INFORMATION ON CAPITAL ADEQUACY OF BANK ZACHODNI WBK GROUP

as at 31th December 2013

2013

Bank Zachodni WBK

Grupa Santander

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1. Introduction

This document is issued under the BZ WBK Group Disclosure Policy formulated based on Resolution No. 385/2008 of the Polish Financial Supervision Authority of 17th December 2008 as amended accepted under KNF Resolutions No. 368/2010 of 12 October 2010, No. 259/2011 of 4 October 2011 and No. 326/2011 of 20 December 2011 on the rules and scope of disclosing by banks qualitative and quantitative information on their capital adequacy which is formed the legal basis of the reporting date i.e. 31 December 2013.

Starting from January 1st, 2014 by the decision of the European Parliament and of the EBA the new regulations of the so-called CRD IV/CRR package come into force. The CRD IV/CRR package consist of two parts, the Directive of CRD IV and the Regulation of CRR. The Directive requires transposition to the specific country law while the Regulation, which is an act of EU law, is binding without any transposition in all the member countries of the EU. These regulations will apply to the disclosure of data for the year 2014.

Bank Zachodni WBK S.A. 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 the top country level of consolidation, which means on the basis of Bank Zachodni WBK Group data.

The purpose of the report is to present information about the capital adequacy of the BZ WBK Group. The presented information relates to the BZ WBK Group for the year-end 2013 and includes

- Risk management principles;
- Own funds;
- Value of Risk Weighted Assets and off-balance sheet liabilities;
- Information on capital adequacy;
- Policy of variable components of remuneration.

Bank Zachodni WBK forms a Group with thirteen subsidiaries which are consolidated in accordance with IAS 27 and one subsidiary which is not consolidated due to the insignificant scale of the conducted operations and associates which are accounted for using the equity method in accordance with IAS 28 and 31. These are:

Subsidiaries:

- BZ WBK Asset Management S.A.
- BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A. – subsidiary of BZ WBK Asset Management S.A.
- Dom Maklerski BZ WBK S.A.
- BZ WBK Nieruchomości S.A.
- BZ WBK Inwestycje Sp. z o.o.
- BZ WBK Finanse Sp. z o.o.
- BZ WBK Faktor Sp. z o.o. – subsidiary of BZ WBK Finanse Sp. z o.o.
- BZ WBK Leasing S.A.[1] – subsidiary of BZ WBK Finanse Sp. z o.o.
- Kredyt Lease S.A.[2] – subsidiary of BZ WBK Finanse Sp. z o.o.
- Lizar Sp. z o.o. – subsidiary of Kredyt Lease S.A.
- BFI Serwis Sp. z o.o. – in liquidation
- BZ WBK – Aviva Towarzystwo Ubezpieczeń Ogólnych S.A.
- BZ WBK – Aviva Towarzystwo Ubezpieczeń na Życie S.A.

On 4 January 2013, Subsidiaries Kredyt Lease S.A., Kredyt Trade Sp. z o.o. in liquidation, BFI Serwis Sp. z o.o. and Lizar Sp. z o.o. were acquired in a merger of BZ WBK and Kredyt Bank.

[1] On 29 March 2013 was the merger of BZ WBK leasing companies, pursuant to art. 492 paragraph 1 item 1 of the Commercial Companies Code. The merger took place as a result of the acquisition by BZ WBK Leasing S.A. as the acquiring company, the company BZ WBK Finance & Leasing SA by transferring all assets of BZ WBK Finance & Leasing at BZ WBK Leasing SA in exchange for shares that BZ WBK Leasing SA issued hitherto shareholder BZ EBK Finance & Leasing.
[2] From 31 January 2014 subsidiary changed its name to BZ WBK Lease

The subsidiaries are fully consolidated with BZ WBK except for Lizar Sp. z o.o. which is excluded from consolidation due to the insignificant scale of the conducted operations.

On 29 March 2013, the BZ WBK leasing companies merged in accordance with Article 492 (1) (1) of the Code of Companies and Partnerships. The merger was effected by acquisition of BZ WBK Finanse & Leasing S.A. by BZ WBK Leasing S.A., being the acquiring entity, and by transfer of the whole of the assets of BZ WBK Finanse & Leasing S.A. to BZ WBK Leasing S.A. in exchange for shares to be issued by BZ WBK Leasing S.A. to the existing partner in BZ WBK Finanse & Leasing SA.

As at 31 December 2013, Bank Zachodni WBK was a co-owner of BZ WBK Asset Management S.A., together with Banco Santander S.A. Both owners are members of Santander Group and each holds an equal stake of 50% in the company's share capital. In practice, Bank Zachodni WBK exercises control over the company and its subsidiary, BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A., because through it Banco Santander pursues its policy in Poland. Consequently, the company is treated as a subsidiary.

On 20 December 2013 Bank Zachodni WBK increased capital investment in BZ WBK-AVIVA Towarzystwo Ubezpieczeń na Życie S.A. and BZ WBK-AVIVA Towarzystwo Ubezpieczeń Ogólnych S.A. In effect of the transaction, as at 31 December 2013 Bank held 66% of the total share capital and 66% of voting rights on a Shareholders' Meeting of both insurance companies. The complementary 34% of votes remains with AVIVA International Insurance Limited. Detailed information on the controlling stake at the companies BZ WBK-AVIVA Towarzystwo Ubezpieczeń Ogólnych S.A. (General Insurance Company) and BZ WBK-AVIVA Towarzystwo Ubezpieczeń na Życie S.A. (Life Insurance Company) are described in **Note 49** to the Consolidated Financial Statements of the BZ WBK Group for 2013.

Associates:

- Krynicki Recykling S.A. – associated undertaking of BZ WBK Inwestycje Sp. z o.o.
- Metrohouse S.A. – associated undertaking of BZ WBK Inwestycje Sp. z o.o.
- POLFUND – Fundusz Poręczeń Kredytowych S.A.

Associated undertakings of BZ WBK Inwestycje Sp. z o.o., Metrohouse S.A. and Krynicki Recykling S.A. are classified as BZ WBK associates since the bank has a significant impact on their operations. The respective shareholdings were acquired as part of the bank's strategy to build a portfolio of "pre-IPO" investments.

The entities connected with the bank are chiefly credit and financial institutions which conduct specialized activities in securities brokerage, leasing, insurance services, asset/mutual funds, factoring and trading in equity securities.

Details about subsidiaries and associates are presented in **Note 1** to the Consolidated Financial Statements of BZ WBK Group for 2013.

Merger of Bank Zachodni WBK S.A. and Kredyt Bank S.A.

On 4 January 2013 (date of merger) the Bank registered the business combination of Bank Zachodni WBK and Kredyt Bank. The transaction was settled through the issue of merger shares. As a result, eligible shareholders of Kredyt Bank S.A. were entitled to acquire shares in accordance with the agreed exchange ratio of 6.96 Merger Shares for every 100 shares of the Kredyt Bank. This represents a total of 18 907 458 ordinary shares with a nominal value of PLN 10 each, with a total nominal value of PLN 189 075k. For the purposes of the settlement, the price of the new shares was determined in the amount of PLN 240.32. This price was calculated on the basis of the average Bank Zachodni WBK share price over the thirty trading days between 21 November 2012 and 8 January 2013, excluding trading days without required turnover.

The merger transaction was designed to implement the strategic objectives of the Bank and its major shareholder Banco Santander on the Polish market and has positioned the bank amongst the top three universal banks in Poland. As a result of the merger, there was an increase of the geographical scope of banking distribution network and the complementary businesses of the two banks were integrated. The bank increased the scope of the services offered and expanded the customer base. This provided significant strengthening of the bank's market penetration potential and with the blended knowledge and experience of the two banks, the merged entity was more effective and achieved a higher quality of its solutions. With the economies of scale and harmonized risk management, the bank's profitability and effectiveness is increasing.

Analysis of acquired assets and liabilities on the merger day

Bank Zachodni WBK Group performed a valuation related to the Kredyt Bank acquisition. The financial information as of 4 January 2013 of Kredyt Bank, which formed the basis of this settlement, were audited by a qualified auditor. Bank Zachodni WBK has completed the process of fair value estimation for the selected assets and liabilities of the Kredyt Bank S.A. such as loans and advances to customers, non-current assets, deposits from customers and contingent liabilities. The bank has also completed the fair value estimation of intangible assets that can be recognized in the transaction. As a result, calculation of the total additional deferred tax assets and liabilities is deemed to be final. At the end of 2013, own funds were higher by PLN 3 321 k compared to previous year. The main reason of the increase was the acquisition by Bank Zachodni WBK Group of Kredyt Bank Group in first quarter of 2013.

Following the legal merger of the Bank Zachodni WBK Group with the Kredyt Bank Group that took place on 4 January 2013 and as a result of issuing the merger shares, the core capital increased by PLN 4 543 840k, where PLN 189 074k representing the nominal value of the newly issued shares increased Bank Zachodni WBK share capital up to PLN 935 451k. The remaining part, i.e. issue premium of PLN 4 354 766k increased the supplementary capital.

On 22 January 2013, the Management Board of the Warsaw Stock Exchange adopted Resolution no. 87/2013 admitting 18,907,458 of the bank's merger shares to the primary stock market effective from 25 January 2013.

Bank Zachodni WBK

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2. Risk Management

The BZ WBK Group monitors and manages a number of risks, including as the most crucial credit risk, market risk, operational risk and liquidity risk. The purpose of risk management is to ensure that the BZ WBK Group takes risk in a conscious and controlled manner while increasing value for shareholders. In the process of strategic risk management, the Bank creates policies that define the approach to the identification, measurement and management of different types of risks, and sets the risk appetite limits. BZ WBK Group regularly reviews and expands its risk management tools taking account of the macroeconomic changes in the banking sector and prevailing regulations.

The Management Board and Supervisory Board set the business direction and actively support the risk management strategies. Supervisory Board exercises general supervision of the risk management system. Management Board is responsible for the effectiveness of the risk management system. It is executed by the approval of the key risk management policies, risk committee membership of the Management Board Members, review and acceptance of the risks and reports on the risk level.

Details about risk management, the corporate governance and the roles of selected units in relation to the risk management process are presented in **Note 4** to the Consolidated Financial Statements of BZ WBK Group for 2013.

2.1. Credit risk

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 in BZ WBK Group arises mainly from **lending activities on the retail, corporate and interbank markets**. Risk management in Group is consistent with risk profile resulting from agreed general risk appetite approved by the Risk Management Committee and the Supervisory Board. In BZ WBK Group the level of acceptable risk has been defined in the form of quantitative limits constituting the **„Risk Appetite Statement"**. Credit risk is managed on the basis of lending policies laid down by the Bank Management Board and the discretionary limits system. 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 a variety of credit risk mitigation tools, both collaterals (financial and non-financial) and specific credit provisions and clauses (covenants).

