.25 p.p. due to introduction of a conservation buffer.

On 4 October 2016, KNF identified Bank Zachodni WBK as other systemically important institution and imposed an additional capital buffer of 0.5 p.p.

Based on the assessment of the systemic importance of the bank, the KNF in its decision of 19 December 2017, as presented in letter No DAZ/7105/5/7/2017, identified the bank as an other systemically important institution (O-SII). O-SII buffer imposed on the bank was 0.50%.

Pursuant to the KNF letter No DBK/DBK 2/7105/20/5/2017 dated 20 November 2017, the bank was required to maintain own funds at the level sufficient to cover an additional capital requirement (add-on) for risk attached to foreign currency home mortgages at 0.54 p.p. above the total capital ratio, referred to in Article 92(1)(c) of Regulation No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms ("Regulation"). It should include at least 75% of Tier 1 capital (which corresponds to a capital requirement of 0.41 p.p. above Tier 1 capital ratio referred to in Article 92(1)(b) of the Regulation) and at least 56% of Common Equity Tier 1 capital (which corresponds to a capital requirement of 0.30 p.p. above Common Equity Tier 1 capital referred to in Article 92(1)(a) of the Regulation). The decision in this respect was expanded upon in the KNF's recommendation of 15 December 2017, as presented in letter No DBK/DBK 2/7111/109/1/2017, whereby the buffer pertaining to foreign currency mortgages to households for Bank Zachodni WBK Group was reduced to 0.44 p.p. in excess of the total capital ratio, which includes at least 75% of Tier 1 capital (which corresponds to a capital requirement of 0.33 p.p. above Tier 1 capital ratio) and at least 56% of the Common Equity Tier 1 capital (which corresponds to a capital requirement of 0.25 p.p. above the Common Equity Tier 1 capital).

Taking into account the above requirements, the minimum capital ratios as at 31 December 2017 are as follows:

- o Tier 1 capital ratio of 11.16% and 11.08% for the bank and the Group, respectively;
- o total capital ratio of 14.29% and 14.19% for the bank and the Group, respectively.

In relation to the entry into force on 1 January 2018 of the Regulation of the Minister of Economic Development and Finance of 1 September 2017 on the systemic risk buffer (3%), the KNF set the minimum capital ratios for banks in 2018. As of 2018, banks should maintain Tier 1 capital ratios at the minimum levels under Pillar 1 as set out in Article 92 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 (Official Journal of the European Union of 2013, p. 1, as amended; "CRR") and under Pillar 2 ("add-on") arising from Article 138(1)(2a) of Banking Law (consolidated text: Journal of Laws of 2017, item 1876) and combined buffer requirement set out in Act of 5 August 2015 on macroprudential supervision over the financial system and crisis management (consolidated text: Journal of Laws of 2017, item 1934). As of 1 January 2018, the conservation buffer will be 1.875%.

The table below presents unconsolidated and consolidated minimum ratios.

Capital buffers of Bank Zachodni and Banku Zachodni WBK Group at 31.12.2017

	31.12.2017			
	BANK		GROUP	
	CAR	TIER 1	CAR	TIER 1
KNF capital decision	12%	9%	12%	9%
Fx buffer	0,54%	0,41%	0,44%	0,33%
Capital conservation buffer	1,25%	1,25%	1,25%	1,25%
O-SII buffer	0,5%	0,5%	0,5%	0,5%
Total minimum ratio	14,29%	11,16%	14,19%	11,08%

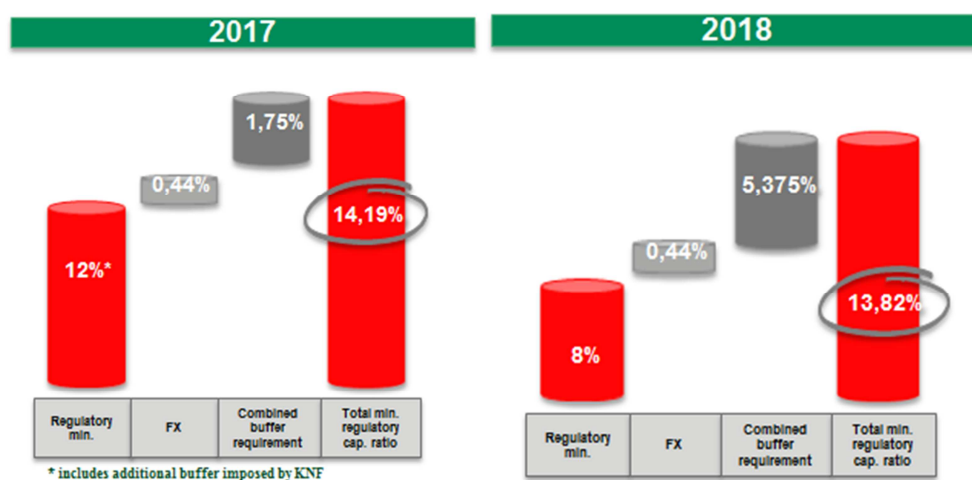
* KNF stance on the minimum capital ratios – KNF letter No DRB/0735/2/1/2014 of 21 March 2014

**additional capital requirement for risk attached to foreign currency home mortgages

Capital buffers of Bank Zachodni and Banku Zachodni WBK Group for 2018

	2018			
	BANK		GROUP	
	CAR	TIER 1	CAR	TIER 1
Minimum capital ratio (CRR)	8%	6%	8%	6%
Systemic risk buffer	3%	3%	3%	3%
Fx buffer	0,54%	0,41%	0,44%	0,33%
Capital conservation buffer	1,875%	1,875%	1,875%	1,875%
O-SII buffer	0,5%	0,5%	0,5%	0,5%
Total minimum ratio	13,92%	11,79%	13,82%	11,71%

***minimum capital ratios under Pillar 1 arising from Article 92 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

Capital buffers and ratios of the Bank Zachodni WBK Group as at 31.12.2017 and 2018

Since 1 January 2016, the countercyclical capital buffer ratio of 0% has been applied to credit exposures in Poland. The ratio shall be effective until it is changed by way of an ordinance of the Finance Minister.

