Capital Adequacy and Risk Management

(Pillar III)

The Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna Group

As at 31 December 2007

INTRODUCTION[1]

The Report „Capital Adequacy and Risk Management (Pillar III)" (hereinafter the „Report") of the Powszechna Kasa Oszczędności Bank Polski SA Group ("the PKO BP SA Group" or "the Group") as at 31 December 2007 was prepared in accordance with the provisions of article 111a paragraph 1 of the Act dated 29 August 1997 – Banking Law[2] ("the Banking Act") as well as the requirements set forth in the Resolution No. 6/2007 of the Commission for Banking Supervision dated 13 March 2007 concerning *detailed principles and the manner of publishing by banks of qualitative and quantitative information relating to capital adequacy and the scope of required disclosure* ("Resolution No. 6 of the CFBS").

In accordance with § 6 of the Resolution No. 6/2007 of the CFBS, Powszechna Kasa Oszczędności Bank Polski SA ("PKO BP SA", "the Bank") which is the parent company within the meaning of § 3 of this Resolution, publishes annually information on its capital adequacy in a separate document, which is issued no later than within 30 days of the approval of annual financial statements by the General Meeting of Shareholders.

The Report covers the year ended 31 December 2007. Unless stated otherwise, the Report includes consolidated data of the PKO BP SA Group. Since the risk profile of the PKO BP SA Group is mainly affected by the PKO BP SA Bank (96%[3] of consolidated assets, 90.5%[4] of consolidated result), certain information included in the Report concerns the Bank PKO BP SA. Unless stated otherwise, the financial data presented in the Report has been expressed in million zlotys (PLN million).

Until 31 December 2007 (inclusive), the Bank exercised the option provided in § 14 point 1 of the Resolution No. 1/2007 of the Commission for Banking Supervision dated 13 March 2007[5] under which the capital requirement for credit risk was calculated in accordance with the current methodology (Basel I). Using this option has also caused that the capital requirement for operational risk as at 31 December 2007 was zero. Given the above, the information on capital requirements included in the Report relates to a large extent to the requirements of Basel I.

As of 1 January 2008, due to the expiry of the above option, the Bank is obliged to comply with the new requirements (the so-called Basel II) as regards calculation of capital requirements defined in Resolution No. 1/2007 of the Commission for Banking Supervision and the process of assessment of internal capital adequacy *(Internal Capital Adequacy Assessment Process – ICAAP)* – the so-called Pillar II of Basel II, defined in Resolution No. 4/2007 of the Commission for Banking Supervision dated 13 March 2007[6]. Since the above requirements were binding for the Bank and the Group only as of the beginning of 2008, the Bank's assessments related to the financial effects of implementation of Basel II were included in order to supplement the information presented in this Report.

The Report was subject to internal verification performed by the adequate Bank's Departments responsible for risk and capital adequacy management of the Bank, with cooperation of an external audit company.

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[1] Any differences in totals and percentage shares result from rounding of amounts to the nearest million and rounding of percentage shares to one decimal place.

[2] Journal of Laws 2002, No. 72, item 665 with subsequent amendments.

[3] The share of subsidiary companies in the consolidated total assets was calculated before consolidation adjustments and exclusions for the year ended 31 December 2007.

[4] The share of subsidiary companies in the consolidated result was calculated in relation to the financial result of the Group before consolidation adjustments and exclusions for the year ended 31 December 2007.

[5] Resolution No. 1/2007 of the Commission for Banking Supervision dated 13 March 2007 concerning scope and detailed principles of determining capital requirements for individual risk types, including the scope and terms and conditions for use of statistical methods and the scope of information attached to applications for the use of those methods, terms and conditions of accounting for contracts for transfer of receivables, contracts for sub-participation and contracts for credit derivative instruments and contracts other than contracts for transfer of receivables and contracts for sub-participation, for the purpose of determining capital requirements, terms, scope and manner of use of ratings given by external rating agencies and agencies of export credit, the manner and detailed principles of calculation of bank capital adequacy ratio, scope and manner of accounting for activities of banks in holdings in calculating capital requirements and capital adequacy ratio a well as defining additional balance sheet items of banks recognised under own funds in the capital adequacy statement and the scope, manner and terms of their determining (Official Journal of the National Bank of Poland 2007, No. 2, item 3).

[6] Resolution No. 4/2007 of the Commission for Banking Supervision dated 13 March 2007 concerning detailed principles of functioning of risk management and internal control systems and detailed terms and conditions for estimation by banks of internal capital and reviewing the process of estimating and maintaining internal capital (Official Journal of the National Bank of Poland 2007, No. 3, item 6).

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1. INFORMATION ABOUT THE BANK AND THE GROUP

The parent company of the Group is PKO BP SA whose share in the consolidated assets amounts to 96%[3], and in the consolidated net financial result – 90.5%[4]. PKO BP SA conducts business activities in the territory of the Republic of Poland and is subject to Polish banking supervision authorities.

Apart from PKO BP SA, the PKO BP SA Group comprises also other companies, and in the two of the companies – KREDOBANK SA and Bankowy Fundusz Leasingowy SA – a significant level of banking risk occurs.

KREDOBANK SA conducts business operations in Ukraine and is subject to the Ukrainian banking supervision. The share of KREDOBANK SA in the consolidated assets is 1.8%[3], and in the consolidated net result – 0.6%[4].

Bankowy Fundusz Leasingowy SA („BFL SA") – together with its subsidiaries – conducts lease operations in the territory of the Republic of Poland. The share of Bankowy Fundusz Leasingowy SA (together with subsidiaries) in the consolidated assets is 1.6%[3], and in the consolidated net result – 1.1%[4].

Other Group companies included in consolidation are as follows:

- Powszechne Towarzystwo Emerytalne BANKOWY SA (pension fund management) and its subsidiary,
- Centrum Finansowe Puławska Sp. z o.o. (management and utilization of Centrum Finansowe Puławska),
- PKO Inwestycje Sp. z o.o. (developer business) – and its subsidiaries,
- PKO Towarzystwo Funduszy Inwestycyjnych SA (investment funds' management),
- Inteligo Financial Services SA (technical servicing of Internet banking),
- Centrum Elektronicznych Usług Płatniczych eService SA (servicing and settlement of transactions made with the use of cards),
- Bankowe Towarzystwo Kapitałowe SA (financial intermediary services as regards trading in shares).

Detailed information on the subsidiary Group companies, consolidation method and shares of the Bank in the share capital of individual companies has been included in the consolidated financial statements of the Group for the year ended 31 December 2007, which were authorised for publication by the Bank's Management Board on 8 April 2008.

Due to the immateriality of the financial data for consolidation purposes, the following subsidiary Group companies, which are in liquidation, have not been included in consolidation:

- International Trade Center Sp. z o.o.,
- Przedsiębiorstwo Informatyki Bankowej „Elbank" Sp. z o.o.

Subsidiary Group companies not included in consolidation has not reported capital shortage as they do not conduct business activities and do not hold any assets or off-balance sheet liabilities.

Exposures in subsidiary companies not included in consolidation does not decrease own funds of the Bank.

At the consolidation level, own funds of the Group are decreased by the Bank's capital exposure in the following entities: Bank Pocztowy SA and Poznański Fundusz Poręczeń Kredytowych Sp. z o.o. (associates valued using the equity method i.e. not subject to consolidation using the full method) which amounted to a total of PLN 114.5 million as at 31 December 2007.

At an individual level, own funds of the Bank are reduced by the Bank's capital exposure in KREDOBANK SA, PTE BANKOWY SA, PKO TFI SA, BFL SA, Bankowe Towarzystwo Kapitałowe SA, Bank Pocztowy SA and Poznański Fundusz Poręczeń Kredytowych Sp. z o.o., which amounted to a total of PLN 744.6 million as at 31 December 2007.

Within the PKO BP SA Group, limitations occur as regards transfer of own funds between the Bank and KREDOBANK SA relating to dividend payment. In accordance with the decision of the Extraordinary Annual General Meeting of KREDOBANK SA dated 17 November 2005, a moratorium was introduced for dividend payment in the years 2005-2008.

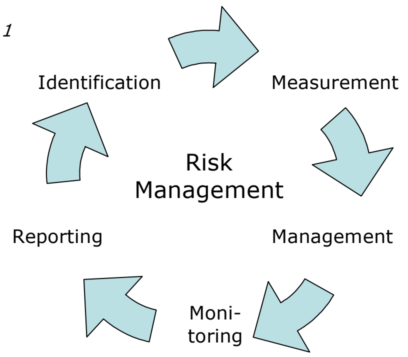
2. RISK MANAGEMENT

Banking activities are exposed to many types of risk, among others credit, market, operational and business risk. Controlling the effect of these types of risk on the functioning of the PKO BP SA Group is one of the main objectives of the Bank and the Group management function, and the risk level is an important factor of planning process.

Risk management at the Bank is based on the following principles:
- full organisational separation is maintained of the risk and debt collection functions from business functions,
- risk management is integrated with the planning and controlling systems,
- the area of risk and debt collection supports, on an ongoing basis, realisation of business objectives while maintaining the acceptable risk level,
- risk level is monitored on a regular basis,
- risk management model is regularly updated to accommodate to new risk factors and sources.

The following are included in the process of risk management in the Group:
- risk identification which consists in defining risk sources, both current and potential, which result from the current and planned business activities of the Bank,
- risk measurement,
- risk management which consists in taking decisions relating to acceptable risk level, planning activities, issuing recommendations and guidance, developing procedures and supporting tools,
- monitoring which consists in on-going monitoring of risk level based on adopted risk measurement methods,
- reporting covering a periodic information to the management on the scale of risk exposure and actions undertaken.

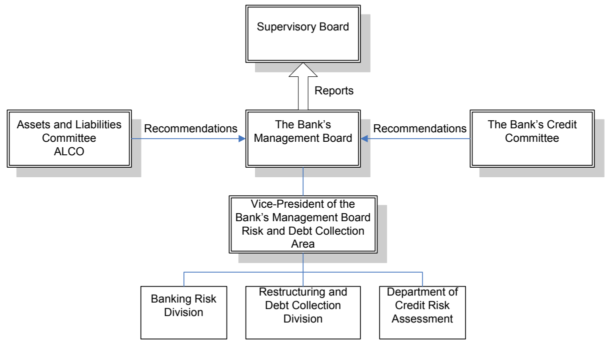
Scheme 2.1



Risk management process is realised in the environment, which comprises the following:
- applied methods and methodologies included in the internal regulations system,
- IT environment of the Bank, which facilitates flow of information required for risk assessment and control (including central IT systems which support risk assessment, and central databases),
- internal organisation which covers organisational units, their tasks, scope of responsibilities and mutual relations.

Scheme 2.2

Risk management organisation chart



Risk management process is supervised by the Supervisory Board of the Bank, which regularly receives information on the risk profile of the Bank and of the PKO BP SA Group and on the most important activities undertaken in the process of risk management.

The Management Board of the Bank is responsible for risk management strategy, including supervising and monitoring the activities taken by the Bank with a view to managing the risk. The Management Board of the Bank accepts the most important decisions affecting the Bank's risk profile and internal regulations which define the Bank's risk management system. Risk management activities – within the scope of the competencies assigned – are conducted by organisational units of the Bank grouped in the Banking Risk Division, Restructuring and Debt Collection Division and the Department of Credit Risk Assessment.