The **credit risk management framework** consists of committees, which have been set up by the Bank Management Board. The committees are directly responsible for development of credit risk management methods, credit risk measurement and monitoring. These are:

- **The Credit Risk Panel** is responsible for supervision of credit risk management. The Panel drafts and approves lending policies and implements risk classification and measurement systems.
- **The Models and Methodology Panel** is responsible for supervision of credit risk models.
- **The Credit Committee** makes credit decisions in accordance with the existing discretionary credit limits.
- **The Provisions Committee** makes decisions about impairment losses on loans and approves the impairment methodology.
- **The Monitoring Committee** is responsible for continuous and effective monitoring of the business and corporate loan portfolio.

The committees are directly supervised by the **Risk Management Committee**.

The Group's credit risk management involves actions taken as a result of the on-going analysis of the macroeconomic environment and the internal review of the particular credit portfolios. The **advanced credit risk** measurement and assessment tools allow remedial actions to be taken in response to the early signs of changes in the credit portfolio quality or structure.

The Group's **lending policy** ensures a sustainable and safe growth of the credit portfolio, which has high quality, high profitability and positive customer assessment. The Group's lending policy is composed of a set of principles and guidelines, which constitute credit policies and procedures, and guidance communicated internally across the Group in response to changes in the business environment.

Internal **limits** are crucial components of the bank's lending policy. They facilitate monitoring of exposure concentration in individual sectors, geographical regions and foreign currencies. The bank's lending manuals set out credit delivery and collateral management processes in retail, SME, business and corporate banking areas. Each lending regulation is reviewed at least once a year in order to ensure it is up-to-date and complies with other internal procedures and laws. **The Credit Risk Panel** signs off amendments to the lending policies and recommends strategic directions of development of the credit portfolios.

The 'Bank Zachodni WBK **Lending Discretions**' guidelines are key regulations governing the credit decision making process. The guidelines define the bank's structure of discretionary limits, which are granted to individual organizational units and staff involved in the credit delivery process. Individual discretionary limits are adjusted to the employees' knowledge and experience and the areas of bank's credit operations (branch banking, business banking, corporate banking). Credit exposures in excess of PLN 25m are referred to the **Credit Committee** composed of senior management and top executives.

The bank continues to develop and streamline the **credit risk assessment tools** in response to changes in the market conditions, regulatory requirements and customers' needs. The Group uses credit risk assessment **models** for its key credit portfolios, including corporate customers, SMEs, retail customers, home loans and income-producing real estate. Other models, e.g. fraud prevention models or recovery models are also used within the risk management process. The **Models and Methodology Panel** is a committee established by the Management Board, which is responsible for development of the credit risk assessment methodology.

The Group carries out **regular portfolio** reviews to determine the actual quality of the credit portfolio, to confirm that adequate credit grading and provisioning processes are in place and to objectively assess professionalism in credit management. Reviews are carried out by specialized units, which are independent of the risk-taking units.

The lending policy includes **collateral** perfection and management process, which falls within the area of responsibility of the Securities Centre and Credit Documentation. The role of the Securities Centre is to ensure that collateral is duly created and held effective in accordance with the lending policy for all business segments. The Securities Centre is also responsible for ensuring standardized internal procedures for perfecting and maintaining validity of collateral as well as ensuring that collateral perfection, monitoring and release processes are carried out in a proper and effective manner. In addition, the Securities Centre provides assistance in respect of collateral to credit units in credit decision making and development of credit policies, gathers data on collateral and ensures adequate management information.

Stress testing is a key 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 of the 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 internal limit of risk and internal capital allocation.

Impairment of credit receivables is reflected through impairment charges, which are made in accordance with IAS/ IFRS. Objective evidences of impairment were defined in accordance with recommendation of Basel Committee and with the International Accounting Standards (IAS 39). The impairment is calculated on the basis of the estimated recoverable amount. Impairments are analyzed 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 analysis takes into account 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**. More details about the impairment are presented in **Note 4** to the Consolidated Financial Statements of the BZ WBK Group for 2013.

Bank Zachodni WBK Group operates on the **leasing** market through leasing companies which specialize in funding different asset categories: lease of machines and equipment as well as computers and office equipment for businesses, financing vehicles for businesses and personal customers. Bank Zachodni WBK Group operates on the **factor** market through BZ WBK Factor. Factoring is a form of short-term commercial finance based on the selling of trade debts at a discount.

2.2. Concentration risk

The concentration risk means the risk of failure to fulfill obligations by a single entity, by entities which are connected through capital or organizational ties and by groups of entities for which the likelihood of failure to fulfill obligations depends on common factors.

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 organization. The policy pursued by the Group aims at minimizing the credit concentration risk, by for example applying more rigorous than regulatory rules in this respect, which are set out in **"The Risk Appetite Statement"** and other internal regulations. This policy is designed to maintain a high diversified of exposures to individual customers.

As at 31 December 2013 pursuant to art. 71 of the Banking Law Act, the maximum limits for the bank totaled:

- PLN 2,911,759 k (25% of Group's own funds).

The statutory exposure concentration limits were not exceeded as at 31 December 2013.

2.3. Market risk

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

The activity and strategies on market risk management are supervised by the Market Risk Panel of the Risk Management Forum. The ALCO is responsible for management of market risk exposure resulting from the structural mismatch between assets and liabilities in the balance sheet of the Bank.

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 and ratios, which are periodically reviewed to align them with the Group's strategy and the current market conditions. The BZ WBK Group uses several risk measures to assets market risk exposure: Value at Risk (VaR), sensitivity measures and stress testing.

The Financial Management Division is responsible for operational management of interest rate risk in the banking book. FX risks incurred in the banking book are transferred to the Global Banking and Markets Division and managed centrally at Bank level. Open positions exposed to interest rate risk and foreign exchange risk of BZ WBK Group subsidiaries are closed with the Bank, with the exception of the BZ WBK Brokerage House, which has been granted risk limits due to the scale and character of its activity. Additionally, in order to curtail losses on the trading portfolio, a stop-loss limit is in place, which allows trading positions to be closed in the event of losses exceeding the stated limit.

Market risk generated by equity instruments in BZ WBK Brokerage House's portfolio (shares, stock exchange indices) (**Equity investment risk**) is managed by the BZ WBK Brokerage House. The entity responsible for equity price risk management is BZ WBK Brokerage House. The source of this risk are transactions conducted on the BZ WBK Brokerage House's own account via stock exchanges and MS CTO (shares, futures). The process of managing the market risk in the BZ WBK Brokerage House is supervised by the BZ WBK Group Market Risk Panel of the Risk Management Forum. The Forum's responsibilities include allocation of the VaR limit to the BZ WBK Brokerage House and approval of changes in the risk measurement methodology and in the risk management process.

The Financial Risk Management Department within the Risk Management Division is responsible for ongoing measurement of the risk, implementation of risk control procedures, risk monitoring and reporting. The Department is also responsible for the market risk policy. Additionally, the Department puts forward measurement methodology proposals, validates the existing models and ensures consistency of the risk management process across the Group. The Department is located within the Risk Management Division, which allows for an independent risk assessment and monitoring.

2.4. Interest rate risk

The interest rate risk in the banking book is the risk of adverse impact of interest rate changes on the bank'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 centers, 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, where the bank's dealers enter 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 try to mitigate their interest rate risk – if there is a mismatch between the repriced assets and liabilities the companies enter into standard placements or derivative transactions with the Bank, which –from the transaction date – manages this risk under a global limit of the 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).

Interest rate risk in the trading book

The trading book contains securities and derivatives held by the Global Banking and Markets 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 in the bank is calculated for the open positions of the Global Banking and Markets 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 materialization 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.

The total regulatory capital requirement for general interest rate risk is calculated for positions arising from transactions in the trading book, using the maturity method.

2.5. 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. Stress tests are used in addition to this measure by providing an estimate of the potential losses in the event of materialization 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.

FX Balance Sheet

The capital requirement for Foreign – Exchange risk is calculated according to the main method as:

1) 8% of the overall foreign-exchange position – if the overall foreign-exchange position exceeds 2% of total own funds
2) 0 – if the overall foreign-exchange position doesn't exceed 2% of total own funds.

As at 31 December 2013, the total foreign exchange position was not higher than 2% of the own funds of the BZ WBK Group.

2.6. Liquidity risk

Liquidity risk is defined as a risk of failure to meet all conditional and unconditional obligations towards customers and partners.

Liquidity Risk Management

The BZ WBK Liquidity Management 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 in BZ WBK;
- 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 bank in its liquidity management process is that all expected short term outflows in respect of deposits, current funds, loan drawdowns, guarantee payments and transaction settlements should be at least fully covered by the anticipated inflows or Qualified Liquid Assets (QLA) 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.

In addition, the policy's aim is to ensure an adequate structure of funding the growing scale of the bank's business by maintaining liquidity ratios at pre-defined levels. The bank uses a number of other limits and observation ratios (including the loans to deposits ratio, the ratio of dependence on funding in the wholesale market, and the ratios required by Basel 3 and CRD4/CRR: LCR and NSFR). In terms of the long-term liquidity, in addition to the internal measures, the bank uses a limit corresponding to the regulatory limit, which requires that the equity and the stable sources of funding should fully cover the credit portfolio and nonliquid assets (e.g. fixed assets).

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.

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 bank has a scenario-based contingency plan approved by the Management Board 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.

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.

2.7. Insurance risk

Bank Zachodni WBK Group became exposed to insurance risk after it acquired control over the two insurance companies: BZ WBK AVIVA Towarzystwo Ubezpieczeń Ogolnych S.A. (BZ WBK AVIVA TUO) and BZ WBK AVIVA Towarzystwo Ubezpieczeń na Życie S.A. (BZ WBK AVIVA TUŻ) on 20 December 2013.

Insurance risk entails the possibility of a loss or adverse changes in the value of liabilities, resulting from changes in the value, trend or fluctuations of the measures used for the estimation of such liabilities, or from unforeseen / exceptional circumstances.

Insurance risk is also understood as the risk of materialization of an insurance event and the related uncertainty about the claim value.

In the process of development of an insurance product and the calculation of insurance premiums, the key risk is seen as the situation where the claims ratio, i.e. the claims paid (including changes in the balance of provisions for unpaid claims) to the premium earned, is higher than the value planned when determining the amount of insurance premiums.

The risk factors affecting accuracy of the estimated claims ratios include the possibility of differences between historical data, which underlie the estimates, and the actual values. Such differences may arise in particular due to the short history of operations of the Insurance Companies and the small insurance portfolio that does not permit the application of the Law of Large Numbers and does not provide sufficient statistical information that might be helpful in managing the insurance risk.

Managing insurance risk, BZ WBK AVIVA TUO and BZ WBK AVIVA TUŻ mainly focus on increasing their insurance portfolios while using reinsurance to limit the volatility of their risk share.

Capital Management

The purpose of Insurance companies is to maintain a constant solvency at the level necessary to enable the dynamic of their development.

To fulfill this, Insurance companies continuously monitor the value of equity in relation to the solvency margin and guarantee capital in accordance with the capital requirements imposed by the regulations in force in Poland (Insurance Act and the Act on accounting together with appropriate regulations).

