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Annual Report 2017

Bank Zachodni WBK
Grupa Santander

Consolidated financial statements of Bank Zachodni WBK Group: Financial Highlights

FINANCIAL HIGHLIGHTS		PLN k		EUR k	
	for the reporting period ended:	31.12.2017	31.12.2016	31.12.2017	31.12.2016
Consolidated financial statements of Bank Zachodni WBK Group					
I	Net interest income	5 276 897	4 770 372	1 243 173	1 090 196
II	Net fee and commission income	2 013 126	1 914 720	474 268	437 580
III	Operating profit	3 700 772	3 453 821	871 857	789 319
IV	Profit before tax	3 335 221	3 122 054	785 738	713 498
V	Net profit attributable to owners of BZ WBK S.A.	2 213 054	2 166 847	521 369	495 200
VI	Total net cash flows	(4 176 431)	(838 893)	(983 917)	(191 716)
VII	Total assets	152 674 444	150 099 716	36 604 676	33 928 507
VIII	Deposits from banks	2 783 083	2 561 281	667 262	578 951
IX	Deposits from customers	111 481 135	112 522 457	26 728 316	25 434 552
X	Total liabilities	129 330 815	129 081 240	31 007 892	29 177 495
XI	Total equity	23 343 629	21 018 476	5 596 785	4 751 012
XII	Non–controlling interests in equity	1 436 409	1 237 649	344 388	279 758
XIII	Profit of the period attributable to non–controlling interests	305 460	217 245	71 963	49 648
XIV	Number of shares	99 333 481	99 234 534		
XV	Net book value per share in PLN/EUR	235.00	211.81	56.34	47.88
XVI	Capital ratio	16.69%	15.05%		
XVII	Profit per share in PLN/EUR	22.29	21.84	5.25	4.99
XVIII	Diluted earnings per share in PLN/EUR	22.25	21.80	5.24	4.98
XIX	Declared or paid dividend per share in PLN/EUR*	5.40	–	1.27	–

** As of the date of publication of this report, the Management Board of Bank Zachodni WBK has not finalised its analysis in respect of recommendation on dividend payout for 2017.On 17 May, 2017 the Annual General Meeting of Bank Zachodni WBK S.A. adopted a resolution on dividend payment. It was decided to allocate PLN 535,866k from the bank's undivided net profit for 2014 and 2015 to dividend for shareholders. The dividend per share was PLN 5.40.*

The following rates were applied to determine the key EUR amounts for selected financials:

- for balance sheet items – the average NBP exchange rate as at 29.12.2017 EUR 1= 4.1709 PLN and as at 30.12.2016: EUR 1 = PLN 4.4240
- for profit and loss items – as at 31.12.2017 – the rate is calculated as the average of the NBP exchange rates prevailing as at the last day of each month in 2017: EUR 1= 4.2447; as at 31.12.2016 – the rate is calculated as the average of the NBP exchange rates prevailing on the last day of each month in 2016: EUR 1 = PLN 4.3757

As at 31.12.2017, FX denominated balance sheet positions were converted into PLN in line with the NBP FX table no. 251/A/NBP/2017 dd. 29.12.2017.

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In 2017 Bank Zachodni WBK consistently pursued the development strategy strengthening our position among the top Polish banks.

Letter from the Chairman of the Supervisory Board

Dear All,

In 2017 Bank Zachodni WBK consistently pursued the development strategy strengthening our position among the top Polish banks. The achieved satisfactory financial performance confirms the strength of our organization and its stable business base for further growth.

The consistent implementation by the Management Board and by the bank's Employees of the growth strategy focused on increasing the level of customer satisfaction and ensuring the highest standard of service at any point of contact with the bank played a pivotal role in achieving a positive result.

The change in the distribution model was one of the key elements of the process. The bank's Management Board focused on developing the omnichannel sales strategy to take full advantage of the potential of the digital channels. In the new model the role of the branch network is to build and strengthen the relationship with the customer, both to facilitate direct sales of our banking services and educate customers on how to use remote channels.

The business objectives could not have been delivered if we had not continued the digital transformation. Technological changes are introduced in internal processes as well as the offer dedicated to individual, SME and corporate customers. The bank has been investing in new technologies enhancing simple, intuitive and integrated access to products and financial services so that they are available in the most convenient way for the customer. Bank Zachodni WBK S.A. also plays an important role in the process of digitalising the Polish banking sector setting the market trends and standards. It is a significant competitive advantage and a commitment to our customers, employees and shareholders.

A key highlight during 2017 was the acquisition of the demerged business of Deutsche Bank Polska. I am convinced that based on the experience and competence of the teams from both institutions, we will offer our customers the best experience in using financial services, strengthening the bank's position on the Polish market and in Santander Group.

We look into the future with optimism and confidence. We are convinced that thanks to the engagement and determination of our employees, and the possibility to leverage the experience and the international potential of Santander Group, Bank Zachodni WBK will continue to grow dynamically, creating model products and services and support the growth in prosperity of our individual and business customers.

On behalf of the Supervisory Board of Bank Zachodni WBK I want to congratulate the bank's Management Board and the entire team on the success and thank everyone for their engagement in delivering the tasks they were entrusted with.

Gerry Byrne
Chairman of the Supervisory Board
Bank Zachodni WBK

On behalf of the Supervisory Board of Bank Zachodni WBK I want to congratulate the bank's Management Board and the entire team on the success and thank everyone for their engagement in delivering the tasks they were entrusted with.

In 2017, Bank Zachodni WBK Group consistently pursued its development strategy, strengthening its position among the top Polish banks.

Letter from the CEO

Dear All,

In 2017, Bank Zachodni WBK Group consistently pursued its development strategy, strengthening its position among the top Polish banks. Our performance demonstrates that we have adopted the right strategy.

Once again, we have set new standards for building relationships with customers and creating innovative bank products. We are actively shaping the Polish banking sector by supporting consolidation processes as evidenced by the planned incorporation of the demerged business of Deutsche Bank Polska into the structures of Bank Zachodni WBK Group. This transaction will strengthen our current position in the domestic banking market and provide new development opportunities for Bank Zachodni WBK Group in the upcoming years, among others in the private banking and business banking areas.

The economic revival on the Polish and European markets has also been a positive stimulus for the Group's growth.

At the same time, the banking sector faced legal challenges resulting from the actions taken by legislative and regulatory bodies both in the European Union and in Poland forcing financial institutions to promptly adjust their business models to the new requirements.

Macroeconomic environment – we are on the rise

2017 positively surprised us with the pace of economic growth. Already at the beginning of the year, the GDP growth rate exceeded 4% yoy to go beyond 5% yoy at the year-end with the average growth of 4.6% over the year.

Consumption was the driving force behind the economic growth (first fueled by 500+ programme and then by growing wages and lower household savings) along with an exceptionally favourable external environment (in particular sound revival in the eurozone), which boosted Polish exports. The long-awaited rebound in investment started to materialise in H2 2017 to gain momentum in the fourth quarter.

Unemployment went down to a record low level and the shortage of labour force has become a serious problem for Polish companies and one of the key obstacles for business growth. Fortunately, employers were relieved by the labour migration, mainly from Ukraine. The domestic labour market was not significantly disturbed even by the lowering of the retirement age in October 2017. However, increasing wage pressure was observed and it seems quite likely that the remuneration growth will accelerate in 2018 as the imbalance between the labour demand and supply is not expected to subside..

The economic revival on the Polish and European markets has also been a positive stimulus for the Group's growth.

Consumption was the driving force behind the economic growth...

Banking sector ready for new challenges

In 2017, the sector consolidation process observed over the last few years has accelerated with Bank Zachodni WBK Group as its active participant. We are convinced that thanks to the acquisition of the demerged part of Deutsche Bank Polska business, based on the experience and skills presented by the teams of the two banks, we will provide customers with a convenient and modern access to services, a branch network covering the entire country and even better, more innovative products and financial solutions.

Banks are also consistently investing in digitisation which is a key to sustaining their profitability in the upcoming years. The Polish banking sector is the most mature in this respect in Central Europe, both as regards the online and mobile channels.

The issue of mortgage fx loans continues to be a significant challenge for the banking sector. We believe that the adopted solutions will take into account both the interests of the customers and the stability of the banking sector and, in consequence, of the Polish economy.

Bank As You Want It

Our customers and the relationship with them have always been in the centre of the development strategy and the business transformation of Bank Zachodni WBK Group. Therefore, in 2017, we implemented a new strategy based on a brand promise "Bank As You Want It". We have focused on improving customer satisfaction and ensuring top service standards at each touchpoint with the bank by providing solutions fully tailored to individual needs.

The first products designed in line with the new concept of "Bank As You Want It" is the "Account As I Want It" which comes with a customised card to enable simple and quick personalisation of selected functions. This is an innovative and pioneering solution in the entire Polish banking sector.

The digital transformation is an important element of the changes. BZ WBK Group is one of the leaders in this area. We invest in new technologies enhancing simple, intuitive and integrated access to services and in interactive relationships with our customers. We were the first in the Polish banking sector to introduce a video identification service based on biometrics and a digital signature in the cloud. Other important initiatives include the digitalisation and robotisation of processes, designing the optimal model of distribution channels, further growth of CRM, Big Data analysis and development of the online and mobile channels, including biometric authentication and authorisation technologies. The digital transformation covers retail, SME and corporate banking.

We have completed work on the distribution strategy defining new roles for digital channels and branches, a new branch design and layout, a new profile of an advisor and the optimised network coverage. We concentrate on leveraging the potential of digital channels while the primary role of branches will be to develop relationships with customers, educate them in using digital channels and sell products to customers preferring personal contacts with advisors.

Through the "Bank As You Want It" strategy we want to be not only the best bank for customers but also an innovator whose primary goal is to increase the satisfaction and loyalty of our customers and of the business partners of Bank Zachodni WBK Group.

Business effectiveness

Our financial performance confirms the effectiveness of our development strategy. In 2017, the gross profit of Bank Zachodni WBK Group totalled PLN 3.3bn, the underlying profit increased and the value of our assets exceeded PLN 152bn.

Our capital position is strong and consistent with regulatory requirements. We maintain strict control over costs whose level has not changed yoy, despite investments in the future and development of the Group. The C/I ratio for 2017 was 43.4%.

In 2017, we decided to pay out a dividend of PLN 5.4 per share from the retained profit. We successfully conducted a subordinated debt issue worth USD 150m, paid out in EUR, in the form of green bonds. It was the first operation of this kind performed by a Polish bank.

The strong financial performance is accompanied by growing trust and satisfaction of our customers who have recognised and appreciated the Group's digital transformation policy. This is evidenced by a 4.5% growth yoy in the number of active digital channel users. In 2017, customers made over 23.5m transactions using the mobile banking channel which represents a 10.2m growth yoy (+76%). The number of credit products sold via remote channels (mobile, Internet, contact centre) surged by 36%.

As for the SME segment, we consistently strive to become the first-choice bank for Polish entrepreneurs. The number of customers is growing in response to a simplified access to financial solutions and business support.

In 2017, the sector consolidation process observed over the last few years has accelerated with Bank Zachodni WBK Group as its active participant.

Our Customers and the relationship with them have always been in the centre of development strategy and business transformation of Bank Zachodni WBK Group. Therefore, in 2017, we implemented a new strategy based on brand promise "Bank As You Want It".

Gross profit

PLN 3.3bn

Our assets

PLN 152bn

In 2017, we decided to pay out a dividend of

PLN 5.4 per share

from retained profit.

The Business and Corporate Banking Division persistently increased its market share in 2017, and the lending activity and new sales were growing steadily. This is the result of a new strategy introduced at the beginning of 2017 with the emphasis on customer acquisition and activation by ensuring a flexible approach to their needs. We continued the Export Development Programme and leveraging the Santander Group's potential, launched the International Business Corridors Programme to facilitate customers' access to new business partners on international markets. We also gradually developed our sectoral approach which is unique on the Polish market and gives us a better understanding how to tailor our products to business needs.

2017 was also successful for the **Global Corporate Banking Division.** We played a leading role in numerous transactions for the main sectors of the Polish economy, such as the biggest private placement transaction in the history of the Warsaw Stock Exchange for a top telecommunication company. We also actively supported our domestic and international customers by financing their development and acquisition deals, hedging fx and interest rate risk, and providing advisory services in capital and M&A transactions.

Santander Consumer Bank Group, a part of Bank Zachodni WBK Group, also generated excellent results – its net profit was higher by 36% than a year ago and the sale of products financing the purchase of passenger cars increased considerably.

The bank's subsidiaries are also in good condition. BZ WBK Leasing financed assets totalling PLN 4.2bn, of which financing machines and equipment accounted for nearly PLN 2bn, i.e. 18.8% up on last year. At the same time, the number of customers increased by 14%. BZ WBK Faktor was ranked second on the factoring market with a 12.6% share. Its turnover went up by 23% yoy while the loan portfolio increased by 25% yoy. In BZ WBK TFI, thanks to excellent management and sales performance, assets under management rose in 2017 by PLN 2.6bn to PLN 16bn which translated into a growth in the retail market share to 10.38%.

In 2017, changes took place in the composition of the bank's Management Board. Dorota Strojkowska, in charge of the Business Partnership Division, Arkadiusz Przybył, in charge of the Retail Banking Division and Maciej Reluga, the head of Financial Management Division, joined the Board. Eamonn Crowley resigned from his post.

In Santander Consumer Bank, Piotr Kończal took up the position of the President of the Management Board.

Corporate social responsibility

Responsibility is one of the foundations of Bank Zachodni WBK Group's business operations. This is why we initiate and actively participate in CSR projects. In 2017, similarly as in the previous years, we focused on activities that are important for large communities and that make a lasting change in the society. By this, I mean investments in science and education, supporting local communities, promoting equal opportunities and social inclusion and popularizing road safety standards. The scale of these activities is constantly growing, reflecting our belief in the synergy of business and investments that stimulate development of a civic society.

In 2017, Bank Zachodni WBK Group engaged in the following social projects: Jak Jeździsz (How's Your Driving), Santander Orchestra, Santander Universidades, Obsługa bez barier (Barrier-Free Banking), the activities of Bank Zachodni WBK Foundation and volunteering campaigns under which 580 of the bank's employees made a lasting difference.

Our commitment to customers

It was our customers' trust in our strategy of being the best bank for them that enabled Bank Zachodni WBK Group to generate satisfactory results in 2017. It was also, and I cannot stress it enough, a reflection of skills, experience and engagement of all Group's employees that is visible in their work, each and every single day. Thanks to all that, Bank Zachodni WBK, as the leading company of our Group, was awarded the "Best Bank in Poland" award for the third time in a row in a prestigious competition "Euromoney Awards for Excellence". Bank Zachodni WBK was also awarded for its outstanding financial results, business efficiency and successful implementation of innovations and new technologies to foster customer satisfaction and add value. The bank also received the "Best Bank in Poland for SME" award as the best bank in Poland for SMEs. Once again, we were ranked first in the "Financing Provider of the Year" category and we received the Eurobuild Awards title for the best real estate bank in CEE.

We perceive all the awards as valuable feedback but also a commitment to continue our hard work on improving the quality of our services and customer satisfaction.

Michał Gajewski
CEO of Bank Zachodni WBK

Responsibility is one of the foundations of Bank Zachodni WBK Group's business operations.

In Santander Consumer Bank, Piotr Kończal took up the position of the President of the Management Board.

It was our customers' trust in our strategy of being the best bank for them that enabled Bank Zachodni WBK Group to generate satisfactory results in 2017.

Annual Report 2017

MANAGEMENT BOARD REPORT ON BANK ZACHODNI WBK GROUP PERFORMANCE IN 2017

(including the Management Board Report on Bank Zachodni WBK Performance)

Bank Zachodni WBK
Grupa Santander

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MANAGEMENT BOARD REPORT ON BANK ZACHODNI WBK GROUP PERFORMANCE IN 2017

I. Overview of Bank Zachodni WBK and BZ WBK Group Performance in 2017

This Management Board Report on Bank Zachodni WBK Group Performance in 2017 includes the information required to be disclosed in the Management Board Report on Bank Zachodni WBK.

This section provides an overview of the activity of Bank Zachodni WBK (BZ WBK/the bank) and Bank Zachodni WBK Group (BZ WBK Group/the Group) in 2017. It presents the financial, business and organisational performance compared with the previous year, and reports on the internal and external factors affecting the Group's activities.

Financial and Business Highlights of Bank Zachodni WBK Group

Key Financial and Business Highlights of BZ WBK Group for 2017

Total income	• Total income of Bank Zachodni WBK Group for 2017 increased by 2.1% YoY to PLN 7,763.6m. • Excluding the remuneration arising from the settlement of the acquisition of Visa Europe Ltd. by Visa Inc. from the reference period figure, the underlying total income increased by 6.5% YoY.
Total costs	• Total costs amounted to PLN 3,372.4m, and remained stable, with a decrease of 3.4% YoY in general and administrative expenses, and an increase of 3.5% YoY in staff expenses.
Profit	• Profit before tax amounted to PLN 3,335.2m, up 6.8% YoY. After the abovementioned income adjustment, the underlying profit before tax increased by 18.9% YoY. • Profit attributable to the shareholders of Bank Zachodni WBK was PLN 2,213.1m and 2.1% higher YoY (15.8% YoY higher on a comparable basis).
Capital ratio	• Capital ratio stood at 16.69% (15.05% as at 31 December 2016), ensuring the security of operations and stable growth.
ROE	• Return on Equity stood at 12.2% (12.8% as at 31 December 2016).
Costs/Income	• Cost to income ratio (C/I) was 43.4% (46.2% for 2016, following the adjustment for one-off items).
Net impairment losses	• Net impairment losses on loans and advances amounted to PLN 690.5m compared with PLN 784.6m in 2016.
Credit quality	• NPL ratio was 5.8% (6.6% as at 31 December 2016), while the ratio of impairment losses to the average gross credit volumes was 0.63% (0.75% as at 31 December 2016).
Loans and advances to customers	• Gross loans to customers increased by 4.4% YoY to PLN 112,686.0m due to the growth of 2.7% YoY in personal loans and 5.8% YoY in loans to enterprises and the public sector to PLN 57,822.4m and PLN 48,005.2m, respectively.
Deposits from customers	• Deposits from customers were relatively stable and amounted to PLN 111,481.1m as a result of an increase of 2.3% YoY in personal deposits to PLN 64,987.7m and a decline of 5.1% YoY in deposits from enterprises and the public sector to PLN 46,493.4m.
Loans/Deposits	• Customer loans to deposit ratio was 96.7% as at 31 December 2017 compared with 91.6% as at 31 December 2016.
Net assets under management	• Net value of assets in mutual funds and portfolios managed by BZ WBK Towarzystwo Funduszy Inwestycyjnych totalled PLN 16.4bn, up 19.8% YoY.
Electronic banking	• The number of customers using BZWBK24 electronic banking services totalled 3.4m (+5.2% YoY), including over 1m customers with access to mobile services (+26.7% YoY). • The number of "digital" customers (those who use BZWBK24 at least once a month) was 2.1m (+4.5% YoY). • The BZ WBK Group payment card base (excluding prepaid cards) included more than 3.6m debit cards (+6.2% YoY) and nearly 1.3m credit cards of BZ WBK and SCB (+4.1% YoY).
Customer base	• The total customer base was close to 6.5m, including 4.4m BZ WBK customers.

Financial and Business Highlights of Bank Zachodni WBK

Key Financial and Business Highlights of BZ WBK for 2017

Total income	• Total income of Bank Zachodni WBK (BZ WBK) for 2017 decreased by 3.0% YoY to PLN 6,123.0m. • Excluding the gains from the settlement of the acquisition of Visa Europe Ltd. by Visa Inc. from the last year's figure, the underlying total income increased by 2% YoY. Further adjusting for dividend income, total income went up by 4.6% YoY.
Total costs	• Total costs declined by 1.6% YoY to PLN 2,679.3m, including a decrease of 6.2% in general and administrative expenses.
Profit	• Profit before tax amounted to PLN 2,515.3m, down 5.1% YoY. Adjusting for the results of the acquisition of Visa Ltd., the underlying profit before tax increased by 7.3% YoY and by 16.4% excluding dividend income. • Profit for 2017 was PLN 1,916.2m and 8.0% lower YoY. On a comparable basis, profit increased by 4.5% YoY (including dividend income) and 15.9% (excluding dividend income).
Capital ratio	• Capital ratio stood at 18.95% (16.52% as at 31 December 2016), ensuring the security of operations and stable growth.
ROE	• Return on Equity was 11.0% (12.6% as at 31 December 2016).
Costs/Income	• Cost to income ratio was 43.8% (45.3% in 2016), excluding one-off items.
Net impairment losses	• Net impairment losses on loans and advances amounted to PLN 540.4m compared with PLN 583.5m in 2016.
Credit quality	• NPL ratio was 5.0% (6.0% as at 31 December 2016), while the ratio of impairment losses to the average gross credit volumes was 0.59% (0.67% as at 31 December 2016).
Loans and advances to customers	• Gross loans to customers increased by 3.8% YoY to PLN 93,569.1m due to the growth of 3.1% YoY in personal loans and 4.7% YoY in loans to enterprises and the public sector to PLN 44,322.8m and PLN 49,239.0m, respectively.
Deposits from customers	• Deposits from customers decreased by 1.2% YoY to PLN 102,155.5m as a result of an increase of 2.5% YoY in personal deposits to PLN 59,310.8m and a decline of 5.9% in deposits from enterprises and the public sector to PLN 42,844.7m.
Loans/Deposits	• Customer loans to deposit ratio was 88.6% as at 31 December 2017 compared with 84.3% as at 31 December 2016.
Electronic banking	• The number of customers using BZWBK24 electronic banking services totalled 3.4m (+5.2% YoY), including over 1m customers with access to mobile services (+26.7% YoY). • The number of "digital" customers (those who used the BZWBK24 platform at least once a month) was 2.1m (+4.5% YoY). • The BZ WBK payment card base (excluding prepaid cards) included 3.4m debit cards (+6.1% YoY) and 803.2k credit cards (+3.0% YoY).
Customer base	• The BZ WBK customer base was more than 4.4m customers.

Impact of Macroeconomic Developments in 2017

Key Macroeconomic Factors Impacting Financial and Business Performance of the Group in 2017

Economic growth	• Surprisingly high economic growth despite a low contribution from investments (in the first three quarters). Private consumption grew by nearly 5% YoY with consumer confidence at record-high levels. • Economic growth recovery and the surprisingly high improvement in business moods in eurozone countries gave strong support to Polish exports.
Labour market	• The exceptionally good situation in the labour market with record-low unemployment and accelerating wage growth in support of private consumption. • Shortage of workforce, making it difficult for companies to expand. Growing labour costs.
Monetary policy	• NBP interest rates remaining at historical lows, with subdued expectations regarding future rate hikes despite the United States and, in our region, the Czech Republic and Romania, already increasing interest rates.
Credit and deposit markets	• Stabilisation of credit growth in the banking sector. Benefiting from the 500+ programme, households were in a position to pay off their debts faster. • A decrease in term deposits, a faster increase in current account balances, the high growth of cash in circulation (suggesting that households seek higher returns than those offered by banking products).
Financial markets	• Changes of mood in international financial markets influenced by the expected policy orientation of the main central banks (Federal Reserve, ECB), incoming macroeconomic data, worries about the geopolitical situation, including concerns about the results of negotiations between the UK and the EU, and about the outcome of various elections in Europe. • Appreciation of the zloty versus the main currencies (USD and CHF) and a further drop in Polish T-bond yields.

Key Developments and Achievements

Major Corporate Events in 2017

January	• Implementation of a new staff performance management process in Bank Zachodni WBK.
February	• Execution of a guarantee agreement with the European Investment Bank providing security for lending up to EUR 300m to be granted by BZ WBK (10 February 2017). • Resignation of Mr Eamonn Crowley as a member of the bank's Management Board (16 February 2017). • Appointment of Mr Maciej Reluga as a Management Board member in charge of the Financial Management Division (16 February 2017). • Issuance of series D certificates of deposit in a total amount of PLN 420m as part of the Issuance Programme (17 February 2017). • Consent granted by the Polish Financial Supervision Authority (KNF) to allocate 10-year bonds with a total nominal value of EUR 120m issued by Bank Zachodni WBK on 2 December 2016 to subordinated debt (24 February 2017).
March	• Appointment of Mr Arkadiusz Przybył as a new Management Board member and nomination of the existing Management Board members as Vice Presidents of the Management Board: Mr Andrzej Burliga, Mr Michael McCarthy, Mr Juan de Porras Aguirre, Mr Mirosław Skiba and Mr Feliks Szyszkowiak (10 March 2017). • Issuance of series E certificates of deposit in a total amount of PLN 250m as part of the Issuance Programme, with a maturity date of 17 October 2017 (17 March 2017).
April	• Take-up of the position of a Management Board member by Ms Dorota Strojkowska based on the nomination of 14 December 2016, following the expiry of her previous employment commitments (1 April 2017). • Execution of an agreement between SCB and PSA Finance Polska on the sale of 10% of shares of the latter for the purpose of their cancellation (5 April 2017). The cancellation of own shares purchased by PSA Finance Polska from both shareholders (SCB and Banque PSA Finance) did not result in any changes in the company's ownership structure.
May	• Convening of the Annual General Meeting of Shareholders of Bank Zachodni WBK (AGM) which approved the distribution of the bank's profit for 2016 and pay-out of dividend of PLN 5.40 per share from the retained earnings for 2014 and 2015, appointed the Supervisory Board members for a new term of office, agreed the remuneration for the Supervisory Board members and a higher maximum ratio of fixed and variable remuneration for persons holding managerial positions, and decided to increase the share capital and launch the 6th Incentive Programme (17 May 2017). • Issuance of subordinated debt in the form of green bonds in a total amount of EUR 137.1m (equivalent of USD 150m), which were taken up by the International Finance Corporation (IFC) (22 May 2017).
June	• Execution of an agreement between BZ WBK Leasing and the Council of Europe Development Bank providing for EUR 100m financing for investments and growth of small and medium companies (1 June 2017). • Private subscription of series M shares of BZ WBK as part of the 5th Incentive Programme, under which 98,947 shares of a nominal value of PLN 10 each were allocated to 426 eligible participants (19 May – 20 June 2017).
July	• Registration of changes to the BZ WBK Statutes adopted by the bank's AGM on 17 May 2017 with the National Court Register (26 July 2017). The changes related to electronic services.
August	• Registration of a change to the BZ WBK Statutes of BZ WBK adopted by the bank's AGM on 17 April 2017 with the National Court Register (3 August 2017). The change related to an increase of PLN 989,470 in share capital to PLN 993,334,810 as part of the private subscription of series M shares taken up by the participants of the 5th Incentive Programme. • Settlement of the sale of 29,496 shares of Bank Zachodni WBK by Nationale-Nederlanden OFE, resulting in a reduction in the shareholding to 4,962,413 shares and in the share of the capital and voting power at the General Meeting of Shareholders of Bank Zachodni WBK below 5%. • Issuance of series F certificates of deposit in a total amount of PLN 750m (18 August) as part of the Issuance Programme with a maturity date of 17 October 2017.
September	• Registration of 98,947 series M ordinary bearer shares, with a nominal value of PLN 10 each, with the Central Securities Depository of Poland (KDPW) (14 September 2017). • Expansion of the range of products and services to include a new Account As I Want It (Konto Jakie Chcę) in accordance with the brand promise: Bank As You Want It (21 September 2017).
October	• Change of the name of BZ WBK Nieruchomości to BZ WBK F24 and expansion of the company's business profile to include lending activities (18 October 2017). • Issuance by BZ WBK Faktor of floating bonds with a nominal value of PLN 700m and maturity date of 18 February 2018 in order to acquire proceeds to reduce the overdraft credit (18 October 2017). • Receipt of the KNF consent to allocate the green bonds of EUR 137.1m to BZ WBK Tier 2 capital (19 October 2017). • Affirmation of BZ WBK's rating by Fitch Ratings (20 October 2017).
November	• Receipt of the KNF requirement (28 November 2017) for the bank to maintain own funds at the level sufficient to cover an additional capital requirement for risk related to foreign currency home mortgages at 0.54 p.p. above the total capital ratio (previously: 0.62 p.p). • Stock swap between Bank Zachodni WBK and BZ WBK Finanse: in-kind contribution of BZ WBK F24 shares to BZ WBK Finanse in exchange for shares of BZ WBK Finanse (24 November 2017). • Removal of AKB Marketing Services in liquidation, member of Santander Consumer Group, from the court register (20 November 2017). • Approval of the liquidation of Giełdokracja by the company's Extraordinary General Meeting (29 November 2017).
December	• Admission of series M shares of Bank Zachodni WBK to trading on the main floor of the Warsaw Stock Exchange (1 December 2017) starting from 19 December 2017 (as agreed on 18 December 2017). • Execution of the following agreements with Deutsche Bank AG (DB AG) (14 December 2017): – a transaction agreement providing for the purchase of a part of Deutsche Bank Polska (DBPL) enterprise, including retail banking, private banking, business banking (SME) and DB Securities; – a pre-demerger agreement setting out the terms of cooperation between the bank and DBPL to close the deal. • Receipt of a letter from the KNF (15 December 2017) including: – a requirement for the bank to maintain own funds at the level sufficient to cover an additional capital requirement for risk related to foreign currency home mortgages at 0.44 p.p. above the total capital ratio for BZ WBK Group; – results of the analyses conducted by the KNF as part of stress tests, concluding that in the case of Bank Zachodni WBK an individual add-on (ST) used in dividend policies of commercial banks to measure sensitivity to an adverse macroeconomic scenario is equal to 0.71 p.p.