Bank Zachodni WBK Group calculates the bank-specific countercyclical capital buffer in accordance with the Act of 5 August 2015 on macroprudential supervision over the financial system and crisis management.

The amount of the institution specific countercyclical capital buffer

	As at 31.12.2017
Total risk exposure amount [PLN k]	119 003 114
Institution specific countercyclical buffer rate [%]	0,00041
Institution specific countercyclical buffer requirement [PLN k]	488

Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer [PLN k]

No.	Country	General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements				Own funds requirements weights [%]	Countercyclical capital buffer rate [%]
		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		
1.	Poland	119 104 961	-	694 046	-	-	-	8 096 957	364	-	8 097 321	98,59083	0,00000
2.	Luksemburg	740 730	-	-	-	-	-	59 258	-	-	59 258	0,72151	0,00000
3.	United Kingdom	262 340	-	-	-	-	-	21 109	-	-	21 109	0,25702	0,00000
4.	Czech Republic	64 835	-	-	-	-	-	5 186	-	-	5 186	0,06315	0,50000
5.	USA	144 139	-	-	-	-	-	11 535	-	-	11 535	0,14045	0,00000
6.	Ireland	55 910	-	-	-	-	-	5 197	-	-	5 197	0,06327	0,00000
7.	Portugal	43 928	-	-	-	-	-	531	-	-	531	0,00646	0,00000
8.	Netherlands	56 195	-	-	-	-	-	5 523	-	-	5 523	0,06725	0,00000
9.	Spain	19 362	-	-	-	-	-	1 575	-	-	1 575	0,01918	0,00000
10.	Slovakia	16 412	-	-	-	-	-	1 305	-	-	1 305	0,01590	0,50000
11.	Germany	12 546	-	-	-	-	-	940	-	-	940	0,01145	0,00000
12.	Mexico	12 453	-	-	-	-	-	996	-	-	996	0,01213	0,00000
13.	Romania	7 517	-	-	-	-	-	598	-	-	598	0,00728	0,00000
14.	Liechtenstein	7 096	-	-	-	-	-	577	-	-	577	0,00702	0,00000
15.	China	3 838	-	-	-	-	-	307	-	-	307	0,00374	0,00000
16.	Ukraine	2 449	-	-	-	-	-	213	-	-	213	0,00260	0,00000
17.	France	2	-	-	-	-	-	142	-	-	142	0,00173	0,00000
18.	Austria	1 517	-	-	-	-	-	120	-	-	120	0,00147	0,00000
19.	Italy	1 064	-	-	-	-	-	87	-	-	87	0,00106	0,00000
20.	Belgium	1 443	-	-	-	-	-	127	-	-	127	0,00154	0,00000
21.	Sweden	822	-	-	-	-	-	52	-	-	52	0,00063	2,00000
22.	Dominican Republic	575	-	-	-	-	-	34	-	-	34	0,00042	0,00000
23.	New Zealand	411	-	-	-	-	-	49	-	-	49	0,00060	0,00000
24.	Switzerland	384	-	-	-	-	-	31	-	-	31	0,00037	0,00000
25.	Tunisia	354	-	-	-	-	-	-	-	-	-	0,00001	0,62500
26.	Israel	329	-	-	-	-	-	-	-	-	-	0,00000	1,50000
27.	Norway	3	-	-	-	-	-	-	-	-	-	0,00000	2,00000
28.	Other countries	2 490	-	-	-	-	-	192	-	-	192	0,00236	0,00000
	Total	120 564 105	0	694 046	0	0	0	8 212 641	364	0	8 213 005	100	



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6. Capital adequacy

6.1. Capital adequacy management

It is the policy of the Bank Zachodni WBK Group to maintain the level of capital adequate to the type and scale of operations and the level of risk. The level of own funds required to ensure safe operations of Bank Zachodni WBK Group and capital requirements estimated for the unexpected loss is determined in accordance with the CRD IV / CRR package plus KNF recommendations regarding national options.

The **Management Board** is accountable for capital management, calculation and maintenance processes, including assessment of capital adequacy vis a vis different economic conditions and evaluations of stress tests results and their impact on internal capital and capital adequacy. Responsibility for general oversight over estimation of internal capital rests with the Supervisory Board.

The Management Board delegated on-going capital management to Capital Committee. Capital Committee conducts regular assessment of capital adequacy of the Bank and the Group, also in extreme conditions, monitors the actual and required capital levels and initiates transactions affecting these levels (e.g. by recommending the value of dividends to be paid).

The Credit Committee is the first body in the bank to define capital policy and rules for assessment of capital adequacy both for the Bank and the Group. It also approves capital plans and sets out rules underpinning allocation of capital into individual segments when estimating profitability of the same. However, any ultimate decisions regarding increase or decrease of capital are taken by relevant authorities of the bank and subsidiaries in accordance with the applicable law and the Bank's Statutes.

Capital Policy

The capital management policy of BZ WBK Group stipulates the minimum capital ratios, taking into account regulatory requirements, applicable capital buffers and additional own fund requirements under Pillar 2.

Pursuant to CRR, institutions must at all times satisfy the following own funds requirements:

- a Common Equity Tier 1 capital ratio of 4.5%;
- a Tier 1 capital ratio of 6%;
- a total capital ratio of 8%.

Pursuant to the KNF decision of 21 March 2014, the minimum regulatory capital ratios were increased to 9% for Tier 1 capital ratio and 12% for total capital ratio, applicable until 31 December 2017.

Pursuant to the KNF requirement of 23 October 2015, selected financial institutions shall maintain own funds at the level sufficient to cover an additional capital requirement for risk attaching to foreign currency home mortgages.

As at 31 December 2017, the minimum capital ratios of the bank and BZ WBK Group satisfying the regulatory recommendations and additional own fund requirements under Pillar 2 were as follows:

- a Tier 1 capital ratio of Bank Zachodni WBK of 11.16%;
- a Tier 1 capital ratio of Bank Zachodni WBK Group of 11.08%;
- a total capital ratio of Bank Zachodni WBK of 14.29%;
- a total capital ratio of Bank Zachodni WBK Group of 14.19%.