Under these provisions the Insurance companies are required to hold own funds in an amount not less than the margin of solvency and not lower than the guarantee capital, the capital guarantee is equal to the greater of: one-third of the solvency margin and the minimum guarantee capital.

The method of calculation of the solvency margin and the minimum guarantee fund defined in the Regulation of the Minister of Finance, which takes into account the need to ensure the solvency of companies engaged in the business of insurance.

Insurance companies when calculating solvency margin and the minimum guarantee capital consider only the statutory requirements.

As at 31 December 2013 solvency margin for BZ WBK AVIVA TUO and BZ WBK AVIVA TUŻ amounted to **PLN 51,140k** and comparing it with their own funds they had capital excess of respectively **PLN 41,321k** and **PLN 34,243k.**

More details of the insurance risk are presented in **Note 4** of the Consolidated Financial Statements of the BZ WBK Group for 2013.

2.8. Operational risk

The BZ WBK Group adopted the definition of **operational risk** from the Basel Banking Supervision Committee which states that an operational risk is exposure to losses resulting from inadequate internal processes or systems, human errors or external factors.

The objective of the **operational risk management** is to minimize the likelihood of unexpected adverse events.

The BZ WBK Group has implemented an integrated risk management framework to ensure that all risks which have a significant impact on the Group business are identified, measured, monitored and controlled. Operational risk management in BZWBK Group involves employees at all levels of the organization and consists of a number of interrelated concepts. Operational risk concerns all the Group's business activities, including the outsourced functions or services delivered jointly with third parties.

BZ WBK Group defined **Operational Risk Management Strategy**. Moreover the BZ WBK Group maintains the **Operational Risk Management Policy and Framework**. In addition, detailed procedures and guidelines are used to define how risks are identified, estimated, monitored and mitigated.

The Operational Risk Management Committee (ORMCo) appointed by the Management Board is an executive committee responsible for setting operational risk standards in the BZ WBK Group. ORMCo is a key forum for official discussions on operational risk, determines strategic direction in respect of operational risk, as well as defines and monitors objectives of managing operational risk including business continuity, information security, outsourcing / insourcing and financial crime counteracting with regard to all areas of activity of BZWBK. The effects of this work are reported to the Risk Management Committee.

Actions concerning the BZ WBK and Kredyt Bank merger were specific tasks in operational risk management in 2013. In order to ensure the highest standards in operational risk management during this dynamic period, every consolidating activity and all the integration projects were covered by operational risk analysis.

What is more, in 2013 all the standards and tools of operational risk management were unified in order to ensure a uniform process of managing this type of risk in the whole organization. The BZ WBK Group are applying the following tools:

- **Identification and estimation of operational risk**

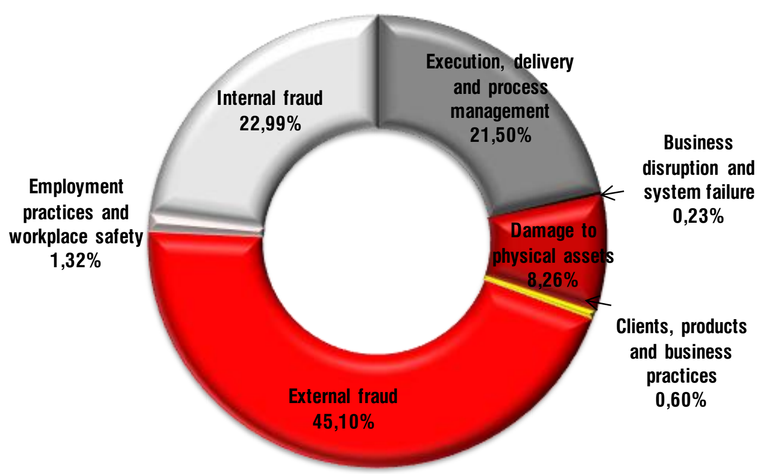
In the self-assessment process the BZ WBK Group identify risks which it can be exposed to during the realization of its functions, assess them at the inherent and residual level in terms of the likelihood and consequences of potential threats as well as evaluate efficiency of existing controls. The process also includes defining actions improving the efficiency of existing and/or new control mechanisms.

- **Reporting on operational incidents and lessons learned process**

Each organizational unit is required to inform on a monthly basis about operational incidents. The BZ WBK Group maintains the database of operational risk events identified in the Group. The collected data are used to carry out a root cause and consequences analysis of the incidents, to define conclusions for the future and to take preventive and corrective actions.

The sum of the gross losses in all categories identified in accordance with Resolution of KNF Resolution no. 76/2010 of 10 March 2010 as the scope and detailed rules for determining capital requirements for particular types of risk and Recommendation 'M' of KNF was PLN 34,855k. Allocation of losses for individual categories is presented in the following graph.

Percentage of different types of operational events classified in accordance with Resolution No. 76/2010 of the Financial Supervision Commission and Recommendation M of Bank Zachodni WBK Group



In the "External fraud" category losses connected with credit process pose the biggest share – in 2013 it was more that 90% of all losses in this category. Nevertheless, it is worth underlining that the BZ WBK Group has adopted a very strict definition of external fraud. In this category the Group classifies, for example, events in which the client used a false certificate / statement of employment and earnings, or cases related to the apparent nature of the run business. The value of external crimes maintains a downward trend because of constant improvement of business processes and implementation of advanced solutions to prevent crime.

The BZ WBK Group is conducting a series of actions aimed at minimalizing losses resulting from operational activity. The actions include inter alia: control processes and policies, separation of the registration and acceptance role and other process or IT solutions. Moreover, the BZ WBK Group defined a Fraud prevention program which aims at assessment and support in the improvement of fraud prevention process as well as evaluation of the connected risks. The value of losses associated with internal crime in 2013 was mainly due to the impact of one isolated incident of crime.

A single operational event concerning not-adherence to the terms of agreement by the service supplier contributed largely to the level of losses in 2013 in the category "Execution delivery and process management' The proper construction of the contract imposing specific requirements on the supplier, allowed to compensate the incurred loss in the full amount within a month.

In 2013 7 non-financial incidents concerning breaches of customer privacy or loss of data were identified. The identified cases were connected with improper dispatch of both paper and email correspondence. In light of the identified cases, measures were taken certain measures to prevent.

- **Analysis of risk indicators**

The BZ WBK Group conduct risk indicators monitoring which includes both financial and operational indicators. The indicators provide early warning of emerging threats and operational losses, and depict the risk level existing in the BZ WBK Group.

- **Business continuity management**

Each organizational unit is required to develop and update its business continuity management plans to ensure that critical business processes remain uninterrupted following an unplanned disruption. Business continuity plans are subject to regular testing at least annually thanks to which the BZ WBK Group obtain assurance that it is possible to restore critical business processes at the required service level and within the agreed timeframe. The BZ WBK Group has backup locations where critical processes can be restored and continued if an incident occurs.

BZ WBK operational events in 2013
Value of BZ WBK Gross losses by Basel category (PLN k)

Operational event class			
Event types	Event category	PLN k	%
1. **Internal fraud**	1.1. Unauthorised activity	210	0,60%
	1.2. Theft and fraud	7 806	22,40%
2. **External fraud**	2.1. Theft and fraud	15 468	44,38%
	2.2. Systems security	256	0,73%
3. **Employment practices and workplace safety**	3.1. Employee relations	459	1,32%
	3.2. Safe environment	0	0,00%
	3.3. Inequality and discrimination	0	0,00%
4. **Clients, products and business practices**	4.1. Customer service, privacy breaches, obligations to customers	30	0,09%
	4.2. Improper trade / market practices	96	0,28%
	4.3. Product flaws	66	0,19%
	4.4. Customer rating and exposures	7	0,02%
	4.5. Advisory services	0	0,00%
5. **Damage to physical assets**	5.1. Natural disasters and other incidents	2 880	8,26%
6. **Business disruption and system failure**	6.1. Systems	77	0,22%
7. **Execution, delivery and process management**	7.1. Transaction capture, execution and maintenance of transactions	2 992	8,58%
	7.2. Monitoring and reporting	0	0,00%
	7.3. Client onboarding and documentation	63	0,18%
	7.4. Client account magement	6	0,02%
	7.5. Counterparties other that the Bank's clients (e.g. clearing chambers)	3	0,01%
	7.6. Vendors and suppliers	4 436	12,73%

- **Insurance**

The BZ WBK Group also secures itself against the impact of operational risk by means of financial risk insurance policies, communication insurance policies, property insurance policy and civil liability insurance policy.

- **Regular reporting to the Risk Management Committee and Supervisory Board**

The aim of reporting operational risk is to provide actual and adequate information for Management. The reporting refers to operational risk issues and includes information concerning inter alia: operational events operational losses, risk indicators, information regarding defined actions aimed at risk mitigations.

The BZ WBK Group **Information Security Management System** has been certified by ISO 27001:2005.

2.9. Legal & compliance risk

Legal and regulatory (compliance) risk is defined – in line with the Basel Committee recommendation and the definition adopted by the strategic shareholder – as risk of regulatory sanctions, material financial loss or loss to reputation that may be incurred by the BZ WBK Group as a result of failure to comply with the applicable laws, standards or codes of conduct applicable to its activities.

The Bank Management Board adopted a **risk management and compliance policy** which was then approved by the Supervisory Board.

Within the BZ WBK Group several bodies have been assigned to manage legal and regulatory (compliance) risk:

- **Compliance Area** - relates to "conduct of business'" compliance obligations, including protection of the clients' rights, anti-money laundering, protection of sensitive information including confidential information and professional secrecy and personal data. Compliance Area co-ordinates as well identification, assessment and monitoring of compliance risk and contacts with market regulators (Polish Financial Services Authority, Office for Competition and Consumer Protection, General Inspector of Financial Information, Inspector General for Personal Data Protection).
- **HR Management Division** - all issues regarding compliance with employment law.
- **Financial Accounting and Control Division** - all issues regarding compliance with taxation law and reporting requirements.

For fulfillment prudential regulation responded Financial Accounting and Control Division and Risk Management Division in respective aspects.

Legal and regulatory (compliance) risk management is coordinated by the Compliance Division reporting to the Management Board Member. The Area coordinates and supervises the process of compliance risk management with subsidiary compliance units as far as applicable within the law stipulations. Key committee to oversee and monitor compliance risk that has been established by the Management Board are the **Compliance Committee** and **Committee for Counteracting Money Laundering and Terrorist Financing**.

More details about legal and regulatory (compliance) risk are presented in **Note 4** to the Consolidated Financial Statements of the BZ WBK Group for 2013.

2.10. Reputation risk

Reputation risk is defined as the risk arising from a negative perception of the Bank and other Group companies by customers, counterparties, shareholders or investors.

The potential sources of risks are internal and external events, such as negative publication in media, dissemination of negative customer feedback, for example in the Internet, social networks and other media. The elements of reputation risk include customer complaints and claims related to the process of offering banking products especially investment products, including complaints about insufficient information about products and related risks, complexity of products, improper sales practices or loss of capital.