The business objective of the Banking Risk Division is preparation and implementation of system solutions for managing credit, operational, non-compliance, market and strategic risk as well as capital adequacy management. The most important tasks of the Division consist in:
- identification of risk factors and sources,
- risk measurement and cyclical monitoring and reporting risk level,
- measurement and assessment of capital adequacy,
- taking decisions and developing recommendations for the Assets and Liabilities Committee and the Management Board of the Bank on the acceptable risk level,
- developing internal regulations relating to risk management and capital adequacy,
- developing IT systems supporting managing risk and capital adequacy.

The business objective of the Restructuring and Debt Collection Division is to ensure effective and efficient collection and restructuring of bad debts. The most important tasks of the Division consist in:
- efficient recovery of bad debts and increasing the efficiency of those activities,

- effective conducting of early monitoring of default in the repayment of debts by retail customers using telephone contacts and other generally used means of communication as well as through direct visits at clients,
- effective sale of bad debts and outsourcing of the tasks realised and effective management of the foreclosures of collaterals.

The business objective of the Credit Risk Assessment Department is to assess and verify the credit risk level of individual credit exposures, which – due to the scale of exposure or risk level – requires special attention.

The function of market risk and credit portfolio risk management at the Bank is supported by two committees, which are chaired by the Vice-president of the Management Board of the Bank overseeing the Area of Risk and Recovery:
- the Assets and Liabilities Committee ("the ALCO"),
- the Bank Credit Committee ("the BCC").

The ALCO takes decisions and issues recommendations to the Management Board of the Bank as regards market and portfolio credit risk management, and assets and liabilities management.

The BCC takes credit decisions in respect of individually significant credit exposures or issues recommendations in this respect to the Management Board of the Bank. Credit committees also function at other levels of the Bank's organisational structure. Their objective is to issue recommendations concerning credit decisions which are significant due to the level of risk or scope of exposure.

The Bank supervises functioning of individual companies of the PKO BP SA Group. As part of this supervisory function, the Bank defines and accepts strategies of companies development, also within the scope of risk, oversees risk management systems in the companies and supports development of those systems, as well as considers the level of risk in the activities of individual companies as part of the risk monitoring and reporting system the Group level.

2.1. CREDIT RISK

Credit risk is understood to mean the risk of incurring losses as a result of customer default in settlement of liabilities towards the bank or the risk of decrease in the economic value of the bank's receivable as a result of deterioration of the customer ability to service its debt.

The Bank and the subsidiaries of the Group apply the following credit risk management policies:
- credit transaction requires comprehensive credit risk assessment, which expresses in the internal rating or scoring,
- credit risk measurement of potential and open credit transactions is made on a cyclical basis and takes into account both changing external conditions and changes in the financial standing of borrowers,
- credit risk assessment of credit exposures which are significant from the point of view of risk level or value is subject to additional verification by credit risk assessment units, irrespective of business units,
- terms and conditions of credit transactions offered to customers depend on the assessment of credit risk level generated by the given transaction,
- credit decisions may be taken only by authorised persons,
- credit risk is diversified for geographical area, industry type, products or clients,
- the expected level of credit risk is secured by credit spreads charged to customers as well as by impairment provisions for credit exposures.

The application of the above policies is ensured by the fact that the Bank uses advanced methods of credit risk management both at the level of individual credit exposures and at the level of the entire credit portfolio of the Bank. These methods are verified and developed for compliance with the requirements of the internal rating based methods (the IRB methods).

RATING AND SCORING METHODS

Risk assessment of individual credit transactions is made at the Bank using scoring and rating methods, which are developed, enhanced and supervised by the Banking Risk Division. Functioning of credit assessment methods is supported by specialised central IT applications. The manner of credit risk assessment was defined in the Bank internal regulations whose main purpose is to ensure uniform and objective credit risk assessment during the credit risk assessment process. The internal regulations define the manner of assessment of credit risk of individual credit exposure, its collateral and taking credit decisions.

The Bank makes credit risk assessment for individual customers at two levels: customer creditworthiness and credibility. Customer creditworthiness assessment consists in verifying current financial standing of prospective borrower, while credibility assessment consists of customer scoring assessment and assessment of customer credit history obtained from the internal documentation of the Bank and from external databases.

Credit risk assessment for institutional clients is made at two levels: client and transaction (except for certain types of transactions of small and medium sized enterprises which are assessed in a simplified manner). The outcomes of those assessments are ratings: of the customer and of the transaction. The synthetic measure of credit risk which reflects those two risk factors is the joint rating.

Information on rating and scoring assessments is widely used by the Bank in the process of risk management, in the system of competencies applied in taking credit decisions, in determining the amounts to be authorised by credit risk assessment units and in the system for credit risk measurement and reporting.

COLLATERALS POLICY

The collaterals policy applied by the Bank and the subsidiaries of the Group is to appropriately secure interests of the Group, and most of all, to establish collaterals that offer the best possible level of debt recovery, if recovery proceedings are to be applied. The policy concerning collaterals was defined in the Group's internal regulations.

Establishing defined types of collaterals depends on the product or customer.

In granting housing loans, collaterals are obligatorily established on the credited property. Until the time the effective mortgage security has been established, the Bank accepts as collateral (depending on the credit type and amount): insurance of loan, guarantee or applies an increased credit spread.

In granting retail loans for individual customers, the Bank mostly accepts personal collaterals (in the form of civil law or bill of exchange guarantee) or establishes a collateral on customer current account, car or securities.

Collaterals for loans granted to finance small and medium sized enterprises and corporate customers are established, among others, on business receivables, bank accounts, moveable goods, real estate or securities.

In accepting legal collaterals for loans, the Bank applies the following policies:

- in the case of high value loans, the Bank accepts several types of collaterals, if possible, to mix personal and material collateral,
- liquid collaterals are preferred, such as property collaterals, for which there is a high probability that the Bank will quickly satisfy its debt achieving prices approximating the value of assets determined at the time of collateral acceptance,
- collaterals exposed to the risk of significant unfavorable fluctuations of value have an auxiliary function,
- in the case of acceptance of material collateral, as an additional security the Bank accepts transfer of rights from insurance policy for the goods serving as collateral, or insurance policy written in favor of the Bank,
- establishing effective collaterals in accordance with the provisions of the agreement is prerequisite to issuance of loan funds.

Established collaterals are subject to periodic monitoring in order to determine the current credit risk level of the transaction. Subject to monitoring are the following:

- financial standing of the entity issuing personal collateral,
- condition and value of the goods serving as material collateral,
- other circumstances affecting the possibility to recover the Bank's debt.

Collaterals in the form of mortgage are subject to special assessment. The Bank performs periodic monitoring of real estate accepted as collaterals (while taking into account the LtV ratio), and monitors prices on the real estate market. Where the analysis shows a significant decrease in prices on the real estate market, the Bank activates emergency procedures.

In making lease agreements, BFL SA as the owner of leased assets treats them as security for the transaction. Where the liquidity (demand for the given fixed asset on the secondary market), pace of loss of market value of the asset or customer financial standing, are not acceptable according to internal procedures, an additional legal collaterals are accepted in the form used by banks. Those additional collaterals comprise property collaterals such as entry in the mortgage register, registered pledges, transfer of ownership rights to goods, repurchase agreements for leased assets concluded with suppliers and financial collaterals such as transfer of receivables, authorisations to bank accounts and deposits.

PORTFOLIO RISK MEASUREMENT

In order to assess the level of credit risk and credit portfolio profitability, the Bank uses various credit risk measurement and assessment methods, including the following:

- probability of default (PD),
- expected loss (EL),
- credit value at risk (CVaR),
- accuracy ratio,
- share and structure of irregular loans,
- share and structure of exposures meeting the criterion of individual loss of value.

The Bank systematically develops the scope of credit risk measures including the requirements of the IRB method, as well as extends the scope of the risk measures used in order to fully cover the Bank credit portfolio with those methods.

Portfolio credit risk measurement methods allow to, among others, include the credit risk in credit spreads or determine the optimum amount of cut-off points, or determine rates for making impairment provisions.

EXPOSURE AMOUNT AS PER BALANCE SHEET VALUATION

The table below shows information on balance sheet and off-balance sheet items included in the capital requirements calculation of the PKO BP SA Group as at 31 December 2006 and 31 December 2007.

Table 2.1

BALANCE SHEET ASSETS	The PKO BP SA Group 2007	2006	Average
Loans and advances*	76 417	58 907	67 662
Securities	15 233	19 281	17 257
Interbank placements	5 292	13 431	9 362
Financial fixed assets	179	180	180
Other assets**	11 447	10 227	10 837
TOTAL ASSETS	108 568	102 026	105 297
OFF-BALANCE SHEET LIABILITIES			
Financial	24 347	22 552	23 450
Guarantees granted	3 885	2 348	3 117
TOTAL Off-balance sheet liabilities	28 232	24 900	26 566
Derivative financial instruments	416 803	300 546	358 675

* Including financial and operating lease receivables.

** Including: cash and amounts due from the Central Bank, derivative financial instruments, intangible fixed assets, tangible fixed assets, current and deferred tax assets, other assets.

The largest level of credit risk exposure is related to the credit portfolio and off-balance sheet liabilities granted. (table 2.2).

Table 2.2

LOANS AND OFF- BALANCE SHEET LIABILITIES BY MATURITY

PKO BP SA

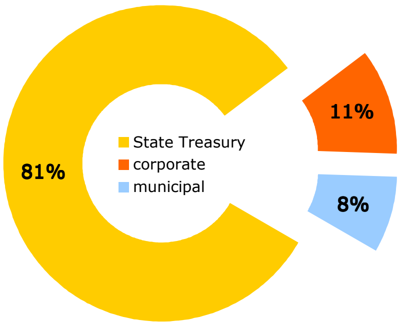
	up to 1 month	1 month to 3 months	3 months up to 1 year	1 year up to 5 years	over 5 years	Total
Gross total loans and advances	12 163	1 800	7 376	21 965	32 825	76 129
of which granted to:						
financial entities*	89	72	330	698	322	1 511
non-financial entities	11 968	1 728	7 046	20 702	29 497	70 941
budget entities	106	0	0	565	3 006	3 677
Total off-balance sheet liabilities	6 715	910	8 898	9 480	2 510	28 513
of which granted to:						
financial entities*	126	10	227	169	485	1 017
non-financial entities	6 551	894	8 451	9 135	1 973	27 004
budget entities	38	6	220	176	52	492

* Includes financial entities other than banks.

The significant level of capital requirement is related also to the interbank placements and securities (a significant part of the portfolio is represented by the Treasury bills – chart 2.1 as at 31 December 2007).

Chart 2.1

SECURITIES
THE PKO BP SA GROUP



IMPAIRMENT OF CREDIT EXPOSURES

The Group has adopted three methods of impairment assessment:

- individualised method, applied to individually significant loans, for which, in particular an impairment indicator has been identified – impairment loss assessment is made on the basis of analysis of forecasted credit-related cash flows;
- portfolio method, applied to individually non-significant loans, for which an impairment indicator has been identified – impairment loss assessment is made at the level of selected portfolios exposures on the basis of forecasted average cash flows generated by individual portfolios;
- collective method (IBNR), applied to loans for which no impairment loss indicator has been identified, but for which indicators have been identified of occurrence of incurred but not recognised losses- impairment losses are assessed on the basis of the expected period of loss disclosure, probability of loss disclosure and the expected loss at the moment of disclosure.

The main criteria of occurrence of loss indicators are as follows:

- delay in loan repayment of at least 3 months,
- significant deterioration of customer internal rating.

In determining the period of loan repayment delay, the outstanding amounts, of interest or principal installments are taken into account, irrespective of the past due amount.

In 2007, the gross balance of loans granted by the Group valued using the individualised method increased by PLN 122 million, while valued using the portfolio method – by PLN 182 million.