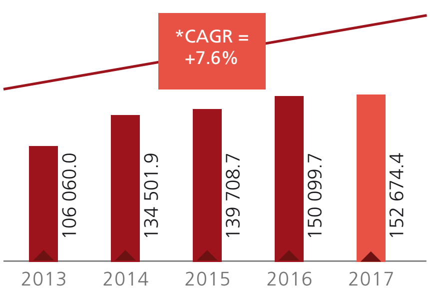
Development of Bank Zachodni WBK Group Over Five Previous Years

The table presents selected data illustrating the performance of Bank Zachodni WBK Group over 5 previous years, i.e. from 2013 to 2017.

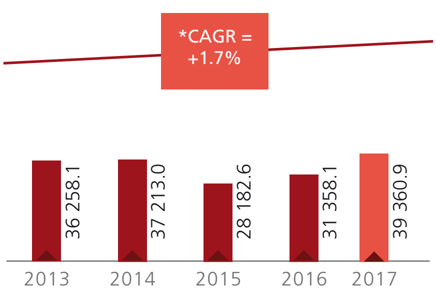
Selected Financial Data (PLN m)	**2017**	**2016**	**2015**	**2014 2)**	**2013 1)**
Total Assets	152 674.4	150 099.7	139 708.7	134 501.9	106 060.0
Net Loans and Advances to Customers 3)	107 839.9	103 068.5	94 913.9	85 820.5	68 091.4
Deposits from Customers 3)	111 481.1	112 522.5	101 245.2	94 824.7	78 376.0
Total Equity	23 343.6	21 018.5	20 568.1	18 051.7	14 482.9
Profit Before Tax	3 335.2	3 122.1	3 178.3	2 640.0	2 514.7
Profit Attributable to Owners of BZ WBK	2 213.1	2 166.8	2 327.3	1 914.7	1 982.3
Selected Ratios	**2017**	**2016**	**2015**	**2014**	**2013**
Cost to Income Ratio 4)	43.4%	46.2%	48.4%	47.3%	47.0%
Capital Ratio	16.7%	15.1%	14.6%	12.9%	13.9%
NPL Ratio	5.8%	6.6%	7.3%	8.4%	7.9%
Earnings per Share (PLN)	22.3	19.4 4)	20.7 4)	19.9	21.2
Net Book Value per Share (PLN)	235.0	211.8	207.3	181.9	154.8
Selected Non-Financial Data	**2017**	**2016**	**2015**	**2014**	**2013**
Number of Branches	735	821	890	961	830
Number of FTEs	14 383	14 772	14 218	14 835	12 612
Dividend per Share Paid Out (PLN)	5.4 5)	13.0 6)	– 7)	10.7	7.6
Number of Shares at the Year-End	99 333 481	99 234 534	99 234 534	99 234 534	93 545 089
Closing Share Price at the Year-End (PLN)	396.25	316.0	284.0	375.0	387.6

1) Financial and non-financial data for 2013 and onwards include Kredyt Bank following the merger with BZ WBK on 4 January 2013.
2) Financial and non-financial data for 2014 and onwards (excluding dividend, number of shares and share price) include SCB Group following the acquisition of a controlling stake in SCB by BZ WBK on 1 July 2014.
3) Loans and advances to customers and deposits from customers do not include repurchase transactions due to changes to the presentation of these operations starting from 30 June 2016. Data for the previous reporting periods have been adjusted accordingly to ensure comparability.
4) The calculations of the C/I and basic EPS ratios for 2015 and 2016 use the Group's total income, total costs and profit (as a pplicable) adjusted for one-off items (gains on interest in Visa Europe Ltd. and BZ WBK-Aviva companies, and 2015 contributions under the deposit guarantee scheme).
5) The AGM of 17 May 2017 decided to allocate PLN 535.9m of undistributed net profit earned by Bank Zachodni WBK in 2014 and 2015 for dividend payment. The dividend totalled PLN 5.40 per share.
6) The AGM of 20 April 2016 decided to allocate PLN 702.5m of net profit earned by Bank Zachodni WBK in 2015 and PLN 587.6m of undistributed net profit for 2014 for dividend payment. The dividend totalled PLN 13.00 per share.
7) Pursuant to the KNF requirement of 1 April 2015 to retain the entire profit for 2014 until the regulator determines an additional capital requirement for the bank, BZ WBK AGM of 23 April 2015 left PLN 952.7m of net profit undistributed after allocating the remaining portion of the profit to reserve capital.

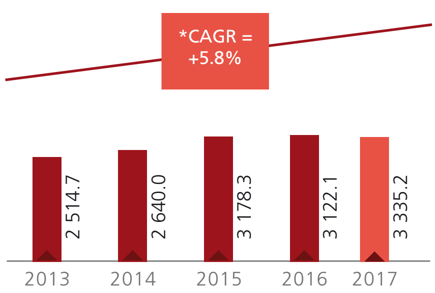
Total Assets of BZ WBK Group (PLN m) as at 31 Dec. in 2013-2017



Capitalisation of BZ WBK (PLN m) as at 31 Dec. in 2013-2017



Profit Before Tax of BZ WBK Group (PLN m) in 2013-2017



** CAGR – compound annual growth rate*

II. Basic Information about Bank Zachodni WBK and BZ WBK Group

1. History, Ownership Structure and Profile

History and Profile of Bank Zachodni WBK as a Parent Entity

2001 Set-up of BZ WBK by way of merger	Bank Zachodni WBK S.A. (Bank Zachodni WBK, BZ WBK) was established following the merger of Bank Zachodni with Wielkopolski Bank Kredytowy. The Wrocław-based entity was entered into the business register in the National Court Register on 13 June 2001 and on 25 June 2001 it debuted on the Warsaw Stock Exchange.
2011 Change of the majority shareholder to Banco Santander	Bank Zachodni WBK was originally a member of AIB Group together with the controlling shareholder – AIB European Investments Ltd. – which on 1 April 2011 sold their entire stake in the bank (70.36% of share capital and voting power) to Banco Santander with its registered office in Santander, Spain. Banco Santander finalised the purchase of Bank Zachodni WBK in the tender for 100% of the bank's shares. As a result, Banco Santander acquired an interest representing 95.67% of share capital and voting power in the bank.
2013 Merger with Kredyt Bank	On 4 January 2013, Bank Zachodni WBK merged with Kredyt Bank pursuant to the Investment Agreement of 27 February 2012 between Banco Santander and KBC Bank NV. The merger by acquisition was completed by way of a transfer of all assets and liabilities of Kredyt Bank to Bank Zachodni WBK in exchange for newly issued series J shares with a nominal value of PLN 189.1m allotted to all of the existing shareholders of Kredyt Bank at the agreed exchange ratio.
2014 Acquisition of a controlling stake in SCB	Pursuant to the Investment Agreement of 27 November 2013 between Bank Zachodni WBK, Santander Consumer Finance and Banco Santander, on 1 July 2014 Bank Zachodni WBK acquired ordinary and preference shares in Santander Consumer Bank with its registered office in Wrocław (SCB), representing 60% of the share capital of SCB and 67% of votes at the General Meeting of SCB. In exchange for an in-kind contribution of SCB shares, the bank issued series L shares with the total nominal value of PLN 53.8m.
2017 Acquisition of a carved-out business of Deutsche Bank Polska	On 14 December 2017, Bank Zachodni WBK and Banco Santander signed a transaction agreement with Deutsche Bank AG (DB AG) to purchase a part of Deutsche Bank Polska (DBPL) business, consisting of retail banking, private banking, SME banking and DB Securities. DBPL's corporate and investment banking business and foreign-currency mortgage portfolio are excluded from the transaction and will remain in DBPL (retained business).

Structure of Share Capital of Bank Zachodni WBK.

The table below presents the entities with significant holdings of Bank Zachodni WBK shares as at 31 December 2016 and 31 December 2017.

Shareholder	Number of Shares Held		% in the Share Capital & Voting Power at AGM	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016
Banco Santander S.A.	68 880 774	68 880 774	69.34%	69.41%
Nationale Nederlanden OFE	n/a	5 110 586	n/a	5.15%
Others	30 452 707	25 243 174	30.66%	25.44%
Total	**99 333 481**	**99 234 534**	**100.0%**	**100.0%**

As at 31 December 2017, Banco Santander was the only shareholder holding more than 5% of the share capital and the total number of votes at the BZ WBK General Meeting of Shareholders, with a shareholding of 69.34%. To the best of the BZ WBK Management Board's knowledge, the structure remained unchanged until the submission of this report for approval (12 February 2018).

Compared with 31 December 2016, the shareholder structure of Bank Zachodni WBK changed as follows:

- The share of Banco Santander in the share capital and voting power at the BZ WBK General Meeting was diluted from 69.41% to 69.34% as a result of an increase in the bank's share capital by way of issuance of series M shares as part of the 5th Incentive Programme. In effect, 98,947 series M shares with a nominal value of PLN 10 were allocated to the eligible programme participants. The increase of PLN 989,470 in the share capital (to PLN 993,334,810) took effect on 3 August 2017 after a relevant entry had been made in the court register.
- Nationale Nederlanden OFE was removed from the list of shareholders holding a significant interest in the bank following the settlement of the sale of 29,496 shares on 7 August 2017. As a result of the transaction, the fund's stake in the share capital and voting power of the bank decreased below 5%.

Scope of Activities of Bank Zachodni WBK and BZ WBK Group

Bank Zachodni WBK is a universal bank which provides a full range of services for personal customers, SMEs, large companies and institutions. The bank's offering is modern, comprehensive and satisfies diverse customer needs with regard to current/personal accounts, credit, savings, investment, settlement, insurance and card products. The financial services of Bank Zachodni WBK include cash management, payments, trade finance and transactions in the capital, money, FX and derivative markets, as well as underwriting, brokerage and custody services.

The bank's own product range is complemented by specialist products offered by its group of related companies, including: BZ WBK Towarzystwo Funduszy Inwestycyjnych (BZ WBK TFI), BZ WBK Leasing, BZ WBK Faktor, BZ WBK-Aviva Towarzystwo Ubezpieczeń Ogólnych (BZ WBK-Aviva TUO) and BZ WBK-Aviva Towarzystwo Ubezpieczeń na Życie (BZ WBK-Aviva TUnŻ). Through all these companies, the bank offers its customers access to investment fund units and asset portfolios as well as insurance, leasing and factoring products.

The bank continually develops its product range to ensure that solutions offered to customers are transparent, simple, digital, flexible and available in self-service channels. Customers are provided with comprehensive services in traditional sales channels and, increasingly, via remote channels.

Santander Consumer Bank, which was incorporated into the structure of Bank Zachodni WBK Group on 1 July 2014, specialises in consumer finance and term deposit accounts for personal and business customers.

As at 31 December 2017, Bank Zachodni WBK Group provided services to 6.5 million customers, including more than 2 million customers of Santander Consumer Bank.

Business Model of Bank Zachodni WBK Group

Operating structure

Bank Zachodni WBK

Bank Zachodni WBK together with its non-banking subsidiaries carries on its operations through the following central units: Retail Banking Division, SME Banking Division, Business and Corporate Banking Division and Global Corporate Banking Division.

Retail Banking Division

The Retail Banking Division offers services to personal customers who are divided into Standard, Premium, VIP or Private Banking customer segments, taking into account their diverse needs and expectations. Retail customers interact with the bank via an extensive network of branches and remote channels, e.g. telephone banking, internet banking and mobile banking (BZWBK24 electronic banking platform and the Multichannel Communication Centre).

Private Banking and VIP customers benefit from a personalised service model under which they may use the support of a specialised advisor and the Affluent Customer Centre operating as part of the Multichannel Communication Centre, which offers support via telephone. Premium customers are serviced by dedicated advisors as part of their individual portfolios, based on a personalised approach and regular contacts aimed at strengthening relationship and customer loyalty. The personalised approach towards other retail customers is reflected in relationship building, sales and after-sales contacts.

SME Banking Division

The SME Banking Division is focused on services for small and medium enterprises, which are assigned to three segments based on turnover and personalised service criteria: Digital SME, SME 1 and SME 2. Entrepreneurs that are assigned to the Digital SME segment are mainly serviced via remote channels (BZWBK24, BZWBK24 Mini Firma, Moja Firma Plus, iBiznes24 platforms) or by the Multichannel Communication Centre. The relationships with active companies with relatively lower turnover (SME 1) are managed by SME advisors in branches and partner outlets, while SMEs with higher turnover and more complex requirements (SME 2) are handled by mobile advisors from the SME Banking Division. The support for SME customers is also provided by the SME Service Centre (part of the Central Operations Area), which delivers a wide range of operational processes.

Business and Corporate Banking Division and Global Corporate Banking Division

Services to business customers with turnover above PLN 40m, local administration units and the public sector are supervised by the Business and Corporate Banking Division and are provided through 12 Corporate Business Centres operating nationwide and the Property and Hotels Department (central unit operating across Poland) in accordance with customer segmentation (corporate or property finance).

The Global Corporate Banking Division is responsible for a banking relationship with the Group's largest clients who are offered investment, credit, transactional and treasury products and services as part of the global Customer Relationship Management Model of Santander Group. It also provides treasury, syndicated lending and advisory services to customers handled by other division.

All business customers, regardless of their segmental allocation and relationship units in the Business and Corporate Banking Division or the Global Corporate Banking Division, are serviced by dedicated advisors responsible for the overall relationship. They are also provided with access to the bank's products and services via remote channels, including internet and mobile iBiznes24 platform as well as phone services of the Business Service Centre. The continuously refined iBiznes24 electronic banking platform allows businesses and corporations to perform a wide range of transactions (e.g. FX and trade finance transactions) and effectively manage finances.

Santander Consumer Bank

Santander Consumer Bank Group, which specialises in consumer finance, forms a separate business segment with its own customer base, product range and distribution channels.

The bank's business model is based on a multi-product and multi-channel approach and a diverse customer base, as well as regular cross-selling and up-selling. To that end, the bank offers consumer loans, car finance through lease and factoring, credit facilities for car dealers, retail and business deposits and insurance products.

Operating Segments

In Operating Segments Reporting as provided in the Consolidated Financial Statements of Bank Zachodni WBK Group for 2017 (Note 3) , the activities of the Retail Banking Division and the SME Banking Division are presented as part of the retail segment. The Business and Corporate Banking Division and the Global Corporate Banking Division make up two separate segments named accordingly. The Group also identifies ALM and Centre Segment and Santander Consumer Segment.

Basic Distribution Channels

As at 31 December 2017, Bank Zachodni WBK operated country-wide through 576 branches divided into and managed by 65 regions and 8 macroregions. The bank's distribution network also included 109 partner outlets and 1,732 self-service units (ATMs, CDMs and deposit ATMs).

In addition to direct banking via branches, partner outlets and Corporate Business Centres, Bank Zachodni WBK carries out a wide range of operations via contact centres (Multichannel Communication Centre and specialised units: Affluent Customers Centre, Business Service Centre, SME Service Centre) and offers 24-hour access to banking products and services by means of internet and mobile channels (BZWBK24, BZWBK24 Mini Firma, Moja Firma Plus and iBiznes 24 electronic banking platforms).

In addition to traditional helpline services, the Multichannel Communication Centre provides support across many other customer contact points such as internet chat, audio call, video call, email or a contact form. Customers can also visit a virtual branch and use Online Advisor services (via video chat).

The bank has been steadily developing an integrated CRM system and multi-channel banking solutions to ensure consistent service levels and continuity of communication with customers in all distribution channels. Strong focus has been placed on security of remote banking processes, which involves regular upgrades of securities in place.

Santander Consumer Bank delivers its products through a network of own branches and franchise outlets, mobile sales force offering car loans and corporate deposits, remote channels (call centre and the internet) and a network of partners selling the bank's car loans and instalment loans.

Basic Distribution Channels of BZ WBK and SCB

Bank Zachodni WBK	31.12.2017	31.12.2016
Branches (locations)	576	658
Partner Outlets	109	110
Business and Corporate Banking Centres	12	12
ATMs	948	1 063
CDMs	13	19
Dual Function Machines	771	684
BZWBK24 – registered users (in thousands) [1)]	3 388	3 221
iBiznes24 – registered companies (in thousands) [2)]	15	16
Santander Consumer Bank	31.12.2017	31.12.2016
Branches	159	163
Partner Outlets	153	148
Registered Electronic Banking Users (in thousands) [3)]	132	4

1) The BZWBK24 customer base includes the users of BZ WBK24 mobile application: 1,094.3k as at 31.12.2017 and 863.9k as at 31.12.2016. There were more than 2 million BZWBK24 customers who used the system at least once a month.
2) Only the users of iBiznes24 – the strategic electronic platform for business customers (the users of Moja Firma Plus and Mini Firma platforms are not included). The YoY decrease in the number of customers results from data cleaning.
3) Users who signed agreements with SCB and used the bank's electronic banking system at least once.

Business Model Framework

The fundamental element of the strategy and business model of Bank Zachodni WBK Group is customer-centricity, an approach whereby each initiative and banking process is analysed from the customer's viewpoint, with a focus on the customer's needs and experience in order to build lasting relationships underpinned by an attractive, simple and innovative products portfolio and high service quality. The Group creates value for customers focusing on modern technologies, digitalisation and multichannel banking. The Group also gives priority to developing a friendly work environment and a corporate culture by promoting cooperation and increasing the motivation, engagement and professionalism of employees. It conducts its business activity taking into consideration the interests of all stakeholders, including shareholders and communities it operates in.

The Group focuses on the diversification of income, expansion in high-margin market segments, maintenance of a solid capital position and effective risk management. This translates into balanced growth of business volumes, an increasing presence in the most profitable market segments and strong and recurring financial performance.

In view of the strategic Transformation Programme launched in 2016, the bank's business model is continually improved in terms of its effectiveness, suitability to customers' needs, digitalisation and integration of distribution channels, among other things.

2. Position of Bank Zachodni WBK and BZ WBK Group in the Banking Sector

Banking Sector in Poland

According to the data released by the KNF Office, 35 commercial banks operated in Poland at the end of 2017. The share of ten biggest ones in the total assets, loans and deposits of the banking sector was 70.5%, 69.8% and 74.5%, respectively. The peer Group of Bank Zachodni WBK which is presently the third bank in Poland by total assets includes primarily: PKO BP, PeKao, mBank, Millenium Bank and ING Bank Śląski.

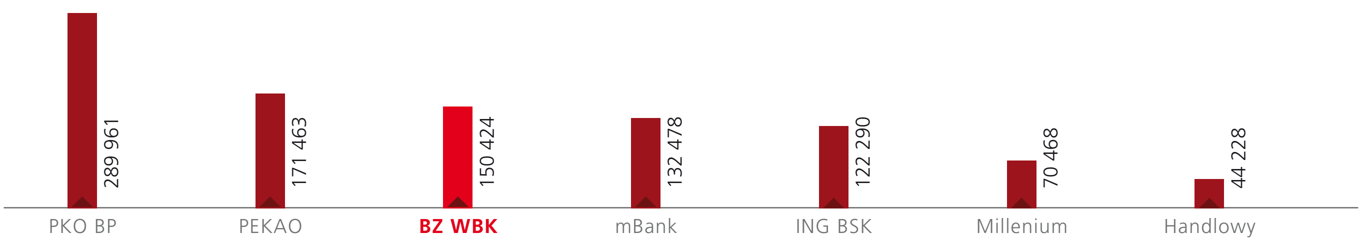
Challenges facing the Polish banking sector

Regulatory environment	High regulatory pressure – a number of new statutory and regulatory provisions and recommendations. Requirements arising from the new Banking Guarantee Fund Act. Unknown impact of possible regulations regarding CHF mortgages. Opportunities and threats arising from the revised Payment Services Directive (PSD2) to be implemented in 2018. Increasing focus on additional capital requirements and consumer protection.
Opportunities and threats	Considerable banking potential of Poland: lower banking penetration rate compared to Western Europe. Economic growth of Poland: increase in investment loans, favourable market conditions and more prosperous middle class as a target customer segment of Bank Zachodni WBK. Changes in the competitive environment: increasing consolidation of the banking sector. Revolutionary changes in banking habits: multi-channel approach, the leading role of remote channels, changes to customers' expectations. Development of breakthrough technologies: Big Data, artificial intelligence, robotic process automation, blockchain. Digitalisation and transformation: focus on new technological and business solutions as a key competitive advantage. Focus on costs and profitability.

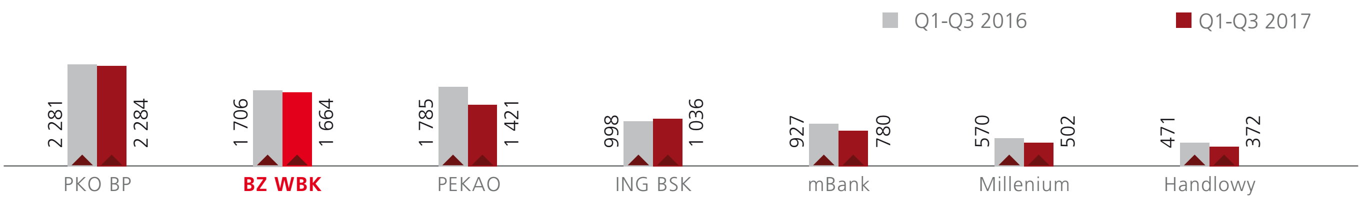
Position of Bank Zachodni WBK and BZ WBK Group in the Polish Banking Sector

According to the financial statements for the three quarters ended 30 September 2017, which at the date of approval of this Management Board report (12 February 2017) were the most up-to-date source of comparable data on the performance of banks listed on the Warsaw Stock Exchange (WSE), Bank Zachodni WBK – including its subsidiaries and associates – was Poland's third largest banking group in terms of total assets, equity, deposits and loans, and the second in terms of attributable profit.

Total Assets (PLN m) as at 30 September 2017 against the peer group



Profit Attributable to BZ WBK shareholders (PLN m) for Q1-3 2017 and Q1-Q3 2016 against the peer group



According to NBP statistics, as at the end of December 2017 the Group's share of the market was 9.8% for loans and 9.4% for deposits.

The Group continued to strengthen its presence in the factoring and leasing markets via its subsidiaries, holding a market share of 12.6% and 6.1%, respectively (according to the Polish Factors Association and the Polish Leasing Association). At the same time, the Group's share in the retail investment funds market was 10.4% (according to Analizy Online) while in the total equity and futures markets it held 4.6% and 10.0%, respectively (according to the Warsaw Stock Exchange).

COMPETITIVE STRENGTHS OF BANK ZACHODNI WBK AND BZ WBK GROUP

Bank Zachodni WBK Group has stable sources of funding, solid capital and liquidity position and a diversified asset portfolio. The Group's competitive position has been supported by a clear, coherent and consistent strategic vision, an efficient and straightforward business model, a broad and diversified scope of business as well as benefits and synergies achieved by the bank as a member of Santander Group. The business scale, quality of products and services and strong focus on building lasting relationships with customers allow the Group to compete successfully with the largest players in the Polish banking market. At the same time, a wide array of complementary services for respective customer segments, a large Poland-wide branch network, modern banking technologies and rapidly expanding functionality and integration of remote distribution channels give opportunity for further market penetration.

Financial Position of Bank Zachodni WBK Group against the Banking Sector

According to the KNF's Banking Sector Report for January-September 2017 which presented the most up-to-date analysis of the Polish banking sector as at the date of this report, the situation in the banking sector over the first nine months of 2017 was stable amid favourable macroeconomic conditions (accelerated economic growth, further improvement of labour market conditions and enterprise and consumer sentiment, low interest rate environment).

Net profit of the banking sector for the period from January to September 2017 decreased by 7.5% YoY on account of a lower profit on non-core banking operations caused by a high base effect of the settlement of the sale of Visa Europe shares in Q2 2016.

The profit on banking operations improved by 1% YoY in the first nine months of 2017 thanks to an increase in net interest income (+10.9% YoY) and net fee and commission income (+8.8% YoY) coupled with a decrease in profit on non-core banking operations (-45.4% YoY). Net interest income hit an all-time high amid changes in the deposit and credit policy and growth of business volumes. The increase in net fee and commission income was driven by higher income from loans and advances, sale of insurance products, maintenance of bank accounts, payment and credit cards, management of investment funds, brokerage activities and issue arrangement.

The banks' general and administrative expenses went up by 3.4% YoY, mainly on account of higher staff expenses and longer taxable period in respect of tax on financial institutions (by one month). An increase was also reported in BFG fees and costs of IT infrastructure, while lease fees and marketing expenses went down.

The impairment write-offs rose slightly after the first three quarters (+1.7%) driven by higher impairment charges on consumer loans, other retail loans and loans for business customers, coupled with increased IBNR provisions.

The above-mentioned developments triggered an improvement of interest margin (up 0.12 p.p.), however other operating efficiency measures deteriorated: cost ratio increased from 55.23% to 56.60%, while ROA and ROE decreased from 0.92% to 0.81% and from 8.51% to 7.42%, respectively.

On the asset side, the key lines reporting growth were corporate and retail loans, while on the liabilities side – public sector deposits. Banks continued to increase their profitability by optimising headcount and sales networks. This was supported by mergers and acquisitions completed in the reporting period as well as the development of electronic banking.

Trends observed in the banking sector were also reflected in the performance of Bank Zachodni WBK, particularly in a dynamic growth of net interest income, a solid increase in net fee and commission income, higher staff expenses and accelerated growth of loan portfolio. Compared to peers however, Bank Zachodni WBK Group performance stood out in the banking sector for the rate of decrease of its impairment charge (-15.5% YoY after the three quarters of 2017; -12% YoY throughout 2017) and for its efficiency ratios, including ROA (1.4% as of 30 September 2017 and 1.5% as of 31 December 2017), ROE (11.7% as of 30 September 2017 and 12.2% as of 31 December 2017) and cost to income ratio (43.5% for three quarters of 2017 and 43.4% for 2017).

3. Entities Related with Bank Zachodni WBK

Subsidiaries

As at 31 December 2017, Bank Zachodni WBK Group comprised of Bank Zachodni WBK and the following subsidiaries:

1. Santander Consumer Bank S.A. (SCB S.A.)
2. Santander Consumer Finanse Sp. z o.o. – a subsidiary of SCB S.A.
3. Santander Consumer Multirent Sp. z o.o. – a subsidiary of SCB S.A.
4. SC Poland Consumer 15-1 Sp. z o.o. – a subsidiary of SCB S.A.
5. SC Poland Consumer 16-1 Sp. z o.o. – a subsidiary of SCB S.A.
6. PSA Finance Polska Sp. z o.o. – a subsidiary of SCB S.A.
7. PSA Consumer Finance Polska Sp. z o.o. – a subsidiary of PSA Finance Polska Sp. z o.o.
8. BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A.
9. BZ WBK Finanse Sp. z o.o.
10. BZ WBK Faktor Sp. z o.o. – a subsidiary of BZ WBK Finanse Sp. z o.o.
11. BZ WBK Leasing S.A. – a subsidiary of BZ WBK Finanse Sp. z o.o.
12. BZ WBK F24 S.A. – a subsidiary of BZ WBK Finanse Sp. z o.o.
13. BZ WBK Inwestycje Sp. z o.o.
14. Giełdokracja sp. z o.o. in liquidation

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

- Merger of BZ WBK Leasing and BZ WBK Lease

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

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

  The Extraordinary General Meeting of AKB Marketing Services held on 28 March 2017 approved the liquidation statements of the company as at 27 March 2017. The funds left after the liquidation of AKB Marketing Services were transferred on 28 March 2017 to an account of Santander Consumer Bank, the sole shareholder. The liquidation of the company became effective after it had been struck off the National Court Register on 20 November 2017.

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

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

On 29 November 2017, the company's Extraordinary General Meeting approved the liquidation of Giełdokracja, which will become effective once recorded in the National Court Register.

All the entities within Bank Zachodni WBK Group are consolidated with the bank in accordance with IFRS 10 as at 31 December 2017.