The reputation risk is owned by **the Corporate Communication and Marketing Area (CCMA)** and **Compliance Area (CA)** and the specialized committee involved into processes of managing reputation risk related to the offering of products and services to customers is **the Local Marketing and Product Monitoring Committee**.

The purpose of reputation risk management is to protect the image of the BZ WBK Group and minimize the adverse events affecting the image and financial results of BZ WBK.

The reputation risk is primarily mitigated by:

1. monitoring of local, national and international media(CCMA);
2. collecting and analyzing information by the Press Office that affect the bank's (CCMA);
3. responding to information that create a risk of worsening public perception of the bank's image (CCMA);
4. customer satisfaction survey (CCMA);
5. preparing and monitoring by the relevant units of the Bank of all important messages and reports to shareholders, the Polish Financial Supervision Authority, Warsaw Stock Exchange and their timely publication;
6. giving opinion on new products, procedures, commercial materials, processes and other bank initiatives in respect of their compliance with the regulations and the regulators' guidelines (CA);
7. coordinating by the Compliance Area of the product acceptance and monitoring process to ensure that:
    a) products and services are sold by duly trained staff,
    b) customers are given the required and appropriate information,
    c) products are distributed in an appropriate market, taking into account the legal and tax environment and the local financial culture,
    d) the policies, procedures and other in-house and external regulations are complied with;
8. taking part in the complaint handling process, especially in respect of complaints submitted to the regulators (CA).

No quantitative risk measurement is carried out or planned for reputation risk as this risk is qualitative in its nature.

Bank Zachodni WBK

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3. Own funds

The level of own funds of the BZ WBK Group is adjusted to the Group's business. In accordance with Art. 127 of the Banking Law, and Resolution no. 325/2011 of the Polish Financial Supervision Authority of 20 December 2011 own funds comprise:

- primary funds;
- complementary funds.

The BZ WBK Group primary funds include:

1. core funds, understood as paid-in and registered share capital, supplementary capital and reserve capital;
2. additional items of the primary funds:
   a) general risk fund earmarked for unidentified risks of the banking business,
   b) retained earnings,
   c) net profit in course of approval and net profit of the current period;
3. non-controlling interests in equity,
   calculated in line with the applicable accounting rules, decreased by any expected charges and dividends. The calculated values may not be higher than the audited net profit;
4. items decreasing the primary funds:
   a) intangible fixed assets measured at book value,
   b) goodwill arising from acquisition transactions,
   c) commitment to equity in financial institutions in excess of 10% of own founds,
   d) other primary funds deductions defined by the Financial Supervisory Authority.

The BZ WBK Group complementary funds include:

1. other items defined by the Financial Supervision Authority as required for safe conduct of the banking business and proper risk management in the bank
2. complementary funds deductions defined by the Financial Supervision Authority.

An additional item included during the financial year in the calculation of own funds is the short-term capital. The bank’s balance sheet of 31 December 2013 does not contain any items which would be considered as short-term capital under § 5.1 of KNF Resolution no. 76/2010 of 10 March 2010, as amended.

As at 31 December 2013, the total own funds of the BZ WBK Group amounted to PLN **11,647,036k.**

The statement of financial position of Bank Zachodni WBK Group as at 31 December 2013 consolidates for the first time of the insurance companies BZ WBK-Aviva TUO and BZ WBK-Aviva TUŻ, which became controlled by the bank upon a transfer by Aviva International Insurance Limited of 16% stake in either entity. Consequently, the specific categories of the Group’s consolidated own funds have been changed, arising from increase of non-controlling interest PLN 525,640 k and due to additional deductions in terms of goodwill (PLN 853,809 k), intangible assets (PLN 153,280 k) and an additional option to sell 34% stake amounted to PLN 684,288 k. Additional information are presented in **Note 49** to the Consolidated Financial Statements of the BZ WBK Group for 2013.

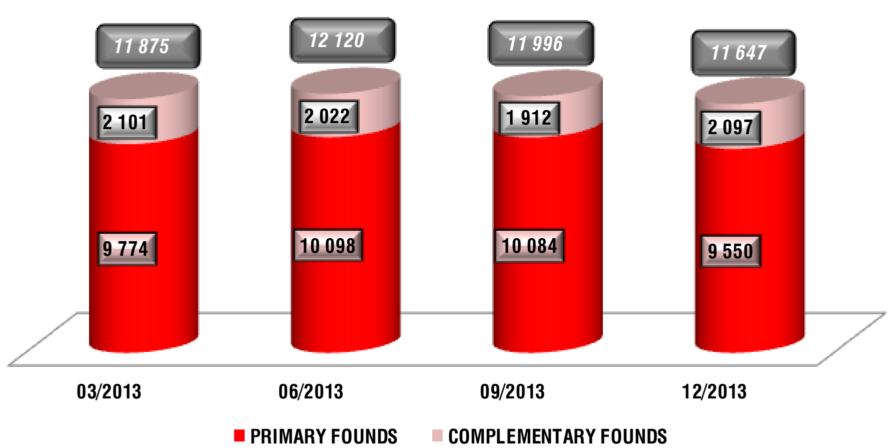
The mix of BZWBK Group’s own funds as at 31 December 2013 with a breakdown into core funds and supplementary funds are presented in the table below.

Own Funds of the BZ WBK Group as at 31 December 2013 (PLN k)

No.	OWN FUNDS	as at 31.12.2013
I	PRIMARY FUNDS	9 549 993
1.	Core funds	10 521 320
1.1.	share capital	935 451
1.2.	supplementary capital	5 267 449
1.3.	reserve capital	4 318 420
2.	Additional items	1 582 350
2.1.	general risk fund	649 810
2.2.	retained earnings	932 540
3.	Non-controlling interests in equity	610 855
4.	Items decreasing the primary funds	(3 164 532)
4.1.	intangible fixed assets	(506 792)
4.2.	unrealised losses on debt instruments classified as available for sale	(72 822)
4.3.	unrealised losses on equity instruments classified as available for sale	(20 904)
4.4.	equity interests in other financial institutions	(21 688)
4,5	goodwill	(2 542 326)
II	COMPLEMENTARY FUNDS	2 097 043
1.	Subordinated Floating Rate Notes	1 381 697
2.	Other items	737 034
2.1.	unrealised gains on debt instruments classified as available for sale	159 053
2.2.	unrealised gains on equity instruments classified as available for sale	577 981
3.	Items decreasing the complementary funds	(21 688)
3.1.	equity interests in other financial institutions	(21 688)
III (I+ II)	TOTAL OWN FUNDS FOR CALCULATION OF THE SOLVENCY RATIO	11 647 036

At the end of 2013, the own funds were higher by PLN 3 321 k compared to previous year. The main reason of the increase was the acquisition by Bank Zachodni WBK Group of Kredyt Bank Group in first quarter of 2013. Dynamics of changes in equity in the coming quarters of 2013 were shown on the chart below.

Own funds of the BZ WBK Group in 2013



3.1. Primary funds

Core funds

Share capital is stated in the nominal amount as shown in the Statutes and in the entry to the Court Register. The nominal value of a share is PLN 10. All the issued shares are fully paid-up. As at 31 December 2013, the share capital was **PLN 935,451k**.

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 2013, the supplementary capital was **PLN 5,267,449k**. incl. share premium of **PLN 4,932,849k.**

Reserve capital is created from net profit allocations in an amount approved by the General Meeting of Shareholders. Reserve capital is 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 2013, the reserve capital together with retained earnings was **PLN 4,318,420k.**

Additional items of the primary funds

In accordance with the Banking Law, **the general risk fund for unidentified banking business risk** is created from net profit allocations in an amount approved by the General Meeting of Shareholders. The general risk fund is used to cover costs and losses connected with unidentified banking risks that were not separately provided for. As at 31 December 2013, 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 2013 totaled **PLN 2,014,611k**, including **PLN 32,283k** of profit attributable to shareholders who do not exercise control. Current year profit less the planned pay-out of a dividend amounted to **PLN 932,540k** (in the capital adequacy account).

Non - controlling interests in equity

As required by § 6 of the Resolution no. 325/2011 of the Polish Financial Supervision Authority, the Bank's consolidated own funds must reflect non-controlling interests in equity, if any. Pursuant to art. 3 of *the Accounting Act* non-controlling interests in equity are the part of the subsidiary's net assets that is owned by external shareholders. As at 31 December 2013, non-controlling interests in equity amounted to **PLN 610,855k.** The increase of the non – controlling interests in equity comparing to the end of the previous year is caused by the takeover of insurance companies by the BZ WBK Group.

Items decreasing the primary funds

As at 31 December 2013, the **intangible fixed assets** amounted to **PLN 506,792k.**

As at 31 December 2013, the **goodwill** amounted to **PLN 2,542,326k**. As at the merger date, the estimated goodwill of **PLN 1,688,516k** was applied in reduction of the primary funds of the merged bank. The goodwill arising on acquisition represents a control premium, and arises from the possibility to generate additional benefits from the expected synergies, increase in revenues, achieved market share, combination of staff competencies and an increase in the effectiveness of processes, all of which is an excess over the fair value of the acquired assets. In consequence of the consolidation for the first time of the insurance companies BZ WBK-Aviva TUO and BZ WBK-Aviva TUŻ , the specific categories of the Group’s consolidated assets were changed certain categories of own funds, which are specified in Section 3 of the Report.

As per § 3 of Resolution no. 325/2011 of the Polish Financial Supervision Authority, other items decreasing the primary funds are **unrealized losses on debt and equity instruments classified as available for sale.** As of 31 December 2013, the BZ WBK Group unrealized losses on equity and debt instruments available for sale decreased the primary funds by **PLN 93,726k** (**PLN 20,904k** applies to unrealized losses on equity instruments available for sale and **PLN 72,822k** applies to unrealized losses on debt instruments AFS). The change of valuation in the financial assets available for sale divided into debt and equity instruments is presented in **Note 23** to the Consolidated Financial Statements of the BZ WBK Group for 2013.

As per § 3 of the Resolution no. 325/2011 of the Polish Financial Supervision Authority, other items decreasing own funds account for 50% of the **capital investment** in financial institutions, credit institutions, domestic banks, foreign banks and insurance companies, expressed as:

a) the value of shareholdings;
b) the amounts classified as subordinated liabilities;
c) other equity exposures in the items of own funds of such entities, including contributions to limited liability companies (at book value).

As at 31 December 2013, the primary funds has been reduced by **PLN 21,688k**. i.e. 50% of capital holding in financial entities.

3.2. Complementary funds

Subordinated liabilities

On 13th October 2010 Bank obtained an approval of KNF for the inclusion of the funds raised through the issue of debt securities dated 5th August 2010 into the Group's supplementary funds. Based on the decision of KNF, the funds raised from this issue amounting to EUR 99m have been included in the calculation of the Group's adequacy ratio.

The merger was also connected with an acquisition of subordinated obligations (three loans) towards KBC Bank NV, O/Dublin, which increased the own funds.

An amount of **PLN 1,381,697k** is presented in this respect in the statement of own funds of 31 December 2013.