Table 2.3

LOANS AND ADVANCES GRANTED TO CUSTOMERS*

	The PKO BP SA Group 2007	2006
Gross loans and advances	78 833	61 354
individualised method	1 412	1 290
portfolio method	1 658	1 476
collective method (IBNR)	75 763	58 588
Impairment provisions	-2 416	-2 447
individualised method	-542	-650
portfolio method	-1 391	-1 263
collective method (IBNR)	-483	-534
Net loans and advances (gross-impairment provisions)	76 417	58 907

* Including financial and operating lease receivables.

Table 2.4

LOANS AND ADVANCES* - STRUCTURE BY PORTFOLIO

	The PKO BP SA Group 2007	2006
Gross loans and advances	78 833	61 354
consumer loans	18 303	14 615
housing loans	33 261	23 807
corporate loans	26 811	22 590
interest	458	342
Impairment provisions	-2 416	-2 447
consumer loans	-650	-503
housing loans	-490	-531
corporate loans	-1 275	-1 413
Net loans and advances (gross-impairment provisions)	76 417	58 907

* Including financial and operating lease receivables.

Table 2.5

LOANS AND ADVANCES* - GEOGRAPHICAL STRUCTURE

	The PKO BP SA Group 2007	2006
Gross loans and advances	78 833	61 354
Poland	77 127	59 915
Ukraine	1 706	1 439
Impairment provisions	-2 416	-2 447
Poland	-2 347	-2 377
Ukraine	-69	-70
Net loans and advances (gross-impairment provisions)	76 417	58 907

* Including financial and operating lease receivables.

At the end of 2007, compared to the end of 2006, the increase in the base used to calculate impairment write-down under the individualised method was resulted from the extended the scope of use of this method. As a result, the majority of the credit portfolio was valued based on individual forecast of cash flows relating to loan exposures, after taking into account the anticipated repayment of loan installments or realisation of the collaterals established.

Increase in the year 2007 of loans valued using the portfolio method resulted from a significant increase in the balance of credit portfolio, and in particular of consumer loans.

In 2007, the increase in the balance of loans for which impairment indicators have been identified (using the individualised and portfolio method) was lower than the dynamics of the entire loan portfolio, as a result of which the share of those loans in the entire portfolio decreased from 4.5% at the end of 2006 to 3.9% at the end of 2007.

As at the end of 2007, the geographical structure of impairment provisions' was in proportion to the credit exposures geographical structure – a significant part (above 97%) was in Poland.

The balance of impairment provisions in 2007 was affected also by loans write-off to a total amount of PLN 143 million with a simultaneous charge to the financial result of approx. PLN 128 million.

Table 2.6

IMPAIRMENT PROVISIONS

The PKO BP SA Group

	Balance as at 2007	Balance as at 2006	Change in 2007	Provisions write-offs	Additional provisions	F/X differences	Other
Loans and advances, of which:	2 376	2 404	-28	-143	128	-13	0
consumer loans	650	503	147	-84	231	0	0
housing loans	490	531	-41	0	-41	0	0
corporate loans	1 235	1 369	-134	-59	-62	-13	0
amounts due from banks	0	0	0	0	0	0	0
Financial lease receivables	40	43	-3	0	-3	0	0
Financial instruments	92	92	-1	0	3	0	-4
Other	157	234	-77	-3	-71	-2	0
Total	2 665	2 773	-109	-147	57	-15	-3

The decrease in the year 2007 of the balance of impairment provisions by PLN 77 million recognised under „Other" item was affected to the largest extent by reversal of impairment write-offs against intangible assets in the amount of PLN 16 million and against tangible fixed assets in the amount of PLN 49 million.

RISK MANAGEMENT TOOLS

The main credit risk management tools used by the Bank are as follows:

- regulations concerning assessment of credit availability, including cut-off points – the minimum number of points awarded during the course or customer creditworthiness assessment made using the scoring system (for individual clients) or the rating class and joint rating (for institutional clients), from which the loan transaction can be made with the given client,
- minimum transaction terms and conditions defined for the given type of transaction (i.e. the minimum value of the LtV rate, maximum credit amount, required collateral),
- minimum credit spread – credit risk spreads related to the Bank's defined credit transaction concluded with an institutional client, with the proviso that the client may not be offered interest rate lower than that resulting from reference rate increased by the credit risk spread,
- concentration limits – limits defined in § 71 point 1 of the Banking Act, industry limits and those relating to financing properties,
- competence limits – define the maximum level of authorisations required to take credit decisions towards the Bank's customers, these limits depend mostly on the amount of credit exposure of the Bank to the given customer (or a group of related customers) and the period of credit transaction; the amount of competence limits depends on the credit decision making levels (in the Bank's organisational structure).

RISK CONCENTRATION

The Bank monitors credit risk concentration in respect of the following:

- exposures to individual customers or groups of related clients,
- exposures to group of clients or credit portfolios exposed to one risk factor.

In particular, the Bank monitors credit portfolios recognised by:
- geographical regions,
- loan currency,
- industry sector,
- portfolio of loans collateralised by real-estate.

The risk of concentration of exposures to individual customers or group of related customers is monitored in accordance with § 71 of the Banking Act in respect of the following:
- exposure concentration limit (the total amount of individual exposure shall not exceed 25% of the Bank's own funds in the case of entities not related to the Bank and 20% of the Bank's own funds in the case of entities related to the Bank,
- large exposures limits (the sum total of individual exposures exceeding 10% of the Bank's own funds shall not exceed the threshold set at 800% of the Bank's own funds).

As at 31 December 2007, the Bank's level of concentration of risk to individual exposures was not high – the largest exposure to an individual customer accounted for 9.6% of the Bank's own funds.

Table 2.7

EXPOSURE TO THE 10 BIGGEST CLIENTS*

PKO BP SA

	2007		2006	
No.	Amount	%	Amount	%
1	918	9.6%	1 031	15.6%
2	867	9.1%	876	13.2%
3	830	8.7%	632	9.6%
4	699	7.3%	616	9.3%
5	577	6.0%	538	8.1%
6	543	5.7%	421	6.4%
7	522	5.5%	374	5.6%
8	452	4.7%	369	5.6%
9	447	4.7%	356	5.4%
10	427	4.5%	307	4.6%
Total	6 282	65.8%	5 520	83.4%

* Total (balance sheet and off-balance sheet) exposure to the non-bank clients which is the basis for concentration limit calculation in relation to the Bank's own funds.

At the end of 2007, the largest concentration of the Bank's exposure to a capital group accounted for 18.3% of the Bank's own funds and resulted from the consolidation of energy sector companies.

Table 2.8

EXPOSURE TO THE 5 BIGGEST CAPITAL GROUPS*

PKO BP SA

	2007		2006	
No.	Amount	%	Amount	% of the own funds
1	1 743	18.3%	1 242	18.8%
2	1 426	14.9%	648	9.8%
3	1 117	11.7%	581	8.8%
4	1 056	11.1%	530	8.0%
5	787	8.3%	437	6.6%
Total	6 130	64.2%	3 438	51.9%

* Total (balance sheet and off-balance sheet) exposure which is the basis for concentration limit calculation in relation to the Bank's own funds.

At the end of 2007, the total of large exposures accounted for 56% of the Bank's own funds, as compared to the limit of 800% of the Bank's own funds.

The risk of credit concentration in respect of geographical regions is monitored for:
- financial institutions – by the country of origin of customer head office,
- for other clients – by region of organisational units of the Bank extending the loan.

In order to ensure geographical diversification of the Bank's exposures to financial institutions, the Bank applies limits of joint exposure to individual countries.

Table 2.9

GEOGRAPHICAL STRUCTURE OF THE EXPOSURES TO BANKS

	The PKO BP SA Group	
State	2007	2006
Germany	17.7%	6.7%
Poland	11.5%	22.3%
Austria	10.3%	14.4%
USA	8.7%	5.4%
France	7.8%	12.7%
Ireland	7.1%	2.9%
Belgium	6.5%	4.2%
Spain	6.4%	4.7%
Portugal	4.7%	3.1%
Great Britain	4.1%	9.4%
Other	15.3%	14.0%
Total	100.0%	100.0%

As at 31 December 2007, no significant exposure by geographical regions in the Group credit portfolio was noted (table 2.10). Approximately half of the credit portfolio is centred upon three regions: mazowiecki, śląsko-opolski and wielkopolski regions, which at the same time show the greatest economic potential. The KREDOBANK SA portfolio of loans granted to Ukrainian clients accounted for approx. 2% of the total portfolio of the Group.

Table 2.10

GEOGRAPHICAL CONCENTRATION OF THE CREDIT RISK

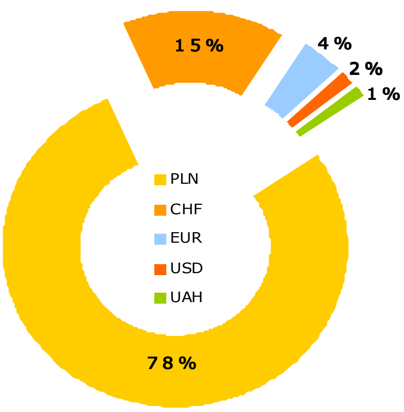
Region	The PKO BP SA Group 2007	2006
mazowiecki	17.7%	21.2%
śląsko-opolski	13.2%	13.8%
wielkopolski	10.5%	9.4%
małopolsko-świętokrzyski	8.9%	7.8%
dolnośląski	8.0%	7.5%
lubelsko-podkarpacki	6.9%	6.9%
zachodnio-pomorski	7.0%	6.5%
łódzki	6.7%	6.4%
pomorski	6.5%	5.7%
kujawsko-pomorski	5.6%	5.5%
warmińsko-mazurski	3.7%	3.5%
podlaski	3.2%	2.6%
other*	0.1%	0.9%
UKRAINE	2.1%	2.2%
Total	100.0%	100.0%

* Loans granted by the Groups Head Offices with no geographical distinction.

The level of foreign currency credit risk concentration is relatively small. In 2007, a decrease was recorded in the share of loans denominated in foreign currencies in the total loan portfolio down to 21.6% (the effect of changes in granting foreign currency loans for purchase of property).

Chart 2.2

CURRENCY STRUCTURE
OF THE LOAN PORTFOLIO
THE PKO BP SA GROUP



Credit concentration risk is monitored also in respect of industry sectors determined based on the PKD (polish industry classification), maintained for institutional clients. In the case of industry sectors with higher credit risk, the Bank applies limits restricting its exposure to those industries.

As at 31 December 2007, there was no significant credit exposure to industry sectors (table 2.11).

Table 2.11

CONCENTRATION OF CREDIT EXPOSURE TO INDUSTRY SECTORS

Section	Section description	The PKO BP SA Group 2007	2006
D	Industry processing	24.7%	22.7%
G	Retail and wholesale, repair of cars, motocycles, personal and household goods	17.5%	14.7%
L	Public administration and national defence, obligatory, social and common health insurance	12.9%	26.6%
K	Property management, lease and business related activities	10.5%	8.7%
F	Construction	5.0%	3.4%
E	Production and supply of energy, gas and water	4.2%	6.9%
	Other engagement	25.2%	17.1%
Total		100.0%	100.0%

Due to the special profile of credit exposure resulting from loans taken out by individual customers to finance purchase of real estate, the Bank sets limits for this portfolio, which account for, among others, industry sector, group of entities, type of credit transaction, length of crediting period, credit transaction currency and accepted collaterals.