The above-mentioned capital ratios take into account the KNF recommendation on an additional capital requirement related to home mortgages and an additional capital buffer in connection with the identification of Bank Zachodni WBK as other systemically important institution, plus a conservation buffer.

Dividend Policy

In the letter of 15 December 2017 the KNF presented its stance on the dividend policy of commercial banks in 2018.

In accordance with the requirements set by the regulator, 50% of 2017 profit may only be distributed by the banks which meet the basic criteria, in particular:

- their Tier 1 capital ratio is not lower than the minimum required level increased by 1.5 p.p.:
 - 6% + 75%*add-on + combined buffer requirement + 1.5%;
- their total capital ratio is not lower than the minimum required level increased by 1.5 p.p.:
 - 8% + combined buffer requirement + 1.5%.

Pursuant to the KNF recommendation:

- 75% of 2017 profit may be distributed by banks which meet all the above criteria along with the target level of the conservation buffer requirement, i.e. 2.5% of total risk exposure;
- 100% of 2017 profit may be distributed by banks which meet all the above criteria (including conservation buffer at the target level), taking into account, as part of the capital criteria, the bank's sensitivity to adverse economic scenario (ST). An individual add-on (ST) used to measure the bank's sensitivity to an adverse macroeconomic scenario is 0.71%.

In addition, the KNF recommendations for dividend payment require that dividend yield be adjusted by banks which have significant exposure arising from foreign currency home loans based on the following criteria:

Criterion 1 – share of foreign currency home loans in the total portfolio of loans granted to the non-financial sector:

- banks with the share above 10% – dividend yield to be adjusted by 20%
- banks with the share above 20% – dividend yield to be adjusted by 30%
- banks with the share above 30% – dividend yield to be adjusted by 50%

Criterion 2 – share of foreign currency home loans granted in 2007-2008 in the portfolio of foreign currency home loans:

- banks with the share above 20% – dividend yield to be adjusted by 30%
- banks with the share above 50% – dividend yield to be adjusted by 50%

Taking into account the exposure of Bank Zachodni WBK arising from foreign currency home loans, as at 31 December 2017 the adjustment to dividend yield is 20% and 50% under the first and second criteria, respectively.

As at the release date of this report, the bank's Management Board did not decide on dividend payment from profit for 2017 or retained profit for 2016.

6.2. Regulatory capital adequacy

Pursuant of Article 92 of CRR, total capital ratio is determined on the basis of own funds and total capital requirements multiplied by 12.5.

The capital requirement for Bank Zachodni WBK Group as at 31.12.2017 was determined in accordance with Regulation no. 575/2013 of the European Parliament and the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms as well as KNF recommendations regarding national options.

The capital requirements for credit, market and operational risks were calculated using a standardised approach. The capital requirement for credit risk is the most significant one.

The value of asset exposure is the carrying value of the asset after adjustments for specific credit risk, additional value adjustments and other own fund deductions related to a particular asset. The off-balance sheet exposure is the percentage of the nominal value less adjustments for specific credit risk.

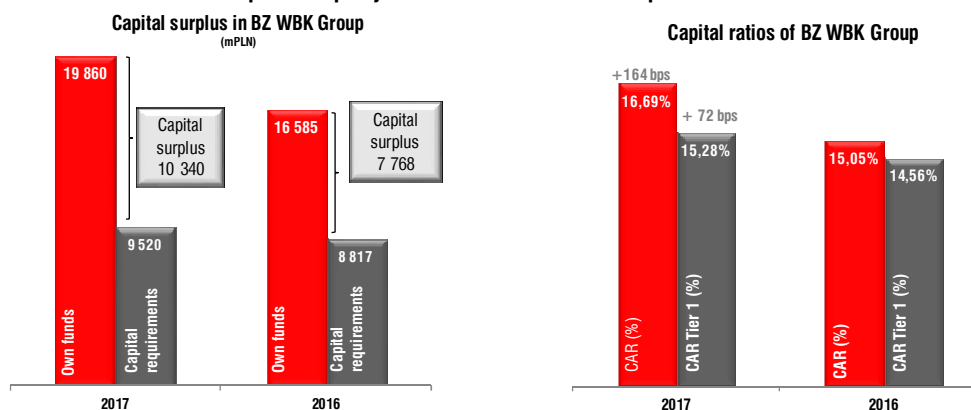
Taking into account total capital requirements of PLN **9 520 249k** as at 31 December 2017 and own funds of PLN **19 860 478k**, the capital ratio of Bank Zachodni WBK Group is **16.69%**.

The total capital ratio as at 31 December 2017 vs. 31 December 2016 was impacted by the following:

- allocation of the profit for 2016 to Tier 1 capital;
- distribution of the portion of the retained profit for 2015 in the form of dividend;

- allocation of PLN 520m to Tier 1 capital, representing 50% of the bank's profit for the period between 1 January 2017 and 30 June 2017 (pursuant to the KNF decision of 11 September 2017, letter No. DBK/DBK 2/7105/14/7/2017);
- allocation of the subordinated bonds of EUR 120m issued by Bank Zachodni WBK on 2 December 2016, maturing on 3 December 2026 and taken up by investors to Tier 2 capital (pursuant to the KNF decision of 24 February 2017, letter No. DBK/DBK 2/7100/6/7/2016/2017);
- allocation of the subordinated bonds of EUR 137.1m issued by Bank Zachodni WBK on 22 May 2017, maturing on 22 May 2027 and taken up by an investor to Tier 2 capital (pursuant to the KNF decision of 19 October 2017, letter No. DBK/DBK 2/7100/1/14/2017);
- increase in the value of risk weighted assets for credit risk arising from the business activity;
- increase in the value of risk weighted assets for credit risk due to the increase in risk weight for foreign currency mortgage loans up to 150%.

Capital adequacy of Bank Zachodni WBK Group in 2016 - 2017



6.3. Internal capital adequacy

Notwithstanding the regulatory methods for measuring capital requirements, Bank Zachodni WBK Group carries out an independent assessment of current and future capital adequacy as part of the internal capital adequacy process (ICAAP). The purpose of the process is to ensure that the level and nature of own funds guarantee the solvency and stability of the bank's and the Group's operations.