Subordinated liabilities of the BZ WBK Group as at 31 December 2013 (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 m]
European Bank for Reconstruction and Development	100 000	EUR	99 000 EUR	05.08.2020	05.08.2015	410 573
KBC Bank NV O/Dublin	100 000	CHF	100 000 CHF	15.06.2018	15.06.2013	338 160
KBC Bank NV O/Dublin	165 000	CHF	165 000 CHF	28.06.2019	28.06.2014	557 964
KBC Bank NV O/Dublin	75 000	PLN	75 000 PLN	31.01.2019	30.01.2014	75 000
						1 381 697

More details about the subordinated liabilities are presented in **Note 33** to the Consolidated Financial Statements of the BZ WBK Group for 2013.

Other items

As per § 4 of the Resolution no. 325/2011 of the Polish Financial Supervision Authority, other items of the complementary funds are **unrealized gains on debt and equity instruments classified as available for sale** in an amount equal to 80% of their pre-tax value. Unrealized gains on debt and equity instruments classified as available for sale included in capital adequacy calculation amounted to **PLN 737,034k**. The change of valuation in the financial assets available for sale divided into debt and equity instruments is presented in **Note 23** to the Consolidated Financial Statements of the BZ WBK Group for 2013.

Items decreasing the complementary funds

As required by § 4 of the Resolution no. 325/2011 of the Polish Financial Supervision Authority, the Bank's complementary funds were decreased by 50% of the Bank's equity interests by value of **PLN 21,688 k.**

3.3. Additional items

In accordance with Art. 128, section 6, point 1) of *the Banking Law* and §10 of the Resolution no. 76/2010 of the Polish Financial Supervision Authority of 10 March 2010, in the calculation of own funds the short-term capital is used. Short-term capital is defined as:

1) sum of:
   a) market profit, calculated cumulatively until the reporting date, decreased by any known charges, including dividends to the extent the profit was not classified into own funds or otherwise distributed;
   b) losses (with a minus sign) on all transactions classified into the banking book, calculated cumulatively until the reporting date, excluding losses due to FX differences and commodity prices to the extent the losses were not classified into own funds or otherwise covered;
   c) obligations in respect of eligible subordinated debt;
   d) the equity of subsidiaries where the equity value is negative and does not reduce the bank's own funds

where the value is positive - in an amount not exceeding the total relevant capital requirements

2) nil - if the above sum is not positive.

The BZ WBK balance sheet of 31 December 2013 contains no entries classified as short-term capital in accordance with Art. § 5.1 of KNF resolution no. 76/2010.

Bank Zachodni WBK

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4. Capital requirements

Currently, the BZ WBK Group calculates capital adequacy in accordance with Resolution no. 76/2010 of the Polish Financial Supervision Authority of 10 March 2010, as amended, on the scope and detailed principles for setting capital requirements for different risks, adopted by KNF resolution no. 369/2010 of 12 October 2010, 153/2011 of 7 June 2011 and 324/2011 of 20 December 2011. In H/Y 2013, BZ WBK applied the standardized 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%. In the case of an asset, the value of the exposure is equal to its balance-sheet value and in the case of an off-balance sheet item, the value of the exposure is equal to its on-balance sheet equivalent. To calculate the value of risk-weighted exposures, risk weights are assigned to all exposures in accordance with Appendix 4 to Resolution no. 76/2010 of the Polish Financial Supervision Authority of 10 March 2010 as amended.

The Bank calculates and monitors capital requirements for all the key risks, including those defined in §6.1 of the Resolution no 76/2010 as amended, namely:

- capital requirement for credit risk
- capital requirement for market risk
- capital requirement for the settlement, supplier and counterparty risk;
- capital requirement in respect of the excess of the exposure concentration limit and the large exposures limit
- capital requirement for capital concentration limit excess
- capital requirement for operational risk

The BZ WBK Group calculates capital requirements separately for the exposures classified into the banking and trading book.

As a result of taking over stake at the companies BZ WBK-Aviva Towarzystwo Ubezpieczeń na Życie S.A. and BZ WBK-Aviva Towarzystwo Ubezpieczeń Ogólnych S.A. on 20 December 2013, the BZ WBK Group for the first time takes into consideration capital adequacy of the insurance companies calculated in accordance with the Regulation of the Minister of Finance of 28 November 2003 as amended, regarding method of calculation of the solvency margin and the minimum guarantee capital for types and groups of insurance and the Insurance Act of 22 May 2013.

4.1. Capital requirements for individual risk types

Total capital requirement of the BZ WBK Group as at 31 December 2013 calculated in accordance with Resolution no. 76/2010 of the Polish Financial Supervision Authority of 10 March 2010, as amended, was **PLN 6,642,593k**, including:

- **PLN 5,763,378k** for credit risk
- **PLN 50,991k** for market risk
- **PLN 66,583k** for settlements and counterparty risk
- **PLN 761,641k** for operational risk

As at 31 December 2013, in capital adequacy, the BZ WBK Group additionally takes into consideration the margin of solvency of **PLN 51,140k**, which is a consequence of the consolidation for the first time the insurance companies BZ WBK-Aviva TUO and BZ WBK-Aviva TUŻ, which became controlled by the bank upon a transfer by Aviva International Insurance Limited of 16% stake in either entity.

Capital requirements of the BZ WBK Group as at 31 December 2013 (PLN k)

No.	CAPITAL REQUIREMENTS FOR INDIVIDUAL RISK TYPES	as at 31.12.2013
1.	Credit risk	5 763 378
2.	Risk of exceeding the exposure concentration limit and the large exposure limit	-
3.	Market risk including:	50 991
3.1	FX risk	-
3.2	commodity prices risk	-
3.3	equity securities prices risk including:	3 031
3.3.1	specific risk	2 544
3.3.2	general risk	65
3.3.3	particular approach for position risk in CIUs	422
3.4	specific debt instrument price risk	105
3.5	general interest rate risk	47 855
4.	Counterparty risk	66 570
5.	Settlement risk	13
6.	Capital concentration excess risk	-
7.	Operational risk	761 641
	TOTAL CAPITAL REQUIREMENT (poz. 1+2+3+4+5+6+7)	**6 642 593**
8.	Margin of solvency of insurance entities	51 140
	TOTAL	**6 693 733**

The biggest item of the total capital requirement of the BZ WBK Group is the capital requirement for credit risk, which on 31 December 2013 accounted for **86.76%** of the total capital requirement. The BZ 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.

When calculating the capital requirement for credit risk, the BZ WBK Group takes into account impairment losses for credit receivables, which are recognized in accordance with the International Accounting Standards/ International Financial Reporting Standards (IAS/ IFRS). The impairment is calculated on the basis of the estimated recoverable amount. Impairments are analyzed 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). More details about the impairment are presented in **Notes 4, 12** and **22** to the Consolidated Financial Statements of the BZ WBK Group for 2013.

As of 31 December 2013, the BZ WBK Group's permanent impairment losses for credit receivables amounted to **PLN 3,489,725k.** More details about the movements on impairment losses on loans to customers are presented in **Note 22** to the Consolidated Financial Statements of the BZ WBK Group for 2013. Provisions for off-balance sheet liabilities came to a total of **PLN 95,934k.**

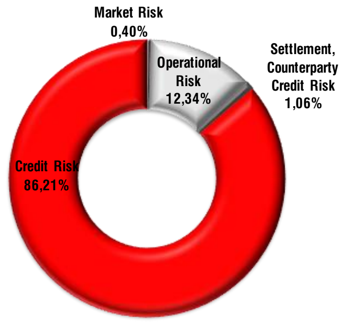
The capital requirement for operational risk amounted to **PLN 761,641k** including **71.65%** in respect of the capital requirement for the commercial banking and retail banking business line.

The capital requirement for market risk was **PLN 50,991k**, including **93.85%** in respect of the capital requirement for the general interest rate risk.

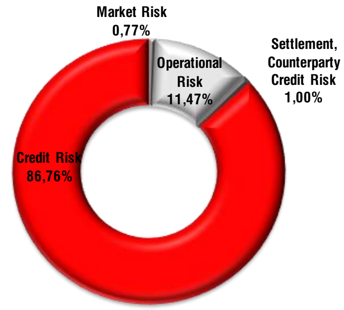
The exposure concentration analysis, which was carried out as of 31 December 2013, showed that the BZ WBK Group's exposures did not exceed the limits defined in Appendix 12 to KNF Resolution no. 76/2010 of 10 March 2010, as amended.

The capital requirement for counterparty credit risk was set in accordance with KNF Resolution no. 76/2010 of 10 March 2010, as amended, and it was PLN **66,570k** as of 31 December 2013.

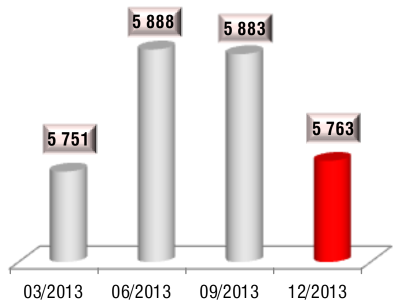
Capital requirements for different risk types as at 31 December 2012



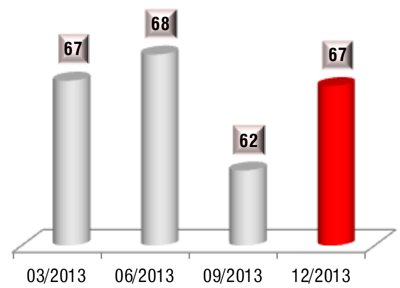
Capital requirements for different risk types as at 31 December 2013



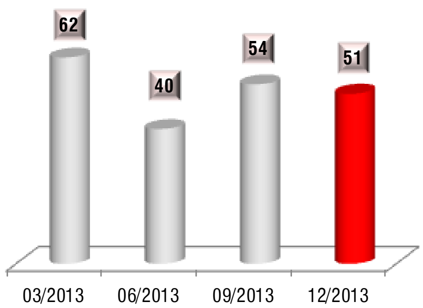
Structure of capital requirements for credit risk in each quarter of 2013 (PLN m)



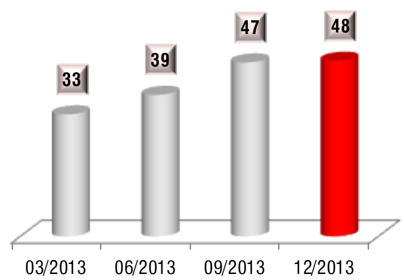
Structure of capital requirements for settlement, counterparty credit risk in each quarter of 2013 (PLN m)



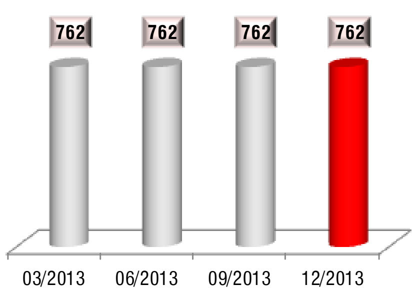
Structure of capital requirements for market risk in each quarter of 2013 (PLN m)