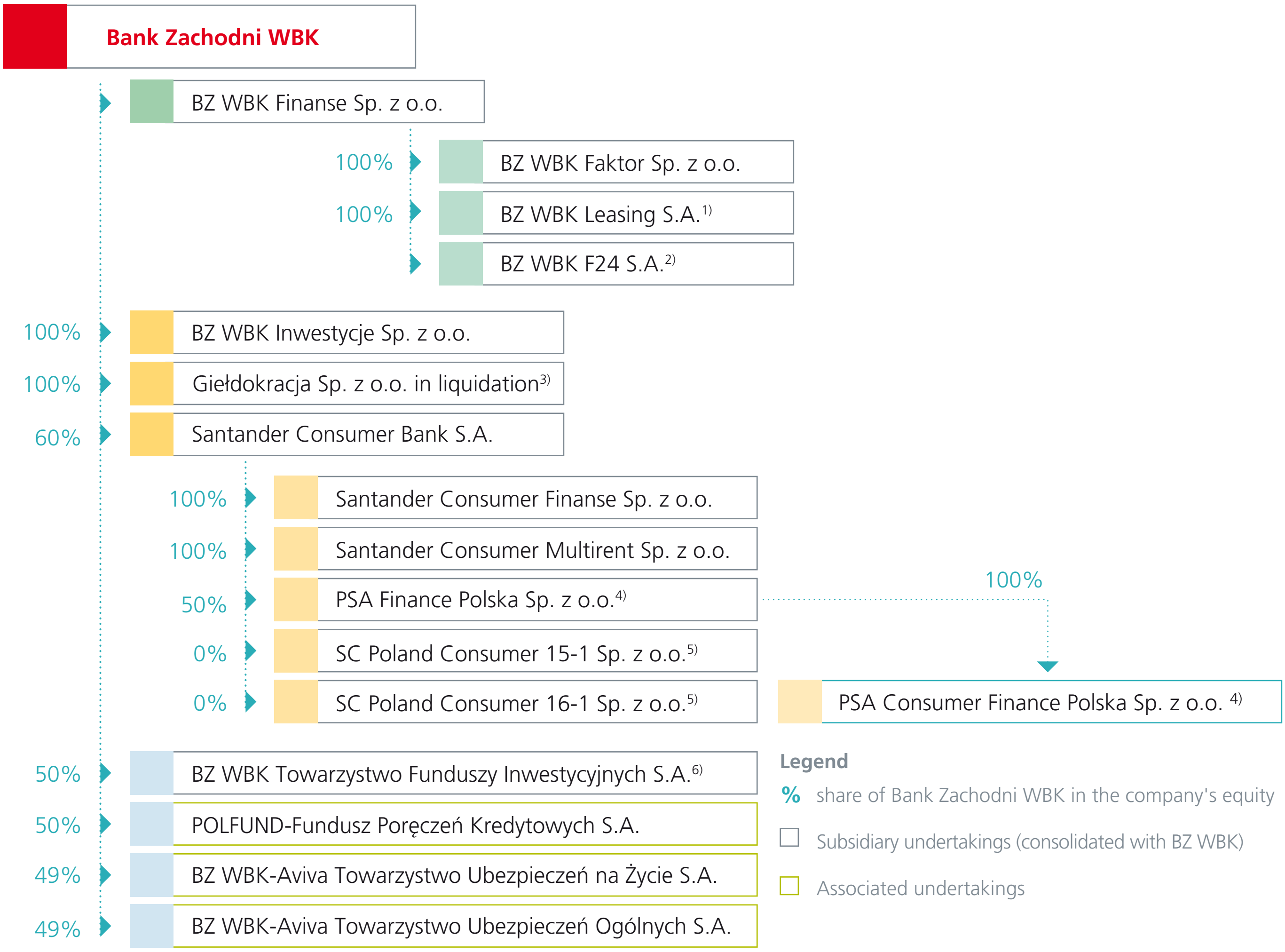
Associates

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

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

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

Organisational Chart of Entities Related to Bank Zachodni WBK Group as at 31 December, 2017



1) On 28 February 2017, the leasing subsidiaries of Bank Zachodni WBK were merged following the acquisition of BZ WBK Lease by BZ WBK Leasing. The acquired company was removed from the National Court Register without formal liquidation.
2) On 18 October 2017, BZ WBK Nieruchomości was renamed BZ WBK F24. In November 2017, as a result of the stock swap between Bank Zachodni WBK and BZ WBK Finanse (in-kind contribution of BZ WBK F24 shares to BZ WBK Finanse in exchange for shares of BZ WBK Finanse) and the purchase by BZ WBK Finanse of an outstanding share ensuring a 100% stake in the share capital of BZ WBK F24, the company became fully controlled by BZ WBK Finanse Sp. z o.o. (previously it was 99.99% owned by Bank Zachodni WBK).
3) On 28 April 2016, the Annual General Meeting of Giełdokracja adopted a resolution to dissolve the company and to start its liquidation as of 1 May 2016.
4) On 1 October 2016, SCB acquired 50% shares of PSA Finance Polska and, indirectly, 50% stake in PSA Consumer Finance Polska. Both companies are controlled by SCB as they meet the conditions set out in IFRS 10.7
5) SC Poland Consumer 15-1 and S.C. Poland Consumer 16-1 are SPVs set up for the purpose of securitisation of part of SCB credit portfolio. Their shareholder is a legal person that has no ties with the Group. The companies are controlled by SCB as they meet the conditions laid down in IFRS 10.7. (since 23 September 2015 and 1 August 2016, respectively).
6) On 31 March 2016, BZ WBK TFI merged with BZ WBK AM, whereby the parent (BZ WBK AM) was taken over by its subsidiary (BZ WBK TFI). Both owners of the acquiring company, Bank Zachodni WBK and Banco Santander Group, hold an equal stake of 50% in the company's share capital. Bank Zachodni WBK exercises control over BZ WBK TFI.

4. Other Equity Investments

As at 31 December 2017 and 31 December 2016, Bank Zachodni WBK Group owned at least 5% of share capital or voting power in the following companies:

Ref.	Company	% in the Share Capital	Voting Power at AGM	% in the Share Capital	Voting Power at AGM
		31.12.2017		31.12.2016	
1.	Reliz Sp. z o.o. in liquidation	–	–	100.00%	100.00%
2.	Zakłady Przemysłu Jedwabniczego DOLWIS S.A. in liquidation	–	–	44.00%	44.00%
3.	Invico S.A. 1)	21.09%	12.21%	21.09%	12.21%
4.	Krynicki Recykling S.A. 1)	19.19%	19.19%	19.19%	19.19%
5.	Polski Standard Płatności Sp. z o.o.	16.67%	16.67%	16.67%	16.67%
6.	i3D S.A. 1)	15.77%	15.77%	15.77%	15.77%
7.	Krajowa Izba Rozliczeniowa S.A.	14.23%	14.23%	14.23%	14.23%
8.	Aviva Powszechne Towarzystwo Emerytalne Aviva BZ WBK S.A.	10.00%	10.00%	10.00%	10.00%
9.	Aviva Towarzystwo Ubezpieczeń Ogólnych S.A.	10.00%	10.00%	10.00%	10.00%
10	Aviva Towarzystwo Ubezpieczeń na Życie S.A.	10.00%	10.00%	10.00%	10.00%
11	PBG S.A. in arrangement bankruptcy	–	–	7.96%	7.96%
12	Biuro Informacji Kredytowej S.A.	7.72%	9.22%	7.72%	5.14%
13	Infosystems S.A. 1)	7.50%	7.50%	7.50%	7.50%
14	Hortico S.A. 1)	6.39%	6.39%	6.39%	6.39%
15	AWSA Holland II B.V.	5.44%	5.44%	5.44%	5.44%
16	Gorzowski Rynek Hurtowy S.A. 1)	2.47%	6.53%	2.47%	6.53%

1) Companies from the equity investment portfolio of BZ WBK Inwestycje Sp. z o.o.

III. Macroeconomic Situation in 2017

Economic Growth

GDP growth accelerated much more than expected in 2017, most probably exceeding 5% YoY in 4Q17 and reaching 4.6% on average in the entire year. It was driven by very strong private consumption boosted by 500+ child benefit program, healthy labour income growth, lower savings rate and a record high consumers' optimism. Exceptionally supportive external environment (solid recovery in the eurozone) also contributed to robust internal economic growth as it fuelled Polish exports. The long-awaited revival in investments started to materialise in 2H17, although slowly and mainly in the public sector. Manufacturing and construction sectors recorded a much higher growth than in 2016. For the better part of 2017, Poland managed to maintain the current account surplus despite strong internal demand and in November the positive balance amounted to record-high 0.3% of GDP.

Labour Market

2017 was a year of "employee market" with companies widely claiming workforce shortages and difficulties in filling the vacancies. These tensions were slightly mitigated by rising labour participation rate and intensification of immigration to Poland, mainly from Ukraine. Unemployment fell to record-low levels (in November, 6.5% for the registered unemployment rate and 4.4% according to LFS). High level of economic activity was generating high demand for labour and so the wage pressure strengthened amid shortage of workforce. Lowering of the retirement age in October did not influence the employment statistics but created a risk that spare workforce could decrease further. In 2017, nominal pace of wage growth in corporate sector was at 5.7% YoY on average and c. 7.1% YoY in 4Q17. At the same time, pace of employment growth in corporate sector settled at around 4.5% YoY throughout the year. Real wage bill pace of growth accelerated despite rebound of inflation.

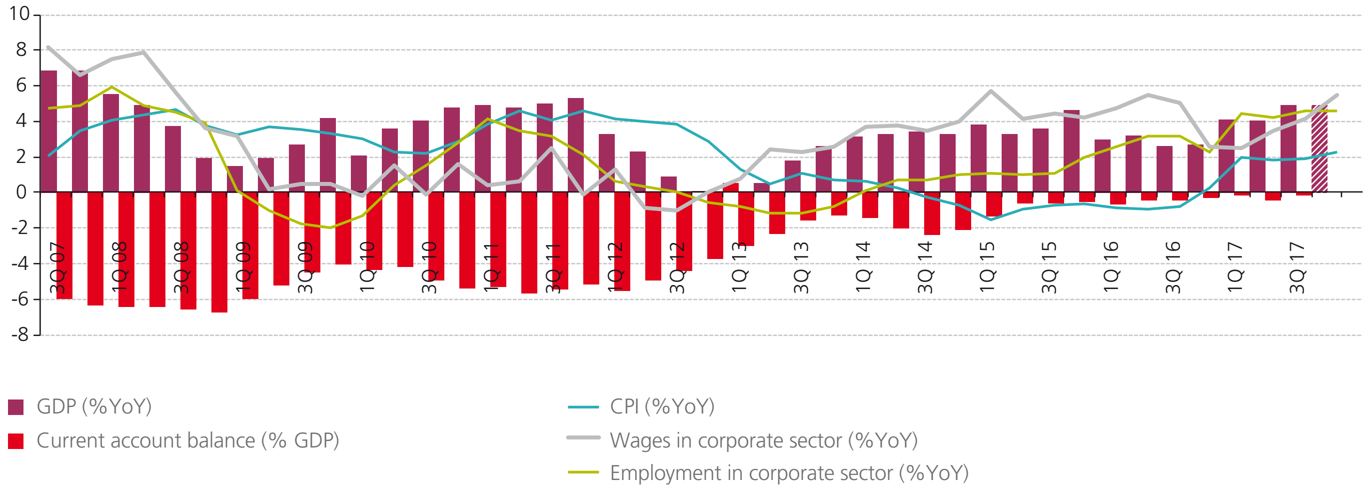
Inflation

Already in January, inflation rose above 1.5% YoY and for the rest of the year stayed above that level and below the 2.5% target (that was finally hit in November, for the first time in five years). On average, in 2017 CPI was at 2% YoY. Intra-year volatility was driven by changes in food prices (distorted by supply of Polish fruit amid adverse weather conditions and rising prices of butter and eggs) as well as fuel (as oil prices rose on the global market and high base effect at the year-end). Core CPI excluding food and energy prices accelerated to 0.8% YoY from 0.0% YoY in early 2017 and stayed around that level for the rest of the year.

Monetary Policy

In 2017, Monetary Policy Council left main interest rates unchanged and changed the interest on required reserves to 0.50% effective since January 2018 and lowered the reserve requirement ratio to 0% for deposits with maturity of at least two years (effective since March 2018). Most of the MPC members still view the current reference rate at 1.50% as appropriate and supportive for realization of the inflation target, helping investment revival and keeping Polish economy on the path of balanced economic growth. Still, opinions among the MPC members became more diversified along the year. Some members feared that inflation could accelerate amid tensions on the labour market and that undesirable side effects of negative real interest rates would show up. However, core inflation did not rise noticeably despite wage acceleration and in the Council's opinion the side effects were not meaningful enough to trigger action.

Selected Macroeconomic Indicators



Credit and Deposit Markets

In 2017, average pace of deposit growth slowed down from 8.3% in January to 4.1% in December. Deceleration was recorded for both corporates and households. Overall, the pace of loan growth was pretty stable around 4.5% YoY. Loans for individuals slowed in late 2017 owing to zloty appreciation but after excluding the FX effect growth remained stable at c.4% YoY. Mortgage credit (after FX adjustment) accelerated (to 3.5% y/y from 3% at the beginning of the year), with PLN-denominated loans rising 10.6% YoY in December. In 2017, consumer loans stabilised in 7.0-7.5% YoY range. As regards loans for companies, investment loans decelerated slightly (from over 16% YoY in the middle of the year to c.12.5% in December), while current loans accelerated from c.4.5% YoY in June to c.8.5% in December.

Financial Market Situation

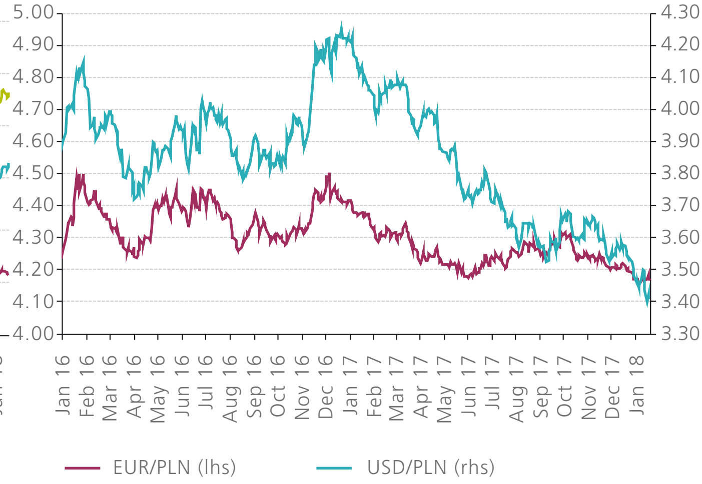
In 2017, global market sentiment was rather optimistic with investors' moods being driven by the following factors: (1) improving worldwide economic prospects and a stronger rebound of domestic economy (2) central bank actions, including the Federal Reserve, which increased interest rates three times in 2017 showing its confidence in strength of economic revival and positive outlook, and the European Central Bank, whose Governing Council cut the size of monthly bond purchases (3) geopolitical factors, including poor results of populist parties in French and Dutch elections which added some optimism to the markets.

Polish events have also had a noticeable impact on the zloty and bonds. Much faster than expected economic growth boosted the zloty and the improved fiscal situation in Poland (leading to lower borrowing needs) supported bonds. Downward trend of yields was also warranted by still dovish rhetoric of the MPC. The conflict of the Polish government with the European Commission about changes in the judiciary system and launching the procedure of Article 7 of the EU Treaty did not have any persistent impact on Polish assets. Robust economic performance and significant improvement in tax collection leading to much lower than planned budget deficit neutralized the negative impact of political uncertainty and in 2017 main rating agencies stopped suggesting that Poland's rating or its outlook could be downgraded. Agencies improved their economic and fiscal forecasts and Moody's lifted the outlook for Poland A2 rating to "stable" from "negative".

Bond yields fell in 1H17 and stayed in the horizontal trend later in the year. Bond curve steepened in 2017 as the short-term yields fell more (-27bp) than on the belly (-11bp) and the long end (-17bp). In the case of IRS, rates ended the year above 2016 closing – the 2Y IRS rose 12bp, 5Y rate by 13bp and 10Y IRS by 6bp. As a result, the asset swap spreads narrowed by 20-40bp. Other measures of risk premium also fell – the 10Y PL-DE bond yield spread dropped by 50bp and the 5Y CDS by 24bp. In 2017, the zloty was the second best performing EM currency vs the euro, dollar, franc and pound. During the past year, EUR/PLN fell by 5.7% (to 4.17 form 4.42), USD/PLN plummeted by 17% (to 3.48 from 4.18 with the key impact of rising EUR/USD), CHF/PLN eased by 13% (to 3.57 from 4.12, down trend being supported by rising EUR/CHF) and GBP/PLN by c. 10% (to 4.70 from 5.14 also thanks to pound depreciation on the global market amid uncertainty related to conditions under which the UK will leave the EU).

Yields of Polish Treasury Bonds (%)

Exchange Rate of the Zloty vs. Dollar and Euro



Stock Market

All stock market indices gained throughout 2017. Still, the benchmark WIG and WIG20 indices yielded 23% and 26%, respectively, which was only enough to make up for losses suffered in 2016 and stabilise at the levels reported two years ago. The mid-cap mWIG40 index made a good start to the year, but decelerated thereafter and closed at 15% up. The small-cap indices fared the worst: the sWIG80 grew by a mere 2.4%, mainly due to strong gains in December which offset the falls reported earlier in the year.

Trading on the Warsaw floor was stimulated by strong investor sentiment observed across global stock markets nearly throughout 2017. However, the inflow of capital to different market segments was rather selective, as confirmed by index readings presented above. A rise for equities was fuelled by an upswing in the Polish and global economies, benefiting not only the Warsaw Stock Exchange but also the Polish zloty, which hit a two-year high. The political situation in Poland had limited impact on the stock market despite social conflicts prevailing throughout the year. Low global risk aversion and expectations for positive outcome of tax reforms introduced by the new US president mitigated the impact of political tensions in the Middle East and the Korean Peninsula as well as further tightening of monetary policy by the US Federal Reserve.

Legal Environment of the Banking Sector

In 2017, the following legislation was ratified, which affected the banking sector in Poland:

Legal act	Effective date	Purpose	Selected regulations affecting the banking sector
Act on out-of-court settlement of consumer disputes	10.01.2017	• Transposition of the EU law on out-of-court settlement of consumer disputes into the Polish legislation.	• Out-of-court settlement proceedings are free of charge for consumers. • The President of the Office of Competition and Consumer Protection (UOKiK) monitors the activities of entities authorised to resolve consumer disputes out of court.
Act of 15 December 2016 on changes to the Code of Civil Proceedings and certain other acts	18.01.2017	• Implementation of the Regulation of the European Parliament and of the Council establishing a European account preservation order procedure. • Facilitation of cross-border debt recovery in civil and commercial matters.	• European account preservation orders issued by EU members states may be used in Poland to instigate enforcement proceedings. • At the request of the Minister of Justice, banks are obliged to disclose information protected by the banking secrecy clause to the extent necessary to apply the European account preservation order procedure.
Regulation of the Minister of Economic Development and Finance of 6 March 2017 on the risk management system and the internal control system, remuneration policy and detailed method of internal capital estimation in banks.	1.05.2017	• Transposition of further provisions of the CRD IV (including new limitations on the award and payment of variable remuneration to material risk takers). • Implementation of the EBA guidelines on sound remuneration policies.	• The regulation addresses the following issues: – risk management system – remuneration policy – internal control system – confidential reporting of breaches of laws, procedures and ethical standards applicable at the bank – estimation and maintenance of internal capital – liquidity and funding risk management
Act of 23 March 2017 on changes to the Penal Code and certain other acts	27.04.2017	• Amendments to the Banking Law improving the effectiveness of mechanisms used to deprive offenders of the proceeds of crime.	• Changes were implemented to enable institutions indicated in Article 105 of the Banking Act to request information necessary to counteract money laundering and terrorist financing under a simplified procedure. • Prosecutors are authorised to freeze certain transactions or funds in bank accounts.
Act of 9 March 2017 on exchange of tax information with other countries	4.04.2017	• Transposition of the EU directive on mandatory automatic exchange of tax information into the Polish legislation. • Introduction of regulations enabling automatic exchange of tax information with countries other than EU member states based on the Common Reporting Standard (CRS).	• Banks are identified as reporting institutions and as such are required to follow: – due diligence rules – i.e. to identify reportable accounts (depository and custodial accounts) held by tax residents in countries which have an agreement with Poland or EU on automatic exchange of information about reportable accounts; – reporting rules – i.e. to provide account information to the head of the National Revenue Administration for a calendar year;
Act of 23 March 2017 on mortgage loans and supervision over mortgage loan brokers and agents	22.07.2017	• The Act: – transposes the EU directive with respect to the principles of marketing, offering and taking out mortgage loans; – establishes the rules and procedure for executing mortgage loan agreements as well as rights and obligations of a mortgage lender and broker/agent in relation to the provision of pre- contractual information and rights and obligations of a consumer, lender and broker/agent in relation to the post- contractual stage.	• A mortgage loan is exclusively granted in a currency of the majority of the customer's income. • Tying practices are forbidden, however cross-selling is permitted. • Customers have a right to early repayment (in whole or in part) during the term of the agreement. • Pre-contractual information obligations of banks/brokers to customers have been defined. • Detailed procedures for granting mortgage loans and concluding mortgage loan agreements have been established. • All employees involved in mortgage lending are required to complete mandatory training and take an exam.
Act of 21 April 2017 on claims in respect of a loss or damage arising from competition law infringements	27.06.2017	• Definition of the liability for a loss or damage arising from the infringement of competition law and claims for damages as part of civil law proceedings.	• The act generally applies to claims in respect of competition infringement committed after the date the legislation entered into force, however, it may also apply, to a limited extent, to actions taken after the effective date and relating to anti-competitive practices from before the effective date. • A final decision of the Office of Competition and Consumer Protection (UOKiK) or the court declaring a practice as restricting competition is binding upon the court in a civil law action for damages.
Act of 30 November 2016 amending the Payment Services Act and certain other acts	8.02.2017 (for the majority of provisions)	• Transposition of the Regulation of the European Parliament and of the Council on interchange fees for card-based payment transactions and the Directive on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features. • Increase in the level of banking inclusion through improving consumer choice and increasing the quality and transparency of the offers.	• Banks are required to implement certain obligations by 8 August 2018 (including access to payment accounts with basic features, account switching, provision of the fee information document before entering into an agreement on services linked to a payment account and statement of fees for linked services).

IV. Development Strategy

1. Mission, Vision, Values and Strategic Objectives for 2018-2020

Strategy of Bank Zachodni WBK and Non-Banking Subsidiaries

In view of dynamic and complex changes in the macroeconomic environment, the strategy of Bank Zachodni WBK Group is regularly verified, which helps to take prompt action in response to emerging market trends. The updated (in 2017) three-year strategy for 2018–2020 is focused on the bank's transformation, in particular: commercial transformation, business model transformation, digital transformation, CRM content management and centralised data management. Most importantly, the new strategy is a continuation of the previous course of action, based on the same values and assumptions. It promotes customer-centric culture in business management, excellent customer service and product range, operational effectiveness, simple, clear and innovative solutions, and corporate culture that reinforces employees' engagement and motivation. The above measures are expected to help the bank achieve the position of the best financial institution for retail and corporate customers and the best employer in the banking market.

BZ WBK Values

Mission	To help people and businesses prosper.
Vision	To be the best retail and commercial bank, and earn the lasting loyalty of people, customers, shareholders and communities.
Values	Simple, Personal and Fair.
Behaviours	Show respect, truly listen, talk straight, keep promises, bring passion, actively collaborate, support people and embrace change.

As part of its strategic vision, Bank Zachodni WBK intends to:

- Become a leading bank in terms of service quality, focusing on customer needs and expectations;
- Anticipate and respond to customers' needs with tailored products, services and solutions;
- Build long-term relationships with customers based on trust, loyalty and enhanced customer experience;
- Modernise banking services through digital transformation, including end-to-end processes and changes to the operating model towards a more effective and less capital-intensive one;

- Create an engaging work environment through collaboration, communication and bottom-up initiatives raised in all the bank's units;
- Grow faster than peers;
- Become the best retail and commercial bank earning the lasting loyalty of people, customers, shareholders and communities.

The bank's mission and vision are reflected in specific measures taken with respect to the key stakeholder groups. Below are the objectives of Bank Zachodni WBK Group for 2017-2019 which are focused on employees, customers, communities and shareholders.

1. People

- ...be **top 1 employer**
- ...have strong internal culture **Simple | Personal | Fair**

2. Customers

- ...significantly **outperform the banking sector**
- ...**simplify and transform our channel proposition**
- ...develop **the best modern bank** proposition and customer experience
- ... grow our market **share** to **11%**
- ...materially **increase activity per loyal customer**

... a bank that strives to be **Simple | Personal | Fair** helping individuals and businesses prosper

3. Communities

- ...be renowned as a **local community bank**
- ... develop cooperation within **Santander Universidades**

4. Shareholders

- ...be the **best governed** and **stable bank**
- ...earn sustainable **superior returns for** our **shareholders**

The corporate culture of Bank Zachodni WBK Group and Banco Santander Group is enshrined in the Simple, Personal and Fair values.

Simple

Products and services are tailored to customers' needs and expectations and based on easy-to-understand and uncomplicated solutions.

Fair

Employees treat others the way they would like to be treated themselves. Banking business is conducted in a transparent and compliant manner.

Personal

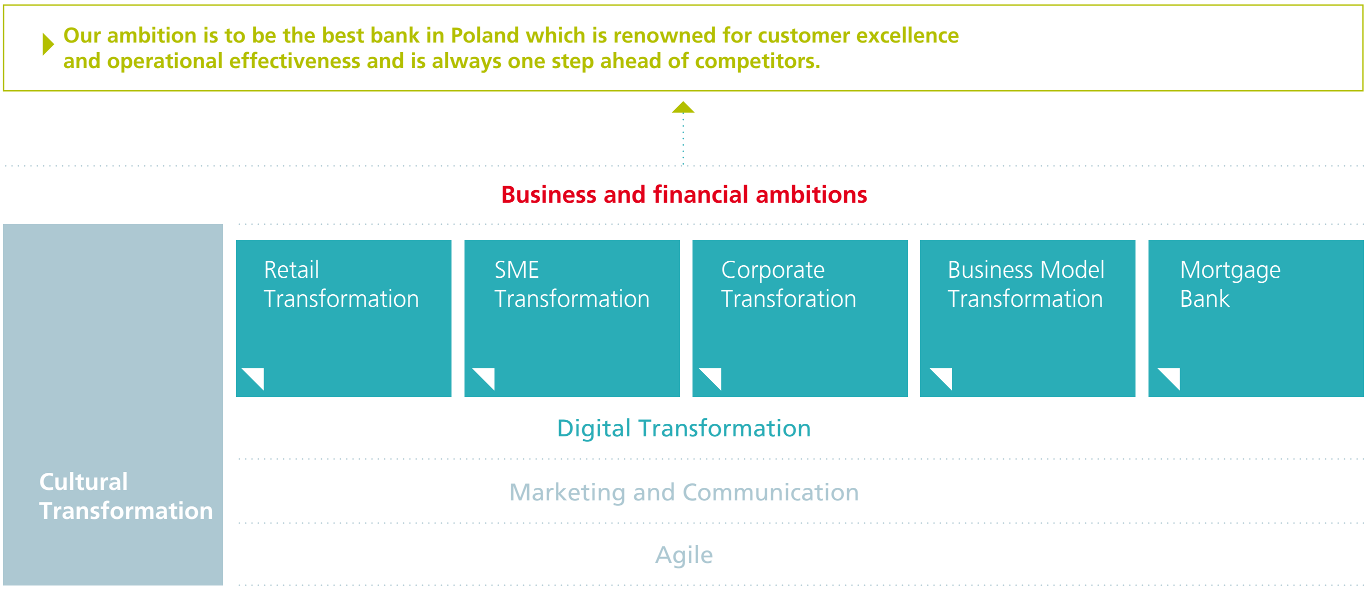
Customer relationships are built on solid foundations, taking a long-term perspective. Customers are provided with tailored products and personalised services.

General assumptions of the financial plan for 2018-2020:

- Increase in recurring net profit;
- Positive growth trends in interest and fee income;
- Cost management discipline resulting in reduction of the cost to income ratio;
- Improvement of the credit portfolio quality;
- Slower increase in the average risk weighted assets compared with loans and advances.

2. Key Strategic Programmes of Bank Zachodni WBK

Transformation of the Bank



The strategic transformation covers a number of strategic programmes, including in particular:

- Commercial transformation

  Commercial transformation covers the area of Retail, SME, and Business and Corporate Banking. It is focused on the development of a business model that will ensure positive customer experience, help simplify products and support optimisation of processes and pricing policies and the new distribution strategy. In 2017, the bank elaborated a new customer segmentation and a new branch model for Retail Banking, which will be implemented in 2018. It also modified the distribution model for larger entities from the SME segment. Furthermore, a number of improvements were made in the credit process, both for SME and corporate customers.

- Business model transformation

  The business model transformation is primarily focused on increasing the effectiveness of the organisation. To that end, the bank controls investments and expenses, optimises property and branch network management, streamlines the organisational structure, eliminates duplicated functions, leverages synergies between different areas, and estimates and monitors the benefits of transformation.

- Digital transformation

  The digital transformation programme covers initiatives taken to improve customer service and develop end-to-end solutions which will be available to customers in all channels, anytime and anywhere. As part of the programme, the bank streamlines the processes to suit customers' needs, offers remote solutions for new products, extends the scope of after-sales services and develops new tools for customer advisors, including CRM development using Business Intelligence tools.

- Digitalisation of processes

  In 2017, the Account As I Want It was implemented, with an innovative functionality whereby customers can select and customise the features they wish to use. A new end-to-end credit process was put in place for sole traders by which they can apply for and obtain a loan online. In some locations, corporate customers can now use a system which automates the credit process from start to finish and thus reduces the turnaround time. Work continues on a new credit process, automation of remote after-sales processes and further extension of the features available within the Account As I Want It.