CREDIT RISK REPORTING

The Bank prepares monthly and quarterly reports on credit risk, which are directed to the ALCO, the BCC and the Bank's Management and Supervisory Boards. The reports include information on the historical amount of credit risk and the forecasted level of credit risk. Apart from the information for the Bank, the reports include also information on credit risk of the two subsidiary companies of the Group: KREDOBANK SA and BFL SA, which both report a significant level of credit risk.

FINANCIAL INSTITUTIONS AND DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments used by the Bank

During the course of its business activities, the Bank uses various types of derivative financial instruments to manage risk resulting from the conducted business. The main types of risk relating to derivative financial instruments (derivatives) are market and credit risk. The Bank enters into transactions with the use of derivatives mainly with other banks.

The majority of derivatives used by the Bank are forward contracts. The most commonly used types of derivatives are IRS, FRA, FX Swap, CIRS and Forward contracts (table 2.12).

Table 2.12

DERIVATIVE FINANCIAL INSTRUMENTS*

	The PKO BP SA Group			
	2007			
	Nominal value		Fair value	
	Purchase	Sale	Negative	Positive
Currency transactions (over-the-counter market)	15 291	15 174	321	528
FX swap	2 114	2 104	67	73
FX forward	1 470	1 480	36	28
Options	657	734	16	15
Cross Currency IRS	11 049	10 856	201	411
Interest rate transactions	198 683	187 386	959	1 029
Interest rate swap (IRS)	124 823	124 823	814	882
Forward Rate Agreement (FRA)	73 860	62 563	145	147
Other transactions	248	22	0	0
Futures for bonds	14	14	0	0
Futures for WIG	0	6	0	0
Options for WIG	2	2	0	0
Credit derivative transactions	231	0	0	0
Total derivative instruments	214 221	202 582	1 280	1 557

*Nominal value of base instruments and fair value of derivative financial instruments

Derivative financial instrument becomes an asset if its fair value is positive and a liability – if its fair value is negative.

The fair value of a financial instrument in trading is its market value reduced by transaction costs. In other cases, derivative's fair value is the fair value determined based on the valuation model to which input data was taken from an active market. Valuation techniques applied are based, among others, on models of discounted cash flows, option models and yield curves.

For the purpose of capital requirements calculation for derivative financial instruments (credit risk and counterparty credit risk), the Bank applies the mark-to-market method.

The Bank reports embedded derivatives, which are elements of contracts of both finance and non-finance nature, and the resultant cash flows, in whole or in part, relating to such contracts change in the manner similar to that resultant from a separate derivative.

Contracts including embedded derivatives are monitored by the Bank and are subject to periodic assessment.

Embedded derivatives are separated from host contracts and recognised separately in the books of account and are valued at fair value. Derivatives' valuation is recognised in the balance sheet under caption „Derivative financial instruments". The effects of re-measurement of derivative financial instruments to fair value are taken to the profit and loss account and recognised under result from financial instruments at fair value.

In 2007, the scale of the Group's activities as regards embedded derivatives was not significant.

Policies of determining credit limits and collateralising derivatives

In order to limit credit risk relating to derivatives, the Bank enters into framework agreements which are to collateralise the Bank's claims towards counterparties, resulting from derivative transactions, by netting due and payable liabilities (mitigation of settlement risk) and liabilities which are not due and payable (mitigation of pre-settlement risk).

Framework agreements with foreign partners are made in accordance with standards developed by ISDA (International Swaps and Derivatives Association) and ISMA (International Securities Market Association), while those made with Polish counterparties – in accordance with the standards developed by the PBA (Polish Banks Association). Framework agreements with Polish financial institutions for debts securities are made based on the internal Bank's standard. To mitigate credit risk, in the case of planned increase in the scale of operations with a financial institution under framework agreement, the parties enter into collateral agreement CSA (Credit Support Annex). Based on the Credit Support Annex, each of the parties, after fulfilling certain criteria specified in the agreement, undertakes to establish appropriate collateral along with the right to set it off.

The Bank has developed a standard of signing ISDA framework agreements, which defines the manner of activities during the course of negotiations and during the course of signing and administering framework agreements and collateral agreements made with Polish banks and financial institutions as well as frameworks agreements and credit support annexes with foreign banks and credit institutions.

The ISMA and CSA agreements signed by the Bank contain provisions defining the allowed difference between credit exposure and collateral value.

The CSA agreements, which are annexes to the ISDA agreements allow two types of collateral: cash and securities.

At the end of 2007, the Bank held 21 open framework agreements with Polish banks and 28 such agreements with foreign banks and credit institutions. In addition, the Bank is a party to 9 CSA agreements facilitating collateralisation of exposures relating to derivatives and 2 ISMA agreements which enable to net liabilities resulting from REPO and BSB/SBB transactions.

The Bank requires that its counterparty establishes additional collateral, for example in the form of blocked securities account, where the planned scope of cooperation with that given counterparty exceeds the level of the limit granted. Subject to collateral are also transactions under the CSA agreement where the value of exposure exceeds the threshold amount specified in the agreement.

Entering into framework agreement with counterparty is the basis for verification of internal limit per counterparty and of the length of period of the Bank's engagement in forward and repurchase agreement transactions. The counterparty limit is based on the internal assessment (internal rating) as well as on the amount of own funds of the Bank and the client.

Where credit transactions are made with financial institutions with registered office outside the territory of the Republic of Poland, international standards of loan agreements of the Loan Market Association are applied.

Collateralisation of transactions made on an interbank market is executed as part of the CSA agreements. The agreement signed by the Bank determines, separately for each counterparty, a fixed amount of allowed non-collateralised exposure. The agreements signed by the Bank to date, did not include any provisions that would require an additional collateral if the rating of one of the parties deteriorated. In addition, at the end of 2007, the Bank held a placement of CHF 50 million secured by a blockade established on Polish treasury bills.

Positive gross fair value of contracts with financial institutions as at 31 December 2007 was PLN 1.3 billion. The above amount was calculated as the sum total of positive market values of all open transactions. The net credit exposure, after taking into account netting of transactions, for customers with framework agreements was approx. PLN 413 million. Balancing benefit amounted to approx. PLN 885 million (these were not accounted for in the calculation of capital requirements for credit risk, as presented in Chapter 4 "Capital requirements (Pillar I)").

As at 31 December 2007, the Bank did not report any credit derivatives contracts entered into on behalf of customers or for speculative purposes.

As at 31 December 2007, the Bank did not report any past due derivatives. If a customer/ counterparty did not meet its liability under such instrument, the settlement amount would be recorded as receivable valued at nominal value adjusted by interest due and reduced by the amount of impairment provisions.

Credit quality of counterparties

The majority of financial institutions - the Bank's business partners on an interbank market – were awarded high external ratings – A or AA (table 2.13).

Table 2.13

QUALITY OF EXPOSURES TO BANKS

	PKO BP SA
Rating	2007
AAA	0.0%
AA	41.4%
A	49.7%
BBB	1.9%
B	3.2%
Lack of rating	3.9%
Total	100.0%

The above listing is based on external rating granted by Moody's, Standard&Poor's and Fitch rating agencies mapped into a uniform rating scale.

Credit derivatives

In order to hedge credit risk, the Bank enters into credit derivatives or other agreements, based on which a transfer is made, of all or part, of the credit risk relating to the Bank's receivables.

At the end of 2007, the Bank reported credit derivatives – the CDS agreements with two counterparties hedging the transactions of purchase of securities from 9 financial institutions for a total amount of approx. PLN 230 million. These counterparties were granted high credit ratings of the AA level.

Credit risk of financial institutions

PKO BP SA actively cooperates on the wholesale market with financial institutions whose registered offices are located in the territory of 48 countries. Within the limits set, the Bank may enter into transactions with over 300 counterparties, including Polish and foreign banks, insurance companies, pension and investment funds. The transactions made include loan and deposit transactions, securities transactions, foreign exchange operations and derivative transactions.

The Bank regularly monitors the financial standing of its counterparties on a regular basis and sets exposures limits adequate to the risk incurred for pre-settlement and settlement exposures of individual counterparties. The integral tools for the management of credit risk of financial institutions are framework agreements signed with counterparties on the basis of ISDA and the PBA's standards. The exposure to financial institutions on the wholesale market is of high quality and low credit risk generated, as confirmed by external ratings granted by rating agencies and by the internal ratings granted to those counterparties by the Bank.

RISK MANAGEMENT AT SUBSIDIARIES OF THE GROUP

The Group's subsidiaries with significant credit risk (KREDOBANK SA, BFL SA) manage credit risk individually, with the proviso that the applied methodologies for credit risk assessment and measurement are adjusted to those used by PKO BP SA, while observing the specific nature of the business conducted by those entities.

Change in the solutions applied by subsidiary Group companies is each time agreed with entities of the Bank responsible for risk management.

BFL SA and KREDOBANK SA cyclically measure credit risk and the results of that measurement are reported to the Bank.

Derivative instruments at subsidiaries of the Group

Subsidiaries of the Group introduced internal regulations concerning derivative instruments risk management – after obtaining the opinion of the Bank and after considering recommendations directed by the Bank to individual companies. These regulations define the method and manner of taking positions in derivatives instruments by individual subsidiaries.

The positions taken by individual subsidiaries in given derivative instruments are determined in a manner similar to that of the Bank in these derivative instruments, and after taking into account the specific nature of business of those companies.

As the result of the Ukrainian Supervision Authority prohibition to enter into derivative transactions KREDOBANK SA does not hold any derivatives. However, other subsidiaries of the Group may conclude transactions with the use of derivative financial instruments only to hedge the risk resulting from core business activities (banking portfolio).

CAPITAL EXPOSURES IN THE BANKING BOOK

The Group's capital exposures in the banking book are divided into two groups depending on the purpose of their acquisition:
- shares and participations – exposures to joint ventures and associates (except for shares reducing own funds of the Group) and to other entities with the minority interest of PKO BP SA and subsidiaries of the Group. The reason behind share acquisition is to obtain capital gains (dividend) or return from investment following their disposal or redemption as well as to the participation of PKO BP SA in the development of financial market;
- participation units in collective investment undertakings– covering investments of PKO TFI SA in participation units of the new investment funds under its management. The reason behind acquisition of those assets is to obtain, in accordance with the Statutes of PKO TFI SA, means to create such fund.

Table 2.14

CAPITAL EXPOSURES - BANKING BOOK

	The PKO BP SA Group			
	2007		2006	
	Carrying amount	Fair value*	Carrying amount	Fair value*
Total	170	170	175	175
Shares in other entities	58	58	60	60
Equity securities	112	112	116	116
shares in entities listed on regulated market**	79	79	85	85
shares in entities not-listed on regulated market	11	11	11	11
collective investment undertakings	22	22	19	19

* Estimated fair value
** Fair value of listed securities equals their market value

Valuation methods and accounting policies

Shares in jointly controlled entities and associates are valued using the equity pick-up method (acquisition costs adjusted by a change in the net assets of the company for the period from the acquisition to valuation date) less impairment write-offs. At each balance sheet date, an assessment is made of whether impairment indicators exist for shares in associates and jointly controlled entities. If impairment indicators are identified, an assessment is made of the higher of the investment's value in use and fair value less selling expenses. The forecast of the value in use is estimated using the discounted cash flow method under the assumption that shares will continue to be held. Forecasts concerning cash flows are developed on the basis of financial plans of business entities and cover the period from 3 to 5 years using varied discount rates adjusted to the specific nature of business of individual entities.

Shares in other entities are valued as follows:
- at fair value determined in the following manner:
  - market value for those shares, for which there is an active market,
  - at a received current offer of purchase price or by way of valuation performed by specialised external entity providing this type of services, for shares, for which there is no active market,
- at acquisition cost less impairment write-offs for those shares, for which reasonable determination of fair value is not possible.