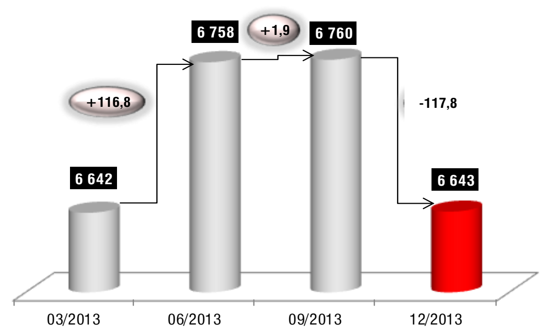
Structure of capital requirements for general interest rate risk (part of market risk) in each quarter of 2013 (PLN m)



Structure of capital requirements for operational risk in each quarter of 2013 (PLN m)



Value and changes of total capital requirement in each quarter of 2013 (PLN m)



4.2. Exposure structure

In the process of capital adequacy assessment, each type of exposure was allocated to the following classes (as required by § 20.1. of Appendix 4 of the Resolution no. 76/2010 of the Polish Financial Supervision Authority of 10 March 2010 as amended):

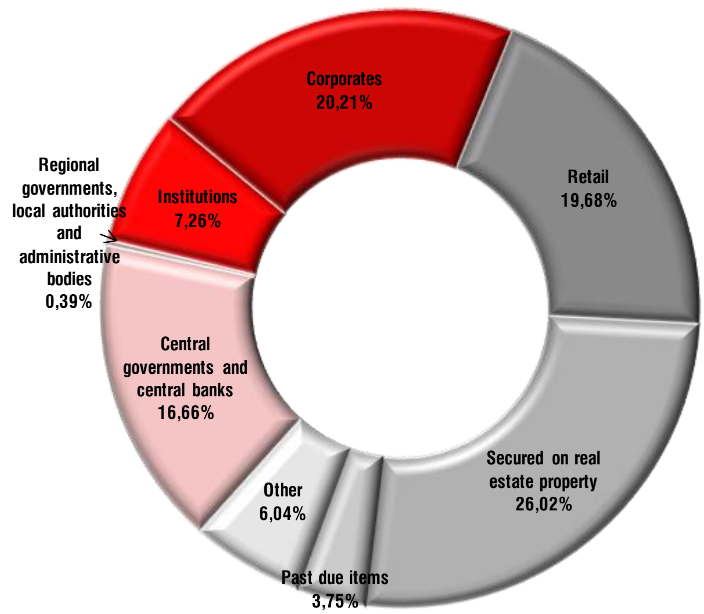
Balance and Off-Balance Sheet Exposures by Asset Classes as at 31 December 2013 (PLN k)

No.	Exposure Class	Exposure Value	Risk-weighted Assets	Capital requirement for credit risk and counterparty risk
1.	Claims or contingent claims on central governments or central banks	22 123 883	239 652	19 172
2.	Claims or contingent claims on regional governments or local authorities	264 824	41 962	3 357
3.	Claims or contingent claims on administrative bodies and non-commercial undertakings	246 813	128 788	10 303
4.	Claims or contingent claims on multilateral development bank	0	0	0
5.	Claims or contingent claims on institutions	9 636 589	2 047 288	163 783
6.	Claims or contingent claims on corporates	26 842 158	18 680 125	1 494 410
7.	Retail claims or contingent retail claims	26 145 406	17 681 179	1 414 494
8.	Claims or contingent claims secured on real estate property	34 554 531	28 647 782	2 291 823
9.	Past due items	4 979 884	2 791 001	223 280
10.	Claims classified to the regulatory high-risk categories	125 564	150 733	12 059
11.	Claims in the form of collective investment undertakings	21 785	32 212	2 577
12.	Other claims	7 880 730	2 433 635	194 691
	Total exposures covered by the standardised approach	**132 822 167**	**72 874 357**	**5 829 949**
	of which: counterparty risk - trading portfolio	1 559 151	832 129	66 570

Equity exposure which is not included in the trading book and which is classified as available for sale, was **PLN 851,603k** as of 31 December 2013 (**PLN 35,980k** is attributable to equity exposures arising from securities listed on the stock exchange, whereas **PLN 815,623k** is attributable to unlisted exposures). The equity securities listed on the stock exchange are either priced with reference to a quoted market price for that instrument. Unlisted equity investments classified as available-for-sale for which no active market exists are recognized at cost and tested for impairment or their fair value is assessed based on valuation models. The movements on financial instruments representing equity rights are presented in **Note 23** to the Consolidated financial statement of the BZ WBK Group for 2013.

The structure of the BZ WBK Group credit exposures mainly includes claims secured on real estate (26,1%) and claims on corporates (20,21%).

Percentage structure of exposure for different asset class as at 31 December 2012 and 31 December 2013



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

Balance and Off-Balance Sheet Exposures by Asset Classes according residual maturity as at 31 December 2013 (PLN k)

		Residual Term to Maturity				
No.	Exposure Class	<1 year	1-5 years	>5 years		Total
1.	Claims or contingent claims on central governments or central banks	37,87%	38,28%	23,85%	-	22 116 318
2.	Claims or contingent claims on regional governments or local authorities	10,51%	55,04%	34,45%	-	264 824
3.	Claims or contingent claims on administrative bodies and non-commercial undertakings	20,65%	53,57%	25,78%	-	246 788
4.	Claims or contingent claims on multilateral development bank	-	-	-	-	-
5.	Claims or contingent claims on institutions	47,48%	27,78%	24,74%	-	8 369 377
6.	Claims or contingent claims on corporates	27,64%	49,93%	22,43%	-	26 567 170
7.	Retail claims or contingent retail claims	23,93%	39,97%	36,10%	-	26 136 610
8.	Claims or contingent claims secured on real estate property	11,33%	24,97%	63,70%	-	34 554 531
9.	Past due items	56,70%	37,88%	5,42%	-	4 979 319
10.	Claims classified to the regulatory high-risk categories	20,61%	79,39%	0,00%	-	125 564
11.	Other exposure classes	-	-	-	6,02%	7 902 515
	Total exposures covered by the standardised approach	**24,98%**	**34,58%**	**34,42%**	**6,02%**	**131 263 016**

List of exposures as of 31 December 2013 and average exposure amounts (PLN k)

No.	Exposure Class	Exposure Value	Average value of the exposures
1.	Claims or contingent claims on central governments or central banks	22 116 318	21 385 577
2.	Claims or contingent claims on regional governments or local authorities	264 824	300 443
3.	Claims or contingent claims on administrative bodies and non-commercial undertakings	246 788	238 740
4.	Claims or contingent claims on multilateral development bank	-	17 378
5.	Claims or contingent claims on institutions	8 369 377	9 695 856
6.	Claims or contingent claims on corporates	26 567 170	25 815 125
7.	Retail claims or contingent retail claims	26 136 610	24 200 701
8.	Claims or contingent claims secured on real estate property	34 554 531	36 313 908
9.	Past due items	4 979 319	4 793 577
10.	Claims classified to the regulatory high-risk categories	125 564	35 612
11.	Claims in the form of collective investment undertakings	21 785	28 513
12.	Other claims	7 880 730	7 204 731
	Total exposures covered by the standardised approach	**131 263 016**	**130 030 161**

The average exposure value was determined on the basis of the last five reporting periods for the BZ WBK Group.

Under the lending policy of the BZ WBK Group, sectors, groups and entities that represent various industries are financed. The diversified credit portfolio allows the BZ WBK Group to mitigate the risk associated with concentration in lending to a single industry. As of 31 December 2013, the highest concentration, excluding the public sector and the retail sector, was reported in the property sector and the distribution.

Balance and Off-Balance Sheet Exposures by Asset Classes according sectors as at 31 December 2013 (PLN k)

		Industry Analysis											
No.	Exposure Class	Public Sector	Detail (including mortgages)	Property	Manuafacturing	Distribution	Construction	Agriculture	Transport	Financial	Energy	Other Secotrs	Total
1.	Claims or contingent claims on central governments or central banks	22 116 318	-	-	-	-	-	-	-	-	-	-	22 116 318
2.	Claims or contingent claims on regional governments or local authorities	264 824	-	-	-	-	-	-	-	-	-	-	264 824
3.	Claims or contingent claims on administrative bodies and non-commercial undertakings	246 788	-	-	-	-	-	-	-	-	-	-	246 788
4.	Claims or contingent claims on multilateral development bank	-	-	-	-	-	-	-	-	-	-	-	-
5.	Claims or contingent claims on institutions	-	-	-	-	-	-	-	-	8 369 377	-	-	8 369 377
6.	Claims or contingent claims on corporates	-	33 060	1 499 035	8 775 204	6 428 276	1 699 048	142 825	885 556	1 555 971	4 133 407	1 414 788	26 567 170
7.	Retail claims or contingent retail claims	-	17 750 388	57 345	1 585 601	2 546 284	717 513	993 512	899 016	187 258	138 938	1 260 755	26 136 610
8.	Claims or contingent claims secured on real estate property	-	18 410 718	6 666 544	3 225 256	3 457 247	283 370	419 219	276 457	112 726	850 416	852 578	34 554 531
9.	Past due items	-	989 003	1 320 648	522 494	601 042	353 061	60 434	127 063	53 414	515 825	436 335	4 979 319
10.	Other exposure classes	-	-	-	-	-	-	-	-	-	-	8 028 079	8 028 079
	Total exposures covered by the standardised approach	**22 627 930**	**37 183 169**	**9 543 572**	**14 108 555**	**13 032 849**	**3 052 992**	**1 615 990**	**2 188 092**	**10 278 746**	**5 638 586**	**11 992 535**	**131 263 016**

The BZ WBK Group calculates the value of exposures and risk weighted exposure amounts for the purpose of counterparty credit risk estimates in accordance with the rules for determining such amounts for the purpose of calculation of capital requirement for credit risk under the standardized approach. Balance sheet equivalent of off-balance sheet transactions is determined in accordance with the mark-to-market method, as described in §10 of Appendix 16 to KNF Resolution no. 76/2010, as amended.

The capital requirement for counterparty credit risk is calculated on the basis of exposure arising from transactions in the trading book, determined on the basis of replacement cost and potential future value of credit exposure. According to Appendix 16 to KNF Resolution no. 76/2010, as amended, replacement cost depends on the market value of a given transaction, whereas potential future credit exposure is determined on the basis of the product of the nominal value and the weight of the product.

List of exposures for capital requirement for counterparty credit risk as at 31 December 2013 (PLN k)

No.	Exposure Class	Exposure Value	Risk-weighted Assets	Capital requirement for counterparty risk
1.	Claims or contingent claims on institutions	1 267 212	549 366	43 950
2.	Claims or contingent claims on corporates	274 988	274 990	21 999
3.	Other exposure classes	16 951	7 773	621
	Total exposures covered by the standardised approach	**1 559 151**	**832 129**	**66 570**

The requirement arising from exposure to businesses was the largest item of the capital requirement for counterparty credit risk in the BZ WBK Group.