The capital adequacy assessment is one of the fundamental elements of the Group's strategy, the process of defining risk appetite and the process of planning.

The Group uses assessment models based on the statistical loss estimation for measurable risks, such as credit risk, market risk and operational risk and its own assessment of capital requirements for other material risks not covered by the model, e.g. reputational risk and compliance risk.

The internal capital is estimated on the basis of risk parameters including the probability of default of BZ WBK Group customers (PD - probability of default) and loss given default (LGD loss given default).

Bank Zachodni WBK Group performs an internal assessment of capital requirements, including under stressed conditions, taking into account different macroeconomic scenarios.

Internal capital estimation models are assessed and reviewed annually to adjust them to the scale and profile of the Group's business and to take account of any new risks and the management judgement.

The review and assessment is the responsibility of the Group's risk management committees, including: Capital Committee and the Models and Methodology Panel, which is part of the Risk Management Forum.



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7. Securitization

SCB securitized cash loans portfolio in August 2016. The transaction was a traditional and revolving one and consisted in transferring the right to securitized receivables to SC Poland Consumer 16-1 Sp. z o. o. (SPV3), with a registered office in Poland. On the basis of the securitized assets, the aforesaid company issued bonds secured in the form of a registered pledge on the assets of SPV3. SCB granted the company a subordinated loan to support the transaction.

On the basis of securitized assets, the SPV3 company issued bonds of total value of PLN 1 225 000k secured by registered pledge on SPV3's estate. As a result of securitization, the SCB Bank received funding of activity in exchange for giving the rights to future flows resulting from securitized loan portfolio. In order to support the funding of transaction, the SCB Bank granted a subordinated loan to SPV3. The loan is subordinated with regard to senior and covered bonds.

The SCB Bank does not perform trading activity, therefore, both securitization positions and securitized portfolio are included in the banking book. Moreover, the SCB Bank does not use hedging and unfunded protection in order to mitigate the risk related to maintained securitization exposures.

Within the securitization transaction with significant risk transfer (hereinafter referred to also as "SRT transaction") performed in 2016, the SCB Bank received funds with the use of assets in the form of loans granted by the SCB Bank, thus improving its financial liquidity.

Tranche Amount Status

Tranche	Amount (PLN k)	Status
A (superior)	1 000 000	Acquired by external investor
B1 (mezzanine)	140 625	Acquired by external investor
B2 (mezzanine)	84 375	Acquired by external investor
Subordinated loan	37 250	Retained*
Total	1 262 250	

* decreasing the Bank's own funds according to Art. 36 clause 1 point k) of CRR

The contractual terms of securitisation do not satisfy the criteria for derecognition of securitised assets from the bank's balance sheet pursuant to IAS 39. Therefore, the Bank recognizes securitized assets in the item Loans granted to clients. At the same time, the SCB Bank recognizes liability for securitization flows in the item Liabilities towards clients. Both the securitized portfolio and securitization positions are estimated according to the amortized cost method, in line with IAS 39. In relation to the fact that the securitized portfolio is not subject to derecognition from the SCB Bank's balance sheet, it is subject to standard procedures of monitoring and managing credit and market risk, in line with the policies and procedures applicable at the Bank.

Securitized portfolio within SRT Transaction

as of the day of transaction launch	Portfolio value (PLN k)
securitized portfolio (cash loans)	1 250 000

Within the SRT transaction, the Bank decreased the common equity Tier 1 by securitization positions maintained as part of SRT transaction according to Art. 36 clause 1. point k) of CRR Regulation, therefore fulfilling the conditions of recognising the significant risk transfer according to Art. 243 clause 1 point b) of CRR Regulation. Moreover, pursuant to Art. 243 and 245 of CRR Regulation, the SCB Bank excluded securitized exposures from calculations of amounts of risk-weighted assets.

The SCB Bank fulfils the requirement to maintain significant net economic share according to rules described in Chapter 5 of Part Three of CRR Regulation.

The main objectives of the SCB Bank related to securitization activity include the following:

- obtaining liquidity - securitization enables to exchange non-liquid assets for liquid assets and to obtain funding through sale or pledge of these liquid assets;
- diversification of funding lines - liquidity obtained from securitization enables diversification due to the length of funding and the product;
- optimization of use of the Bank's capital - through securitization transactions, the Bank can reduce the risk-weighted assets and optimize exposure to credit risk.

The Bank's role in securitization transactions is limited to being an initiator of transaction. In addition, the Bank fulfils a service role with regard to the securitized portfolio.

Risks related to securitization transactions include:

- credit risk - the risk of deterioration in securitized assets quality;
- risk of loan prepayment - the risk of early repayment of total or part of securitized assets;
- basis risk - the risk of mismatch of tenor or interest rate index of securitized assets and securitization positions;
- liquidity risk - the Bank's liquidity risk decreases as a result of securitization due to exchange of non-liquid assets for liquid assets and adjusting the funding structure to assets.



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8. Remuneration Policy

The remuneration principles of BZ WBK Group are defined in the BZ WBK Group Remuneration Policy.

The above-mentioned document contains all provisions required by law, including the rules of calculating fixed and variable components of remuneration, setting the variable remuneration payment criteria and determining all parts of total remuneration (fixed and variable components, long-term incentive programmes, etc.).

BZ WBK Group has put in place general regulations applicable for all employees, including those whose professional activity has a significant impact on the Bank's risk profile ("material risk takers").

Material risk takers are additionally subject to specific provisions of the **BZ WBK Group Remuneration Policy** and corresponding regulations applicable in the subsidiaries of BZ WBK. The policy is reviewed once a year and after each significant organisational or legal change.

Decision-making process for determining the remuneration policy

The BZ WBK Group Remuneration Policy is adopted by the BZ WBK Management Board and approved by the Bank's Supervisory Board. The remuneration (both fixed and variable) of management board members is determined by the resolutions of the Supervisory Board. The bonus schemes for other employees are reviewed by the Remuneration Committee of the Supervisory Board and approved by the Management Board member in charge of the Business Partnership Division. All regulations on awarding variable components of remuneration that apply to all employees of the Bank are published in the form of ordinances issued by the Management Board member in charge of the Business Partnership Division, in accordance with and on the basis of the BZ WBK Remuneration Policy.