The effects of changes in the fair value of shares are taken to revaluation reserve, except for impairment losses which are taken to the profit and loss account. Revaluation reserve item is amortised to the profit and loss account at the time the asset is sold or impaired. In the case of impairment loss of the given asset, the amounts recognised previously as increase in the value due to re-measurement to fair value decrease revaluation reserve. If the amount of previously recognised revaluation is not sufficient to cover current impairment loss, the resultant difference is taken to the profit and loss account

Impairment losses of shares in other entities are not reversed through profit and loss account i.e. any subsequent increases in their fair value are recognised in the revaluation reserve.

Participation units in collective investment undertakings are valued at fair value with an effect taken to the profit and loss account.

Dividends on capital exposures are recognised in the profit and loss account at the time the entity's right to receive payment has been established.

In 2007, the PKO BP SA Group earned profit on disposal or liquidation of capital exposures in the total amount of PLN 12 million.

At the end of 2007, the unrealised loss of the PKO BP SA Group relating to revaluation of capital exposure amounted to a total of PLN 9.7 million.

2.2. OPERATIONAL RISK

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

The Bank's internal regulations clearly define the segregation of duties and competencies in the area of operational risk management. In accordance with these regulations, all the issues relating to operational risk management are supervised by the Management Board of the Bank which:
- sets the objectives for operational risk management,
- defines policies for operational risk,
- accepts reports relating to operational risk.

Operational risk management is carried out in the area of strategic and "day-to-day" operational risk management.

Strategic operational risk management consists in developing internal regulations and other solutions relating to operational risk and concerning, among others, the following:
- human resources,
- organisation of the Bank,
- accounting,
- IT,
- security,
- internal processes,
- client service processes,
- outsourcing of the banking operations and actual business operations to external parties.

Strategic operational risk management is centralised at the level of the Bank's Head Office. Each business and support line has a dedicated unit which is responsible for identification and monitoring of operational risk in the products or internal processes supervised and for taking appropriate steps to ensure acceptable operational risk level.

"Day-to-day" operational risk management consists in the following:
- preventing from operational risk events that arise during the course or product realisation and within internal processes or systems,
- taking actions aimed at limiting the number and scale of threats (operational risk events),
- liquidating negative effects of operational risk events,
- collecting data on operational risk events.

"Day-to-day" operational risk management is carried out by each operational unit of the Bank.

A significant role in the operational risk management is performed by the Banking Risk Division, which coordinates identification, measurement, monitoring and reporting of operational risk in the entire PKO BP SA Group.

MITIGATION OF OPERATIONAL RISK

In order to mitigate operational risk exposure at the Bank, various solutions are applied. These include, among others, the following:
- control instruments,
- human resources management instruments (personnel selection and recruitment, employee qualifications enhancement systems and incentive systems),
- defining threshold values for key risk indicators (KRI),
- contingency plans,
- insurance,
- outsourcing.

Selection of instruments used to mitigate operational risk is performed, among others, depending on the following:
- availability and adequacy of instruments mitigating the risk,
- nature of business or process, in which the operational risk has been identified,
- risk materiality,
- cost of use of instrument.

In addition, internal regulations of the Bank provide for the obligation not to undertake an excessively risky business, and if such business is conducted – withdrawal from such business or its limitation. The level of operational risk is considered to be excessive, if potential benefits from conducting such business are lower than potential operational losses from engagement in such operations.

OPERATIONAL RISK ASSESSMENT

Operational risk assessment is conducted using the following:
- gathered data on operational risk events,
- internal audit results,
- results of internal functional control,
- results of operational risk self-assessment,
- key risk indicators (KRI).

The Bank regularly monitors the level of KRI and operational risk events that exceed the threshold value defined for the operational risk.

RISK REPORTING

Reporting operational risk-related information concerning the Bank or subsidiaries of the Group is conducted on a half-yearly basis. The recipients of such reports are the Management and Supervisory Boards of the Bank. The reports contain information relating to the following:
- the Bank's operational risk profile resulting from the process of identification and assessment of threats,
- results of operational risk assessment and monitoring,
- operational events and their financial effects,
- the most significant projects and undertakings as regards operational risk management.

RISK MANAGEMENT AT SUBSIDIARIES OF THE GROUP

Other subsidiaries of the Group manage operational risk in accordance with the operational risk policies binding in the PKO BP SA Group, including the specific nature and scale of their business.

In 2007, subsidiaries of the Group improved the process of operational risk management by implementing new solutions concerning identification of operational risk, classification of operational risk events and calculation of capital requirement for operational risk.

2.3. MARKET RISK

Market risk is defined as risk of loss due to unfavourable market parameters such as interest rate, foreign exchange rate or the risk of liquidity loss. Market risk covers interest rate risk, foreign exchange risk and the liquidity risk.

The Bank and the subsidiaries of the Group apply the following principles in managing market risk:

- activities are undertaken with a view to keeping the level of risk within the accepted risk profile,
- an accepted level of liquidity is maintained, the basis of which is keeping the appropriate level of liquid assets,
- the main source of financing the Bank's assets are stable sources of finance such as stable deposit base,
- FX position is closed within the accepted limits for FX risk,
- the result of the Bank is optimised while observing the accepted level of interest rate risk.

MARKET RISK MEASUREMENT

In order to determine the level of market risk, the Bank uses various methods of its measurement, including:

- for interest rate risk: the value at risk model (VaR), stress tests and interest income sensitivity measures,
- for FX risk: the value at risk model (VaR) and stress tests,
- for liquidity risk: contractual and real-terms liquidity gap method, surplus liquidity method, verification of stability of deposit base and loan portfolio and shock analyses.

The value at risk (VaR) is defined as potential loss resulting from changes in the present value of cash flows from financial instruments or as potential loss of value on the maintained currency positions due to changes in the currency exchange rates, on the assumption that a defined confidence level and holding period of the position are kept. In order to determine VaR for risk management purposes, the variance-covariance method is applied with the 99% confidence level. For interest rate and FX risk management purposes, the following, among others, are applied: the VaR value determined for individual financial instruments and for the portfolios of the Bank, as well as determined by individual types of business activities of the Bank.

Stress tests are used to assess potential losses on interest rate positions as well as potential losses on currency positions where market situation occurs which can not be described using the statistical measures. The following scenarios are applied at the Bank:

- for interest rate risk
  - hypothetical scenarios - under which fluctuations in interest rates are adopted arbitrarily (parallel movements of interest rate curves in the following currencies: PLN, EUR, USD, CHF and GBP by ±50 BPS or by ±200 BPS, and non-parallel movements of yield curves);
  - historical scenarios – under which fluctuations in interest rates are adopted on the basis of fluctuations of interest rates in the past;
- for FX risk:
  - hypothetical scenarios – under which hypothetical appreciation or depreciation of exchange rates is adopted (10% or 50%),
  - historical scenarios – scenarios of fluctuations of exchange rates observed in the past;
- for liquidity risk:
  - scenarios of mass withdrawal of deposits by non-financial customers.

In the process of interest rate risk measurement, the Bank assumed that the balance of future earlier repayments of loans and withdrawal of deposits with unfixed maturity date will be replaced, respectively, by future sales of loans and future unfixed maturity dates placements made. The assumption results from implemented types of interest rates for loan and deposit products in the Bank.

For the purpose of liquidity risk management, the Bank defines the following:

- contractual liquidity gap – listing of all balance sheet items by their maturity,
- real-terms liquidity gap – listing of balance sheet individual categories by their real maturity,
- liquidity surplus – the difference between the most liquid assets and expected and potential liabilities, which mature in the given period.

RISK MANAGEMENT TOOLS

The basic market risk management tools used by the Bank are as follows:

- limits and threshold values, by individual market risk types,
- defining allowed types of transactions exposed to the given market risks,
- transactions ensuring long-term financing of credit activities.

As regards mitigating interest rate risk, the Bank defined limits and threshold values relating to, among others, degree of price sensitivity and of interest income sensitivity, the amount of losses and allowed derivatives sensitive to interest rate fluctuations. These limits have been set for particular portfolios of the Bank.

As regards FX risk mitigation, the Bank defined limits relating to, among others, value of currency position, value at risk calculated in the 10-day time horizon (10-day VaR) and daily loss from speculative transactions on the FX market.

As for limiting liquidity risk, the Bank defined limits and threshold values for measures of both current and mid- and long-term liquidity.

INTEREST RATE RISK

In 2007, the interest rate risk of the PKO BP SA Group was low. It was determined mainly by the risk of mismatch of dates of revaluation of assets and liabilities.

At the end of 2007, the PKO BP SA Group reported cumulative negative gap in PLN in the time horizon of 1 month and cumulative positive gap in other time ranges. The exposure of the PKO BP SA Group to the risk of PLN interest rate at the end of 2007 was mainly composed of the exposure of the Bank. The PLN interest rate risk generated by other subsidiaries of the Group did not significantly influence the interest rate risk of the entire Group and hence did not materially change its risk profile.

The Group exposure to the USD interest rate risk was composed of both the Bank's exposure and the exposures of individual subsidiaries of the Group. The interest rate risk of subsidiaries reduced the interest rate of the Group in the time span of 1 to 3 months. The interest rate risk of subsidiaries increased the interest rate of the Group in all time ranges to 1 month and above 3 months.

The Group exposure to the EUR and CHF interest rate risk is composed mainly of the Bank's exposure. The interest rate risk in those currencies generated by subsidiaries of the Group did not significantly influence the interest rate of the Group and hence did not change its risk profile.

The Group exposure to interest rate risk remained within accepted limits.

The tables below show interest rate gaps as at 31 December 2007, by currency.

Table 2.15

PLN Interest rate gap (in PLN)

	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	above 5 years	Total
PKO BP SA								
Periodic gap	-14 266	29 056	4 008	-8 716	-1 306	-202	153	8 727
Cumulative gap	-14 266	14 790	18 798	10 082	8 776	8 574	8 727	-
Group subsidiaries								
Periodic gap	-85	-148	-135	53	28	-68	23	-332
Cumulative gap	-85	-233	-368	-315	-287	-355	-332	-
TOTAL - Periodic gap	-14 351	28 908	3 873	-8 663	-1 278	-270	175	8 395
TOTAL - Cumulative gap	-14 351	14 557	18 430	9 766	8 489	8 219	8 395	-

Table 2.16

USD Interest rate gap (in USD)

	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	above 5 years	Total
PKO BP SA								
Periodic gap	-196	161	-37	-46	0	5	-25	-138
Cumulative gap	-196	-35	-72	-119	-119	-113	-138	-
Group subsidiaries								
Periodic gap	-121	-12	-27	-33	23	59	70	-41
Cumulative gap	-121	-133	-159	-193	-170	-110	-41	-
TOTAL - Periodic gap	-317	149	-63	-80	23	65	45	-178
TOTAL - Cumulative gap	-317	-168	-231	-311	-288	-224	-178	-

Table 2.17

EUR Interest rate gap (in EUR)

	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	above 5 years	Total
PKO BP SA								
Periodic gap	220	75	-12	-17	8	2	-47	228
Cumulative gap	220	295	282	265	274	275	228	-
Group subsidiaries								
Periodic gap	-15	-33	-12	-11	7	18	1	-43
Cumulative gap	-15	-47	-59	-70	-63	-45	-43	-
TOTAL - Periodic gap	206	42	-24	-28	15	20	-46	185
TOTAL - Cumulative gap	206	247	223	195	210	231	185	-

Table 2.18

CHF Interest rate gap (in CHF)

	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	above 5 years	Total
PKO BP SA								
Periodic gap	3 153	-3 156	-1	-2	0	0	3	-4
Cumulative gap	3 153	-3	-4	-7	-7	-7	-4	-
Group subsidiaries								
Periodic gap	-1	1	0	0	0	0	0	0
Cumulative gap	-1	0	0	0	0	0	0	-
TOTAL - Periodic gap	3 152	-3 155	-1	-2	0	0	3	-4
TOTAL - Cumulative gap	3 152	-3	-4	-6	-6	-7	-4	-

The VaR and analyses of stress tests' scenarios in respect of financial assets of the Bank and of the Group (jointly for the banking and trading portfolios) exposed to the interest rate risk at the end of 2007 and 2006 are presented in the table below.