  - Development of internet, mobile and telephone banking

    In 2017, the bank introduced a number of customer-friendly solutions in the area of internet, mobile and telephone banking. Further credit facilities were made available for sale in the mobile channel. A quick account overview functionality was introduced and a more ergonomic and efficient application was put in place. Payment card management services were introduced, including push alerts and a card cancellation option. New products were made available in the internet banking channel, and a new mailbox and after-sales forms for credit facilities were implemented. The bank also introduced an option of opening accounts online via video verification, an innovative solution in the Polish market.

  - CRM development programme

    To ensure more effective communication with customers about the offers prepared for them, as part of the CRM Development Programme a new functionality was implemented for sending pre-defined text messages and e-mails directly from the CRM system. Customer advisors were provided with a wide range of offers generated at regular intervals. Advanced analytical models used by the bank helped to tailor the products and services to particular customers' needs.

  - Development of iBiznes24 platform

    The purpose of this programme is to transform the iBiznes24 platform into a leading platform for corporate customers. To that end, three applications are being currently developed: iBiznes24 internet, iBiznes24 mobile and iBiznes24 connect. In 2017, a number of functionalities were implemented to facilitate the use of the platform, specifically with regard to transaction approval, sign-on, helpdesk contact and a new application design. At the same time, work is underway to maintain the highest security standards.

  - Development of insurance (4Sure)

4Sure is a strategic programme designed to support insurance development to promote the sales of insurance to retail and SME customers, increase the share of digital channels in insurance sales and improve customer satisfaction with insurance solutions. In 2017, the bank introduced a new offer of the Locum household insurance in all distribution channels, and a new Plan B insurance in the Multichannel Communication Centre.

- Communication and marketing

  Marketing and communication are expected to strengthen the bank's brand through new messages based on values and emotions. In this context, in 2017 the bank introduced its new brand promise: "You Bank As You Want It" ("Bankujesz jak chcesz").

- Cultural transformation

  The cultural transformation that is currently taking place in the organisation is fundamental to the success of all changes introduced by the bank. It covers such aspects as:

  - enhancement of leadership skills and development of staff and teams;
  - delivery of strategic goals and performance of day-to-day tasks in line with the Simple, Personal and Fair values;
  - increase in employee engagement and delivery of employer branding initiatives.

- Mortgage Bank

The purpose of the initiative is to set up the Mortgage Bank as a separate entity within Bank Zachodni WBK Group specialising in mortgage loans.

- Agile Transformation

The market environment and customer requirements are changing rapidly. To be able to keep abreast of and respond to those changes, in 2017 the bank started implementation of a new working model in accordance with the Agile methodology. The transformation towards agile cooperation methods is expected to expedite the time-to-market, facilitate the search for and testing of new innovative solutions and increase customer satisfaction. The new methodology will entail modification of the existing operating models with a departure from complex structures in favour of small, cross-functional teams with a sound understanding of customer needs and a capability of fast and effective delivery of new solutions.

The implementation of particular change programmes is supervised by the Strategic Transformation Office, which reports to the President of the Management Board and the Chairman of the Supervisory Board.

Strategy of Santander Consumer Bank

The key strategic goal of Santander Consumer Bank for 2018-2020 is to strengthen the position and image of the bank as an innovative, secure and customer-friendly financial institution with a strong capital base, structure and corporate culture harmonised with Santander Group and a leading position in the consumer finance market.

The strategy of SCB can be summarised as follows:

Car finance	Improve the range of products and services and achieve a dynamic growth of the lease business Ensure a stable growth in the volume of new car finance by increasing the number of active dealers Achieve a dynamic growth in the volume of second hand car finance through remote distribution channels and a dedicated sales network Acquire new partners and continue the cooperation with PSA companies
Consumer finance	Maintain high volume of cash loans and expand the range of products and services for new profile customers Ensure a stable volume of instalment loans, while reducing the share of sales in lower profitability channels Develop online sales of cash loans and instalment loans Increase sales of co-branded cards to new customers Develop mobile payments and e-commerce solutions Enter the DIY sector with the instalment loan proposition Develop digital business
Funding sources	Ensure a stable deposit base Finance working capital requirements through the issue of own securities and securitisation Ensure a diversified structure of funding Maintain LCR > 100%
IT and operations	Provide IT support for development of distribution channels, in particular remote ones Develop infrastructure and mobile technologies Optimise and streamline processes
Risk, cost and financial management and other areas	Maintain stable risk level, including steady non-performing loans ratio and high provision coverage ratio Achieve operational excellence: optimise branch structure, relocate the Contact Centre, review the scope of control Deliver the digitisation project in the following areas: DIGI business, DIGI process, DIGI support Monitor key profitability and growth indicators Maintain secure capital position in line with the CRR and regulatory requirements

V. Human Resources and Corporate Culture

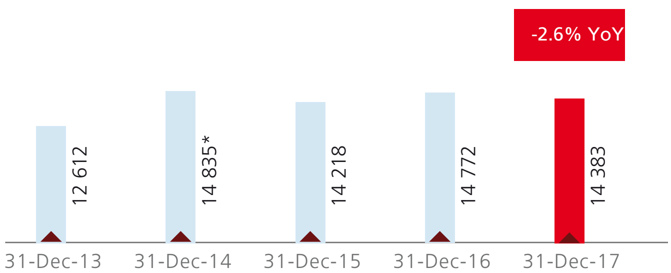
1. Human Resources Management

Human Resources

As at 31 December 2017, the number of FTEs in Bank Zachodni WBK Group was 14,383 vs. 14,772 as at 31 December 2016. These headcount figures include 11,291 FTEs of Bank Zachodni WBK (11,733 as at 31 December 2016) and 2,664 FTEs of SCB Group (2,637 as at 31 December 2016).

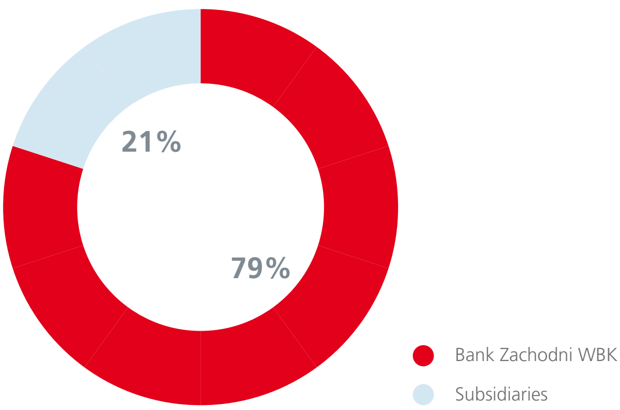
The YoY decrease in employment levels in BZ WBK Group (down 389 FTEs) is attributable to the ongoing transformation of Bank Zachodni WBK business model with a view to increasing the share of new technologies, the dynamic development of remote distribution channels, and the gradual migration of customers to new solutions. In line with these business development directions, branch banking headcount was gradually reduced, while selected business support functions were strengthened. All changes leveraged the natural staff turnover to the largest possible extent, recognising business needs and prevailing market conditions.

Employment in BZ WBK Group in 2013-2017 (in FTEs)



** Includes employees of SCB Group for the first time as a result of the acquisition of a controlling stake in SCB on 1 July 2014*

Employment Structure in BZ WBK Group as at 31.12.2017



Human Resources Management Strategy

The strategy of the Business Partnership Division in charge of human resources management includes the following mission statement and objectives:

Mission of the Business Partnership Division:

The mission of the Business Partnership Divsion is to create a distinctive corporate culture that promotes the **Simple | Personal | Fair** values.

Objectives of the Business Partnership Division:

The objective is to strengthen the bank's image as an employer of choice through recruiting best qualified employees (in compliance with the needs of respective units), creating positive employee experience at each stage of their professional life, supporting staff development and creating a friendly work environment.

The Business Partnership Division builds an engaging work environment and enhances employee experience based on:

- a corporate culture that promotes Simple, Personal and Fair values and behaviours;
- a clear and competitive remuneration policy which rewards staff knowledge, experience, competence and behaviour, as well as effective incentive schemes and additional benefits;
- the successful delivery of HR commitments, including personnel and payroll services, financial obligations towards staff and regulators;
- the development of employee relationships through effective intervention and analysis of circumstances, preventive actions and education aimed at promoting ethical behaviours across the organisation;
- employer branding initiatives including employer value proposition that is consistent with the perception of the bank by existing employees;
- effective recruitment models and induction programmes aimed at different employee groups;
- the development of managers and specialists on the basis of development models, career paths, etc.;
- ensuring the continuity of knowledge and talent management by designing succession plans and delivering development plans;
- contribution to the development of a customer-centric approach.

The position of the best banking institution in Poland is to be achieved through the strengthening of leadership and corporate culture transformation.

The bank promotes a leadership model that is based on corporate values, leading by example and the development of the leaders' skills. Corporate culture transformation, which underpins all changes implemented in the bank, supports employer branding initiatives (both inside and outside the organisation) as well as staff development and engagement. The effectiveness in both of these areas has positive effect on employee experience and helps create an engaging work environment.

Employer branding

- The employer branding initiatives are aimed at ensuring a steady inflow of talented people to Bank Zachodni WBK.
- The model for recruitment and induction of new employees is continuously adapted to the changing environment.

Engagement

- The bank is committed to increasing the engagement of its employees by catering to their needs at each stage of their professional life.
- The processes connected with recruitment, induction, development, training and termination of employment are improved on an ongoing basis.
- An engagement survey is held each year to examine the level of employee engagement, identify trends and accelerate improvements.

Development

- The bank focuses on training and development initiatives for experts and managers (such as management by objectives, 270° and 360° surveys, development options ('cafeteria scheme'), talent management programmes and training activities).

HR Policy

Recruitment

Bank Zachodni WBK recruits new employees both internally and externally using methods and sources which are relevant to existing vacancies, including internal recruitment processes, the Referrals Programme, external service providers, specialised social media, practical training and internships, career fairs, events organised by universities, science clubs and career services. The bank's employees have precedence over other candidates in the internal recruitment processes at Bank Zachodni WBK and SCB Group companies, which increases their development opportunities and helps build individual career paths. The candidate profiles are checked to see if they meet the required job criteria in terms of their competence, experience, knowledge, motivation, personality and compatibility with the organisational culture. All persons involved in the recruitment process must comply with business ethics principles arising from the Labour Code and internal policies, in particular with regard to confidentiality and non-discrimination regulations.

The BZ WBK Referrals Programme engages employees in the recruitment process as it provides an opportunity to recommend candidates for upcoming job vacancies in the bank. This system helps to reach a wider group of prospective employees who have relevant skills, aptitude and motivation, and are interested in taking up a role at the bank.

The recruitment process is additionally supported by the Practical Training and Internship Programme run in cooperation with universities across Poland, which is designed to recruit young, qualified and talented individuals.

Performance Management

In January 2017, a new objectives management process was put in place to support staff development and promote behaviours in accordance with the bank's Simple I Personal I Fair values. The process allows for greater flexibility (as the objectives can be modified along the way) and for communication efficiency (as it facilitates communication between employees and their line managers due to more frequent meetings, regular feedback, and support of the HRup! System). In the new model individual performance (assessed in two dimensions: WHAT and HOW) is closely related to the bonus level. The launch of the new process and the IT tool was preceded by extensive preparations which included workshops for all managers.

Remuneration and Incentive System

Pursuant to the Resolutions of the Management Board (74/2017 of 20 April 2017) and the Supervisory Board (41/2017 of 17 May 2017), a new BZ WBK Group Remuneration Policy was introduced. The policy covers all employees of the bank and its subsidiaries, including managers and members of the Management Board. The policy is consistent with the remuneration policy of Santander Group, the EBA guidelines on sound remuneration policies (EBA/GL/2015/22), the Regulation of the Minister of Economic Development and Finance dated 6 March 2017 on the risk management system and the internal control system, remuneration policy and a detailed method of internal capital estimation in banks (Journal of Laws of 6 March 2017, item 637).

The new policy covers, among other things, bonus regulations for sales staff, identification and bonus regulations for material risk takers, remuneration for employees of control units, and the application of malus clauses (the identification, assessment and ex-post adjustment to variable remuneration payable to material risk takers of the Group).

The Remuneration Policy of Bank Zachodni WBK Group has been established taking into account the interests of key stakeholders: shareholders, employees, customers and local communities. It promotes behaviours that reflect corporate values.

Base Salary

The key component of remuneration at Bank Zachodni WBK is the base salary, which is determined on the basis of the role performed, area of responsibility, and qualifications and experience. In its approach to job valuation, the bank uses best market practices to ensure competitiveness of remuneration. In response to dynamic changes in the labour market, the bank's remuneration system is periodically revised in terms of the approach to job families, reference levels and dispersion, using the payroll reports supplied by leading advisory companies and data published by the Central Statistical Office (GUS). The last comprehensive review of base salaries took place in 2016, leading to adjustment to the salaries of BZ WBK as of 1 December 2016.

Material risk takers are subject to a remuneration policy containing provisions which do not differ from the regulations applicable to other staff members.

Variable Components of Remuneration

The bonus schemes adopted by the bank enhance staff motivation and support the delivery of strategic objectives set by the organisation. Such schemes are linked to the results of the bank, respective units and individual employees whose performance, delivery of objectives, behaviour and engagement are reviewed on a regular basis.

Variable remuneration depends on a bonus scheme relevant to a given employee (including bonus regulations for branch employees and Business Support Centre employees). Individual bonus schemes differ in terms of eligibility criteria, the bonus amount and payment frequency. Bonus payment is conditional upon the delivery of specific financial objectives (a stated gross or net profit growth rate or amount) and quality targets.

Incentive programmes for the company's management board members and its key managers make their reward dependent on assessment of the company's long-term financial position, long-term growth in shareholder value, stability of the company's operations and risk appetite. In accordance with KNF guidelines, at least 50% of variable remuneration is paid in the form of phantom shares. In addition, 40% of variable remuneration is deferred for a period of three years, and payment of each deferred portion is possible only when no adverse events occur which would prevent the disbursement or trigger a reduction in the amount payable.

Variable remuneration components also include long-term (three-year) incentive programmes addressed to key employees of the bank. The award is granted in the form of new issue of BZ WBK shares provided that certain business criteria defined in the terms of the programme have been met (for more information, see section "Governing Bodies", Chapter XI "Statement on Corporate Governance in 2017").

The base and variable remuneration policy adopted by Bank Zachodni WBK also applies to the bank's subsidiaries.

In 2017, incentive schemes for sales functions were reviewed in terms of business efficiency and compliance with regulatory requirements.

The Group also offers additional benefits to meet with employees' needs such as: healthcare packages and a cafeteria system which provides a wide range of cultural, sports and tourism benefits. In 2017, Bank Zachodni WBK was awarded for the Best Benefits Strategy 2017 in a competition for the most interesting and effective strategy to offer non-cash benefits to employees in which the bank competed against some of the largest global corporations operating in Poland.

Delivery of the HR Policy in 2017

In 2017, Bank Zachodni WBK consistently implemented its strategy focused on key processes in the employee's professional life cycle. The most important activities shown below.

Talent management focused on developing the bank's intellectual and expert potential

Modifications of the recruitment model

In 2017, the bank focused on acquiring talent with a new profile, i.e. better prepared to deal with such market challenges as volatility, digitalisation and robotisation. The actions were supported by the new recruitment model for the bank's distribution network. The effectiveness of the recruitment campaigns held in 2017 was enhanced by the initiatives which promoted the bank's image as an employer (participation in 20 labour fairs), social media activity (LinkedIn), programmes targeted at selected candidate groups (e.g. the "Do IT at BZ WBK Programme" addressed to IT students, with workshops at universities facilitated by bank technology experts, as well as a unique programme of internships). One of the objectives for 2018 will be to reach new segments of candidates (50+, graduates of technical schools, persons without banking experience).

Staff development at all levels

In 2017, a flexible catalogue of development proposals was developed to suit the bank's business needs. Training programmes were addressed to individual employee groups:

- For the first time, the whole management was covered by the 360° skills assessment. A development programme was implemented for the highest management level ("Strategic Leadership. Direction. Influence. Authority"), and development programmes were carried out in response to the needs and requirements of individual divisions (e.g. the "Leader driving engagement" for the Global Corporate Banking and "Armada" for the Business and Corporate Banking Division).
- In March 2017, the bank launched another edition of the programme for the newly appointed managers. This consisted of several workshop and training modules (including tele-workshops and e-learning courses). The process of induction into the role of manager involved our HR Business Partners, line managers and local professional mentors.
- Individual employee groups were involved in talent programmes, including: "Become an Advisor with a Portfolio", "Be a Transformation Leader", "Be a Branch Manager" and "Managing Teams of Leaders". A comprehensive Advisor Skills Matrix was implemented in the branch network, the first such initiative in the bank's history, supported by our 270° skills assessment for advisors at all branches.

Increasing the efficiency of back office processes

Digitalisation of HR processes

In 2017, all HR processes (including holiday planning, work time management or a workflow for HR decision-making processes), were reviewed and the concept of their digitalisation was developed. Digitalisation will gradually cover more processes, such as payroll, work model, e-file or e-signature).

Building a positive employer image inside and outside the organisation

Recognition for colleagues

In order to increase employee motivation and strengthen the corporate culture, in 2017 the bank launched the StarmeUp platform whereby employees of all units can express recognition for their colleagues for behaviour and attitudes conforming to the bank's values. The most recognised employees will be invited to meetings with the President or members of the Management Board. By the end of December 2017, 67% of the employees used the platform.

A wide array of additional services

Employee benefits

The bank provides a broad range of benefits available to all employees and adapted to their needs. These include, for example, a comprehensive medical service plan, a cafeteria system (ensuring access to many cultural, sports and leisure events and benefits), life insurance, discount schemes and financial aid in fortuitous events. The bank also regularly organises the "Banker's Hike", its signature initiative as part of which employees and their families can travel to different places in Poland and abroad. In 2017, nearly 2000 people took part in the hike.

Support for employees to maintain a work-life balance and lead a healthy lifestyle

Work time

In 2017, employees were trained in work time management. Holiday leave usage was regularly tracked by means of a new holiday planning and monitoring tool.

Health-related initiatives

2017 was the second year in which the bank continued its "Be Healthy" Programme with a number of interesting initiatives promoting healthy lifestyle, including appointments with doctors at the company, webinars with experts, and articles on healthy diet, ergonomics and active leisure. The BZ WBK Runners Team and BZ WBK Bike Team represent the bank in competitions held in the country and abroad.

Annual BZ WBK Group staff engagement survey

Staff Engagement Survey

Each year a survey is carried out to gauge engagement of the employees of Bank Zachodni WBK Group. The survey results, in particular the improvement areas identified by employees, constitute valuable feedback for team managers. In 2017, the bank put in place a new platform for analysing the results. Out of the 89% of the employees who participated in the survey:

85% think highly of their leaders' management skills and appreciate clear and regular feedback from their direct supervisors and trust-based relationships;

98% admit that BZ WBK expects top performance from its staff;

94% understand risks they face in their day-to-day work and feel personally accountable for their management;

85% know the Group's strategic objectives and have a perfect understanding of what it means to be a bank which is Simple I Personal I Fair.

2. Development and Training

The Business Partnership Division provides development programmes and business-as-usual training to support the development of employees and management, and in this way contribute to the delivery of the bank's strategic goals and key business projects. The development and training model provides mutual benefits: it improves the bank's performance while responding to employees' career development needs.

The bank's development activities carried out in 2017 are presented in the section: "Delivery of the HR Policy in 2017".

Training Activity

In 2017, the number of registered training attendees totalled 219k, of whom 10.3% took part in workshops and the rest participated in remote learning courses.

Advisors from the branch network took part in mandatory training resulting from regulatory requirements and in customer service quality courses. They worked on their skills of selling selected products of the bank and the Group, in line with the needs identified in individual customer segments. Sales force training focused on insurance products (Premium, Retail and SME Advisors), investment products (Premium and Retail Advisors); business loans (courses preparing SME Advisors for certification at three advancement levels) and mortgage loans (Mortgage Advisors). In addition, VIP Advisors were trained on how to achieve high satisfaction levels with VIP clients, conduct negotiations and provide financial advisory services based on the European Financial Advisor EFPA EFA III certificate.

In 2017, branch network managers were able to improve their managerial skills as part of quality licences, with a particular focus on telephone conversation skills. In macroregions, workshops were organised and devoted to team building and strengthening the bank's values.

Training initiatives for the Business Support Centre were delivered in two streams, i.e.:

- Training required by law and supporting the strategic initiatives of the bank, including PSD2, MIFID II, MIFIR II, safety at work, first aid, security, changes in the Civil Code, prevention of money laundering, the Personal Data Protection Act and Payment Services Act.
- Specialist training supporting individual needs within particular divisions, including risk analysis, property valuation, audit, expertise and product knowledge development, management and interpersonal skills. Employees refined their skills by learning new teamwork or project management methodologies, including design thinking and Agile management.

3. Business Ethics

Bank Zachodni WBK is committed to maintaining high ethical standards in its relationship with shareholders, customers and employees. Integrity, fairness and honesty are fundamental elements of the Group's corporate culture.

The binding General Code of Conduct establishes standards and promotes attitude and behaviour that is compliant with the values "Simple, Personal and Fair". It provides a set of guidelines for all employees, irrespective of their role in the organisation.

Ethical values promoted by the Group's General Code of Conduct

Equal opportunities	Respect	Work-life balance	Health and safety at work	Environmental protection and social responsibility	Collective employee rights

Attitudes promoted among employees

Compliance with law, external and internal regulations, ethical standards and social responsibility rules	No competition	Responsibility (professionalism)	Engagement (acting in the Group's best interest)

The code of standards is complemented with regulations concerning specific areas: Code of Conduct in the Securities Markets, General Conflict of Interest Policy, Anti-Money Laundering Policy, Personal Data Protection Policy and the Anti-Corruption Programme.

The Group continually develops tools and resources to be able to minimise the occurrence and materialisation of legal liability risk arising from its operations. The Corporate Defence Model adopted in this respect is a set of internal rules aimed at mitigating this type of risk.

In order to protect its reputation, the bank continues to deliver the ethics and compliance e-learning programme (COMET), which has become a constant element of the staff training system. Ethical and reputational issues are also incorporated in the RiskPro campaign that promotes risk culture across the organisation.

In 2017, a reputational risk management model was implemented as an integral part of the bank's risk management framework. Reputational risk drivers are now effectively monitored and managed.

The bank consistently promotes the idea of an open dialogue with employees and provides them with special communication channels whereby they can report any breaches of the General Code of Conduct or other issues and concerns they have, also anonymously. In addition to etyka@bzwbk.pl mailbox, employees may use two helplines to report ethical or employment-related issues, respectively. In relation to the Dignity at Work Policy, the bank implemented an operating procedure establishing step-by-step instructions to be followed in connection with reports made by employees.

4. Corporate Social Responsibility of Bank Zachodni WBK

Key Assumptions of BZ WBK Sustainability (CSR) Policy

Corporate social responsibility initiatives undertaken by the bank are governed by the Sustainability (CSR) Policy which addresses key matters in this respect. It is complemented by a range of social and environmental policies. Bank Zachodni WBK recognises that customers are fundamental to its business and endeavours to support the communities it operates in to the largest possible extent. The bank has a major impact on its environment, therefore it has identified a number of areas where it can make a positive contribution. The main objectives are: to support education; to build a civil society; to promote equality of opportunity; to prevent social exclusion. The measures taken by the bank respond to the biggest challenges of the modern world and reflect the global Sustainable Development Goals set by the United Nations in 2015. The bank endeavours to ensure that its activities bring real benefits to local communities and contribute to social and economic development of individual regions and the country as a whole.

CSR PRIORITIES FOR BANK ZACHODNI WBK

Communities	Contribution to social and economic development of local communities through investments in education, support of social initiatives and promotion of equal opportunities.
Customers	Building trust and long-term relationships based on dialogue, customised products and services and responsible sales.
Shareholders and the market	Maintenance of a dynamic growth and responsible risk management. Transparency of information and creation of a long-term value for shareholders.
Employees, suppliers and business partners	Creation of a corporate culture based on the Simple, Personal, Fair values, focusing on collaboration, dialogue, bottom-up initiatives, respect for diversity and environmental protection.

Key Initiatives in 2017

Initiative	Measures
Sponsorship projects in 2017	For many years now, culture and education have been the main priorities of the bank's sponsorship initiatives. The bank is focused on long-term projects which can be associated with the bank's brand and facilitate communication and relationship building activities aimed at employees and customers alike.
Santander Orchestra Academy	The project was launched in 2015 by MyWay Foundation, the Krzysztof Penderecki European Centre for Music and Bank Zachodni WBK. In 2017, the third edition was held in the form of Santander Orchestra Academy, combining musical workshops with additional initiatives for young musicians entering the labour market. The participants had the opportunity to practise their musical skills as well as get an insight into issues that are key to their career, such as public relations, social media or copyright law. 125 musicians – students and graduates from Polish universities – took part in the workshops and lectures held between 30 September and 17 December 2017.
"How's Your Driving" ("Jak Jeździsz")	In 2015, the bank launched an educational project called "How's Your Driving" ("Jak Jeździsz") in order to broaden the knowledge of traffic rules and promote responsible and safe driving, particularly among young people. The project is delivered in cooperation with Kuba Giermaziak, a racing driver, and addresses such issues as driving etiquette, roundabout rules and first aid. An integral part of the project is extensive communication with the market, customers and employees. Over two years, the number of project fans in social media reached 85 thousand. Interactive quizzes and competitions on safe driving each time attracted several thousand web users. In order to reach local communities, in 2017 the bank extended the scope of the project and launched cooperation with a new partner – a local road traffic centre in Warsaw (WORD). Five thousand trainees participated in a three-month educational initiative organised by the Bank and WORD at three driving test centres in Warsaw. Other educational activities undertaken as part of the project in different locations across Poland attracted approximately. 700 customers and employees of the bank. Each month, three thousand BZ WBK employees received a newsletter with educational materials about safe driving.
BZ WBK Press Photo	In 2017, the bank organised the 13th edition of the BZ WBK Press Photo competition held since 2005. The objective of the competition is to reward the most talented photographers, many of whom have already been awarded. The competition attracted nearly eight thousand entries from a record number of 500 Polish press photographers. The panel awarded 149 photos in six categories: events, everyday life, society, culture and art, sports and nature. As each year, award-winning photos were shown at 15 exhibitions held in local culture centres across Poland. All those interested in photography could also attend the meetings with the winners or develop their skills during free two-day workshops, which attracted more than 300 people in the period from May to December 2017.
National Museum in Wrocław	The bank was a patron of the exhibition called "Fashion for Cranach" ("Moda na Cranacha") held by the National Museum in Wrocław between 31 October and 30 December 2017. The exhibition included art works of the Reformation period in Wrocław and the Silesia to commemorate the 500th anniversary of the year Martin Luther made his 95 Theses known to the world. One of the highlights were drawings from the 16th century which had not been exhibited before. The exhibition was accompanied by a series of lectures, workshops for children and curator tours. During two months, the exhibition was visited by around 30 thousand people.

Bank Zachodni WBK Foundation

A large number of CRS initiatives are undertaken by Bank Zachodni WBK through its Foundation, which was set up 20 years ago. The Foundation delivers grant programmes for youth organisations. As part of the last year's edition of the "Bank of Ambitious Youth" programme ("Bank Ambitnej Młodzieży"), the bank granted PLN 300k for 41 initiatives. Furthermore, in 2017 the Bank Zachodni WBK Foundation provided support to local communities as part of the third edition of the "Here I live here I make changes" competition ("Tu mieszkam, tu zmieniam"), granting PLN 500k to 100 organisations. A new grant programme called "The Bank of Young Sports Champions" ("Bank Młodych Mistrzów Sportu") was launched to promote sports and fair play. A total of PLN 300k was granted to 60 organisations. The overall support under the grant programmes totalled PLN 1.1m and was provided to 201 organisations.

Since 2010, Bank Zachodni WBK Foundation has supported the corporate volunteering initiatives at the bank. In 2017, more than 100 social projects were initiated and delivered by the bank's employees. They included initiatives to help people in need as well as educational workshops for children, young people or the elderly.

In 2017, an online platform was launched for volunteers to facilitate the planning and delivery of volunteering activities. Each employee of the bank may register as a new volunteer, choose a volunteering activity, propose their own initiative or join the existing one, as well as settle their project upon completion.

Market Communication on CSR

In July 2017, Bank Zachodni WBK published the fourth CSR Report for 2016, which had been prepared in accordance with GRI (Global Reporting Initiative) Guidelines 4.0. The report won three awards in the CSR Report Competition – from journalists, web users and the voting panel. The report was available online at www.bzwbk.pl/ms/csr.

The bank's commitment to corporate social responsibility is confirmed by its inclusion in the Respect Index of Poland's socially responsible companies.

In 2017, the bank was also awarded with CSR Golden Leaf by Polityka magazine and was the only company from the financial sector which was ranked top in the 11th Responsible Company Ranking.