List of exposures for capital requirement for counterparty credit risk by product as at 31 December 2013 (PLN k)

No.	Product	Exposure Value	Risk-weighted Assets	Capital requirement for counterparty risk
1.	Forward Rate Agreement	16 160	6 411	513
2.	FX Spot, FX Swap, FX Forward	401 323	183 188	14 655
3.	FX Option	23 353	16 621	1 330
4.	Interest Rate Swap (IRS), Cross Currency Swap (XCCY)	1 017 689	558 518	44 681
5.	Other	100 626	67 391	5 391
	Total exposures covered by the standardised approach	**1 559 151**	**832 129**	**66 570**

Foreign currency transactions account for ca. 27.2% of the value of exposures in the trading book, which is subject to calculation of capital requirement for counterparty credit risk.

Detailed information relating to valuation and the nominal values of derivatives is presented in **Note 20** to the Consolidated financial statement of the BZ WBK Group for the 6-month period ended 30 June 2013.

4.3. Allocating risk weights to the credit portfolio

The risk weights used in the calculation of capital requirement for credit risk in the standardized approach are based on the provision of Appendix 4 to KNF Resolution no. 76/2010 as amended. Risk weights are allocated in line with the class of the exposure and the credit quality of the claim/entity as defined in §24-100 of Appendix 4 to KNF Resolution no. 76/2010 as amended.

The Group applies techniques of reducing the credit risk both with regard to tangible (real) and financial collaterals as per Appendix no. 17 to KNF Resolution no. 76/2010 as amended. In the case of financial collaterals, borrowers covered by the credit protection in the form of a guarantee are assigned a risk weight arising from the risk grade of the entity that grants the guarantee. The prevailing group of suppliers of financial collaterals is composed of banks including Bank Gospodarstwa Krajowego ("de minimis" program) and the Ministry of Finance acting as a unit of the State Treasury.

For past-due exposures, the risk-weight is set by the rules specified in §70 of Appendix 4 to KNF Resolution no. 76/2010 as amended. An exposure is considered as past due if it is past due for more than 90 days and the past due amount is greater than PLN 500 in the case of retail exposures and greater than PLN 3000 in case of other exposure classes.

Exposures to the parent company, subsidiary or other entities controlled by the parent company have a preferential risk weight of 0% (§12 of Appendix 4 to KNF Resolution no. 76/2010 as amended)

The Group has a separate class of retail exposures secured on residential real estate, applying a preferential risk weight of 35% to it (as per §65 of Appendix 4 to KNF Resolution no. 76/2010 as amended). Bank Zachodni WBK S.A. does not have a separate class of exposures effectively secured on commercial real estate (§66 of Appendix 4 to KNF Resolution no. 76/2010 as amended) where preferential risk weight can be assigned.

According to Resolution no. 153/2011 of 7 June 2011, retail exposures with respect to which the principal or interest installment depends on exchange rate movements or on currencies other than the currency of the borrower's income are assigned a 100% risk weight. Other retail exposures which are not past-due and which are processed on the basis of the standardized approach qualify for the risk weight of 75%.

Preferential approach was used to the risk weights for the PLN claims on regional government, the city of Warsaw and their associated bodies. (in accordance with §31 of Appendix 4 to KNF Resolution no. 76/2010 as amended).

As at 31 December 2013, the Group's debt instruments portfolio comprised **PLN 2,368,155k**-worth of the bonds of Bank Gospodarstwa Krajowego, fully covered by the guarantee of the State Treasury. The bonds are assigned a preferential risk weight of 0%

Part of credit portfolio for SMEs within 'de minimis' guarantee program (not exceeding 60% of the loan) has a preferential risk weight which is assigned to Bank Gospodarstwa Krajowego.

In each asset class, appropriate risk weight is allocated depending on the available credit rating of reliable external rating institutions or export credit agencies acceptable to the Bank. 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 three 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.

Balance and Off-Balance Sheet Exposures by Asset Classes according to risk weight as at 31 December 2013 (PLN k)

		Risk Weightings							
No.	Exposure Class	0%	20%	35%	50%	75%	100%	150%	Total
1.	Claims or contingent claims on central governments or central banks	20 918 059	1 198 259	-	-	-	-	-	22 116 318
2.	Claims or contingent claims on regional governments or local authorities	-	264 572	-	252	-	-	-	264 824
3.	Claims or contingent claims on administrative bodies and non-commercial undertakings	2 932	16 589	-	157 960	-	69 307	-	246 788
4.	Claims or contingent claims on multilateral development bank	-	-	-	-	-	-	-	-
5.	Claims or contingent claims on institutions	151	6 309 267	-	2 011 992	-	47 967	-	8 369 377
6.	Claims or contingent claims on corporates	78 247	164	-	276 159	-	26 212 600	-	26 567 170
7.	Retail claims or contingent retail claims	4 196	174	-	71 080	20 891 941	5 169 219	-	26 136 610
8.	Claims or contingent claims secured on real estate property	-	-	5 024 030	24 338	7 112 949	22 393 214	-	34 554 531
9.	Past due items	25	-	-	15 760	26 522	3 783 099	1 153 913	4 979 319
10.	Claims classified to the regulatory high-risk categories	-	-	-	-	-	-	125 564	125 564
11.	Claims in the form of collective investment undertakings	-	-	-	-	-	930	20 855	21 785
12.	Other claims	5 227 404	260 445	-	-	-	2 392 881	-	7 880 730
	Total exposures covered by the standardised approach	**26 231 014**	**8 049 470**	**5 024 030**	**2 557 541**	**28 031 412**	**60 069 217**	**1 300 332**	**131 263 016**

There are not many companies on the Polish market which have a credit rating from the agencies listed above. As a result, 74.2% of the exposures presented below do not have a credit quality step.

Balance and Off-Balance Sheet Exposures by Asset Classes according to credit quality step as at 31 December 2013 (PLN k)

		Credit quality step							
No.	Exposure Class	1	2	3	4	5	6	Lack	Total
1.	Claims or contingent claims on central governments or central banks	10 021 429	12 094 889	-	-	-	-	-	22 116 318
2.	Claims or contingent claims on regional governments or local authorities	-	101 739	-	-	-	-	163 085	264 824
3.	Claims or contingent claims on administrative bodies and non-commercial undertakings	12	192 366	-	-	-	-	54 410	246 788
4.	Claims or contingent claims on multilateral development bank	-	-	-	-	-	-	-	-
5.	Claims or contingent claims on institutions	224 316	4 388 322	2 447 840	94 666	9 549	-	1 204 684	8 369 377
6.	Claims or contingent claims on corporates	164	148 841	3 000 223	77 180	-	-	23 340 762	26 567 170
7.	Retail claims or contingent retail claims	-	71 030	43	-	-	-	26 065 537	26 136 610
8.	Claims or contingent claims secured on real estate property	-	33 195	-	-	-	-	34 521 336	34 554 531
9.	Past due items	-	292	15 520	-	-	-	4 963 507	4 979 319
10.	Claims classified to the regulatory high-risk categories	-	-	-	-	100 263	-	25 301	125 564
11.	Claims in the form of collective investment undertakings	-	-	-	-	-	-	21 785	21 785
12.	Other claims	-	-	-	-	-	-	7 880 730	7 880 730
	Total exposures covered by the standardised appr	**10 245 921**	**17 030 674**	**5 463 626**	**171 846**	**109 812**	**-**	**98 241 137**	**131 263 016**

Bank Zachodni WBK

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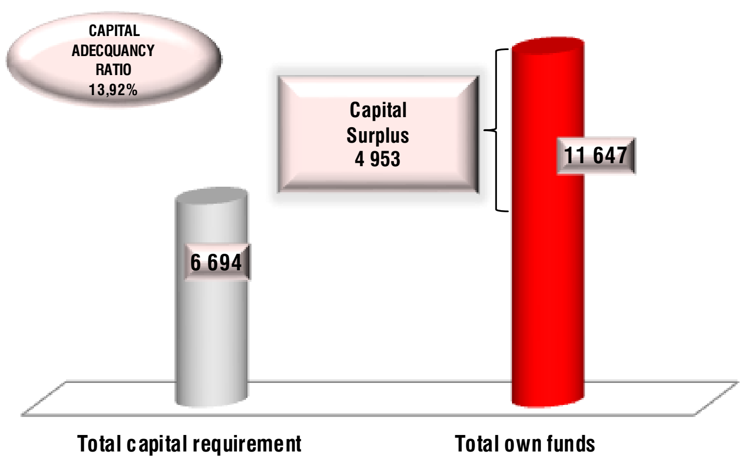
5. Capital adequacy

5.1 Regulatory capital adequacy

According to § 10 of KNF Resolution no. 76/2010 of 10 March 2010, as amended, the capital adequacy ratio is calculated on the basis of own funds plus short-term capital multiplied by 12.5 total capital requirement.

With the total capital requirement of **PLN 6,693,866k** and own funds of **PLN 11,647,036k** as at 31 December 2013, the capital adequacy ratio of the BZ WBK Group was **13.92%**.

Capital Adequacy of Bank Zachodni WBK Group as at 31 December 2013



5.2 Internal capital adequacy

Introduction

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 the bank and capital requirements estimated for the unexpected loss is determined in accordance with applicable Polish Banking Law, the provisions of the Polish Financial Supervision Commission and the regulations and directives of the European Parliament and of the Council of the EU prudential requirements.