Table 2.19

Sensitivity of financial assets exposed to interest rate risk

	2007		2006	
	10-day VaR	Stress-test +200 basis points	10-day VaR	Stress-test +200 basis points
PKO BP SA	10.5	101.9	4.8	108.1
Other Group companies	-	54.0	-	56.7
Total	10.5	155.9	4.8	164.8

As at 31 December 2007, the 10-day VaR on interest rate was PLN 10.5 million and accounted for approx. 0.11% of the Bank's own funds.

The results of stress tests showing changes in the market value resulting from shifts of yield curves, by individual currency, are presented in the table below.

Table 2.20

Stress-tests results - parallel shift of interest rate curves by +200 basis points

	Bank		Other Group companies		Total	
Currency	2007	2006	2007	2006	2007	2006
PLN	51.4	74,0	0.8	6.2	52.2	80.2
EUR	26.4	15.9	4.9	5.7	31.3	21.6
USD	9.9	27.7	48.3	57.2	58.2	84.9
CHF	14.4	9.6	0.0	0.0	14.4	9.6
GBP	0.1	0.2	0.0	0.0	0.1	0.2

Given the nature of business operations of subsidiaries of the Group generating the largest interest rate risk (BFL SA and KREDOBANK SA) and the specific nature of market on which these companies conduct their businesses, the Bank does not determine the consolidated VaR sensitivity measure in respect of interest rate. The Group companies use their own risk measures to manage interest rate risk. The 10-day VaR measure for main currencies is used by KREDOBANK SA. Its value as at the end of 2007 was PLN 3.5 million.

FX RISK

In 2007, the FX risk of the Group was low as it is the Bank's policy to close currency positions.

The VaR and stress-test analysis in respect of the Bank's and the Group's financial assets (jointly for all currencies) exposed to FX risk at the end of 2007 and 2006 was as follows:

Table 2.21

Sensitivity of financial assets exposed to FX risk

	2007		2006	
	10-day VaR	Stress-test ± 10%	10-day VaR	Stress-test ± 10%
PKO BP SA	1.6	4.7	2.6	8.7
Other Group companies	-	2.5	-	0.8
Total	1.6	7.1	2.6	9.5

As in the case of interest rate risk exposure, given the nature of business activities of the subsidiaries of the Group exposed to the largest FX risk (BFL SA and KREDOBANK SA) and the specific nature of market on which these companies conduct their businesses, the Bank does not determine the consolidated VaR sensitivity measure for FX risk. The Group companies use their own risk measures to manage FX risk. The 10-day VaR measure is used by KREDOBANK SA. Its value as at the end of 2007 was PLN 0.05 million.

LIQUIDITY RISK

The table below presents data concerning periodic gap and cumulative periodic gap of the Bank and of the Group's subsidiaries as at the end of 2007 and 2006.

Table 2.22

REAL-TERMS LIQUIDITY GAP - ASSETS AND LIABILITIES

2007	a'vista	0-1 month	1-3 months	3-6 months	6-12 months	1-3 years	3-5 years	above 5 years
PKO BP SA								
Periodic gap	296	1 528	3 305	4 344	6 387	11 901	6 361	-34 122
Cumulative gap	296	1 824	5 129	9 472	15 859	27 760	34 122	-
Group subsidiaries								
Periodic gap	50	-132	-221	-86	81	-92	466	-67
Cumulative gap	50	-82	-303	-389	-307	-399	67	-
TOTAL - Periodic gap	346	1 396	3 084	4 258	6 468	11 809	6 827	-34 189
TOTAL - Cumulative gap	346	1 742	4 826	9 084	15 552	27 361	34 189	-

2006	a'vista	0-1 month	1-3 months	3-6 months	6-12 months	1-3 years	3-5 years	above 5 years
PKO BP SA								
Periodic gap	4 089	1 755	1 767	4 465	9 578	10 482	5 655	-37 791
Cumulative gap	4 089	5 844	7 611	12 077	21 655	32 136	37 791	-
Group subsidiaries								
Periodic gap	114	-182	-347	-16	-44	93	559	-176
Cumulative gap	114	-68	-415	-432	-476	-383	176	-
TOTAL - Periodic gap	4 202	1 574	1 420	4 449	9 534	10 575	6 214	-37 967
TOTAL - Cumulative gap	4 202	5 776	7 196	11 645	21 179	31 754	37 967	-

In all time ranges, the cumulative real-terms liquidity gap of the PKO BP SA Group showed positive values. This means a surplus of matured assets over matured liabilities.

The table below shows data concerning contractual off-balance sheet liquidity gap of derivative financial instruments of the Group.

Table 2.23

CONTRACTUAL OFF-BALANCE SHEET LIQUIDITY GAP FOR DERIVATIVES

The PKO BP SA Group

2007	0-1 month	1-3 months	3-6 months	6-12 months	1-3 years	3-5 years	above 5 years	Total
TOTAL - Periodic gap	-87	107	138	102	585	352	278	1 476
TOTAL - Cumulative gap	-87	21	159	261	846	1 198	1 476	-

2006	0-1 month	1-3 months	3-6 months	6-12 months	1-3 years	3-5 years	above 5 years	Total
TOTAL - Periodic gap	36	84	133	-52	357	342	277	1 177
TOTAL - Cumulative gap	36	120	253	201	558	900	1 177	-

RISK REPORTING

Reporting information on the level of market risk is conducted in the following cycles:

- on a daily and weekly basis – for operating purposes,
- on a monthly, quarterly and half-year basis – for management purposes.

The recipients of monthly, quarterly and half-year reports are mainly the ALCO and Management and Supervisory Boards of the Bank. The reports contain information on the market risk the Bank and the PKO BP SA Group are exposed to.

RISK MANAGEMENT AT SUBSIDIARIES OF THE GROUP

Other subsidiaries of the PKO BP SA Group, which due to the nature of the business conducted report a significant level of market risk, have their own internal regulations in place on management of this type of risk. These regulations have been developed after consultations with the Bank and after considering the recommendations directed by the Bank to the subsidiaries of the Group.

Transactions in the trading book are made exclusively by PKO BP SA. Other subsidiaries of the Group make transactions solely on the banking book to hedge against the risk.

2.4. BUSINESS RISK

Apart from credit, operational and market risk, other types of risk that the Group is exposed to are managed as part of the so-called business risk management. These other types of risk include, in particular:

- reputation risk – relating to the possibility of occurrence of negative variances from budgeted figures due to deterioration of the Bank's image,
- strategic risk – relating to the occurrence of negative financial consequences caused by incorrect decisions, decisions taken on the basis of incorrect assessment or caused by not taking any correct decisions relating to the direction of the Bank's strategic development.

Reputation risk

Reputation risk management is to limit reputation losses by minimising the effects of image-related events on the reputation risk level or taking preventive measures.

Reputation risk management covers, in particular:

- monitoring the external and internal channels of the Bank's communication with the environment in order to define the effects of image-related events that already occurred,
- registering image-related events and describing their effects,
- selecting the effective tools and protection measures and carrying out preventive activities,
- conducting research and analysing based on the effectiveness of protection and prevention activities,
- assessment of the level of reputation risk.

Monitoring and measurement of level of reputation risk is conducted on an annual basis. The recipients of annual reports on reputation risk are, in particular, the Bank's Management and Supervisory Boards. The reports include information on the image-related events (and description of their effects) as well as the forecast of reputation risk level for the next year.

Strategic risk

Strategic risk management at the Bank comprises:

- strategic risk measurement,
- reporting the level of strategic risk and its changes,
- activities undertaken in the event of occurrence of high level of strategic risk.

Strategic risk measurement is carried out by way of assessment and then quantification of the effect of group of the factors, which are the main sources of strategic risk identified in the Bank's activities and environment. These comprise, in particular:

- external factors,
- factors relating to the increase and development of banking business,
- factors relating to human resources management,
- factors relating to investing activities,
- factors relating to organisation culture.

Monitoring and measurement of strategic risk is performed on an annual basis. In the case of occurrence of high level of strategic risk (as per internal rating scale adopted by the Bank), the Bank's Management Board takes actions aimed at reducing the level of the strategic risk of the Bank.

3. OWN FUNDS

Own funds comprise basic funds, supplementary funds and short-term capital.

Included in the basic funds are:
- core funds comprising:
  - share capital – in the amount defined in the Bank's Statutes and entry in the Register of Entrepreneurs, at nominal value,
  - reserve capital – created in accordance with the Bank's Statutes from appropriations of net profits and issue premiums on issuance of shares, assigned to absorb balance sheet losses that may arise during the course of the Bank's regular activities; decisions concerning utilisation of the reserve capital are taken by the General Shareholders Meeting,
  - other reserves – to be utilised for purposes defined in the Statutes, created from appropriation of net profits in the amount defined by the General Shareholders' Meetings,
- general banking risk reserve – created in accordance with the Banking Act from the net profit,
- retained earnings,
- net financial result for the year during the course of approval and the net result for the current year – calculated in accordance with the provisions of the binding accounting rules less any expected charges and dividends in the amounts not exceeding the amount of profit verified by an independent auditor.

In addition, the basic funds are reduced by the following items:
- intangible assets at carrying amount,
- capital exposures[7] of the Bank in financial institutions, lending institutions, Polish and foreign banks and insurance companies, in the form of:
  - shares held,
  - amounts classified as subordinated liabilities,
  - other capital exposures in items classified as own funds or capital of those entities, including additional payment to the share capital of limited liability companies,

  in the amount of 50% of their carrying amounts,
- unrealised losses on debt and equity instruments classified as available-for-sale.

Supplementary funds comprise the following:
- unrealised gains on debt and equity instruments classified as available-for-sale – in the amount of 60 % of their pre-tax value,
- subordinated liabilities understood as liabilities arising from acceptance by the Bank – in the amount and based on the principles defined by the Commission for Banking Supervision - of cash, which together with the agreement meet the following criteria:
  - cash was accepted for the period of at least 5 years (term of contract),
  - cash shall not be withdrawn from the bank prior to the completion of the term of contract,
  - cash is to be returned as the last item in the case of bank bankruptcy or liquidation,
  - return of cash is not guaranteed by the bank, either directly or indirectly.

In addition, supplementary funds are reduced by 50% of the value of the Bank's capital exposures[7] in financial institutions or lending institutions, Polish and foreign banks and insurance companies. Where the value of those reductions decreases the amount of supplementary funds to below zero, the amount is to be deducted from basic funds.

In addition, included in the balance of consolidated own funds of the Group are:
- goodwill of subordinated entities (reduces own funds),
- negative goodwill of subordinated entities (increases own funds),
- minority capital (increases own funds),
- FX differences on the translation of foreign entities (FX losses reduce own funds, while FX gains – increase them).