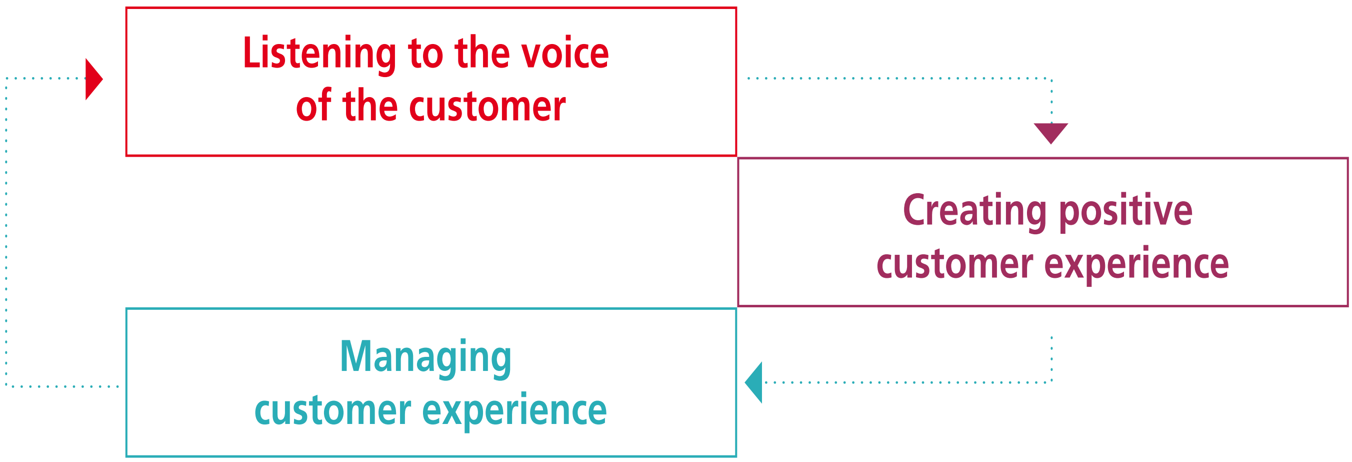
CONTENTS

5. Customer Relationship Management

Service Quality and Customer Experience Management in 2017

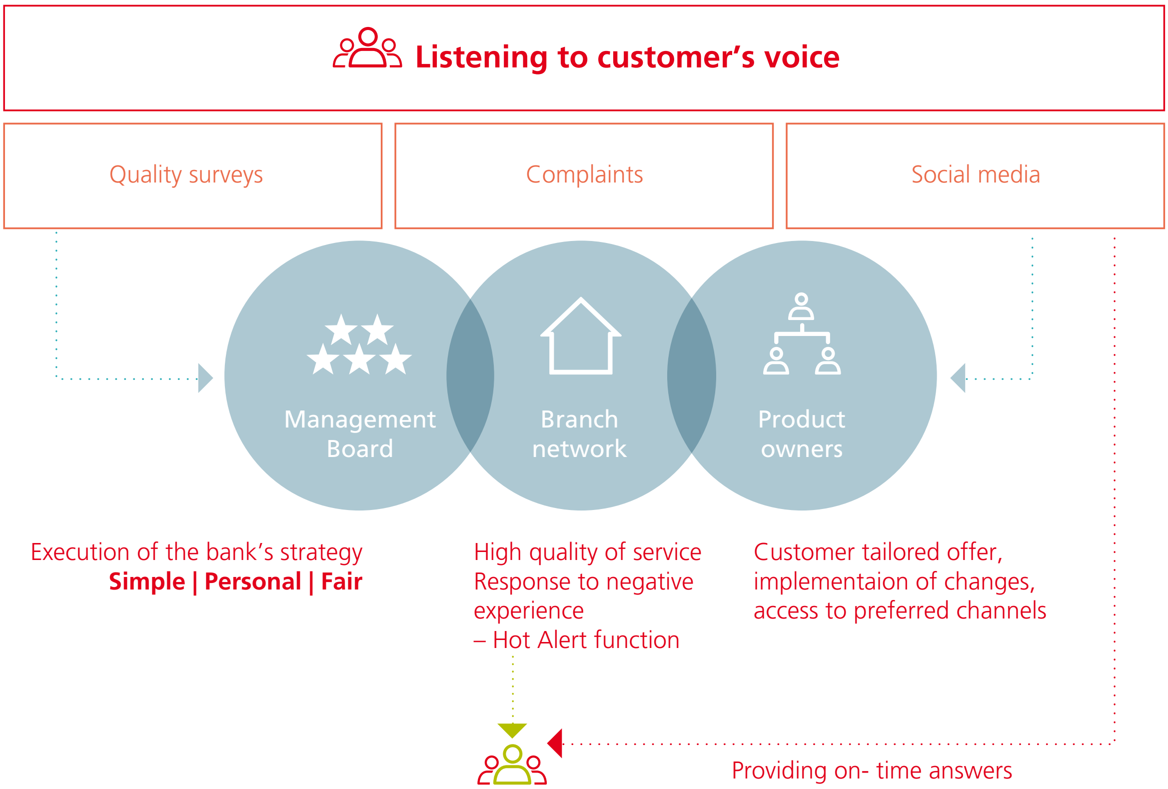
Customer satisfaction and loyalty are the fundamental elements of the customer centricity strategy pursued by Bank Zachodni WBK. The bank analyses customers' expectations and needs to create and manage positive customer experience as well as to build loyalty and long-standing relationships with customers. Customer loyalty and willingness to recommend BZ WBK brand are measured through the Net Promoter Score (NPS), which has been included in the objectives of the sales network and back-office units.

KEY ELEMENTS OF BANK ZACHODNI WBK'S QUALITY MANAGEMENT SYSTEM



Listening to the Voice of the Customer

In order to understand customers' needs and expectations, the bank analyses customer feedback from different sources such as complaints, opinions shared on social media or satisfaction surveys. The bank continually monitors loyalty and satisfaction of customers at different points of contact: after they have been serviced at the bank's branch, logged into the mobile or internet platform, used an ATM or a CDM, or called a helpline. The bank also has an alert system in place to notify branch managers of any negative feedback received from the customer (for example, in a questionnaire) so that they can investigate the issue and take measures to prevent any negative experience in the future.



Creating Positive Customer Experience

The bank builds positive experience taking into account customers' expectations, changes in the market and the banking sector, as well as social and cultural trends. Great emphasis is placed on ensuring consistent experience and access to products and services across all contact channels.

Managing Customer Experience

The bank manages customer experience with a focus on a customer journey across all brand touchpoints, taking into account the role of each of them. The bank takes measures to deliver on its brand promise: "Bank As You Want It" ("Bank jaki chcesz"), and will monitor the effectiveness of changes, including customers' brand awareness, loyalty and willingness to recommend the bank to a family or friends.

Building Customer Loyalty

The initiatives taken last year, such as the launch of the Account As I Want It (Konto Jakie Chcę) and "You Bank As You Want It" ("Bankujesz jak chcesz") campaign, helped the bank to strengthen its relationships with customers and even exceed their expectations. The bank's NPS increased considerably by 6 p.p. YoY to 32%.

Complaint Management

The complaint handling process at Bank Zachodni WBK satisfies regulatory requirements and is continuously improved to increase effectiveness and customer satisfaction.

Customers may submit a complaint by following a simple procedure in any of the following ways: at a branch, in writing, over the phone or via an electronic banking platform, including via a video call or chat. The reply to the complaint may have a form of a letter, a text message or a message sent via BZWBK24 internet or mobile banking services. Customers receive a text message informing them about the receipt and resolution of a complaint.

In 2017, 70% of complaints were resolved within three business days, which improved by 13 p.p. compared to the last year. The NPS based on the results of customer surveys on the complaint handling process was 24% on average, up 3 p.p. YoY.

Barrier-Free Banking Programme

For the last seven years, the bank has been delivering the Barrier-Free Banking Programme to enhance banking experience of customers with special needs (disabled customers, elderly people, pregnant women) across all contact channels (from branches to mobile banking).

The programme facilitates day-to-day banking for customers with special needs through the following:

- branches without architectural or other barriers with accessibility certificates in place (167 outlets as at the end of 2017);
- Online Advisor services available in sign language via video call (accessible by means of BZWBK24 mobile, BZWBK24 internet, the bank's website or tablets available at the bank's branches);

- ATMs designed for visually impaired or blind customers (233 specially adapted machines installed as at the end of December 2017);
- BZWBK24 electronic banking services certified for accessibility to sight impaired customers (work is underway to provide access to the BZWBK24 mobile application);
- portable induction loops available at 20 barrier-free branches since January 2017 (devices facilitating interactions with customers who use hearing aids);
- access to the bank's communication tools suitable for disabled customers such as advertisements, tutorials, the Barrier- Free Banking website, as well as local initiatives promoting services and facilities offered by barrier-free branches.

Marketing and Communication Campaigns

In 2017, Bank Zachodni WBK introduced a new format of marketing communication based on the bank's brand promise: "Bank As You Want It" ("Bank jaki chcesz") and "You Bank As You Want It" ("Bankujesz jak chcesz"), which focuses on the fundamental consumer need of having influence and control. The new brand promise is conveyed by the offer of the new Account As I Want It (Konto Jakie Chcę), which features a range of options that can be freely modified by customers. The brand promise and the innovative functionality of personal account customisation were emphasised in a marketing campaign run from September to December 2017 in TV, press, cinemas, internet, billboards and branches. The campaign was a great success in terms of sales and image building and strengthened the unaided and top-of-mind awareness of the bank as one of the top three banks in Poland.

In spring 2017, the bank launched a consolidation loan campaign called "Zero gravity" ("Zero ciążenia"). The campaign, which was run in branches and the media, encouraged customers to transfer their debt from other banks and benefit from low credit payments. Nearly 16 thousand commercials conveyed the message to 25 million people. The campaign contributed to record high sales of cash loans (Q3 2017).

In 2017, the bank continued its activity in social media, strengthening its position as one of the financial institutions with the largest number of Facebook and Twitter fans and followers (287k and 16.2k, respectively). A number of extensive campaigns were also run, including an educational campaign of Pajacyk credit card organised in cooperation with the Polish Humanitarian Action (PAH) and "Hello money" ("Halo pieniądze") campaign. Social media were used to promote the Account As I Want It and the mobile application of the bank (1st place in the Mobile Trends Awards).

6. Awards, Recognitions, Rankings

	Bank Zachodni WBK (BZ WBK)
Best Bank in Poland	• Best Bank in Poland and Best Bank in Poland for SME at the Euromoney Awards for Excellence in recognition of excellent financial results combined with the effective implementation of the strategic digital transformation programme. It is the third accolade for the bank in a row and fourth in the last six years.
Golden Banker	• Award granted by Bankier.pl and internet users in the "Safe Bank" category of the eighth edition of the Golden Banker ranking in recognition of the best sector practice.
Best Mobile Banking in Poland	• The main award for BZWBK24 mobile application granted by Eksperci Bankier.pl in the mobile banking ranking for the widest range of options available to users, which make the bank stand out in the market.
Top Employers Poland 2017	• An accolade for Bank Zachodni WBK as one of the companies that create the best working conditions for their personnel, cater for developing their talents and improve recruitment processes.
Best Benefits Strategy 2017	• Award in the competition Best Benefits Strategy 2017 for the most interesting and most effective strategy of non- salary benefits for employees.
Banking Leader Incubator	• Title of the Banking Leader Incubator for the highest amounts of guarantees issued, in a competition organised by Bank Gospodarstwa Krajowego and the Polish Bank Association. Three bankers from the Business and Corporate Banking Division were awarded as Leaders in Sales of Guarantees from the Guarantee Fund of the Innovative Economy Operational Programme.
Most effective bank	• Awards in five categories at the "Banking Horizons" conference, including first place in the "Operational effectiveness of banks" category. • Third position in the Banking Stars Ranking in recognition of the annual performance, and an accolade for profitability, effectiveness and business structure.
Social Campaign 2016	• The main award in the "Social Campaign 2016" competition for the "Hello, Dad" ("Halo Tato") project. The project was also awarded with the Golden Clip accolade in a competition organised by the Polish Public Relations Consultancies Association.
Best CSR Report	• Three awards in the CSR Reports Competition organised by the Responsible Business Forum and Deloitte. Bank Zachodni WBK was the only entity from the financial sector to receive the award, including an accolade from the voting panel, journalists and internet users.
Top Brand 2017	• Third place in the Top Brand 2017 Ranking in recognition of the highest positive publicity rate in terms of number, scope and type of publicity. The Top Brand Ranking is conducted by Press monthly based on publicity in media, internet and social media analysed by Press-Service.

VI. Business Development

1. Bank Zachodni WBK and Selected Subsidiaries

1.1. Retail Banking Division

Main Directions

BZ WBK Retail Banking provides services to more than four million personal customers who are assigned to Standard, Premium, VIP and Private Banking segments which differ in terms of the personalisation of services.

In 2017, the bank progressed well with its strategic transformation into a customer-centric organisation. In the retail banking area, the main focus was on:

- building customer loyalty by strengthening relationships and increasing satisfaction with banking services;
- developing products and services which are simple and clear, suit customers' needs and are available in remote channels;
- increasing the efficiency of remote channels by encouraging customers to use them more frequently;
- effective management of customers' portfolios to increase consumer loans and generate higher fee income, mainly from investment products and services;
- developing the knowledge and skills of customer advisors.

One of the flagship products launched by the bank in 2017 was the Account As I Want It (Konto Jakie Chcę) – a personal account coming with a Customised Card (Karta Dopasowana) and a range of services and options that can be freely modified by customers according to their needs. This product is a part of the bank's new brand strategy: You Bank As You Want It, which is aimed at increasing satisfaction of customers and, ultimately, their loyalty and willingness to recommend the bank's services. Since November 2017, the Account As I Want It (Konto Jakie Chcę) has been a central element of the simplified range of personal accounts offered by Bank Zachodni WBK.

As part of the Multichannel CRM Programme, in 2017 the bank continued the integration of sales channels such as electronic banking, ATM network, email and text message solutions with front-end systems operated by branches and the Multichannel Communication Centre. Effective, two-way communication across all channels is fundamental to creating a seamless multichannel CRM environment that will enable the bank to respond to customers' needs in a consistent way, regardless of how they contact the bank.

The full integration of the ATM network and CRM systems allowed the bank to launch its first multichannel initiatives in real time, which are elements of the bank's target CRM architecture. Online communication with electronic banking platform was established as a pilot, preceding full implementation in 2018.

In the reporting period, the bank improved algorithms and mechanisms which are used to identify the most suitable products for customers, taking into account their preferences as well as developments in their private lives.

The bank also continued the New Distribution Model project, as part of which new branches formats are created and branch staff skills are adapted to modified roles and operating concepts.

Personal Accounts and Bundled Products

Personal Accounts

New Account As I Want It (Konto Jakie Chcę)

On 21 August 2017, Bank Zachodni WBK launched a new personal account called Account As I Want It (Konto Jakie Chcę). The account comes with a Customised Visa a or Customised Mastercard debit card and is offered in the following two options: to customers under 26 and to other customers. The account is operated free of charge and provides free online transfers. Customers may choose the amount of a card fee and decide how to pay it. A range of options that may be freely modified by customers add to the competitive edge of this product. Customers may open or switch to this new account at a branch, via the internet or over the phone, without the need to change their account number.

The Account As I Want It comes with a new Regular Savings Account (Konto Systematyczne), which makes it possible to save money via standing order from the Account As I Want It.

The Account As I Want It has been recognised in industry rankings. It was voted the best and the most customer friendly personal account in the rankings published by gazeta.pl (11 September 2017) and Comperia.pl (26 September 2017).

The new product is an important element of the bank's strategy aimed at simplifying the range of personal accounts and debit cards. Since 1 November 2017, customers may only choose from the Account As I Want It (Konto Jakie Chcę) with the Customised Card, the VIP Account (Konto VIP) with the Customised Card or VIP Card and the FX Account24 (Konto24).

From 21 August 2017 till the end of December 2017, 335k Account As I Want It accounts were opened. Until 31 January 2018 (i.e. before the release date of this report), this number exceeded 400k thanks to attractive and flexible parameters of the account and an effective marketing campaign.

Personal Account Portfolio of Bank Zachodni WBK

In 2017, the portfolio of PLN personal accounts grew by 2.5% YoY and reached 3.2m as at the end of December 2017. Including FX accounts, the personal accounts base totalled nearly 4m.

The Account As I Want It was the most popular account among customers, followed by the Account Worth Recommending (Konto Godne Polecenia).

Debit Cards

The offer of the bank's debit cards allows customers to manage card parameters on their own using remote channels. On 3 June 2017, self-service options available to the users of BZWBK24 internet and BZWBK24 mobile were extended to include the functionality of blocking and activating debit and credit cards of Bank Zachodni WBK, and additional processes connected with the new Account As I Want It, enabling customers to choose their preferred options and fees related to the Customised Card.

Having simplified the range of personal accounts and debit cards (November 2017), the bank took measures to streamline these product portfolios (customers whose debit cards have expired now receive Customised Visa or Mastercard card).

As at the end of December 2017, the personal debit card portfolio of Bank Zachodni WBK (excluding 0.4m prepaid cards) comprised over 3.4m items and increased by 6.1% YoY. Taking business cards into account, the total number of debit cards reached 3.6m, up 6.2%.

Prepaid Cards

The value of the prepaid card portfolio has been gradually decreasing in the wake of the Management Board's decision of November 2015 to withdraw prepaid cards from the bank's offer following an industry debate and guidance from the market regulator.

Accompanying Services

In view of a growing share of non-residents in the BZ WBK customer base, in particular customers from Ukraine, the bank prepared marketing materials and regulations in the Ukrainian language. Customer advisors were provided with a dedicated website with information and materials about services for non-residents. In addition, on 1 June 2017 the Multichannel Communication Centre launched phone service in Ukrainian.

Savings and Investment Products

Deposit and Investment Products for Personal Customers

Turning to deposit and investment products, in 2017 Bank Zachodni WBK focused on strengthening relationships with deposit customers, diversifying the portfolio and increasing the share of investment solutions, simplifying the range of deposits and increasing their availability in remote channels as well as optimising the structure of deposits. The optimisation measures taken by the bank in a low interest rate environment contributed to further growth in the share of stable balances of current and savings accounts bearing low interest rate in the total deposit portfolio. At the same time, the share of term deposits decreased, while the transfer of deposits to BZ WBK TFI investment funds hit an all-time high.

Retail Deposits Management

One of the new features of the bank's deposit range is the Regular Savings Account (Konto Systematyczne) introduced in

August 2017 in branches, partner outlets and BZWBK24 internet as one of the products and services linked to the Account As I Want It (Konto Jakie Chcę). This account turned out to be very popular among customers as it pays relatively high interest. From August to December 2017, more than 50k customers signed up for this product.

New funds were also acquired on the back of two Max Savings Account (Konto Max Oszczędnościowe) campaigns, which offered attractive interest over a defined period. As a result, more than PLN 2.2bn new funds were collected.

In 2017, the bank continued to reward active deposit customers, increasing product penetration. New special offers were launched using a mechanism called "Active Deposit" ("Aktywny Depozyt") which automatically increases an interest rate on savings accounts once the volume of transactions in a personal account (including online and card transactions) reaches a stated level. The bank also revamped its Bonus Deposit (Lokata Bonusowa), which paid high interest on condition of active use of other banking products (e.g. credit cards or insurance products) and continued to offer the e-Investor Deposit (e-Inwestor) via the internet banking platform to holders of investment products.

Deposit retention was facilitated by negotiated deposits and the centralised retention process, using term deposits and savings accounts.

At the end of December 2017, the total balance of savings accounts was PLN 25.0bn, an increase of 6.9% YoY. The total deposit base of the personal segment amounted to PLN 59.2bn, i.e. up 2.7% YoY. Aside from current and savings accounts, the fastest balance growth was reported for negotiated deposits offered to VIP and Private Banking customers as well as term deposits available only via remote channels: 1-month eDeposit (eLokata) and eInvestor Deposit (eInwestor).

Thanks to an effective product and pricing policy, the bank achieved the target structure of the deposit portfolio, with 72.4% share of current and savings account balances (68.5% in December 2016).

Structured Products

Structured Deposits

In 2017, Bank Zachodni WBK continued its activity on the structured deposit market. The bank sold products with a yield linked to exchange rates, stock indices or investment fund performance, providing 100% capital protection at the end of the deposit term.

The bank offered 99 products with a wide variety of tenors in the total of 46 subscriptions, including:

- 44 subscriptions for standard personal customers:
  - in 21 subscriptions, the bank offered deposits with interest rate linked to the EUR/PLN or USD/PLN rate, and the investment strategy adopted by the customer: appreciation, depreciation or stabilisation of the currency;
  - in 17 subscriptions, the yield was linked to the following stock indices: Nasdaq 100, Euro Stoxx®Oil&Gas, Euro Stoxx 50®, DAX, STOXX® Europe 600 Health Care or performance of investment funds: SPDR® S&P® Metals and Mining and SPDR® Gold Shares;
  - 6 subscriptions of FX structured deposits paid interest linked to the EUR/PLN, USD/PLN or EUR/USD rate;
- 2 subscriptions were aimed at Private Banking customers, with interest linked to the performance of investment funds: SPDR® S&P® Metals and Mining and SPDR® Gold Shares.

In all, more than PLN 550m was collected as a result of the aforementioned subscriptions.

Brokerage Products

In terms of services for individuals, in 2017 BZ WBK Brokerage House focused on products and services offered with investment advice and on strengthening its position in the foreign investments market by optimising pricing and implementing further enhancements for customers (for example, new analytical materials and access to foreign stock market quotes).

The range of products and services was simplified to suit customers' needs: some products were withdrawn from the offer and fees and charges were harmonised by introducing a single fee regardless of the order value or target market. The offer for active customers was further developed and a fast track process was put in place for customers intending to sign an agreement with the bank (based largely on remote channels).

The brokerage products distribution model was reviewed to align the number of service points with customers' needs and to implement new technology solutions. This is expected to make the product proposition more attractive, encourage more active use of remote channels and increase market share.

The range of brokerage products and services for business customers was extended to include the Direct Market Access service that gives investors in Poland (including foreigners) an opportunity to place orders themselves. Customers may use an FIX protocol to make orders abroad and have access to analytical materials concerning Czech and Hungarian companies.

BZ WBK Brokerage House achieved a leadership position in the IPO, SPO, ABB and trade offer markets, participating in the following deals:

- IPO of PLAY Communications S.A. – the largest deal of this kind in the history of the WSE, with the bank acting as a co-manager;
- IPO of Griffin Premium RE N.V. – with the bank acting as the lead manager;
- IPO of Maxcom S.A. – with the bank acting as the lead manager;
- IPO of Dino Polska S.A. – with the bank acting as a syndicate member;

- Trade offers: PELION, Integer, Griffin Premium RE, InPost, Paged.

In 2017, BZ WBK Brokerage House fully leveraged the buoyant stock market and generated strong income from brokerage fees as a result of processing 75% higher turnover originating from individual customers.

Investment Funds

Arka Investment Funds on Offer

In 2017, a number of prospectuses and/or statutes of Arka investment funds managed by BZ WBK TFI were updated to reflect changes to:

- selected elements of the investment policy (e.g. Arka Prestiż Gotówkowy, Arka BZ WBK Gotówkowy, Arka BZ WBK Obligacji Europejskich, Arka Platinum Stabilny, Arka Platinum Dynamiczny),
- level of payments to sub-registers (Arka Prestiż SFIO, Platinum sub-funds of Arka BZ WBK FIO and Arka BZ WBK FIO),
- operating services provided to customers investing in open-ended funds (Arka BZ WBK FIO, Arka Prestiż SFIO);
- calculation of the investment value (Arka Prestiż SFIO);
- asset pricing methods (all the funds);
- terms of liquidation (Arka BZ WBK Akcji Środkowej i Wschodniej Europy) and other.

The availability of Arka funds was increased as a result of significant reduction of the minimum initial investment in Arka Prestiż SFIO and Arka Platinum subfunds as part of Arka BZ WBK FIO (May 2017) and of the minimum subsequent investments in Arka BZ WBK FIO (October 2017).

On 3 November 2017, BZ WBK TFI set up a new subfund as part of Arka BZ WBK FIO, i.e. Arka BZ WBK Akcji Małych i Średnich Spółek (BZ WBK Arka Small and Medium-Sized Enterprises). The subfund is aimed at investors who look for high returns over a longer time horizon and accept risks associated with the performance of small and medium-sized companies based in Poland. It is an equity fund, with min. 66% of funds invested in shares and similar instruments issued by Polish SMEs and traded on the WSE. The debt portion is invested in treasury bills, treasury bond and other debt instruments.

22 December 2017 was the last trading day for investment funds of Arka BZ WBK Akcji Środkowej i Wschodniej Europy FIZ (CEE Equity Close-end Fund) before the start of the liquidation process on 29 December 2017.

Investment Funds in Remote Channels

Since January 2017, BZ WBK customers have been able to purchase Arka investment funds via telephone or video call, in line with the strategy to increase sales in remote channels. In November 2017, a full array of services was made available in the multichannel BZWBK24 platform, "Arka Funds" tab (including product offering, new ways to execute a transaction, information about an investment portfolio, monitoring of stock market quotes, etc.). The remote investment fund model is based on an IT platform which was implemented as part of the MiFID II project, taking into account both regulatory requirements and customers' expectations. In 2018, further features will be offered to customers, which along with other product, procedural and operational changes are expected to strengthen the competitive edge of Arka funds.

Positive customer experience is also created through the Welcome Programme launched in 2017 and easy access to information about investment funds, also on social media.

In 2017, net sales of Arka funds via BZWBK24 (telephone and internet) accounted for 67% of total sales generated by Bank Zachodni WBK.

Sale of Investment Funds

As at 31 December 2017, the total net assets in investment funds managed by BZ WBK TFI were nearly PLN 16.0bn and up 19.5% on 31 December 2016.

Corporate bond subfunds and selected equity subfunds (particularly Polish equity ones: Arka Prestiż Polish Equity and the new Arka BZ WBK Small and Medium-Sized Enterprises, and also Arka Prestiż European Equity) continued to be most popular among customers. There was also a relatively good demand for money-market and stable growth funds.

In 2017, BZ WBK TFI was one of the top investment fund companies in Poland, both in terms of net sales and growth in assets under management.

Awards for Arka Funds

- In March 2017, Arka funds received the following three accolades from an independent research company Analizy Online for their performance in 2016:
  - Arka Prestiż Polish Equity, in the category: Best Polish Equity Fund
  - Arka Prestiż Corporate Bonds, in the category: Best Polish Corporate Bond Subfund
  - Arka Prestiż Corporate Bond, in the category: Best Selling Fund.
- Analizy Online affirmed the three-star rating for Arka BZ WBK Balanced Fund as a solid product aimed at investors who accept moderate investment risk. The managers of this fund proactively search for additional yields. The advantages for customers include limited volatility of fund performance and relatively low fees.
- In October 2017, BZ WBK TFI was voted third best investment fund company in the "Your Money" ranking published by Rzeczpospolita daily. The company was recognised for its wide range of products and services for retail investors and the

security of investments regardless of the fund chosen by the customer.

Lending Proposition

Cash Loans

In 2017, Bank Zachodni WBK introduced a number of solutions to make its cash loans more attractive to customers such as a variable interest rate for loans with tenors exceeding 24 months, a minimum fixed interest rate of 4.99% for loans ranging from PLN 4k to PLN 15k, and a lower fee for loans with the Worry-Free Loan (Spokojny Kredyt) CPI insurance or loans up to PLN 4k obtained via the BZWBK24 electronic banking platform.

In March 2017, the bank modified the terms of consolidation loans by extending the lending period above 72 months for the bank's customers. A marketing campaign was also run (via TV spots, posters and the internet) for a "Zero gravity" ("Zero ciążenia") loan whose purpose was to transfer and consolidate credit obligations. The campaign was supported by a special offer with 0% fee on the value of obligations transferred.

In Q3 2017, a range of special offers were launched across all channels to support the sale of retail loans, often bundled with other products, such as the Account As I Want It (Konto Jakie Chcę):

- Cash loan with the Worry-Free Loan (Spokojny Kredyt) CPI insurance available at a lower fee;
- Cash loan up to PLN 4k;
- Cash loan with the Account As I Want It (Konto Jakie Chcę);
- Overdraft with the Account As I Want It (Konto Jakie Chcę);
- Cash loan with a credit card;
- Zero Gravity (Brak Ciążenia) II – a special deal on loans taken out to repay debt with other banks.

In 2017, cash loan sales increased by 5.9% YoY, reaching more than PLN 4.2bn. The most effective distribution channels in terms of sales were the BZWBK24 electronic banking platform (+61% YoY) and the Multichannel Communication Centre (+43% YoY). Remote channels accounted for 21% of cash loan sales in this period.

The cash loan portfolio was up 5.8% YoY and totalled PLN 7.6bn.

Mortgage Loans

In 2017, the bank's range of mortgage loans was modified in accordance with customers' needs and regulatory requirements.

Pursuant to Recommendation S issued by KNF, in 2017 the minimum deposit was increased to 20%. The bank accepts lower deposits (min. 10%) on condition of taking out a payment protection insurance from PZU in relation to home loans with an LTV above 80%.

Pursuant to the Act of 23 March 2017 on mortgage loans and supervision over mortgage loan brokers and agents, on 22 July 2017 Bank Zachodni WBK introduced changes to the range of mortgage loans and terms of their sanction. In particular, the bank:

- suspended EUR mortgage lending;
- cancelled an early repayment fee for fixed rate mortgage loans and equity releases;
- cancelled a charge for reminders related to untimely service of loans;
- aligned the application process, information form and credit decision process;
- modified the terms of cooperation with credit intermediaries.