The Nominations and Remuneration Committee of the Supervisory Board, which operated until 16 May 2017. It was divided into two separate bodies: the Nominations Committee and the Remuneration Committee on 17 May 2017. The responsibilities of the Nominations Committee of the Supervisory Board include the review of remuneration regulations before they are implemented.

The Nomination Committee:

- planning the succession and appointment of the Bank's Management Board members
- selection and suitability assessment of the Bank's Management Board members

The Remuneration Committee of the Supervisory Board provides support for the supervisory board in issues such as:

- general monitoring of market practices regarding remuneration and its levels
- providing the Supervisory Board with recommendations on decisions to be taken to introduce fair and competitive remuneration policies and practices ensuring that Management Board members and top executives remain adequately motivated.

In 2017, the Remuneration Committee of the Supervisory Board met five times (including two times as the Nominations and Remuneration Committee). Additionally, two meetings of the Nominations Committee of the Supervisory Board were held.

From 1 January to 16 May 2017, the Nominations and Remuneration Committee was composed of:

- the Committee Chairperson: Gerry Byrne
- Committee Members: Danuta Dąbrowska, Witold Jurcewicz, José Luis de Mora, Jerzy Surma.

Three of the members: Danuta Dąbrowska, Witold Jurcewicz and Jerzy Surma, were independent.

Starting from 17 May 2017, the Remuneration Committee has been composed of:

- the Committee Chairperson: Danuta Dąbrowska
- Committee Members: Gerry Byrne, Witold Jurcewicz, José Luis de Mora, Marynika Woroszyńska-Sapieha.

The criteria for the identification of material risk takers applied in BZ WBK Group are compliant with 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.

All employees of the Bank are subject to bonus schemes defining the variable component of their remuneration. In each of the schemes, the bonus and its amount are contingent on the achievement of pre-defined business goals.

The business goals are related to the performance of the relevant area or the entire Bank (for support units). In the case of sale units, the variable remuneration is also affected by the individual performance of the employee.

Characteristic features of the remuneration scheme and performance criteria that have to be met to obtain rights to shares, share options or variable remuneration components.

The remuneration scheme consists of two basic elements: fixed and variable remuneration.

The fixed component of remuneration depends on the employee's grade. For each grade, remuneration brackets are determined based on an annual pay report prepared by renowned consulting companies.

The variable component of the remuneration depends on the bonus scheme applicable for the employee. Payment of bonuses under a scheme is contingent on the delivery of pre-defined business goals (PBT or PAT level or growth rate) and quality indicator levels. An additional goal for business units is the achievement of a pre-set level of the RoRWA ratio (return on risk-weighted assets).

Variable components of remuneration (including shares and phantom shares) are awarded based on the bonus scheme regulations applicable for the employees in question.

In accordance with the guidelines of the Polish Financial Supervision Authority (KNF), at least 50% of the variable remuneration of material risk takers is paid in the form of capital market instruments (in the case of the Bank, phantom shares). Moreover, payment of 40% of the variable remuneration component is deferred for 3 years. Each of the deferred parts can be reduced or withheld if specific negative factors occur.

Long-term (3-year) incentive programmes for key employees are another form of variable remuneration used in the Bank. Under the programme, newly issued BZ WBK shares are awarded to the participants if the business conditions specified in the programme rules are met.

Ratio between fixed and variable components of remuneration

The ratio between the fixed and variable components of remuneration depends on the bonus scheme applicable for the employee and the extent to which the relevant business goals have been achieved (which determine the amount of the bonus) as well as on whether the employee is covered by a long-term incentive programme. If the employee has not achieved their business goals at the minimum required level, the variable part of the remuneration may be withheld.

The total amount of the variable remuneration granted to a material risk taker for a single calendar year cannot be higher than 200% of the fixed remuneration paid to that employee for that calendar year.

Main parameters of variable components of remuneration

The BZ WBK remuneration scheme was designed to enable the effective acquisition and retention of employees whose competences are required to deliver all strategic objectives of the Bank successfully and efficiently.

Consequently, BZ WBK has implemented a range of diverse bonus schemes addressed to various groups of employees, in particular the employees of sale units and support units. The schemes differ in terms of criteria which determine whether the bonus will be paid and what its final amount will be. Other differences between the schemes include the frequency of bonus payments and maximum levels of bonus available to the employees covered by the given scheme.

There is a policy in the Bank- **Policy of selection and evaluation of qualification of Board Members and people fulfilling the most important functions in the BZ WBK**. With regard to the members of the Supervisory Board, the competences belongs to the Supervisory Board based on the recommendations of the Remuneration Committee of the Supervisory Board. As part of this policy, both the process of individual assessment of qualifications and reputation of individual members of the Management Board in relation to relevant competence profiles and the process of collective assessment of the Board as a collegial body, based on the Collective Competence Profile are conducted.

The Bank also cares for the continuous development of its employees and ensuring succession for the most important positions at the Bank. The processes are implemented on the basis of the **Policy of loading and succession of the Board Members and people who**

have the most important functions in the BZ WBK. According to this policy, when promoting or appointing individuals to the positions of Management Board members or Key Function Holders in the Bank, Bank Zachodni WBK acts to ensure that the candidates for those positions and functions are highly qualified, hold professional experience corresponding with the tasks assigned to a given function and have an impeccable reputation both in the professional and private life.

Promoting the policy of diversity, the Bank acts on the best effort basis to ensure that the candidates for the positions of the Management Board members and key function holders are characterised by a wide range of features and competence and the ability to make independent judgement and opinions.

Summary information about remuneration paid to management body members and identified employees (material risk takers) of BZ WBK Group (divided by business area) (PLN k)

Area	Management Board*	Retail Banking	Business and Corporate Banking	Global Corporate Banking	Business Support	Subsidiaries**	Total
Fixed remuneration***	12 898	4 328	3 612	3 100	10 784	19 209	53 931
Variable Remuneration****	8 186	2 071	791	1 057	4 986	7 682	24 773
TOTAL	21 084	6 399	4 403	4 157	15 770	26 891	78 704

*The "Management Board" line shows the aggregated data for periods during which the persons acted as the Management Board members. The remaining part of the remuneration payable to the persons who did not sit on the Management Board for 12 months was included in a relevant group.