The value of short-term capital reflects the total of daily market profits:
- in 2006 – for the entire year 2006,
- in 2007 – for the second half of 2007 – due to including in own funds of part of profit presented in the Bank's financial statements prepared for the first half of 2007, reviewed by the auditor.

Information on the structure of the Bank's and the Group's own funds is presented in table 3.1 below.

[7] Exposures in financial institutions meeting the requirements set forth in § 5.1 of Resolution No. 2/2007 of the Commission for Banking Supervision dated 13 March 2007 concerning other decreases to basic funds, their amount, scope and terms and conditions of decreasing basic funds by those amounts, other bank balance sheet items included in supplementary funds, their amount, scope and terms and conditions to include in the supplmenetary funds, decreases to supplementary funds, their amount, scope and terms and conditions of decreasing basic funds by those amounts, as well as the scope and manner of accounting for bank activities in holdings in calculation of own funds (Official Journal of the National Bank of Poland 2007, No. 3, item 4).

Table 3.1

	Group		Bank	
	2007	2006	2007	2006
OWN FUNDS	9 983	7 077	9 543	6 783
BASIC FUNDS (Tier 1)	8 449	6 928	8 324	6 634
core funds	8 110	7 036	7 983	6 914
general banking risk reserve	1 070	1 070	1 070	1 070
retained earnings	-72	-167	0	0
net financial result for the year	654	0	654	0
intangible assets	-1 183	-944	-928	-726
capital engagement	-84	-151	-399	-619
unrealized losses on available-for-sale instruments	-55	-4	-55	-4
FX differences on translation	-48	-14	0	0
minority capital	58	102	0	0
Supplementary funds (Tier 2)	1 518	0	1 203	0
subordinated liabilities	1 601	0	1 601	0
unrealized gains on available-for-sale instruments	1	5	1	5
capital engagement	-84	-5	-399	-5
Short-term capital (Tier 3)	16	149	16	149

In 2007, the amount of the Group's own funds increased by PLN 2.9 billion and the increase was mainly due to:

- issuance by the Bank in the 4th quarter of 2007 of subordinated liabilities in the amount of PLN 1.6 billion (10-year bonds) and obtaining the permission of the CFBS to include those liabilities in the balance of supplementary funds – this amount would be reduced by 20% of the initial value at the end of each year during the last 5 years from the redemption date defined in the terms and conditions of bonds issuance,
- including the amount of approx. PLN 1.1 billion from the 2006 net profit of the Bank in basic funds,
- including in the basic funds of the Bank the amount of approx. PLN 0.65 billion representing profit presented in the Bank's financial statements prepared for the first half of 2007, reviewed by the auditor.

4. CAPITAL REQUIREMENTS (PILLAR I)

Information on the structure of capital requirements of the Bank and the Group (as per Basel I) has been presented in the table 4.1 below.

Table 4.1

	The Group		Bank	
	2007	2006	2007	2006
Total capital requirement	6 645	4 797	6 431	4 640
Credit risk	6 425	4 665	6 183	4 508
credit (banking book)	6 401	4 648	6 159	4 491
counterparty credit risk (trading book)	24	17	24	17
Market risk	220	132	248	132
FX	0	0	0	0
prices of commodities	0	0	0	0
prices of equity	1	0	1	0
specific risk of debt instruments	167	95	193	95
general interest rate risk	52	37	54	37
Operational risk	0	0	0	0
Other types of risk*	0	0	0	0

* covers requirements concerning the risk of settlement and supply, the risk of exceeding the exposure concentration limit and the large exposure limit as well as the risk of exceeding equity exposure treshold

The scale of trading activities of the Bank and the Group is significant and hence the total capital requirement consists of:

- credit risk – including the credit risk of instruments from the banking book and the counterparty credit risk,
- market risk – including FX risk, commodities price risk, equity price risk, and specific risk of debt instruments and general interest rate risk,
- operational risk,
- other types of capital requirements relating to:
  - settlement and supply risk,
  - the risk of exceeding exposure concentration limit and large exposures limit,
  - the risk of exceeding equity concentration threshold.

As at 31 December 2007, the Bank made use of the option provided in § 14 section 1 of Resolution No. 1/2007 of the CFBS, and hence as at that date:

- capital requirement for credit risk was calculated in accordance with the methodology used to date (Basel I),
- capital requirement for operational risk was zero.

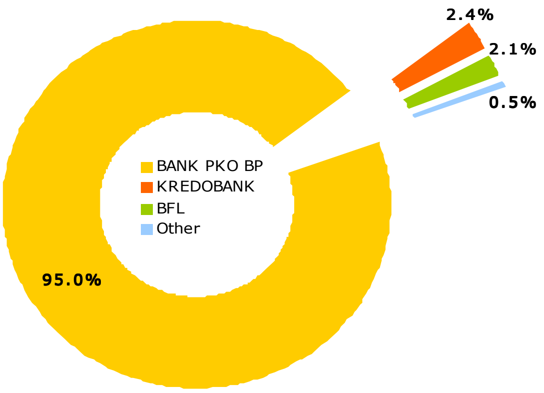
For the purpose of calculation of capital requirement for market risk, the Bank applied methods defined in Appendices Nos. 6 - 10 to Resolution No. 1/2007 of the CFBS.

During the year 2007, the capital requirement of the Group rose by approx. PLN 1.8 billion. Increase in capital requirement for credit risk of PLN 1.76 billion accounted for the largest share of the above amount and this resulted from the high dynamics of credit portfolio (increase by approx. 30%) and from off-balance sheet liabilities issued (increase by approx. 13%).

A significant part (approx. 95%) of the total capital requirement of the Group represented capital requirements of the Bank.

Chart 4.1

STRUCTURE OF CAPITAL REQUIREMENTS OF THE GROUP



A significant part of the Bank's capital requirement results from its exposure in the banking portfolio (table 4.2 – year 2007), and in particular capital requirement relating to receivables.

Table 4.2

	Book		
	banking	trading	total
Capital requirement*	6 159	217	6 376
Balance sheet exposures	5 717	88	5 805
cash	0	0	0
receivables	5 226	0	5 226
debt instruments	12	87	99
equity securities	41	1	42
non-current assets	182	0	182
other assets	256	0	256
Off-balance sheet liabilities	424	107	531
loan liabilities	307	0	307
guarantees issued	74	107	181
letters of credit	22	0	22
other	21	0	21
Derivative financial instruments	18	22	40

* covers credit risk, counterparty credit risk and specific risk of debt instruments. Does not cover general interest rate risk.

Capital requirements of the Group for the risk of settlement and supply, exceeding the exposure concentration limit and the equity concentration threshold were zero at the end of 2007 due to the fact that such events did not occur.

4.1. CREDIT RISK

BASEL I

Capital requirement for credit risk as at 31 December 2007 was calculated in accordance with the Appendix No. 21 to Resolution No. 1/2007 of the CFBS (Basel I). The amount of capital requirement of the Group for credit risk, by risk weights, has been presented in the table 4.3 below.

Table 4.3

CAPITAL REQUIREMENT FOR CREDIT RISK*
The PKO BP SA Group

	2007		2006		
	Exposure	Requirement	Exposure	Requirement	Average value of exposure
Total	133 511	6 383	125 683	4 629	129 597
0% risk weight	39 875	0	45 029	0	42 452
20% risk weight	9 623	150	20 178	287	14 901
50% risk weight	12 145	484	10 925	378	11 535
100% risk weight	71 868	5 749	49 551	3 964	60 710

* Does not cover capital requirement for derivative financial instruments in the banking book.

In 2007, capital requirement for credit risk increased compared to the prior year by approx. PLN 1.8 billion, and the increase resulted from intensification of credit campaign directed to non-financial customers (100% risk weight), with a simultaneous decrease in exposure to the State Treasury and the NBP (0% risk weight) and other banks (20% risk weight).

The value of exposure secured by individual types of collaterals that which enable to reduce capital requirement as per Basel I was PLN 4.8 billion at the end of 2007 (table 4.4).

Table 4.4

VALUE OF EXPOSURE* COLLATERALISED AS PER BASEL I

	Group
	2007
TOTAL collateralised exposure	4 802
Collaterals - 0% risk weight	2 929
cash transferrred to the Bank's account	128
guarantees of class I entities	2 787
debt instruments issued by class I entity	14
Collaterals - 20% risk weight	44
guarantees of class II entities	44
debt instruments issued by class II entity	0
Collaterals - 50% risk weight	1 829
mortgage established on housing property	1 829

* Exposure carrying amount.

A significant portion of collateralised exposures (PLN 2.8 billion) are exposures collateralised by guarantees (sureties) of class I entities (governments and central banks of the EU or the OECD countries), which consists in the largest degree of the guarantee of the State Treasury to repay the so-called „old housing loans portfolio” to the amount of 90% of the entire exposure balance.

The second largest (PLN 1.8 billion) collateralised group of credit exposures are exposures with collaterals efficiently established on housing property (the part of the exposure that is efficiently collateralised by a housing property is assigned the preferential 50% risk weight), with the proviso that this value shall not be higher than:
- value of credit exposure,
- value of the entry in the mortgage register,

- 50% of the value determined by an independent valuer.

The next largest exposure groups are exposures collateralised by a cash deposit transferred to the Bank's account (PLN 0.1 billion) or by guarantees issued by class II entities (banks and local government units from the EU and OECD countries).

In order to assess capital requirements for derivative financial instruments (in respect of credit risk and counterparty credit risk), the Bank uses market valuation method.

In 2007, the greatest influence on the amount of capital requirement of the Group for derivatives had the IRS, CIRS and FRA transactions (table 4.5).

Table 4.5

CAPITAL REQUIREMENT FOR DERIVATIVE INSTRUMENTS*

	Book		Group
	banking	trading	total
Derivatives	18	22	40
FRA	0	4	4
IRS	5	17	22
Forward	0	0	0
SWAP	0	0	0
FX Futures	0	0	0
CIRS	13	1	14
OPTIONS	0	0	0
SBB	0	0	0
CDS	0	0	0
other	0	0	0

* Does not cover general interest rate risk.

In 2007, during the process of calculation of capital requirement for derivatives, no off-balance sheet netting was used. Also, no CDS contracts were used as unfunded credit protection.

BASEL II

As of 1 January 2008, the Bank started to calculate its capital requirement for credit risk and counterparty credit risk in accordance with the provisions of Appendices Nos. 4 and 16 to Resolution No. 1/2007 of the CFBS (standardised method). In these calculations, the Bank uses rating assessments given by the following rating agencies:

- Moody's,
- Standard&Poor's,
- Fitch.

Table 4.6 includes information on the assessments made by the Bank of the Basel II implementation effect on the amount of its capital requirement for credit risk as at the end of 2007.

Table 4.6

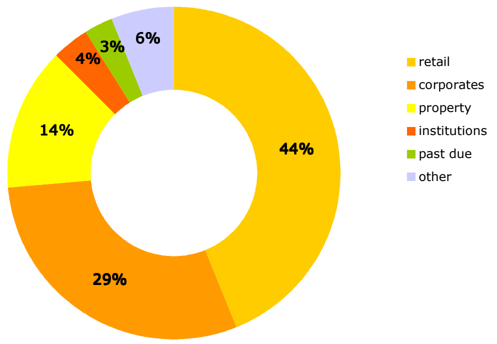
ESTIMATED EFFECT OF IMPLEMENTATION OF BASEL II ON CAPITAL REQUIREMENT FOR CREDIT RISK AND COUNTERPARTY CREDIT RISK

	Bank PKO BP SA		
	Basel I	Basel II	B II - B I
Credit risk	6 183	5 712	-471
credit (banking book)	6 159	5 668	-491
balance sheet exposures	5 717	4 947	-770
off-balance sheet exposures	424	694	270
derivatives	18	26	8
counterparty credit risk (trading book)	24	44	20

In accordance with these assessments, implementation of Basel II (standardised method) could result in a decrease in capital requirement for credit risk of approx. PLN 500 million. This results mainly from the fact that a significant portion of credit risk portfolio of the Bank, according to Basel II, would be classified as retail exposures (chart 4.2), to which, in accordance with Basel II, a smaller risk weight is assigned compared to Basel I (75% rather than 100%).