In response to customers' needs, in February 2017 the terms of self-build mortgage loans were modified to increase their availability and facilitate credit application processing.

Bank Zachodni WBK took further measures to assist mortgage borrowers:

- It provided support to customers with CHF mortgage loans by:
  - applying a negative CHF LIBOR interest rate;
  - reducing the currency spread to 2% for CHF;
  - providing an opportunity to reduce loan instalments free of charge through an interest-only option, payment holidays or an extension of maturity;
  - offering loan conversion to PLN at the mean NBP rate with no additional fees charged;
  - waiving a fee for annexes made in relation to CHF loans.
- It introduced a solution which made it easier for borrowers to sell a mortgaged property with a swap of collateral into a newly purchased property;
- It accepted requests from home loan borrowers under the Act on supporting borrowers in financial distress, providing for a financial support of max. PLN 1,500 per month for up to 18 months.

In 2017, the value of new (disbursed) PLN mortgage loans totalled PLN 5.2bn, down 6.6% YoY. In this period, sales of home loans offered under the "Home for the Young" ("Mieszkanie dla Młodych") programme decreased as the pool of funds for subsidies in 2017 had been used in full. Most mortgages were sold via own branch network and via local intermediaries.

The gross mortgage portfolio grew by 2.7% YoY, reaching PLN 34.8bn at the end of December 2017. The value of PLN mortgage loans amounted to PLN 24.3bn, up 16.1% YoY.

Credit Cards

In 2017, Bank Zachodni WBK took measures to increase the availability of credit cards, develop their functionality, grow credit card sales and promote card transactions.

- The functionality of remote channels was extended as follows:
  - New cards were added to the range of cards sold via the BZWBK24 internet platform: MC 1|2|3, Visa Platinum and World MC (now a full array of credit cards offered by the bank is available via BZWBK24 internet);
  - New features were added to the BZWBK24 mobile application, including an option to increase a credit card limit, sign up for the Ratio service or conclude a credit card agreement (for MC 1|2|3, Visa Silver Akcja Pajacyk, MasterCard Silver or Visa Platinum cards);
  - In both channels, i.e. BZWBK24 internet and BZWBK24 mobile, the bank offered the 1|2|3 card on attractive terms and new features such as: blocking and activating credit (and debit) cards, generating card statements, reducing credit limit and changing an automatic payment option.
- Initiatives were taken to make BZ WBK credit facilities more available and customer friendly:
  - The limits of respective credit cards were changed;
  - On 20 February 2017, the Balance Transfer service was offered to customers looking to transfer their credit card debt from other banks on attractive terms;
  - The minimum net income requirement for the 1|2|3 card was reduced (in line with Mastercard Silver and Visa Silver Akcja Pajacyk cards) along with the waiver of a requirement for automatic minimum payment.
  - The process of applying for an additional credit card, such as Visa Silver Akcja Pajacyk, MC Silver or 1|2|3 card was simplified (the process is initiated by the holder of the main card and the card user does not need to be present);
  - The Ratio service was optimised and aligned with regulatory requirements.
- The bank continued to proactively promote credit cards and accounts in order to increase sales and encourage wider use of these products. This included:
  - special deals such as "A welcome PLN 200" ("200 zł na dzień dobry"), "Holidays with a Credit Card" ("Wakacje z kartą kredytową"), 2nd edition of CashBack campaign, "Recharge Your Batteries with a Visa Credit Card" („Ładuj baterie z kartą kredytową Visa"), "PLN 50 for the average grade of min. 4.0 on your school certificate" ("50 zł za średnią minimum 4,0 na świadectwie szkolnym"), "Suitcase with a credit card" ("Walizka do karty kredytowej");
  - a loyalty programme called Priceless Specials launched by Mastercard for holders of World MasterCard cards in January 2017, encouraging active use of the card with partners and online;
  - special offers for customers signing up for a credit card for the first time or after some time: "Starter Card" ("Karta na start") and "ENTRY Credit Card" ("Karta kredytowa ENTRY");
  - modified fees applying to 1|2|3 credit cards issued after 1 July 2017: customers who made a specific number of transactions with the above-mentioned card were not charged periodic fees;
  - launch of long-term cooperation with a partner from the fuel sector under which 1|2|3 credit card customers earn cashback at Circle K and Statoil petrol stations (financed by the partner);
  - the first educational platform in Poland (kartoswajanie.bzwbk.pl) providing practical guidelines about credit cards (launched in October 2017);
  - mobile payments campaign focusing on the benefits of different payment methods offered by the bank (BLIK, Android Pay, HCE) along with special deals for customers e.g. "More power with Visa mobile card" ("Zyskaj moc z kartą mobilną VISA");

As at 31 December 2017, the credit card portfolio of Bank Zachodni WBK comprised 803.2k instruments, an increase of 3.0% YoY.

Bancassurance

Insurance offer

Bank Zachodni WBK offers all insurance products in an individual model, acting as an agent of BZ WBK-Aviva TUO and BZ WBK-Aviva TUnŻ.

The bank's insurance offer includes products linked with the bank's credit facilities for retail and business customers and non-linked products.

In 2017, the Safe Money (Pewne Pieniądze) debit card insurance was modified in terms of insurance cover and sum insured, and the range of non-linked products was expanded to include Plan B (unemployment insurance available only via the Multichannel Communication Centre) and Locum Comfort (home insurance replacing the former Locum insurance). The Locum Comfort insurance has a flexible structure, which means that the insurance cover may be freely modified to suit customers' needs. At the end of the year, the product was made available in the BZWBK24 internet platform.

In July 2017, a loyalty insurance programme was put in place to offer lower premiums to holders of Locum Comfort, Onkopolisa or Family Care insurance provided they renew their insurance cover or have more than one insurance product obtained via the bank. Customers were provided with an option to buy debit card insurance via BZ WBK ATMs.

In 2017, the bank started a three-year strategic programme 4Sure, which is designed to increase penetration of insurance products among retail and SME customers, increase customer satisfaction and loyalty, stimulate digitalisation of insurance processes, grow the share of digital channels in insurance sales and expand the product range.

Insurance Sales

In 2017, sales of linked insurance products were broadly stable YoY, while sales of non-linked insurance products increased due to a proactive approach taken by branch advisors and positive feedback received from customers in relation to the Locum Comfort insurance.

The following products contributed most to bancassurance income: the Worry-Free Loan (Spokojny Kredyt) individual insurance package for cash loan borrowers, Family Care (Opiekun Rodziny) life insurance, Business Guarantor (Biznes Gwarant) insurance package for business loan borrowers, and Locum/ Locum Comfort home insurance.

Services to Financial Institutions

Bank Zachodni WBK cooperates with more than 20 Polish and foreign banks and financial institutions in terms of outsourcing services related mainly to card personalisation, issuance and handling, and ATM network management.

The bank's partners are offered a modern IT infrastructure and real-time access to transaction data. High quality and security of services was confirmed by the certification of personalisation processes for magnetic strip and chip cards conducted by Visa and MasterCard. The bank continues to adapt its products and functionalities to suit the requirements of its customers and gradually expands its offering, ensuring it is highly innovative. In 2017, the cooperation was extended to include Android Pay services, webservice for mobile and electronic banking, enablement and disablement of contactless technology in ATMs, 3D Secure – authorisation of card- not-present transactions and DCC services for five new currencies (CZK, CNY, RUB, TRY and RON). As at the end of December 2017, the bank managed a network of 506 third-party ATMs and handled nearly 3.2 million cards.

New products and features related to card and ATM services were developed, such as personalisation of custom cards and services connected with multi-currency cards. They will be offered to banks in the coming months.

1.2. SME Banking Division

Scope of Business

The strategy of the bank is to support the business expansion of small and medium-sized companies based on the following three pillars: top quality customer services provided through qualified branch advisors and robust remote communication channels, the building of loyalty and long-term relationships with customers and simple but distinctive products with additional non-financial services.

The SME segment is made up of almost 308k entities with an annual turnover of up to PLN 40m. In 2017, the SME Banking Division modified internal segmentation rules and services for SME customers and changed the organisational structure accordingly. In addition to the existing SME segments, i.e. mass customers (SME 1) and customers with a higher turnover (PLN 5–40m) and more complex requirements (SME 2), in 2017 a process was launched to carve out an SME Digital segment created by customers who prefer the remote service model via electronic banking, the mobile application or remote advisor.

In order to facilitate multichannel access to SME products and services, the SME Digital Customer Office was set up to manage remote communication with customers. Furthermore, the scope of operations performed by the SME Service Centre was extended and a project was launched to create a virtual branch for SME customers in the Multichannel Communication Centre which provides companies with support from a dedicated advisor. At the same time, the functionality of online banking within iBiznes24 was extended. The above measures enabled the bank to steadily release the resources that are needed to strengthen relationships with SME customers and to provide them with products and services that even better suit their needs in traditional sales structures.

During the reporting period, the SME Banking Division focused on increasing the quality of services provided to customers from the upper-end of the segment (SME 2). Accordingly, new sales structures were set up in the Division to cater for the needs of the above customers. Previously, such structures were located in macroregions (Branch Banking). The newly created SME Sales Area was divided into four regional departments (central, south, west and north) composed of service centres employing around 160 customer advisors in total. Furthermore, a new operational agenda was introduced to focus on customer relationships, and an incentive scheme was implemented to support the delivery of targets on the basis of objective business criteria. Additionally, changes were introduced to simplify and streamline credit delivery to customers from the SME II segment, while maintaining the high quality of the portfolio.

The bank developed new CRM activities and tools to support the delivery of the strategy. It launched a number of sales initiatives in relation to non-interest products, based on the sale of POS terminals, cross-selling to lease customers and an increase in FX transaction volumes. The range of products and services was modified in line with customers' expectations.

The bank's goal is to become a partner for SME customers by offering advice and a wide array of non-financial services (e.g. support in networking with prospective counterparties and investors, industry insight, specialist workshops and training).

Product Range Development

Scope of the Offer

The fundamental elements of the offering for SME and other business segments are as follows:

- customised business accounts;
- a wide array of credit facilities such as working capital financing, investment loans (including via the European Investment Bank), preferential loans subsidised by the Agency for Restructuring and Modernisation of Agriculture and guarantees, leasing and factoring facilities.

An extensive range of deposit and investment products, modern distribution channels, comprehensive trade finance services and treasury services serve as additional tools to build sustainable relationships with customers.

Development of Credit Facilities for SME Customers

The Business Express Loan (Kredyt Biznes Ekspres) for SMEs is the bank's flagship credit facility which is distinctive by its customer-friendly service procedures (minimum documentation, fast turnaround, availability in remote channels), no requirement to define the purpose of financing and the possibility to finance working capital needs and investments up to PLN 500k for up to five years. The EIB Business Express (Biznes Ekspres EBI) launched in June 2017 additionally offers a favourable interest rate (at a lower margin) based on a guarantee agreement with the European Investment Bank (EIB). In August 2017, a capped rate functionality ("Oprocentowanie nie wyższe niż") was implemented to protect customers against an increase in interbank rates.

In 2017, the scope of credit services for SME customers in remote channels was materially extended. New customers (sole traders) were offered a fast remote credit decision (within 15 minutes) for online financing applications of up to PLN 50k. Starting from January 2017, the bank's customers with a predefined offer may sign up for a Business Express loan of up to PLN 50k over the telephone and without any need to provide collateral or leave their office, and since November 2017 they may avail of loans with the above parameters in the "buy by click" (end-to-end sales process) as part of the BZWBK24 Mini Firma services.

The bank steadily streamlined its lending processes and introduced a new and convenient solution in its credit service to customers. In February 2017, the level of debt (all existing and sought mortgage-backed loans) requiring a customer to submit a valuation report was increased to PLN 500k. In March 2017, the bank introduced a new simplified credit application form for SME II customers in relation to all credit facilities. In May 2017, a multiline was introduced for SME II customers which combines credit facilities (overdraft, w/c loan) with credit and settlement services (guarantees and letters of credit) under one agreement. The benefits include fewer formal requirements (one loan agreement for a number of products), a one-off cost of collateral establishment and access to a wide range of facilities in various currencies as part of the available limit.

Participation in Guarantee Programmes

The bank works with external institutions to provide such market loan collateral tools as de minimis guarantees, COSME guarantees, guarantees of the Polish Agency for Agriculture Restructuring and Modernisation (ARiMR) and POLFUND civil law guarantees, which allow the customer to avoid encumbering their tangible assets to secure the loan and at the same time benefit from a lower loan interest rate.

At the end of January 2017, Bank Gospodarstwa Krajowego (BGK) completed the Guarantee Fund project delivered under the Innovative Economy Operational Programme (FG POIG). Bank Zachodni WBK was ranked first among ten participating banks in terms of sales of de minimis guarantees distributed by BGK under the above government scheme. The bank received a distinction from BGK and a statuette of the leader of the portfolio with the highest quality secured with a de minimis guarantee. It also maintained second position in terms of the number and value of de minimis and COSME guarantees distributed by BGK.

Development of Services in Electronic Channels

In 2017, Bank Zachodni WBK improved its electronic banking services provided to companies cooperating with foreign partners by simplifying the process of opening accounts in non-standard foreign currencies, extending the scope of FX transactions, prolonging the working hours of its FX Currency Exchange platform in iBiznes24 and BZWBK24 Exchange in Moja Firma Plus and BZWBK24 Mini Firma, as well as providing access to the Santander Trade Network – a unique service which facilitates international expansion.

The functionality of iBiznes24 internet was upgraded by implementing a cash module that helps SME customers to manage their cash in a more convenient way under the agreement for sealed cash deposits and withdrawals. Customers can now remotely order or cancel such services as cash transport, bank confirmation of cash deposit or a review of cash counting reports and cash deposits status.

Since 17 July 2017, SME II customers can be identified using voice biometrics, which, coupled with the phone number recognition mechanism, eliminates any need to use the NIK (customer identification number), PIN or password.

Sole traders and partnerships were given an opportunity to set up a Trusted Profile in BZWBK24 Mini Firma and Moja Firma Plus, enabling easy access to online public administration services and allowing them to deal with formalities related to the conduct of business, including social insurance (ZUS) documents, changing their company's data in the business registry (CEiDG) or applying for sectoral approvals, permits and concessions.

Also, the bank was the first in the market to offer business customers the possibility of opening accounts utilising video authentication – a modern, secure and convenient identity verification mechanism based on biometric features.

On 1 March 2017, the range of products and services was extended to include the Visa Business BZ WBK card dedicated to customers who make frequent payments and cash withdrawals abroad and have an interest in comfort and additional benefits such as access to VIP airport lounges and the Visa Luxury Hotel Collection programme.

Multidimensional Customer Relationship

Bank Zachodni WBK continued initiatives aimed at growing the sales of business accounts, POS terminals, currency exchange and factoring products. To that end, the bank launched a special offer called "Business Account Worth Recommending with a Payment Terminal" („Konto Firmowe Godne Polecenia z terminalem płatniczym"), which rewards customers who sign up for the " Business Account Worth Recommending" ("Konto Firmowe Godne Polecenia") and who settle their transactions via a POS terminal. In November 2017, sales of POS terminals were supported by ID-Instant Decision – a system which makes it possible to generate and conclude a payment terminal agreement during a single visit to a branch.

Delivering the concept of partnership relations with customers, the bank, in cooperation with external experts, shared its know-how and experience with companies during regular customer-friendly conferences within the Entrepreneur's Academy (Akademia Przedsiębiorcy). In 2017, 15 conferences were organised, dealing with the following topics: "How to be successful in business. Communication skill is the key" and "Women in business." The initiative attracted 500 participants representing companies from all around Poland. Additionally, as part of the "Business Evolutions" ("Firmowe ewolucje") initiative, local meetings and workshops were held, focusing on succession planning, foreign trade, EU funds, taxes, recruitment, HR management, and funding and financial management in companies. 325 workshops attended by 4000 entrepreneurs were held across Poland by the end of December.

Best SME Bank in Poland

In July 2017, Bank Zachodni WBK was awarded the best Bank in Poland for SME in the Euromoney Awards for Excellence, one of the most renowned competitions in the financial sector and one that sets benchmarks and trends for the whole industry.

Leasing

Merger of Leasing Companies

In order to simplify the business model and provide access to comprehensive finance and lease services from one company, BZ WBK Leasing merged with BZ WBK Lease. A relevant entry to the National Court Register (KRS) was made on 28 February 2017. Accordingly, BZ WBK Leasing, the acquiring company, assumed all rights and obligations of BZ WBK Lease, the acquired company, which was removed from the National Court Register without formal liquidation.

BZ WBK Leasing is now a universal lessor which offers financing for a wide range of assets to SME, corporate and large corporate customers. The company specialises in the lease of machines and equipment, property and vehicles; basic products and services are complemented by insurance packages and fuel cards.

Fixed Asset Financing

In 2017, BZ WBK Leasing financed fixed assets of nearly PLN 4.2bn, achieving record-high twelve-month sales. In the segment of machines and equipment, where BZ WBK Leasing has been the leader for years, the lease volumes came in at almost PLN 2bn, up 18.8% YoY.

Development of Lease Products and Services

In early 2017, the leasing offer was complemented by Truck Assistance, a new insurance product for trucks and trailers, offering a comprehensive coverage for breakdowns, accidents or immobilisation.

The parameters of Autoleasing were modified such that customers may apply for financing of max. PLN 150k net for new or second-hand cars or vans. In June 2017, BZ WBK Leasing received the "Portfel Wprost" distinction for Autoleasing in the "best leasing" category.

Since July 2017, the company has been the sole financial partner of Subaru, providing complete financial solutions, tools and services to dealers. As a result, by August, every third purchase of a Subaru car was financed by BZ WBK Leasing. In December 2017, vendor finance schemes were launched on the market of agricultural machines from Samasz Finance and FarmTrade Finance to enable the implementation of a loan with a 0% interest rate for farming equipment with subsidies for suppliers.

Since May 2017, customers of BZ WBK Leasing have been using the eBOK24 customer service portal, in which they have 24/7 access to their agreements, balances and documents.

Based on the guarantee agreement between Bank Zachodni WBK and the European Investment Bank (EBI), and the credit agreement between BZ WBK Leasing and the Council of Europe Development Bank, the subsidiary was able to finance development of SMEs. As part of cooperation with the European Bank for Reconstruction and Development (EBRD), BZ WBK Leasing extended the scope of financing of environmental projects and earmarked EUR 50m for the modernisation of Polish enterprises in terms of energy efficiency, renewable energy sources or waste and water management.

1.3. Business and Corporate Banking Division

Scope of Business

The Business and Corporate Banking Division provides services to business customers with a turnover of more than PLN 40m and a credit exposure exceeding PLN 10m. The customer base was divided into two basic segments by turnover volume: corporate segment and property finance segment.

As at the end of December 2017, the Business and Corporate Banking Division provided services to the customer base of 8,700 entities from various sectors, supporting them in building and growing their business. Advisors from the 12 Corporate Banking Centres, together with credit partners and product specialists delivered tailor-made solutions to these customers and comprehensive services in the area of loans, deposits, transactional banking, treasury, leasing, factoring and capital markets. Positive customer experience was supported by easy and quick access to the banking offer and information necessary for corporate finance management provided via the dynamically developing electronic and telephone banking, i.e. iBiznes24 Internet, iBiznes24 mobile and the Customer Service Centre.

In the process of improving comprehensive customer service, in 2017 special emphasis was put on areas which build competitive advantage in the chain of values provided by the division, i.e. foreign trade, offer for selected sectors, digitalisation of processes and products for the corporate segment, efficiency of risk management processes and development of electronic banking channels. Additionally, the programme aimed at broadening the scope of automation of customer service processes continued in all electronic channels (internet, mobile, B2B web service). The programme focuses on the implementation of Internet and mobile banking solutions for the Business and Corporate Banking and SME Banking segments, as well as the largest business customers from the Global Corporate Banking.

Products and Services for Strategic Sectors

In 2017, Bank Zachodni WBK developed comprehensive products and services for sectors identified as strategic, in line with specific needs and profiles of related production chain companies. This approach is based on the bank's experience of servicing the food and agri sector, the first industry of strategic importance to the bank. The same solution is now transferred to other significant sectors of the market.

The development of the Strategic Sectors Department was further continued to build up the bank's competence in the selected sectors. A team was formed to improve the bank's position through participation in industry events in Poland and abroad (Food Show, AutoEvent, Hannover Messe), presence in the industry media (press, Internet, LinkedIn), preparation of reports and analyses for the bank's customers and provision of specialist training for employees.

Export Development Programme

2017 was the third year in a row when the Export Development Programme was organised in Bank Zachodni WBK.

Meetings of customers with business practitioners and experts (bank's representatives and partners) organised within the programme constitute an efficient communication platform to transfer know-how about foreign trade and specific foreign markets, share experience regarding international business and present the latest methods of searching for business partners and identifying opportunities for investing abroad. As public administration representatives participate in the programme, customers have a chance to learn about available forms of the state support. In line with the adopted formula, subsequent editions of the programme are devoted to selected markets.

The last, sixth edition of the Export Development Programme, which was organised in H2 2017 in cooperation with Bisnode, Deloitte, KPMG and Mintel under the auspices of the Ministry of Foreign Affairs and the Ministry of Economic Development, focused on two sectors, which ensured participants' access to correctly profiled know-how and product solutions, and enabled them to establish relationships in target economic sectors. In addition to the expertise shared by the bank and its partners, the biggest benefit from such meetings is an opportunity to exchange experience and best practices with professionals from the same sector.

As part of the programme, the Business and Corporate Banking Division organised trade missions in cooperation with other members of Santander Group. Over the year, four trade missions were arranged (to Mexico, Shanghai and twice to the UK) for Polish companies from different sectors which look for business relationships with foreign partners. The bank expanded its offer as part of the Santander Trade Network, which facilitates the international expansion of exporters and importers into the markets where Santander Group operates. The Santander Trade Network gives access to a solid network of local professionals who provide services in these four key areas: marketing and communication (market research, communication strategy, marketing action plan, optimisation of search engines), networking (commercial agenda, showroom, international trade fairs), business centres (virtual office, business meeting space), other services (legal and tax advice, recruitment services). In 2017, the Santander Trade Network portal was offered to customers. This innovative platform launched in Santander Group over a year ago helps bring together customers in the markets where Santander Group is present.

The bank not only leverages the opportunities created by the international presence of the Santander Group, but also forges its own strategic alliances with financial institutions from different parts of the world, depending on the customers' needs.

In its operating activity the bank focuses on supporting international business of its customers in selected geographical locations (international corridors) which are deemed advantageous from the point of view of entrepreneurs. These include Germany, the UK and Spain. Knowing the specific conditions of each market, the bank defines appropriate strategies of cooperation and product offering for customers and also ensures services of dedicated International Desk advisors.

Product Range Development

Digital evolution of services and continued product range development are on top of the strategic agenda of the Business and Corporate Banking Division.

In 2017, Bank Zachodni WBK was the first bank in Poland to implement customer identification on the basis of the telephone number and voice biometrics, which shortened and simplified telephone contacts between corporate customers and the Business Service Centre. The users of iBiznes24 were given access to eGwarancja (eGuarantee), a modern version of the banking guarantee which is issued electronically and signed with a qualified electronic signature. Additionally, the bank introduced a "perpetual" guarantee, where it is difficult or indeed impossible to determine the period of the Guarantor's liability. Since June 2017, companies have been able to use preferential financing within the EUR 600m guarantee agreement with the European Investment Fund. As part of Santander Group's global initiative, charge cards started to be issued for foreign customers of the International Desk with minimum formalities.

Appreciating the role of remote channels in product and services sales and communication with customers, the Business and Corporate Banking Division steadily implemented subsequent facilities within iBiznes24:

- As part of digitalisation of distribution channels, new online services were made available, such as new features in the cards and trade finance modules and an opportunity to draw down and repay an FX revolving loan.
- The functionality of the iBiznes24 mobile application was improved in terms of operations related to several companies, and new features were introduced such as an option to log in via Touch ID on iOS devices. New solutions were also introduced to enhance the security of operations with Android devices.
- The scope of urgent and express FX payments available in iBiznes24 was extended to include 10 new currencies: CAD, CHF, CZK, DKK, HUF, MNX, NOK, RON, SEK and TRY.
- In April 2017, users of iBiznes24 Internet were provided with an option to define the best EU programmes in the 2014–2020 perspective, the first solution of this kind available in the banking market. The bank's portal "Subsidy for Your Company" ("Dotacja dla Twojej Firmy") was designed in cooperation with Crido Taxand, a company specialising in EU subsidies. It is yet another solution offered to iBiznes24 users as part of development of an unparalleled electronic banking system which helps build competitive advantage of the Bank.
- To improve the communication with customers, a mailbox (for incoming and outgoing mail) was implemented to facilitate the management of complaints and queries regarding iBiznes24. In addition, new electronic request forms (eWnioski) were introduced which are more transparent and user-friendly, with only one signature needed for several requests and an option to save a draft version with some fields left blank.
- The pilot run ofiBiznes 24 Connect (web-service) was successfully and the scope of the solution was extended to include new features.
- Customers were given access to the advisor's business card in the form of a tile in the menu (the advisor may be assigned to the company or to the specific system installation).

Factoring Business

The range of products and services offered by BZ WBK Faktor includes recourse and non-recourse factoring, domestic and foreign reverse factoring, bill of exchange discounting and confirming. The company provides services to customers from the SME, Business and Corporate Banking and Global Corporate Banking segments.

In 2017, the receivables purchased by BZ WBK Faktor came in at PLN 23.4bn, up 23% YoY, which means that the business grew faster than the domestic factoring market (+17% YoY). This gave the company a market share of 12.6% and second position in the ranking of members of the Polish Association of Factoring Companies. As at the end of December 2017, the company's credit exposure was PLN 4.2bn, higher by 25% YoY.

In October 2017, the company issued bonds in a private placement with a nominal value of PLN 700m, 1M WIBOR-based variable interest rate and maturity date of 18 February 2018. The bonds were purchased by entities from outside Bank Zachodni WBK Group. Proceeds from the issue allowed the company to reduce its overdraft balance.

1.4. Global Corporate Banking

Main Directions

In 2017, the Global Corporate Banking Division (GCB) provided an end-to-end support to the largest corporate customers of Bank Zachodni WBK and rendered services to corporations within the global Santander Group GCB structures. As at 31 December 2017, the active GCB customer base included nearly 250 of the largest companies and groups (allocated to that segment based on the turnover) representing all economic sectors in Poland.

The division's comprehensive offer encompasses a wide range of products and services, including transactional banking, short-, mid- and long-term financing, guarantees, M&A solutions, share issues, liquidity management and custodian services. The GCB Division conducted the bank's business on financial markets and provided specialist financial products (including treasury, brokerage and capital market offers).

Notably, the GCB Division leveraged opportunities from Santander Group's global presence and rendered services to corporations within international GCB structures, cooperated with several Santander Group in respect of the issue of bonds, sold Polish bonds to foreign investors and traded in Latin American bonds in Poland.

The ambition of Bank Zachodni WBK is to become a bank of choice for the largest corporate customers and to provide an unparalleled investment offering. To that end, the Global Corporate Banking Division puts customers at the heart of its business, trying to meet their needs and enhance their positive experience, while focusing on service quality, market position and staff development. Service quality is continually improved through the customisation, digitalisation and diversification of products and services. The market position is strengthened through business growth, whereas staff professionalism is supported by training programmes and development in accordance with the Group's values.

In order to raise customer service quality, in 2017 the GCB Division:

- Implemented a customer service model that included assistance from sector bankers, improved customer segmentation and the introduction of a schedule of regular meetings to discuss services for specific customers;
- Improved features of the FX Kantor BZWBK24 currency exchange platform regarded as a best practice model at Santander Group level in terms of IT, marketing, CRM, product range and incentive scheme;
- Developed new products in the area of securities and derivatives, which will be gradually implemented over the next three years;
- Steadily increased the range of underwriting solutions offered by the Credit Markets Department;
- Expanded transactional banking solutions, particularly in the area of cash management through the implementation of the host-to-Host service in a number of companies;
- Optimised the structure of the income statement and the balance sheet by growing the fee-generating business.

Through cooperation with other units, the GCB Division modified its business model in accordance with new regulations (MIFID II, FRTB, PRIIPs, IFRS9, EMIR).

Performance of Selected Areas

In 2017, individual units of the GCB Division focused on the initiatives described below.

Credit Markets

- The Credit Markets Department provided funding towards medium and long-term investment projects delivered by GCB customers through loans and corporate bond issues, including funding extended in cooperation with other units, both within its division (e.g. with Global Transactional Banking and Financial Markets) and outside it (e.g. with the Business and Corporate Banking Division). Credit Markets closed several financing deals with companies from economically-important sectors such as the telecommunications, services, cosmetics, agriculture, automotive and energy sectors.

Capital Markets

- Capital Markets provided analytical and advisory services to customers and was engaged as a financial/transactional advisor for companies from the property, production, infrastructure, telecommunications, pharmaceutical and services sectors. In the reporting period, the Capital Markets Office together with the BZ WBK Brokerage Houses completed the largest public offering in the history of the Warsaw Stock Exchange, with the transaction value of PLN 4.4bn. Other notable transactions include arrangement and management of a tender offer for a company operating in the property, service and manufacturing sectors.