**Including Management Board members and other executives of subsidiaries.

***Fixed remuneration takes into account an allowance in lieu of annual leave at PLN 124,695.92 in the case of the Management Board members and PLN 129,589.94 in the case of other executives. It does not include additional benefits, though.

**** Variable remuneration paid in 2017. As at the date of report preparation, data about variable remuneration components for the accounting year were not available.

Data not refer to the former employees covered by the policy on variable components of remuneration.

The figures relating to variable remuneration components for 2017 will be published along with the information about the capital adequacy of BZ WBK Group for H1 2018.

The amounts of remuneration for 2017 split into fixed and variable remuneration (PLN k)

	Headcount	Fixed remuneration for 2017*****	VARIABLE REMUNERATION PAID IN 2017								
			Deferred bonus for 2012	Deferred bonus for 2013	Deferred bonus for 2014	Deferred bonus for 2015**	Deferred bonus for 2016**	VARIABLE REMUNERATION FOR 2017			
								Headcount	Bonus for 2017*	Non-redeemed phantom shares (number of phantom shares)	Long-term performance share programme completed in 2017 (number of BZ WBK shares)*****
Management Board***	13	12 898	-	900	1 002	3 478	2 806	-	-	9 124	10 036
Other persons holding managerial positions*****	113	41 033	276	720	1 467	5 655	8 469	-	-	23 667	18 826
TOTAL	126	53 931	276	1 620	2 469	9 133	11 275	-	-	32 791	28 862

* At the report preparation date, no data on variable components of remuneration for the financial year.

** The portion paid in 2017 for 2016, not deferred. Contains phantom shares cashed in the financial year.

*** The "Management Board" line shows the aggregated data for periods during which the persons acted as the Management Board members. The remaining part of the remuneration payable to the persons who did not sit on the Management Board for 12 months was included in a relevant group.

**** Fixed remuneration takes into account an allowance in lieu of annual leave at PLN 124,695.92 in the case of the Management Board members and PLN 129,589.94 in the case of other executives. It does not include additional benefits, though.

***** Including subsidiaries (Management Board members and other executives).

***** Number of shares allotted to an employee as part of the long-term Performance Share Programme.

Data not refer to the former employees covered by the policy on variable components of remuneration.

**The amount of variable remuneration from previous years
not payable yet**

	BONUS DEFERRED (2013/2014/2015/2016) remuneration not payable yet		
	In cash	In phantom shares (number of phantom shares)	Long-term performance share programme launched in 2017 (number of shares)*
Management Board**	3 669	15 712	34 670
Other persons holding managerial positions**	5 751	28 292	41 194
TOTAL	9 420	44 004	75 864

* Maximum amount, subject to meeting business criteria during the programme.

** The "Management Board" line shows the aggregated data for periods during which the persons acted as the Management Board members. The remaining part of the remuneration payable to the persons who did not sit on the Management Board for 12 months was included in a relevant group.

*** Including subsidiaries (Management Board members and other executives).

Data not refer to the former employees covered by the policy on variable components of remuneration.

In 2017, no reductions were made in the deferred remuneration payable to persons holding managerial positions on account of the adjustment related to the results.

New sign-on and severance payments in 2017 (PLN k)

	Area	Headcount	PAYMENT AMOUNT	Highest severance pay
New sign-on made in 2017	Management Board	-	-	-
	Other management persons	-	-	-
Severance pay in 2017	Management Board*	-	-	-
	Other persons holding managerial positions	-	-	-
Amounts of severance payments awarded	Management Board	-	-	-
	Other management persons	5	75	15

* The "Management Board" line shows the aggregated data for periods during which the persons acted as the Management Board members. The remaining part of the remuneration payable to the persons who did not sit on the Management Board for 12 months was included in a relevant group.

In the analysed financial year, no employee of BZ WBK Group was paid more than EUR 1m.

In 2017, 5 material risk takers were hired while 3 other material risk takers terminated their employment agreements (none of them received a severance payment).

Detailed information regarding the remuneration paid to the Management Board Members is presented in note 48 of the Consolidated Financial Statements of Bank Zachodni WBK Group for 2017.

Long-term incentive programme (6th edition)

Key employees of BZ WBK Group can be rewarded with shares under long-term incentive programmes (LTIPs). The sixth LTIP, which began in 2017, covers 230 employees of the Bank and its subsidiaries.

The current programme supports the delivery of the business and financial objectives of BZ WBK. It ensures that the participants strive to meet the expectations of the Bank's shareholders. It also aims to make the work environment in the Bank even more engaging and improve professional customer service in line with the Simple | Personal | Fair values.

The sixth edition of the programme, just like its predecessors, guarantees a competitive and balanced remuneration package to BZ WBK Group employees.

The full award is granted only if, before the end of the programme, BZ WBK Group meets the financial and quality-related objectives defined by the annual general meeting of shareholders in terms of the PAT growth rate, RoRWA, customer satisfaction and staff engagement.

The progress of long-term incentive programmes is monitored quarterly. As part of the monitoring, it is verified if any events have occurred that could make LTIP members lose their right to participate in the programme. The most frequent event of this type is termination of the employment relationship with the Bank or another entity from BZ WBK Group. The qualitative and financial indicators whose levels determine the right to the reward are also monitored (in cooperation with the Finance Division).



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Bank Zachodni WBK



9. Leverage ratio

In December 2010, the BCBS published guidelines (Basel III: A global regulatory framework for more resilient banks and banking system) defining the methodology for calculating the leverage ratio. Those rules provide for an observation period that will run from 1 January 2013 until 1 January 2017 during which the leverage ratio, its components and its behavior relative to the risk-based requirement will be monitored. Based on the results of the observation period the BCBS intends to make any final adjustments to the definition and calibration of the leverage ratio in the first half of 2017, with a view to migrating to a binding requirement on 1 January 2018 based on appropriate review and calibration. The BCBS guidelines also provide for disclosure of the leverage ratio and its components starting from 1 January 2015.