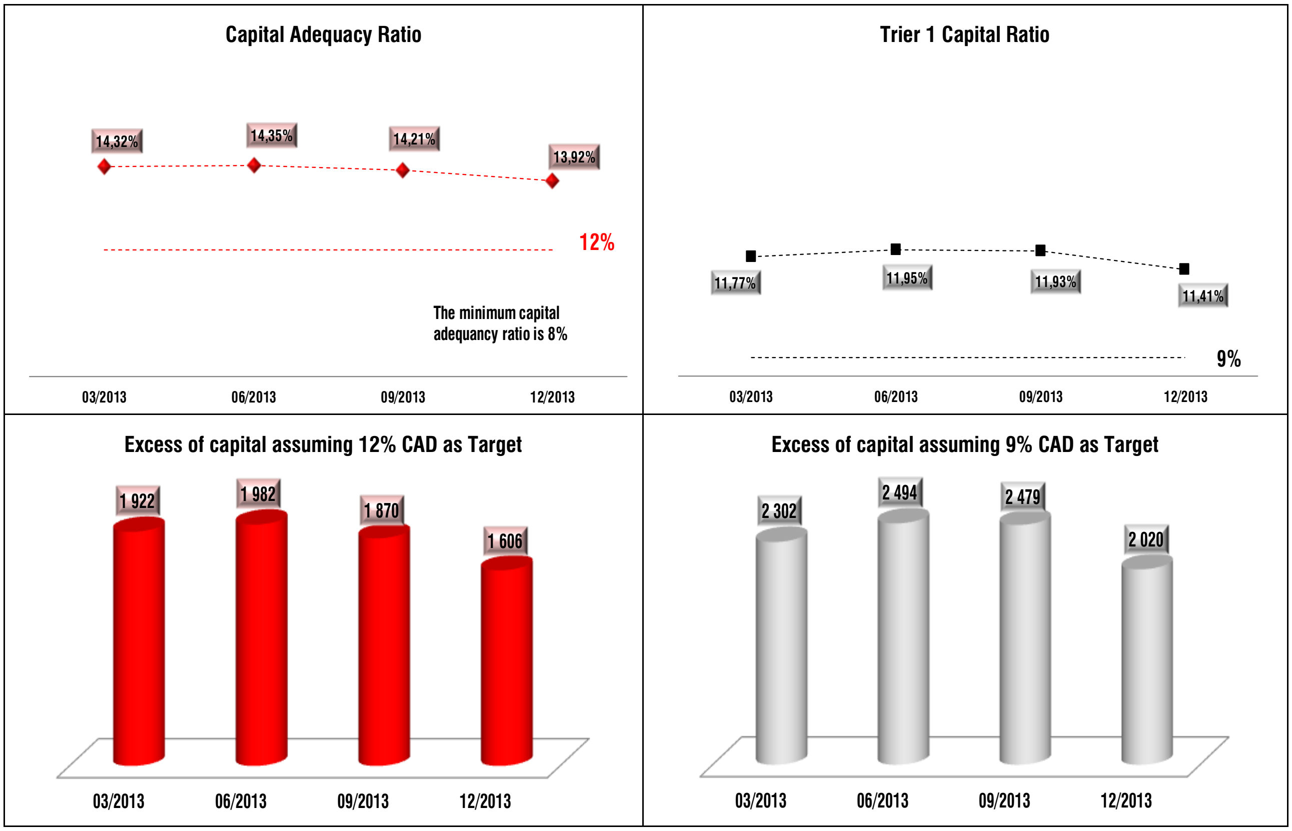
The Management Board is accountable for capital management, calculation and maintenance processes, including assessment of capital adequacy vis a vis different economic conditions and evaluations of stress tests results and their impact on internal capital and capital adequacy. Responsibility for general 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).This body is responsible for tracking 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 aim of the BZ WBK Group is maintain the Bank's and Group's capital adequacy ratios at the level of minimum 12% for solvency ratio and minimum 9% for Tier 1 capital adequacy ratio (core equity capital to Risk Weighted Assets for credit, market and operational risk).It is in accordance with the expectations of the Polish Financial Supervision Commission communicated in the document DBK/DBK 2/7113/122/1/2013 from 9 August 2013.

The regulatory solvency ratio is 8%.



Internal Capital

Independent from the regulatory methods for measuring capital requirements, the BZ WBK Group assesses both current and future capital adequacy based on internal methods and models of risk measurement - process (ICAAP).

Under the ICAAP process, the Group estimates the required level of internal capital to ensure secure conduct of its banking business in accordance with the Group's risk profile defined in the "Risk Appetite Statement".

For the purpose of the ICAAP process, the Group uses statistical loss estimation models for measurable risks, such as credit risk, market risk or operational risk, and carries out qualitative assessment for other material risks not covered by the model, e.g. reputation risk or compliance risk.

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

Results of the ICAAP process are an element of assessment of the current and future capital requirements, and are the basis for assessment of risk appetite and the Group's strategy.

The BZ WBK Group performs an internal assessment of capital requirements also in stressed conditions, taking into account different macroeconomic scenarios.

The 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 judgment.

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.

Bank Zachodni WBK

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6. Policy of variable components of remuneration

The BZ WBK Group has a **Policy of variable components of remuneration paid to selected officers of the BZ WBK Group,** which has been accepted and signed off by the Bank Management Board and the Supervisory Board. The Policy is subject to review, which are carried out on an annual basis or more often in the case of significant organizational changes.

Bank Zachodni WBK, in its remuneration policy, uses Criteria of identifying individuals who have a material impact on the Bank's risk profile pursuant to KNF resolution no. 258/2011 of 4 October 2011 detailed rules underlying the operations of the risk management system and internal control system as well as detailed conditions of measuring internal capital by banks and reviewing the processes of assessing and maintaining the internal capital and the rules of setting the policy on variable components of remuneration paid to individuals holding managerial positions.

Criteria of identifying individuals who have a material impact on the Bank's risk

The Committee composed of Chairman of the Supervisory Board, President of the Managements Board, Member of the Management Board in charge of the HR Management Division recommended the following criteria of identifying individuals holding managerial positions:

- being a member of the Bank's Management Board;
- being a member of the Bank's top management, the so-called Top Executive;
- managing one of the control functions listed in the resolution (HR management, compliance risk management, internal audit, risk management) or holding another position listed in KNF resolution no. 258/2011 if it is not separately covered by these criteria;
- holding powers for taking single-handedly decisions which have a material impact on the Bank's risk profile (in excess of the amount representing 0.25% of the common equity);
- holding entitlement to take collectively decisions that have a significant impact on the bank's risk profile (members of committees and forums dealing with credit policy, risk, capital expenditure);
- having personal financial interest in taking on excessive risk, material in terms of the bank's risk profile;
- the base salary in the group of 0.3% of the highest salaries in the Bank;
- Individuals listed in above points are not deemed to be holding Managerial Positions if they do not have a material impact on the Bank's risk profile.

The performance criteria on which any entitlement to share options, shares or variable components of remuneration

The variable components of remuneration are awarded based on the evaluation of individual performance achieved by employees holding Managerial Positions and the Bank's business results generated in the area of a given employee's responsibility. The performance evaluation is made as part a periodic performance review process applicable in the Bank. The performance evaluation should take into account such a period of time which allows to factor-in the Bank's economic cycle and the risk of conducted operations.

Under this Policy, the variable remuneration depends on the evaluation of the performance of a given employee who has a material impact on the Bank's profile in the way adopted in a given organizational unit of the bank; the evaluation covers the period of the last 3 years.

The main parameters of the variables system and other non-cash benefits

The variable remuneration is paid to individuals holding managerial positions once a year, following the end of a given accounting period and announcement of the Bank's results.

If detailed bonus regulations applicable to a given individual provide for a different frequency of payments, amounts accrued in settlement periods will accumulate and be paid after the end of the accounting period and the announcement of results.

The variable remuneration awarded based on bonus regulations is paid in cash and in the form of Phantom shares. Yet, the variable component in the form of Phantom shares cannot be lower than 50% of the total value of the variable remuneration payment.

Minimum 40% of variable remuneration components, specified in item f. is deferred for the period of three years and is paid during that period in equal, annual installments in arrears, depending on the performance of a given employee over the period subject to review and price of Phantom shares.

The possibility for not paying the deferrals is appearance of situations mentioned below:

- Deficient financial performance of the Group
- Breach by the beneficiary of internal rules or regulations, particularly including those related to risks
- Material restatement of the Group's financial statements, except when appropriate pursuant to a change in accounting standards
- Significant changes in financial capital or Group´s risk profile

If the total amount of variable remuneration components exceeds EUR 1,000,000 p.a. (as per the average NBP fx rate as at the day of granting the right to a given variable component of remuneration), at least 60% of the awarded total amount is deferred.

Variable remuneration paid in 2013 to staff of Bank Zachodni WBK covered by Policy on variable components of remuneration (PLN k)

	The Management Board	Other posts
Base remuneration	**11 520**	**6 705**
Variable remuneration	**10 277**	**4 316**
Paid		
in cash (*)	8 193	3 884
in shares	-	-
Deffered	-	-
in cash (*)	2 084	432
in phantom shares (*)	8 037 shares	1 665 shares
in BZ WBK shares (**)	38 570 shares	16 591 shares
Entitled persons (1)	**10 persons**	**12 persons**

(*) including deferred bonus from previous years

(**) shares granted under the Long Term Incentive Program for years 2011-2013, to be paid after approval by the General Meeting of the Bank's results for the year 2013

(1) Information prepared according to current list of persons covered by 'Policy of variable components of remuneration paid to selected officers of BZ WBK Group'.

Quantitative data on remuneration by business lines as at 31 December 2013 (PLN k)

Business line	Base remuneration paid during 1.01.2013-30.06.2013 [k PLN]	Bonus for 2012			Deffered bonus for 2011 paid in 2013	Long-term intencive shame (number of granted share)
		Paid [k PLN]	Deffered			
			Paid in cash [k PLN]	Number of phantom share granted		
Business & Corporate Banking Division	1 099	759	196	756	96	3 250
Retail Banking Division	1 669	1 362	316	1 218	283	4 088
Global Banking & Markets Division	3 532	2 095	382	1 041	216	5 572
ALM	1 221	974	189	729	141	3 074
Other	10 703	6 887	1 433	5 958	1 148	20 328
	18 225	**12 076**	**2 515**	**9 702**	**1 883**	**36 312**

Share based incentive scheme

On the 20th of April 2011, Annual General Meeting of the Shareholders of Bank Zachodni WBK S.A. implemented three-year Incentive Scheme no. IV which initially addressed 496 key employees of the Bank Zachodni WBK Group, including Members of the Management Board.

The fourth edition of the BZ WBK incentive scheme closed as at 31 December 2013. It has been assumed that the incentive scheme vested at the maximum level. Realization through issuance of new shares and their allocation to entitled individuals will be processed in first
half of 2014, provided all the formal requirements would be fulfilled.

Vesting condition will be considered from two perspectives, separately for every year of operation of the scheme and on a cumulative basis after 3 years.

In every single year annual award not exceeding one third on total award will be considered. Shares will vest on a linear pattern between 25% and 100% contingent on profit before tax (PBT) growth. The range of the scale requires PBT growth between 8% and 15% in first year and between 15% and 22% in second and third year of duration of scheme.

Following the merger of Bank Zachodni WBK and Kredyt Bank as at 04.01.2013 the vesting conditions for annual reward for 2013 have been modified. Concerning the lack of comparative financial information for the purpose of the calculation of the profit growth, the quantitative levels of after tax profit have been established to asses vesting at the level between 25% and 100% also maintaining linear relation between vested rewards and the profit amount in this range.

Additionally, after 3 years cumulative award will be considered. Shares will vest on a linear pattern between 25% and 100% contingent on PBT compound annual growth rate in 3 years' time between 12.6% and 19.6%. If number of shares resulting from cumulative assessment will be higher than sum of annual awards vested to date, additional shares will be allocated to individuals up to the amount resulting from cumulative assessment.

The Black Scholes model has been used to value awards granted at the grant date. The expected volatility is based on an analysis of historical volatility based on 160 sessions preceding the grant date. The following table details the assumptions used, and the resulting fair value.

The movements of the incentive scheme in 2012 and 2013 (PLN k)

	12 months of 2013 Number of share based payments	12 months of 2012 Number of share based payments
Outstanding at 1 January	311 989	317 971
Granted	-	4 523
Exercised	-	-
Forfeited	(2 684)	(6 577)
Expired	-	-
Outstanding at 31 December	314 673	315 917
Exercisable at 31 December	**-**	**-**