Global Transactional Banking

- The Global Transactional Banking Department closed a number of deals in relation to financing, guarantees and supply chain finance with companies from the automotive, construction, clothing, retail and energy sectors. As part of cash management, the host-to-host service was further improved to provide an opportunity for the effective exchange of information between the bank and ERP systems. In 2017, this solution was implemented in 10 groups of large companies.

Treasury Sales Department

- In the reporting period, the Treasury Sales Department continued its income diversification strategy. The range of interest rate hedging instruments offered by the bank was extended to include new solutions for leasing and factoring customers. The department focused on the promotion of foreign exchange instruments to enable customers to hedge currency risk in the long term and thus stabilise their balance sheet positions. Distribution channels for treasury products were further developed to ensure higher level of digitisation, increased penetration of the customer base and greater competitive advantage (e.g. an upgrade of the Kantor BZWBK24 currency exchange platform).

Financial Market Transactions Department

- In 2017, the Financial Market Transactions Department focused on the further development of products, mainly in relation to hedging instruments. The department joined the global foreign exchange platform and became one of the leaders in global electronic trading platforms for Polish treasury bonds. The Financial Market Transactions Department grew its portfolio of corporate customers using the global know-how of Santander Group. It organised a number of road-shows to attract customers from Western European, American and Asian markets to invest in Poland. The Department also acted as an intermediary in relation to the sale of products and services offered by the bank and Santander Group in Poland (including government bonds issued by eurozone peripheral and South American countries).

Institutional Equities Department

- The department focused on the development of systems to automate processes connected with brokerage services offered to business customers.

Equity Research Department

- The Equity Research Department worked closely with Santander Group to implement a new distribution channel: an equity research online platform which will be launched for business customers in 2018. In addition to other conferences and events, in November 2017, the department organised an Investor Day "20 Stories Worth Telling" ("20 historii wartych opowiedzenia"), during which members of the Management Boards of 20 listed companies met with institutional investors.

Largest deals of the Global Corporate Banking Division

- The bank maintains a leadership position in such areas as: public offerings, mergers and acquisitions and supply chain finance.

The largest deals completed by the GCB Division in 2017 include:

- Participation in the largest financing deal of 2017 with a customer from the telecommunications sector, with the bank acting as the Facility Agent in the transaction;
- Participation in the IPO worth PLN 4.4bn, the largest transaction of this kind in the history of the Warsaw Stock Exchange;
- Significant loan agreements signed with customers from the agriculture, automotive and services sectors;
- Financing the acquisition of companies from the services, cosmetics and food sectors;
- Issuance of bonds in the Polish market for customers from the services and finance sectors;
- Issuance of eurobonds for customers from the finance and energy sectors;

- Conclusion of major supply chain financing contracts with customers from the trade and energy sectors, for an amount exceeding PLN 1.0bn;
- Participation in the IPO of a client from the property sector, and then organising and financing a tender offer for the shares acquired as a result of the above process for a strategic investor from Romania.

2. Santander Consumer Bank Group

Profile

Santander Consumer Bank (SCB) is a financial institution with many years of experience and a strong position in the consumer finance sector, which specialises in providing credit facilities to households and businesses (mainly car dealers and importers).

Its lending business is based on the following credit facilities: cash loans, instalment loans, car loans, business loans and credit cards. Retail and business deposits and insurance products are also important elements of the bank's product range.

The bank's offer is supplemented with car finance through lease facilities provided by Santander Consumer Multirent, a wholly-owned subsidiary of Santander Consumer Bank, and through lease and factoring solutions offered by PSA Finance Polska, in which Santander Consumer Bank holds a 50% stake.

In addition, PSA Consumer Finance Polska, a subsidiary of PSA Finance Polska which is indirectly 50% owned by SCB, provides consumer finance solutions to support car sales.

Other entities controlled by Santander Consumer Bank are: Santander Consumer Finanse (investment of cash surpluses and cooperation with BZ WBK and Warta in terms of financial intermediary services), and SC Poland Consumer 15-1 and SC Poland Consumer 16-1 (SPVs set up for the purpose of securitisation transactions).

Business Development

Strategic objectives delivered in 2017

The main strategic objective of Santander Consumer Bank Group is to build a modern and secure bank with an effective and consistent organisational structure and a management culture that leverages the extensive experience of Santander Group. In terms of sales objectives, the Group is looking to maintain its strong position in the consumer and car finance markets.

In the pursuit of 2017 objectives, in the first half of the year, the SCB Group:

- Strengthened its business position and perception as a leading institution in the consumer finance market.
- In 2017, SCB held:
  - 1st place in the hire purchase market;
  - 3rd place in terms of growth in the number of credit cards;
  - 4th place in the cash loans market;
  - 3rd place in the car finance market;
- Maintained strong sales of high-margin consumer loans (cash loans and credit cards) and increased the volume of car finance with a growing share of lease solutions chosen over car loans;
- Diversified and built up stable sources of funding and optimised its cost in an environment of low interest rates and a changing regulatory regime owing to a higher share of the most stable sources (long-term deposits and securitisation bonds), increased activity in the corporate deposits market and higher long-term FX funding based on repurchase agreements;
- Maintained a stable risk level, high provision coverage ratio and a steady non-performing loans ratio compared with 2016;
- Ensured a stable level of operating costs (excluding obligatory costs) and improved cost-effectiveness;
- Maintained a solid capital position.

Development directions

Pursuant to the strategy adopted by SCB Group, measures taken in 2017 focused on maintaining the Group's leadership position in the hire purchase market, with a stable share in traditional sales and a growing share in online sales, as well as on identifying new sales growth opportunities and maintaining the profitability of collaboration with trade partners.

The Group continued its customer acquisition strategy based on installment loans and credit cards, maximising sales opportunities by cross-selling and up-selling. The Group extended cooperation with a key partner in terms of hire purchase and co-branded credit cards, and entered into partnership with a chain of DIY stores.

In terms of cash loans, SCB Group continued to maximise the value of customer relationships and optimise the product range. The NPS (Net Promoter Score) survey conducted by the bank among active customers gave satisfactory results (57%, i.e. above the market average), which proved that the product and sales strategy was effective.

In view of the prevailing trends in car finance (growth of lease and car fleet management markets fuelled by the sale of new cars, change of customers' preferences in the low interest rate environment towards a lower-cost and simple cash loan), SCB Group focused on services provided to SMEs and individuals (other than sole traders) to deliver on its lending objectives.

Development of products and services

In the reporting period, SCB Group expanded its range of products and services to include:

- an instalment loan for farmers and sole traders;
- a new credit card offered in partnership with a large chain of DIY stores, and solutions offered as part of cooperation with the bank's key partner from the household appliances sector which was extended for another three years;
- instant issuance of credit cards and assistance insurance linked to credit cards sold in the bank's branches;
- modified terms of cash loans, reflecting the bank's policy of maximising the effectiveness of customer relationships and optimising the product range;
- cash loans offered in customer service points of the selected household appliance stores and DIY chains;
- cash loans for new-profile customers with external consolidation and an increased cash loan amount and tenor for new customers;
- additional banking services offered to customers holding a loan with SCB (available in three options);
- a new sales channel for retail deposits, providing customers with an opportunity to manage their term deposits online;
- a pilot of the Full Service Lease, a product offering additional benefits such as car service by approved repairers and full motor insurance.

Core Business Volumes

Loans to customers

As at 31 December 2017, gross loans and advances granted by SCB Group amounted to PLN 16.0bn (excluding intercompany transactions) and were 3.3% higher YoY due to growth in lease facilities, w/c loans, cash loans and credit cards. The increase in w/c loans and lease facilities was attributed to the acquisition of a controlling interest in PSA Finance Polska, a company offering factoring solutions to car dealers, among other things. The growth in the balance of cash loans was achieved due to higher sales supported by an extensive marketing campaign.

Cash loans offered to existing and new customers have the highest share in the SCB credit portfolio, followed by instalment loans, which are an important customer acquisition and cross-selling tool. For many years, SCB Group has been one of the market leaders in terms of car loans for individuals and businesses. The Group is strengthening its position in the car finance market by liaising with car dealers and importers. SCB is also one of the top 10 issuers of credit cards in Poland.

Deposits from customers and debt securities issue

One of the main funding sources of SCB Group are deposits from customers, which totalled PLN 8.2bn at the end of December 2017 (excluding intercompany transactions) and were broadly flat compared with the last year (-0.9%), with a relatively stable level of term deposits from corporate and retail customers.

Retail deposits are the bulk of the Group's deposit base, and mainly include term deposits with a fixed capitalisation rate at maturity. The remaining portion of the Group's deposit base is made up of corporate deposits. The bank focuses on the sale of deposits for tenors of one year or more, by offering attractive pricing, particularly on 24-month and 36-month deposits.

The value of new bonds issued by SCB in 2017 under the programme of debt securities issue underwritten by SCB exceeded the value of matured bonds, as a result of which the Group's liabilities in respect of debt securities increased by 5.6% YoY to PLN 4bn.

Key Developments

Cooperation with business partners

On 1 March 2017, SCB entered into partnership with one of the largest chains of DIY stores in Poland, as part of which customers are offered instalment loans, credit cards and cash loans. Credit facilities are complemented with insurance products.

In April 2017, SCB extended cooperation with three key partners from the household appliances sector, reinforcing its leadership position in the consumer loans market. As part of the agreement, customers of SCB partners may buy goods and services with instalment loans and credit cards offered by the bank.

Sale of credit portfolio

In 2017, Santander Consumer Bank sold the written-off portfolio of cash loans, instalment loans, car loans, mortgage loans and credit cards of PLN 382.7m in total.

Extension and amendment of the securitisation agreement

In March 2017, an agreement was signed whereby the current balance of loan agreements securitised by SC Poland Consumer 15-1 was extended by another two years.

Liquidation of AKB Marketing Services

The information about the removal of the company from the National Court Register is presented in the section "Entities Related with Bank Zachodni WBK" Chapter II "Basic Information about Bank Zachodni WBK and BZ WBK Group".

Reduction of the share capital of PSA Finance Polska

Pursuant to the resolution of the General Meeting of PSA Finance Polska of 7 December 2016, on 5 April 2017 SCB sold 30 thousand shares of PSA Finance Polska (representing 10% of share capital) to the latter for the purpose of their cancellation.

The Management Board of PSA Finance Polska acquired own shares from both shareholders (SCB and Banque PSA Finance) in equal proportions. The shares were subsequently cancelled and the company's ownership structure did not change in effect.

Distribution Network of Santander Consumer Bank

In 2017, Santander Consumer Bank continued measures taken to optimise its sales network. To that end, the structure of branches and franchise outlets was reviewed, taking into account customers' needs and the development of remote and mobile services.

As at 31 December 2017, Santander Consumer Bank sold its products through the following distribution channels:

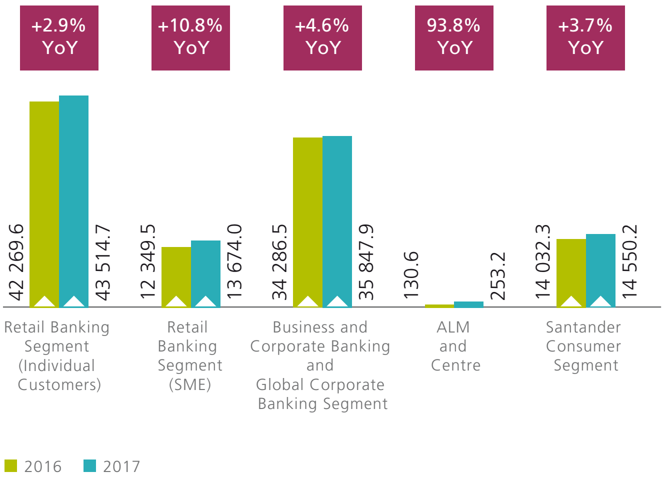
- own network of 159 branches and 153 franchise outlets (163 and 148 at the end of December 2016, respectively) offering consumer loans and retail deposits;
- a mobile sales channel for car loans;
- a mobile sales channel for corporate deposits;
- remote channels, including a call centre and the internet, where customers can sign up for consumer loans or retail deposits;
- a network of 656 partners offering the bank's car loans plus 11,581 active partners offering the bank's instalment loans (662 and 12,516 at the end of December 2016, respectively);
- a remote channel for car loans.

The number of SCB customers using electronic and mobile banking services was 131.7k as at 31 December 2017 (4.2k as at 31 December 2016).

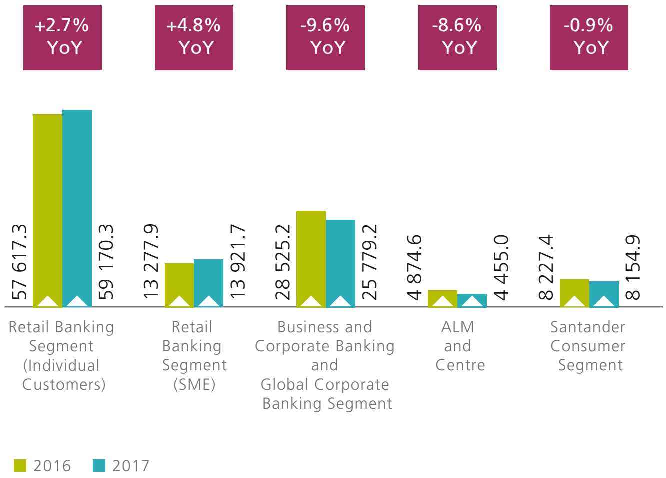
3. Core Business Volumes by Segments

The charts below show net loans and advances to customers and deposits from customers (as presented in segment reporting in Note 3 of the Consolidated Statements of Bank Zachodni WBK Group for 2017), which have been restated for analytical purposes. Personal and SME customers from the largest Retail Segment are presented separately, whereas the Business and Corporate Banking Segment is combined with the Global Corporate Banking Segment due to the transfer of the largest corporate customers from the former segment to the latter in 2017.

Net Loans and Advances from Customers by Business Segments as at 31 December 2017 and 31 December 2016 (PLN m)



Deposits from Customers by Business Segments as at 31 December 2017 and 31 December 2016 (PLN m)



In 2017, deposits from customers from the Retail Segment increased by 2.5% YoY, including growth of 2.7% YoY and 4.8% YoY for personal and SME customers, respectively. This was mainly attributed to an increase in funds in current accounts, including those acquired via remote distribution channels. Loans and advances to individuals, net of impairment losses, increased by 2.9% YoY as a result of sales of cash and mortgage loans. In turn, net loans and advances to SMEs went up by 10.8% YoY on account of overdrafts and leases. Customers also took out Business Express (Biznes Ekspres) loans and investment loans. Lending to SMEs was supported by BGK guarantees, including COSME guarantees granted to secure credit transactions and POIG guarantees issued to secure overdrafts, as an attractive alternative to de minimis guarantees.

Net loans and advances to customers from the Business and Corporate Banking Segment and the Global Corporate Banking Segment increased by 4.6% YoY, including factoring receivables. In the Global Corporate Banking Segment, the growth was mainly driven by the supply chain finance which supports the core business of customers. The value of those transactions increased by a third compared to the last year as the number of programmes and suppliers went up. Combined deposits from customers from both segments decreased by 9.6% YoY. The customer base of the Business and Corporate Banking Segment increased on account of new agreements signed with corporate customers from key sectors.

Changes to loans and advances to customers and deposits from customers are presented in section 2 of this chapter devoted to SCB Group.

VII. Organisational, Infrastructural and Technological Development

1. Organisational Development

Bank Zachodni WBK

Organisational Changes in 2017

In order to achieve its strategic goal to become the bank of choice for retail and business customers, in 2017 Bank Zachodni WBK continued its large-scale transformation process that covered such areas as products and services for different customer segments, digitalisation, business model, data management and corporate culture. This involved changes to the bank's organisational structure, particularly to the following divisions: the Small and Medium Enterprise Banking Division, the Digital Transformation Division, the Legal and Compliance Division and the Business Partnership Division.

In the SME Banking Division, the SME 2 Sales Area was set up to deal with customers from the upper-end of the segment, i.e. firms with a turnover of PLN 5–10m. Previously, such customers were serviced by branch banking, now they are handled by four regional departments (Central, South West and North). Furthermore, the SME Digital Customer Office was created to provide SME customers with wider remote access to banking products and services across different channels.

Changes connected with the transformation process resulted in the reorganisation of a number of units in the Digital Transformation Division, namely: the Change and Project Management Department, the Financial Fraud Prevention Department, and the Control Department. In October 2017, the Documentation Management Office was set up to support the development of a digital bank by creating an optimum flow of documents within modern, multichannel banking processes while ensuring security and compliance with Polish and EU laws and regulations (such as the General Data Protection Regulation).

The organisational changes in the Legal and Compliance Division included the liquidation of the Legal Area. The lower-level units operating as part of the Area were reorganised into departments: the Business Support and Group Legal Services Department, and the Sales Processes Legal Services Department. The above changes were prompted by the transformation processes in place and the need to streamline the activities performed by the division to reflect the actual circumstances and to enhance the efficiency.

The Environment, Health and Safety Office was incorporated into the structures of the Business Partnership Division, and the HR Business Partnership Area was divided into two Business Partnership Departments: BSC, and Segments and Distribution, respectively. The responsibilities of the Recruitment and Personal Development Department were taken over by new centres of competence such as the Personal Development Department, the Recruitment Office and the Corporate Culture Transformation Department.

The Private Banking Department, which handles high net worth customers, was separated from the Retail Banking Division and now operates as part of the Wealth Management Programme outside the bank's divisional structure. The Technology Modelling and Analyses Office was moved from the Digital Transformation Division to the Business Intelligence Area, the centre of competence for data processing, which also operates outside the divisional structure.

In 2017, the bank continued the process of restructuring its branch network, relocating or closing down less effective branches.

Planned Acquisition of a Carved-out Business of Deutsche Bank Polska

Agreement on the Acquisition of a Carved-out Business of Deutsche Bank Polska by Bank Zachodni WBK

On 14 December 2017, Bank Zachodni WBK and Banco Santander signed a transaction agreement with Deutsche Bank AG (DB AG) to purchase a part of the Deutsche Bank Polska (DBPL) business, consisting of retail banking, private banking, SME banking and

DB Securities. DBPL's corporate and investment banking business and foreign-currency mortgage portfolio are excluded from the transaction and will remain in DBPL (retained business).

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

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

Structure of the Transaction

Before the demerger, Bank Zachodni WBK will buy DBPL's shares from DB AG, representing 10% of votes at the DBPL's General Meeting of Shareholders. Next, the bank and DBPL will file requests for the registration of the demerger with relevant registry courts.

The demerger will be effected on the following terms:

- DBPL will be a demerged company and BZ WBK will be an acquiring company;
- The share capital of DBPL will be decreased by at least an equivalent of the total nominal value of the shares purchased by Bank Zachodni WBK. On the date of the registration of such a capital decrease, all the shares purchased by the bank will cease to exist and DB AG will become the sole shareholder of DBPL;
- In exchange for the transfer of the carved-out business to Bank Zachodni WBK, DB AG will receive a stated number of BZ WBK shares (demerger shares) on the demerger date, calculated based on the agreed formula which will be used to determine a share exchange ratio in the demerger plan. The demerger will be effective as of the date of registration of the bank's capital increase by way of the issuance of demerger shares;
- On the demerger date, the carved-out business will be transferred to the bank and the business which is not subject to the transaction will remain in DBPL. DBPL's assets and liabilities will be allocated between the carved-out business and the retained business based on the terms specified in the transaction agreement and the demerger plan.

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

The consideration for the transaction will be paid in:

- Cash, through the payment of a price for the purchased shares (20% of the preliminary purchase price);
- Newly issued shares of the bank representing approx. 2.7% of the bank's share capital (80% of the preliminary purchase price).

Once the transaction agreement is executed, the preliminary purchase price will be adjusted to reflect changes in relevant assets and liabilities that have taken place between the transaction agreement date and the demerger date.

The transaction is subject to regulatory approval, including a consent from the Polish Financial Supervision Authority (KNF) and the President of the Office of Competition and Consumer Protection (UOKiK), as well as resolutions of the General Meetings of Shareholders of BZ WBK and DBPL, signing of the demerger plan and fulfilment of certain operational conditions. The transaction is expected to close in Q4 2018. The migration of IT systems is planned to be completed immediately after closing.

As a result of the transaction, Bank Zachodni WBK is expected to increase its share in the mass, high net worth, Private Banking and SME markets, consolidating its position as the third largest bank in Poland.

Bank Zachodni WBK Group

Changes in the Structure of the Group in 2017

Changes in the structure of Bank Zachodni WBK Group that took place in 2017 resulted from the following:

- Acquisition of BZ WBK Lease by BZ WBK Leasing (28 February 2017);
- Removal of AKB Marketing Services (a member of SCB Group) from the National Court Register following its liquidation (20 November 2017).
- The stock swap between Bank Zachodni WBK and BZ WBK Finanse (in-kind contribution of BZWBK F24 shares to BZ WBK Finanse in exchange for shares of BZ WBK Finanse) and the purchase by BZ WBK Finanse of an outstanding share ensuring a 100% stake in the share capital of BZ WBK F24 (November 2017 – January 2018).

For more information about changes in the structure of Bank Zachodni WBK Group, see the section "Entities Related with Bank Zachodni WBK" Chapter II "Basic Information about Bank Zachodni WBK and BZ WBK Group".

Mortgage Bank Project

Bank Zachodni WBK intends to launch a mortgage bank and is currently in the process of drawing up a motion to be submitted to the relevant regulator.

2. Development of Selected Distribution Channels

Branch Network and Complementary Channels

In 2017, Bank Zachodni WBK carried out a review of its branch network, taking into account customers' needs and changes in their banking behaviour, development of electronic services (including mobile services) and the distribution strategy of the bank. The process of rationalisation, optimisation and relocation of branches was continued accordingly, as a result of which the number of outlets decreased by 82 during the last 12 months to reach 576 as at 31 December 2017. Two branches were reorganised into partner outlets in accordance with the bank's distribution strategy. This process will continue in the next few years.

The bank gradually increased the number of branches operating under a new cash services model (with cash operations transferred to self-service devices), as a result of which branches can devote more time to developing and strengthening relationships with customers. The bank also progressed well in the integration of its branches with remote channels, to ensure more effective use of advanced CRM tools.

Transformation of the Distribution Model

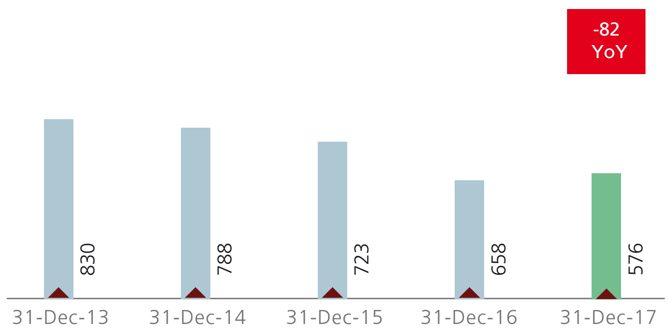
In 2017, the bank launched a new distribution strategy. The key streams included: the role and function of distribution channels, the advisor profile, branch formats and branch distribution. According to the strategy, retail business growth will be supported mainly by digital channels, with branches being primarily responsible for developing relationships with customers, promoting digital channels and selling more complex products. The distribution network will include new formats such as small points of acquisition and partner outlets. The profile of advisors and the interior design of branches will be aligned with the changing role of branches and customers' expectations.

In September 2017, Bank Zachodni WBK opened a branch in one of Warsaw shopping centres and launched a pilot scheme for a new service model. The branch is open seven days a week and offers access to self-service devices. Given the pilot's positive results, the bank has now started the process of rolling out the new model across its branch network.

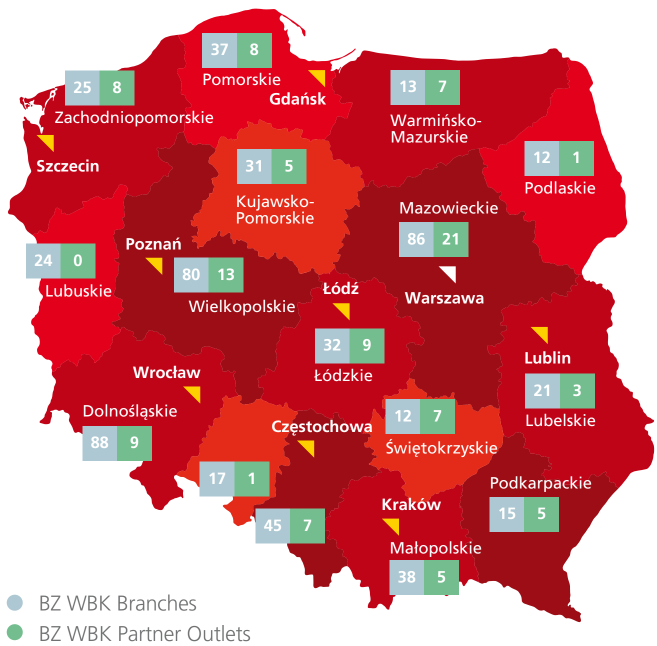
Partner Outlets

The branch network of Bank Zachodni WBK was complemented by 109 partner outlets (110 as at 31 December 2016) offering a range of the bank's products and services (excluding foreign exchange services and investment products) to individuals and businesses, mainly in small and medium towns.

BZ WBK Branch Network at the end of individual years from 31 December 2013 to 31 December 2017



Distribution of BZ WBK branches and partner outlets in Poland as at 31 December 2017



Santander Consumer Bank offered cash loans, credit cards, retail deposits and other banking products through its own network of 159 branches and 153 franchise outlets. The bank also sold car loans and instalment loans through mobile sales structures and a network of partners. It continued to operate its remote distribution channels using online and telephone platform.

ATMs/Cash Deposit Machines

In 2017, Bank Zachodni WBK continued the development of self-service channels in order to reduce cash desk services in branches and enhance the customer experience. The bank focused on the extension of the network of self-service devices featuring cash deposit and withdrawal functions. The functionality of the traditional ATMs was upgraded and cash recyclers were put in place. The cash recycling functionality (withdrawal of cash that is previously deposited in a recycler by other customers) helped to increase the effectiveness of the network and reduce costs associated with cash services.

The bank's ATMs and CDMs were equipped with a contactless interface to enable individuals and businesses to perform a range of contactless operations such as deposit/withdrawal of cash, balance check, mini-statements, phone top-ups, card activation and repayment of credit card debt balances. Transactions may be initiated with contactless cards and HCE mobile cards.

As at the end of December 2017, the network of self-service machines operated by Bank Zachodni WBK comprised 771 deposit ATMs (vs. 684 as at 31 December 2016). In all, there were 1,732 machines including ATMs and CDMs (vs. 1,766 as at 31 December 2016).

Mobile and Internet Banking

Development of Functionality

BZWBK24 mobile and internet applications were further developed to improve self-service and ease of use. Customers were provided with an option to set up the parameters of the Account As I Want It (Konto Jakie Chcę) according to their choice. They can now also benefit from longer operating hours on the Kantor BZWBK24 currency exchange platform. In order to standardise the features of internet and mobile banking, customers were provided with a mailbox with both the BZWBK24 internet platform and the BZWBK24 mobile application.

Users of the BZWBK24 mobile application were offered an opportunity to sign up for new credit facilities such as a credit card, Ratio service or credit card limit increase. The quick view of accounts was extended, the functionality of alerts was expanded, and an upgraded version of BLIK was introduced, featuring a mechanism for payments via trusted websites without the use of a code. Customers were provided with a more user-friendly application and new features such as the option to log in using a fingerprint. Finally, payment card management services were introduced, including push alerts and an option to cancel the card.

The scope of products available via the BZWBK24 internet platform was extended to include a consolidation loan and an insurance package. Special after-sales forms were introduced for customers using credit facilities. Furthermore, the online sale of personal and business accounts was optimised to improve the customer experience, as was the process of setting up an account for retail and SME customers, and website navigation. The bank progressed well with the integration of internet banking and CRM solutions and additionally completed the next stages of its ongoing projects, such as setting up additional anti-fraud mechanisms on the online platform. Users of the BZWBK24 platform were provided with access to a new investment fund platform ("Arka Funds" tab) which will become fully operational in 2018. The bank further contributed to the digitalisation of the administration system and online services gateway for Polish citizens by offering the bank's customers the opportunity to set up a trusted profile via the internet banking platform to then log into official Polish government portals (such as ePUAP, obywatel.gov.pl, biznes.gov.pl, PUE ZUS, CEIDG, Emp@tia) to administer their information and official records.

Increased Activity of Customers

As at 31 December 2017, the number of digital customers, i.e. BZWBK24 users who have logged into the bank's electronic banking system at least once, exceeded 2.1 million (vs. 3.1 million customers with access to BZWBK24) and increased by 4,5% YoY. The number of mobile application users went up by 26.7% YoY and exceeded 1.1 million (including 145 thousand customers who use BZWBK24 mobile only).

Multichannel Communication Centre

Development of Functionality

The Multichannel Communication Centre provides services across different customer contact points such as a helpline, Internet chat, audio call, video call, email and the contact form. Customers may also visit a virtual branch and use Online Advisor services (via video chat). The Centre is responsible for sales, customer service, retention and support for personal, VIP and SME customers (also accessible in foreign languages and sign language).

The strategy of the BZ WBK Multichannel Communication Centre focuses on facilitating interaction between the customer and the bank, and the improvement of its end-to-end processes (E2E) to enable customers to buy products and services through remote channels.