Considering the above and having regard to the legal aspects of the introduction of a leverage ratio, ie. Articles 511 CRR, the European Commission will present to the European Parliament and the Council a report on the impact and effectiveness of the leverage ratio. Where appropriate, the report shall be accompanied by a legislative proposal on the introduction of an appropriate number of levels of the leverage ratio that institutions following different business models would be required to meet.

The leverage ratio of Bank Zachodni WBK Group is set in accordance with 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 ("CRR") and Commission delegated Regulation (EU) 2015/62 of 10 October 2014 amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to the leverage ratio.

The leverage ratio (LR) shall be calculated as an institution's capital measure divided by that institution's total exposure measure and shall be expressed as a percentage.

A reference day for the following data is 31 December 2017. Presented leverage ratio is calculated in relation to Tier 1 capital phase in definition. Bank Zachodni WBK Group disclose the information on sub-consolidated basis. Fiduciary items are not eliminated from the total leverage ratio exposure.

Summary reconciliation of accounting assets and leverage ratio exposures as at 31.12.2017 (PLN k)

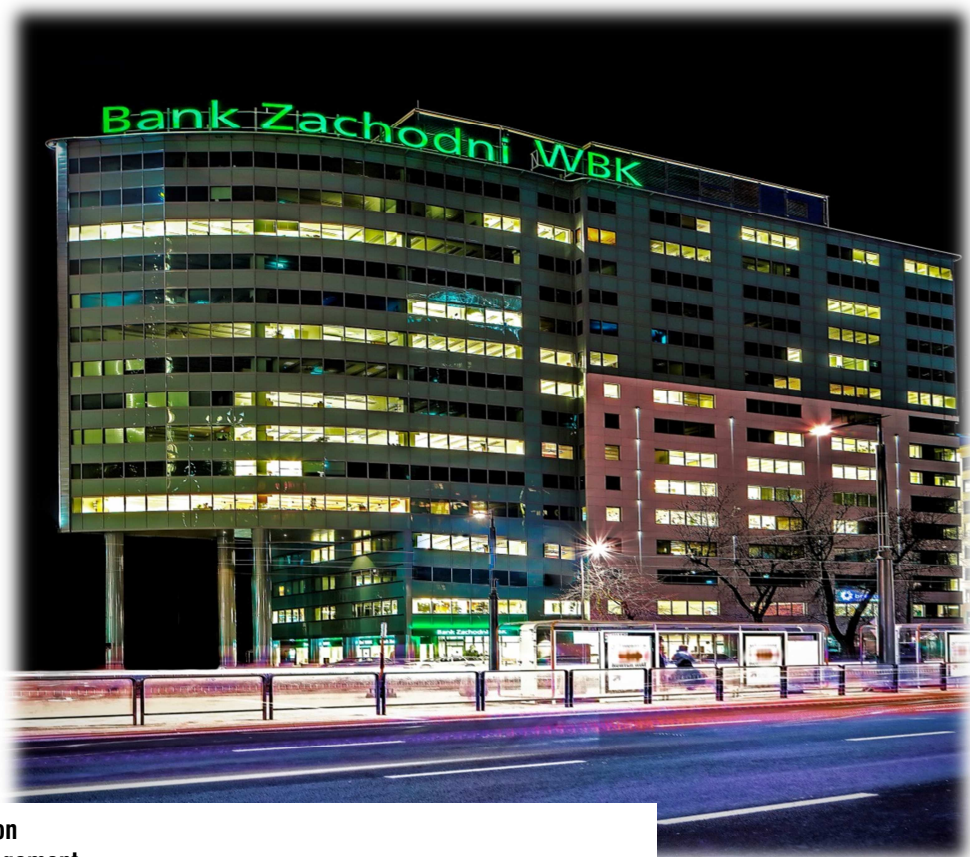
		Applicable Amounts
1	Total assets as per published financial statements	152 674 444
2	Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	125 079
3	(Adjustment for fiduciary assets recognised on the balance sheet pursuant to the applicable accounting framework but excluded from the leverage ratio exposure measure in accordance with Article 429(13) of Regulation (EU) No 575/2013 "CRR")	-
4	Adjustments for derivative financial instruments	890 478
5	Adjustments for securities financing transactions "SFTs"	309 481
6	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)	5 843 411
EU-6a	(Adjustment for intragroup exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (7) of Regulation (EU) No 575/2013)	-
EU-6b	(Adjustment for exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (14) of Regulation (EU) No 575/2013)	-
7	Other adjustments	(3 352 652)
8	Total leverage ratio exposure	156 490 241

**Leverage ratio common disclosure
as at 31.12.2017 (PLN k)**

		CRR leverage ratio exposures
On-balance sheet exposures (excluding derivatives and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	150 456 348
2	(Asset amounts deducted in determining Tier 1 capital)	(2 454 088)
3	Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)	148 002 260
Derivative exposures		
4	Replacement cost associated with <i>all</i> derivatives transactions (i.e. net of eligible cash variation margin)	1 035 978
5	Add-on amounts for PFE associated with <i>all</i> derivatives transactions (mark-to-market method)	1 299 112
EU-5a	Exposure determined under Original Exposure Method	-
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	-
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	-
8	(Exempted CCP leg of client-cleared trade exposures)	-
9	Adjusted effective notional amount of written credit derivatives	-
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-
11	Total derivative exposures (sum of lines 4 to 10)	2 335 090
Securities financing transaction exposures		
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	308 686
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	-
14	Counterparty credit risk exposure for SFT assets	795
EU-14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Article 429b (4) and 222 of Regulation (EU) No 575/2013	-
15	Agent transaction exposures	-
EU-15a	(Exempted CCP leg of client-cleared SFT exposure)	-
16	Total securities financing transaction exposures (sum of lines 12 to 15a)	309 481
Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	29 528 026
18	(Adjustments for conversion to credit equivalent amounts)	(23 684 615)
19	Other off-balance sheet exposures (sum of lines 17 to 18)	5 843 411
Exempted exposures in accordance with CRR Article 429 (7) and (14) (on and off balance sheet)		
EU-19a	(Exemption of intragroup exposures (solo basis) in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet))	-
EU-19b	(Exposures exempted in accordance with Article 429 (14) of Regulation (EU) No 575/2013 (on and off balance sheet))	-
Capital and total exposures		
20	Tier 1 capital	18 178 179
21	Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)	156 490 241
Leverage ratio		
22	Leverage ratio	11,62%
Choice on transitional arrangements and amount of derecognised fiduciary items		
EU-23	Choice on transitional arrangements for the definition of the capital measure	"phase in"
EU-24	Amount of derecognised fiduciary items in accordance with Article 429(11) of Regulation (EU) NO 575/2013	-