Chart 4.2

CAPITAL REQUIREMENT FOR CREDIT RISK AS PER BASEL II



The table below presents information concerning the credit risk mitigation techniques limiting applied by the Bank, which facilitate reducing capital requirement as per Basel II at the end of 2007, by class of exposure.

Table 4.7

CREDIT RISK MITIGATION TECHNIQUES
at PKO BP SA

	Exposures before collaterals	Unfunded credit protection (guarantees)		Funded credit protection	Exposures after collaterals
		Outflows	Inflows		
TOTAL	132 460	-1 774	1 774	-293	132 167
Central governments and central banks	14 574	0	1 679	0	16 253
Regional governments and local authorities	3 737	0	21	0	3 758
Administratvie bodies and non-commercial undertakings	5	0	0	0	5
Institutions (banks)	6 369	0	73	0	6 442
Corporates	29 873	-1 155	0	-175	28 544
Retail	51 741	-619	0	-118	51 003
Exposures secured by real estate property	13 861	0	0	0	13 861
Past due	1 418	0	0	0	1 418
Regulatory high-risk category	192	0	0	0	192
Short-term exposures	2 368	0	0	0	2 368
Other	8 323	0	0	0	8 323

As part of the credit risk mitigation techniques, the Bank, in accordance with Basel II, uses guarantees (94% of the guarantees accepted are the guarantees issued by the State Treasury) and financial collaterals as funded credit protection (mainly registered pledges on securities, cash irrevocably blocked on bank account or on the deposit account kept by the bank or payment of cash to the account of the Bank), with an adjusted value at the end of 2007 of PLN 1.8 billion and PLN 0.3 billion, respectively. The Bank did not use balance sheet and off-balance sheet netting or derivative financial instruments as techniques of credit risk exposure mitigation. In using the collaterals, the Bank applies Financial Collateral Comprehensive Method, which makes use of haircuts. Apart from financial collaterals and guarantees, the Bank uses mortgage to classify its exposures to class of exposures secured by real estate property. At the end of 2007, the value of the portfolio of those exposures was PLN 14 billion, with the proviso that the value of the preferential risk rate of 35% was not applied in the case of mismatch of currency of exposure and currency of client revenue, and where no property valuer assessment was available.

In the year 2007 or in prior years, the Bank did not conduct any securitisation transaction within the meaning of the Banking Act and supervision regulations.

4.2. OPERATIONAL RISK

A decisive effect on the operational risk profile of the Group has PKO BP SA. Other Group companies, due to considerably lower scale of their businesses, generate only limited operational risk.

At the end of 2007, the Bank calculated capital requirement for operational risk using the basic indicator approach (BIA), in accordance with Appendix No. 14 to Resolution No. 1/2007 of the CFBS. At the same time, as the Bank exercised the option provided in § 14 paragraph 1 of Resolution No. 1/2007 of the CFBS, as at 31 December 2007 it reduced the value of calculated capital requirement by 100%, and hence the resultant capital requirement for operational risk was zero. Prior to the decrease, the value of the Group capital requirement for the operational risk was PLN 1.09 billion (of which, PLN 1.02 billion related to the capital requirement for operational risk of the Bank).

4.3. MARKET RISK

Market risk of the PKO BP SA Group is determined primarily by the Bank. The Group capital requirement for Group market risk is calculated in accordance with the provisions of Resolution No. 1/2007 of the Commission for Banking Supervision. In order to calculate capital requirement for FX risk, equity price risk and the specific risk of debt instruments, the Bank uses basic methods. For the purpose of calculation of capital requirement for general interest rate risk, the Bank applies the method of duration based method.

The total capital requirement for market risk increased in 2007 by approx. 70%. The largest share in the value of capital requirement for market risk has the specific risk of debt instruments (approx. 76%), and results from holding corporate and municipal debt securities in the trading portfolio of the Bank and from underwriting issuance of those securities.

Another significant, as far as its value is concerned, type of capital requirement is the capital requirement for the general interest rate risk (approx. 24%).

Capital requirement for all other types of market risk is approx. PLN 1 million. Capital requirement for FX risk is zero due to the fact that the total currency exposure does not exceed 2% of the Bank's own funds, while that for the commodities price risk also being zero – due to the lack of this type of instruments in the Bank's portfolio.

After implementation of Basel II, as of 1 January 2008 capital requirement for market risk will not change.

5. INTERNAL CAPITAL (PILLAR II)

Internal capital is the assessed by the Bank amount of capital which is required to cover all identified significant types of risk present in the Bank's business and the effect of changes in the economic environment, after taking into account the anticipated risk level.

Commencing from 2008, the internal capital of the PKO BP SA Group is calculated to cover each significant risk type:
- credit risk, including default risk,
- market risk, including FX risk, interest rate risk and liquidity risk,
- operational risk,
- business risk, including strategic risk and reputation risk.

The Bank cyclically monitors the significance of individual types of risk relating to the activities of the Bank and other subsidiaries of the Group.

The total of the internal capital of the Group is the sum of internal capital required to cover all significant risk types that occur in Group companies (without the effect of correlation between individual risk types).

The amount of internal capital for credit risk is determined at the level of unexpected loss for the entire portfolio of exposures, covered by portfolio risk measurement and is calculated based on the VaR model. The unexpected loss is the difference between the credit value at risk (CVaR) and the amount of the expected loss (EL). For credit portfolios not covered by portfolio risk measurement, it is accepted that internal capital for credit risk equals capital requirement for credit risk.

The value of exposure to a customer being a financial institution is determined on the basis of market value of balance sheet transactions (placements and bonds) as well as on the basis of balance sheet equivalent understood as the sum total of the cost of replacement and future potential credit exposure, for off-balance sheet transactions, less the recovery rate. The value of the recovery rate and probability of default is calculated on the basis of data of the Moody's rating agency.

To calculate internal capital for interest rate risk and FX risk, the Bank uses the VaR methodology, after considering the results of stress tests.

Internal capital for operational risk equals capital requirement for operational risk determined using the basic indicator approach.

Internal capital for business risk is determined in proportion to the total net assets of the Bank.

Internal capital calculation methodologies are defined in the internal regulations accepted by the Bank's Management Board. To asses the internal capital based on statistical models, annual forecast horizon and 99.9% confidence level are applied.

The chart below presents the structure of internal capital, by individual types of risk, as assessed as at 31 December 2007 for the Bank.

Chart 5.1

INTERNAL CAPITAL OF THE BANK

Allocation of total internal capital is made by business line and by Group companies.

In order to assess the amount of capital required to safely conduct business in unfavorable economic conditions, the Bank carries out stress tests.

6. CAPITAL ADEQUACY

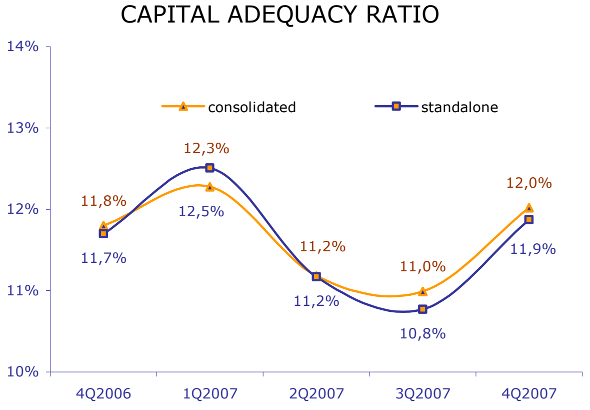
Capital adequacy is the condition under which the amount of capital base of the PKO BP SA Group is sufficient to meet regulatory requirements concerning capital requirements (the so-called Pillar I) and internal capital (the so-called Pillar II). The objective of capital adequacy management is to maintain, on an on-going basis, the level of capital that is adequate to the scale and risk profile of business activities of the Group.

The process of capital adequacy management at the Bank covers:
- defining and monitoring the list of significant types of risk,
- calculating the amount of internal capital for individual types of risk,
- calculating the amount of total internal capital required to cover all significant types of risk,
- carrying out stress tests of capital adequacy,
- monitoring, reporting, forecasting and limiting capital adequacy,
- allocating internal capital to business lines for the purpose of profitability analyses,
- using tools having an effect on capital adequacy level (including the tools changing the level of own funds, the scale of deduction of own funds and the amount of credit portfolio).

The main measure of capital adequacy is the capital adequacy ratio with the minimum required level set by the Banking Act at 8%.

The chart below presents changes in the capital adequacy ratio calculated for the Bank and the PKO BP SA Group.

Chart 6.1



In 2007, the amount of capital adequacy ratio remained at safe level, i.e. above both the regulatory level of 8%, and the level set forth in the internal regulations of the Bank. Also, the proportion of own funds to internal capital as at 31 December 2007 remained at the level above that determined by the internal limits.

Due to dynamic development of lending activities of the Group and the necessity to implement as of 1 January 2008 the requirements of Basel I, which cause increase in capital requirements, the Bank:
- in the 3rd quarter of 2007 included into own funds a part of verified net profit for the first half of 2007,
- in the 4th quarter of 2007 carried out an issuance of subordinated debt and obtained a permission of the CFBS to include it in the Bank's own funds (detailed information has been presented in Chapter 3 „Own funds").

In 2007, the Bank complied with the requirements of Basel II as regards the following:
- Pillar I (Resolution No. 1/2007 of the CFBS), by way of:
  - adjusting its IT systems to calculating and reporting capital requirements,
  - adjusting its internal processes to the requirements of reporting of capital adequacy;
- Pillar II (Resolution No. 4/2007 of the Commission for Banking Supervision), by way of:
  - developing and approving internal regulations defining capital management policies (effective as of 1 January 2008),
  - implementing solutions facilitating capital assessment (the so-called ICAAP process);
- Pillar III (Resolution No. 6/2007 of the Commission for Banking Supervision), by way of:
  - developing, approving and publishing principles of information policy on capital adequacy.

In 2007, other Group companies developed a process, coherent with the solutions applied by the Bank, of segmentation of assets and off-balance sheet exposures, in accordance with the requirements of Basel II, after taking into account collaterals, ratings, applying risk weights, and developed internal regulations concerning transaction classification and calculating capital requirements for individual risk types.

Commencing from 1 January 2008, the Bank and the Group are obliged to comply with the requirements of Basel II, which changed the manner of calculation of capital requirements.

The table below shows the results of assessment of the effects of Basel II on the level of capital adequacy ratio and the level of capital requirements as at 31 December 2007.

Table 6.1

EFFECT OF IMPLEMENTATION OF BASEL II

	Bank PKO BP SA		
	Basel I	Basel II	B II - B I
Capital adequacy ratio	11,9%	11,0%	-0,9 pp.
Own funds	9 543	9 543	0
Capital requirements, of which:	6 431	6 975	544
credit risk*	6 183	5 712	-471
operational risk	0	1 015	1 015
market risk	248	248	0

*/ covers also counterparty credit risk

Change in the level of capital adequacy ratio, which is the effect of implementation of the Basel II requirements, results to a large extent from the implementation of new capital requirement for operational risk (for detailed information see Chapter 4 „Capital requirements (Pillar I)").