Procedures used for the purpose of management of excessive leverage risk and factors affecting the leverage ratio between the current period and the last period for which the ratio was presented

Description of the processes used to manage the risk of excessive leverage	The bank has the Leverage & Excessive Leverage Risk Policy in place which defines the objectives and addresses the key aspects of measurement, monitoring and reporting the leverage ratio and its compliance with the regulatory requirements as well as identification, management and monitoring of excessive leverage risk. The document sets out the roles and responsibilities of the parties involved in the relevant processes.
Description of the factors that had an impact on the leverage Ratio during the period to which the disclosed leverage Ratio refers	As at 31 December 2017, the leverage ratio of Bank Zachodni WBK Group totalled 11.62% and was three-fold higher than the minimum requirement of 3%. The factors determining the financial leverage were PLN 519 865k worth of profit generated in the current period which was taken to own funds while increasing of total assets.



- 1. Introduction**
- 2. Risk Management**
 - 2.1. Credit risk
 - 2.2. Market risk
 - 2.3. Liquidity risk
 - 2.4. Operational risk
 - 2.5. Compliance risk
 - 2.6. Reputation risk
- 3. Own funds**
 - 3.1. Tier I capital
 - 3.2. Tier II capital
- 4. Capital requirements**
 - 4.1. Capital requirements for individual risk types
 - 4.2. Exposure structure
 - 4.3. Allocating risk weights to the credit portfolio
- 5. Capital buffers**
- 6. Capital adequacy**
 - 6.1. Capital adequacy management
 - 6.2. Regulatory capital adequacy
 - 6.3. Internal capital adequacy
- 7. Securitization**
- 8. Policy of variable components of remuneration**
- 9. Leverage ratio**
- 10. Encumbered assets and unencumbered assets**

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10. Encumbered assets and unencumbered assets

An asset is treated as encumbered if it has been pledged or if it is subject to any form of arrangement to secure or credit-enhance any on-balance-sheet or off-balance-sheet transaction from which it cannot be freely withdrawn (for instance, to be pledged for funding purposes).

Assets of Bank Zachodni WBK Group as at 31.12.2017 (PLN k)

	Carrying amount of encumbered assets *	Fair value of encumbered assets	Carrying amount of unencumbered assets*	Fair value of unencumbered assets
Assets of the reporting institution	7 462 823		145 211 720	
Loans on demand	798 351	-	2 588 854	
Equity instruments	-	-	936 342	936 342
Debt securities	4 526 885	4 526 885	26 421 706	26 421 706
of which: covered bonds	-	-	-	-
of which: asset-backed securities	-	-	-	-
of which: issued by general governments	3 987 227	3 987 227	22 278 695	22 278 695
of which: issued by financial corporations	539 658	539 658	1 520 230	1 520 230
of which: issued by non-financial corporations	-	-	1 242 941	1 242 941
Loans and advances other than loans on demand	2 136 690		105 049 797	
of which: mortgages	-		52 340 416	
Other assets	897		10 215 021	

* Total assets is presented in accordance with the prudential consolidation (CRR 575/2013).

Collateral of Bank Zachodni WBK Group as at 31.12.2017 (PLN k)

	Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance
Collateral received by the reporting institution	-	76 374
Loans on demand	-	76 374
TOTAL ASSETS, COLLATERAL RECEIVED AND OWN DEBT SECURITIES ISSUED	7 462 823	-

**Encumbered assets/collateral received
and associated liabilities as at 31.12.2017 (PLN k)**

	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
Carrying amount of selected financial liabilities	7 140 195	7 461 926
Derivatives	397 058	798 351
of which: over-the-counter	397 058	798 351
Deposits	4 464 177	4 526 885
Repurchase agreements	2 650 698	2 990 773
of which: central banks	-	-
Collateralised deposits other than repurchase agreements	1 813 479	1 536 112
of which: central banks	-	-
Debt securities issued	2 278 960	2 136 690
of which: covered bonds issued	-	-
of which: asset-backed securities issued	2 278 960	2 136 690
Other sources of encumbrance	897	897
Nominal of loan commitments received	-	-
Nominal of financial guarantees received	-	-
Fair value of securities borrowed with non-cash collateral	-	-
Other	897	897
TOTAL SOURCES OF ENCUMBRANCE	7 141 092	7 462 823

As of 31 December 2017, the BZ WBK Group held assets encumbered under:

- financial transactions involving the sale of securities with a simultaneous commitment to their repurchase at a fixed date in the future (repo transactions),
- financing agreements signed by BZ WBK and its subsidiary companies with international financial institutions,
- collateral resulting from the Bank's operations on the derivatives market.

The evolution in time of encumbrances related to financing agreements signed with international financial institutions is a result of the following:

- changes of value of assets constituting the collateral (increase due to signing new financing agreements or drawing tranches within the already signed agreements, decreases caused by repayments of obligations under financing agreements),
- parameters of financial instruments used as a collateral.

Within financing agreements signed with international financial institutions, the Bank concluded financial pledges agreements based on T-bonds. Pledge coverage ratio depends on the Bank's rating and changes according to the rating upgrade/ downgrade. If the actual collateral value falls below the contractually required minimum level, the Bank is obliged to constitute additional collateral. The evolution in time of encumbrances related to collaterals granted in respect of the Bank's operations on the derivatives market results from changes in the market valuation of the Bank's transactions concluded with individual counterparties on the above-mentioned market.

Within non-encumbered assets, the balance of cash and intangible fixed assets have the largest share. Moreover, non-encumbered assets include derivatives, investments in subsidiaries, shares in joint investments and associated units, assets under deferred income tax, other assets and fixed assets held for sale and disposal groups of assets.