In 2017, particular focus was placed on Online Advisor services provided via video call, audio call or chat. The number of advisors and processes handled in this channel was increased accordingly. Online identity verification was introduced using face recognition technology, end-to-end credit application processes were launched for retail and SME customers and the range of services was also extended to include instructions regarding mortgage and cash loans, the generation of account statements, the issuance of certificates, the establishment/modification of bereavement payment terms and the purchase/conversion/redemption of investment fund units.

The number of operations that may be performed using the Multichannel Communication Centre was further expanded to include the execution or cancellation of a credit facility agreement, notification of a cash withdrawal, card services for retail customers (including termination of a debit card with a 14-day notice in the case of account switching), setting up a business customer folder, opening a brokerage account via phone, and Ukrainian-language customer support.

In 2017, the bank continued the mass roll-out of its call centralisation project, which covered nearly 50% of branches. Each customer calling a branch is now redirected to the Multichannel Communication Centre, which provides end-to-end support.

Increased Activity of Customers

In 2017, the number of interactions with customers over the phone or via an Online Advisor increased by 27% YoY.

Likewise, credit sales generated in remote channels (mobile, internet, the Multichannel Communication Centre) went up by 34% YoY and 38% YoY in terms of number and value.

3. IT Development

Development of IT Systems

Digital Transformation

In 2017, the bank further upgraded its IT infrastructure as part of a large-scale Digital Transformation Programme, including customer service systems as well as underlying hardware and software resources. The initiatives taken by the bank in this respect were aimed at increasing its ability to respond to changing customers' needs, enhancing customer service, improving operational efficiency and reliability, automating business processes, and improving software and hardware solutions.

Compliance with Regulatory Requirements

A considerable part of the IT initiatives delivered by the bank were connected to regulatory requirements imposed on financial institutions. Particularly noteworthy are three large-scale and long-term initiatives derived from the following EU regulations:

- Payment Services Directive (PSD 2), which imposes a number of obligations on banks connected with payments initiated by third parties and access to information about customers' accounts;
- Markets in Financial Instruments Directive (MIFID 2), which sets out banks' obligations related to offering investment products to customers;
- General Data Protection Regulation (GDPR/RODO), which establishes rules for personal data processing.

Along with these obligatory projects, the bank is to introduce further enhancements to its customer service standards, upgrades IT solutions and therefore gains additional benefits business benefits.

Automation and Extension of Functionality and Access to IT Systems

Changes to IT systems and underlying hardware and software resources are also prompted by the need to extend the scope of information and the range of operations available 24/7 to customers and organisational units of the bank. The bank uses a systemic approach in this respect, taking into account the IT architecture as a whole, while simplifying and reducing the number of connections between systems. At the same time, the change implementation process itself is being automated. A specialist unit was set up to handle this process. The unit created its own operating model that relies on a repetitive development process and fully automated business processes. The processes are executed by systems/robots which use their own highly reliable infrastructure that automatically adapts to changes in the workload.

The bank continually works towards solutions ensuring controlled and automated workflow as well as the electronic circulation and storage of documents. The bank's achievements in this respect make it one of the most innovative institutions in the Polish banking sector.

The automation process also covered financial information, including issues connected with the products offered and effectiveness.

The bank continued to develop electronic and mobile banking solutions to suit individuals, SMEs and corporates. A particular focus was placed on the simplicity, ease of use and security of the proposed solutions.

To ensure information security, the bank provided advanced mechanisms to protect IT resources and associated operations. Relevant control methodologies and tools were developed or revised in accordance with existing needs and emerging threats.

4. Capital Expenditure

The capital expenditures incurred by BZ WBK Group in 2017 totalled PLN 414.2m (PLN 334.8m in 2016). The highest spend was on projects related to the development and management of IT systems and infrastructure, process digitalisation, risk management and development of internet, mobile and phone banking. Significant outlays were also made on dual function ATMs, the target CRM architecture, modernisation of the branch network and implementation of EU regulations.

In view of growing business needs and the increasing amount of information processed by the bank, IT infrastructure and associated software were further developed and upgraded. The hardware (servers, disk arrays, etc.) supporting test and production systems was extended to increase capacity and enhance performance.

In 2017, the robotic process automation platform was deployed to facilitate the automation of manual processes without the need for complex modifications to IT systems. In effect, after-sales and back-office operations related to credit delivery and complaint handling were automated, a centre of competence was set up to manage systems related to the flow of digital documents in banking processes, and a customer communication platform was launched, making it possible to generate agreements and certificates and handle mass communication in one place. The bank also completed the second stage of the Central Collateral Database project whose purpose is to aggregate all collateral information, while ensuring the consistency and security of data.

Strong focus was placed on maintaining an adequate level of day-to-day IT security and ensuring high quality and continuity of operations within the entire IT environment.

Significant investments were also made as part of the Digital Transformation Programme in the redesign and digitalisation of key sales and after-sales processes for retail and corporate customers, taking into account business needs and external factors. In 2017, particular focus was placed on the digitalisation of processes connected with credit and investment facilities, and accounts and insurance products (for more information, see Chapter VI “Business Development”).

As part of the development of the multichannel service model, efforts were taken to further enhance mobile and internet banking, by adding new features and improvements to the BZWBK24 and iBiznes24 applications (detailed information is presented in the section “Development of Selected Distribution Channels” of this chapter).

A number of initiatives were also undertaken in the area of risk management as part of strategic and obligatory projects. The bank implemented, among other things, Advanced Internal Rating-Based Models in decision-making processes for retail and SME customers. Data structures were developed to be later used for the purpose of the calculation of capital requirements under an advanced approach. The bank also continued measures to implement the Basel Committee’s guidelines set out in BCBS 239.

The ALM Programme was underway, including the development of a new ALM system supporting the oversight and management of interest rate risk in the banking book and liquidity risk. This Programme will continue in 2018.

In 2017, the bank started a process to implement requirements arising from the Payment Services Directive 2 (PSD2). Measures were also taken to develop an Application Programming Interface (API) to connect with third party providers. This project is planned to be finalised in 2018.

In terms of CRM systems, the bank continued to extend the range of features implemented in previous years. The front-end platform used by the Multichannel Communication Centre and the branch network was expanded to include solutions facilitating the management of customer portfolios. New analytical features were implemented, whereby operations are launched on the basis of an analysis of a sequence of events. The CRM environment was integrated with the ATM network and, as a pilot project with the electronic banking platform.

In order to reduce cash desk in branches, the bank continued to replace old ATMs with new deposit ATMs utilising cash recycling technology. The functionality of self-service devices was expanded to include a range of contactless transactions (aside from deposits and withdrawals).

Finally, the branch infrastructure was further upgraded to standardise IT equipment, improve working conditions, enhance the customer experience and increase security.

VIII. Financial Situation of Bank Zachodni WBK and BZ WBK Group

1. Income Statement of Bank Zachodni WBK Group

Structure of Bank Zachodni WBK Group Profit in 2017

Structure of Bank Zachodni WBK Group Profit Before Tax

PLN m

Condensed Consolidated Income Statement of BZ WBK Group (for analytical purposes)	2017	2016	YoY Change
Total income	**7 763.6**	**7 606.2**	**2.1%**
– Net interest income	5 276.9	4 770.4	10.6%
– Net fee & commission income	2 013.1	1 914.7	5.1%
– Other income [1]	473.6	921.1	-48.6%
Total costs	**(3 372.4)**	**(3 367.7)**	**0.1%**
– Staff, general and administrative expenses	(2 939.4)	(2 935.2)	0.1%
– Depreciation/amortisation	(318.9)	(277.2)	15.0%
– Other operating expenses	(114.1)	(155.3)	-26.5%
Impairment losses on loans and advances	**(690.5)**	**(784.6)**	**-12.0%**
Profit/loss attributable to the entities accounted for using the equity method	58.3	55.4	5.2%
Tax on financial institutions [2]	(423.8)	(387.2)	9.5%
Consolidated profit before tax	**3 335.2**	**3 122.1**	**6.8%**
Tax charges	(816.7)	(738.0)	10.7%
Net profit for the period	**2 518.5**	**2 384.1**	**5.6%**
– Net profit attributable to BZ WBK shareholders	**2 213.1**	**2 166.8**	**2.1%**
– Net profit attributable to non–controlling shareholders	305.4	217.3	40.5%

1) Other income includes the following items of the full income statement: dividend income; net profit on shares in subordinate entities; net trading income and revaluation; gains on other financial instruments; other operating income.
The figure for 2016 includes one-off gains of PLN 316.1m reported by BZ WBK and SCB on account of the settlement of the acquisition of Visa Europe Ltd. by Visa Inc. (in the full version of the income statement this amount is reported as part of gains on other financial instruments).
2) The banking tax is calculated in accordance with the Act on tax imposed on certain financial institutions that became effective on 1 February 2016.

In 2017, Bank Zachodni WBK Group posted a profit before tax of PLN 3,335.2m, up 6.8% YoY.

Excluding one-off gains on equity instruments from the corresponding period (PLN 316.1m arising from the settlement of the acquisition of Visa Europe Ltd. by Visa Inc. in 2016), the underlying profit before tax increased by 18.9% YoY on account of an improvement in net interest income (+10.6% YoY) and net fee and commission income (+5.1% YoY) as well as a decrease in credit impairment charges (-12.0% YoY), general and administrative expenses (-3.4% YoY) and other operating costs (-26.5% YoY). The increase in the Group's underlying profit combined with a decrease in the above costs more than offset:

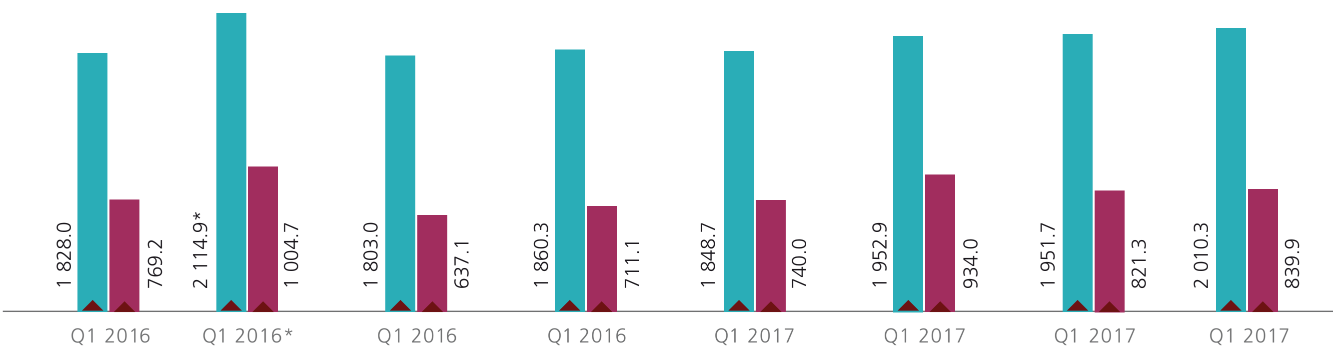
- decreases in other income items (-21.7% YoY), including dividend income (-20.5% YoY), gains on available-for-sale debt instruments (-77.7% YoY) and gains on derivative and interbank FX transactions (-39.9% YoY), and
- an increase in depreciation/amortisation (+15.0% YoY), staff expenses (+3.5% YoY) and the tax on financial institutions (+9.5% YoY as the taxable period in 2017 was one month longer compared with 2016).

Profit attributable to the shareholders of Bank Zachodni WBK was PLN 2,213.1m and increased by 2.1% YoY due to a slightly higher effective tax rate attributed to changes in the regulations which govern the tax treatment of BFG costs, a higher loss on the sale of a portion of debt and a longer taxable period in 2017 in relation to the tax on financial institutions. Considering the base period adjustment by the above one-off gain on the equity shares, the underlying attributable profit went up by 15.8% YoY.

Comparability of Periods

Selected income statement figures	Comparability of Periods in the Income Statement of BZ WBK Group for 2017	
	2017	2016
Gains on available-for-sale equity instruments	• PLN 26.5m, including PLN 10.8m and PLN 13.5m on account of the sale of all shares of Polimex-Mostostal and PBG from the bank's portfolio of equity investments.	• PLN 317.8m, including remuneration of PLN 316.1m for BZ WBK and SCB in respect of the settlement of the acquisition of Visa Europe Ltd by Visa Inc. on 21 June 2016.
Dividend income	• PLN 76.8m, including a dividend of PLN 68.6m paid by Aviva Group companies from the BZ WBK portfolio of equity investments.	• PLN 96.6m, including a dividend of PLN 88.6m paid by Aviva Group companies from the BZ WBK portfolio of equity investments.
Contributions to BFG (change in the amount, collection and calculation basis since January 2017)	• PLN 211.0m, including an annual contribution to the bank resolution fund and the bank guarantee fund.	• PLN 252.4m, including an annual contribution and a prudential fee for BFG.
Performance of obligations arising from the deposit guarantee scheme	• No obligations.	• PLN 13.5m contributed by the Group to reimburse guaranteed funds to deposit customers of insolvent cooperative banks.
Tax on financial institutions effective as of 1 February 2016	• PLN 423.8m for 12 months of 2017.	• PLN 387.2m for 11 months of 2016.

Total Income and Profit Before Tax by Quarter in 2016 and 2017 (PLN m)



** As a result of the settlement of the acquisition of Visa Europe Ltd. by Visa Inc on 21 June 2016, BZ WBK andSCB recognised a total gain of PLN 316.1m on their shareholdings in the acquired entity*

Key Factors Affecting the Profit of Bank Zachodni WBK Group in 2017

	2017/2016	2017	Determinants of BZ WBK Group's Profit for 2017
Increase in net interest income	+10.6%	PLN 5,276.9m	• An increase in net interest income in the record low interest rate environment reflects the growth of the net interest margin (up 0.16 p.p. to 3.84%) driven by flexible management of the banking offer parameters, effective credit delivery to high-margin segments (a larger portfolio of retail loans) and optimisation of funding sources (a major increase in low-cost balances of current accounts coupled with a reduction of term deposits base).
Increase in fee and commission income	+5.1%	PLN 2,013.1m	• The increase in net fee and commission income is the cumulated effect of the performance of many business lines in the Group. This result is mainly due to electronic products and services (debit and credit cards, currency exchange using the e-FX platform) and business diversification which allows the Group to enhance its fee income from brokerage and fund management activities during favourable stock exchange market conditions. • The growth in net fee and commission income was adjusted by a decrease in insurance fees due to a regulatory change in the insurance sales model.
Decrease in other income	-21.7%	PLN 473.6m	• The underlying decrease in other income (i.e. excluding the remuneration of PLN 316.1m posted in 2016 in respect of settlement of the sale of shares in Visa Europe Ltd.) was induced by lower dividends from the portfolio of equity investments and reduced gains on held-for- trading and available-for-sale instruments as a result of the prevailing situation in the financial markets and the goals pursued by the Group in the process of liquidity and balance sheet structure management.
Improvement of credit quality indicators	-12.0%	PLN 690.5m	• The lower YoY level of impairment losses is attributed to the Group's conservative approach to credit risk management, effective tools to support decision making processes and the favourable macroeconomic environment in terms of accelerated economic growth and labour market situation. The above decrease occurred in the consolidated gross loan book growing at a rate of 4.4% YoY and steadily improving its credit quality ratios.
Effective cost management	+0.1%	PLN 3,372.4m	• The Group's total cost base was stable as a result of a decrease in general and administrative expenses and other operating costs which counterbalanced the increase in staff expenses and depreciation/amortisation. • A significant reduction was noted in the bank's BFG contributions and the cost of marketing campaigns (which are elements of general and administrative expenses) and in provisions for legal disputes (recognised in other operating costs). Growth was driven by development of the IT infrastructure, revision of bonus schemes/salaries and changes in the Group's structure, which translated into increases in amortisation and staff expenses, respectively.

Structure of Profit Before Tax Earned by BZ WBK Group by Contributing Entities

PLN m

Components of Bank Zachodni WBK Group Profit Before Tax by contributing entities	2017	2016	YoY Change
Bank Zachodni WBK	**2 515.3**	**2 649.2**	**-5.1%**
Existing subsidiary undertakings:	**984.1**	**761.3**	**29.3%**
Santander Consumer Bank and its subsidiaries [1)]	823.3	613.9	34.1%
BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A.	82.1	65.3	25.7%
BZ WBK Finanse Sp. z o.o., BZ WBK Leasing S.A. and BZ WBK Faktor Sp. z o.o. [2)]	79.3	90.2	-12.1%
Other subsidiary undertakings [3)]	(0.6)	(8.1)	-92.6%
Equity method valuation	**58.3**	**55.4**	**5.2%**
Elimination of dividends received by BZ WBK	**(222.5)**	**(343.8)**	**-35.3%**
Profit before tax	**3 335.2**	**3 122.1**	**6.8%**

1) As at 31 December 2017, SCB Group comprised Santander Consumer Bank and the following entities: Santander Consumer Multirent, Santander Consumer Finanse, SC Poland Consumer 15-1 and SC Poland Consumer Finance 16-1, PSA Finance Polska and PSA Consumer Finance Polska. AKB Marketing Services has been liquidated and removed from the court register on 20 November 2017. The amounts provided above represent profit before tax (after intercompany and consolidation adjustments) of SCB Group for the periods indicated.

2) On 28 February 2017, BZ WBK leasing companies merged. BZ WBK Leasing, an acquiring company, assumed all rights and obligations of BZ WBK Lease, an acquired company, which was removed from the court register. BZ WBK Nieruchomości was renamed as BZ WBK 24F, and as a result of ownership changes (an exchange of shares between BZ WBK and BZ WBK Finanse, and the repurchase of shares from the other shareholder), it became 100%-owned by BZ WBK Finanse.

3) Other subsidiaries, i.e. BZ WBK Inwestycje and Giełdokracja in liquidation, disclosed a total loss of PLN 0.6m for 2017 and PLN 8.1m for 2016.

Bank Zachodni WBK (Parent Entity of Bank Zachodni WBK Group)

The unconsolidated profit before tax of Bank Zachodni WBK for 2017 was PLN 2,515.3m and 5.1% lower YoY as an effect of the high base arising from the recognition of the remuneration of PLN 305.9m in respect of the settlement of the sale of Visa Europe Ltd and above-average dividend income (PLN 439.3m in 2016 vs. PLN 299.5m in 2017). Excluding the impact of the above items on the current and base periods, the underlying profit before tax of Bank Zachodni WBK increased by 16.4% YoY.

Changes in the individual items constituting the profit before tax are discussed below in the "Income Statement of Bank Zachodni WBK".

Subsidiaries

The subsidiaries consolidated by Bank Zachodni WBK reported an increase of 29.3% YoY in their total profit before tax as a result of higher profitability of SCB Group and BZ WBK TFI.

SCB Group

The contribution of SCB Group to the consolidated profit before tax of Bank Zachodni WBK Group for 2017 was PLN 823.3m (after intercompany transactions and consolidation adjustments) and increased by 34.1% YoY due to the following factors:

- An increase of PLN 194.9m in net interest income to PLN 1,342.7m, driven by a higher net interest margin, steady growth of the credit portfolio and favourable changes in its structure (e.g. a bigger share of high-margin products such as cash loans and credit cards);
- A decrease of PLN 46.0m in net fee and commission income to PLN 130.2m on account of lower insurance income and one-off partner commissions incurred by the bank in connection with the development of the sales network and extension of contracts with the key hire purchase partners;
- Lower net impairment charges of PLN 110.8m (down PLN 70.9m) resulting from the extension of the recovery horizon to 60 months for all credit facilities and normalisation of the portfolio;
- An increase in other operating income to PLN 58.0m, mainly as a result of the release of a legacy operating provision (PLN 22m) and provisions for cases disputed in court.
- A rise of PLN 40.9m in operating costs to PLN 576.0m due to higher costs associated with modifications and development of IT systems and an extension to the scope of consolidation of SCB Group to include PSA Finance Polska and PSA Consumer Finance Polska on 1 October 2016.

Other Subsdiaries

The 25.7% YoY rise in profit before tax reported by BZ WBK TFI (the legal successor to BZ WBK Asset Management following the merger) reflects a high growth in fee and commission income from asset management on the back of an increase in the average margin and net assets. The strong performance of BZ WBK TFI in terms of fund management and favourable stock market conditions observed during the year affected the sales structure (e.g. higher share of equities) and ensured a consistent flow of assets, mainly to equity and corporate bond funds.

Total profit before tax posted by companies controlled by BZ WBK Finanse decreased by 12.1% YoY.

- The profit before tax earned by BZ WBK Faktor dropped by 17.1% YoY to PLN 18.8m due to a decrease in net interest income (attributed to increasing costs in funding the core business) and a moderate increase in net impairment losses on factoring receivables coupled with an increase in the value of credit exposures (up 25% YoY).
- The total profit before tax of BZ WBK Leasing, BZ WBK Finanse and BZ WBK F24 declined by 10.2% YoY to PLN 60.5m as a result of higher credit impairment charges and an increase in portfolio financing costs. The rapid growth of the leasing business in that period caused the performing portfolio to grow by 14% and drove interest and fee income. Despite the increase in impairment losses, leasing portfolio quality remained at a stable, high level.

Structure of Bank Zachodni WBK Group Profit Before Tax

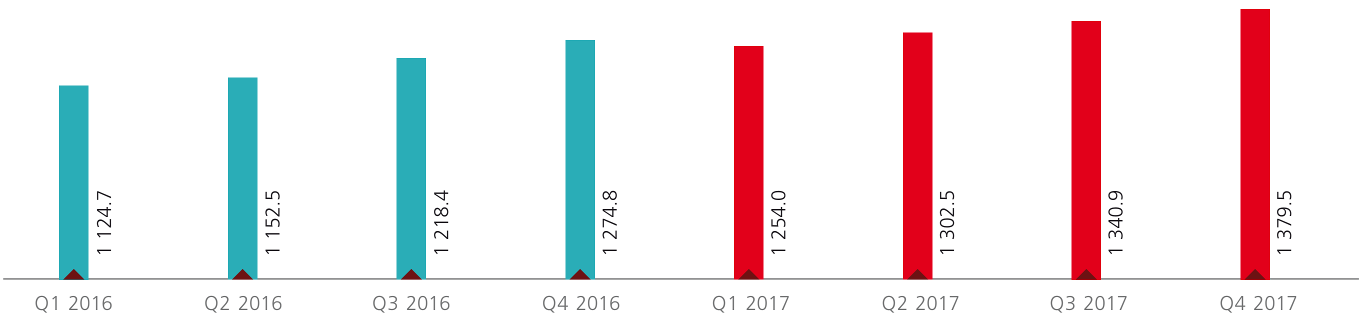
Total Income

Total income of Bank Zachodni WBK Group for 2017 increased by 2.1% YoY to PLN 7,763.6m. Excluding a gain of PLN 316.1m arising on the acquisition of Visa Europe Ltd by Visa Inc, underlying total income increased by 6.5% YoY.

Net Interest Income

In 2017, net interest income amounted to PLN 5,276.9m and increased by 10.6% YoY.

Net Interest Income of BZ WBK Group by Quarter in 2016 and 2017 (PLN m)

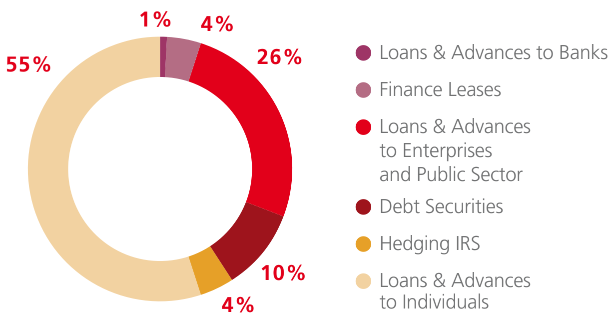


The Group reported increased interest income (up 7.7% YoY to PLN 6,529.3m) alongside a decline in interest expense (down 3.0% YoY to PLN 1,252.4m).

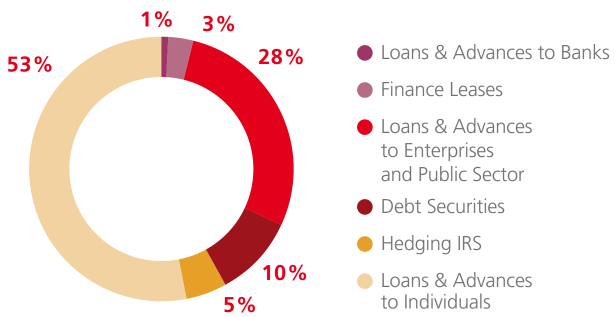
The growth rate of interest income was fuelled by loans to retail customers, lease receivables and securities available for sale but slowed down by CIRS/IRS transactions hedging cash flows.

The continued decline in interest expense was driven by deposits from retail customers and the enterprise sector. It was partly offset by increasing interest expense connected with the issue of securities, bank and public sector deposits and obligations on account of repo transactions.

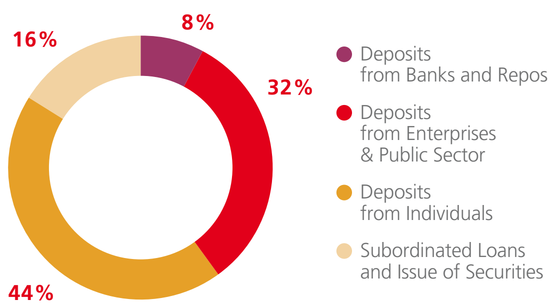
Structure of Interest Revenues of BZ WBK Group in 2017



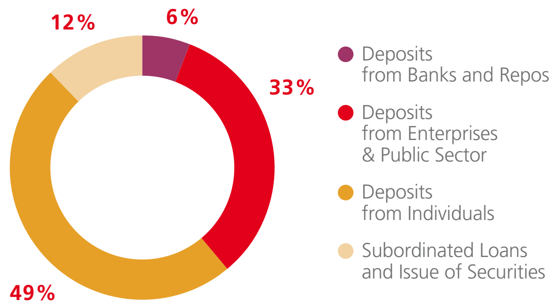
Structure of Interest Revenues of BZ WBK Group in 2016



Structure of Interest Expense of BZ WBK Group in 2017



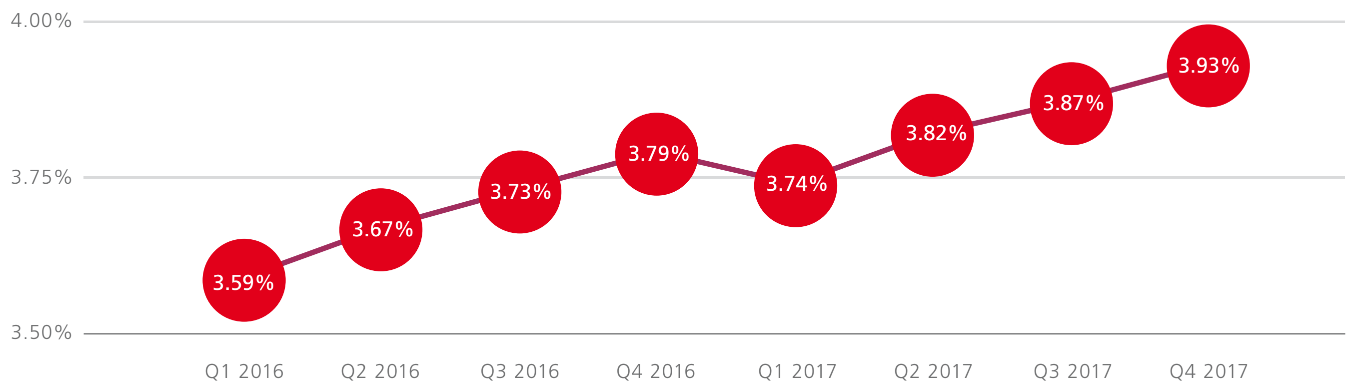
Structure of Interest Expense of BZ WBK Group in 2016



The cumulated (annual) net interest margin of Bank Zachodni WBK Group went up from 3.68% in 2016 to 3.84% in 2017. Margin growth was supported by a slight increase in mid-term market interest rates in 2017. At the same time, the Group's funding costs decreased under the impact of the optimisation of funding sources and adaptation processes within the Group's product portfolio. Thanks to favourable trends in sales stimulated by means of the tools designed to improve the quality, accessibility and competitiveness of products and services, the Group reported positive changes (from the perspective of margin) in core business volumes such as a YoY increase in loans and advances to retail customers (notably cash loans) and a significant rise in low-cost current account balances belonging to individuals and companies, as well as a drop in term deposits from both of the above customer segments.

In 2017, loans to customers brought a yearly average nominal interest income of 5.1% compared with 4.8% in 2016. Customer deposits carried a yearly average nominal interest cost of 0.9% compared with 1.0% the year before.

Net Interest Margin by Quarter in 2016-2017 (including SWAP points*)



** The calculation of the net interest margin of Bank Zachodni WBK takes account of a swap points allocation from derivative instruments used for the purpose of liquidity management but excludes interest income from the debt trading portfolio.*

After a slight decrease in Q1 2017, the Group's quarterly net interest margin (annualised on a quarterly basis) returned to the growth trend maintained since early 2016. Margin growth in 2017 was supported by the above-mentioned factors, in particular the effective management of deposit and credit parameters and such structural changes.

Net Fee and Commission Income

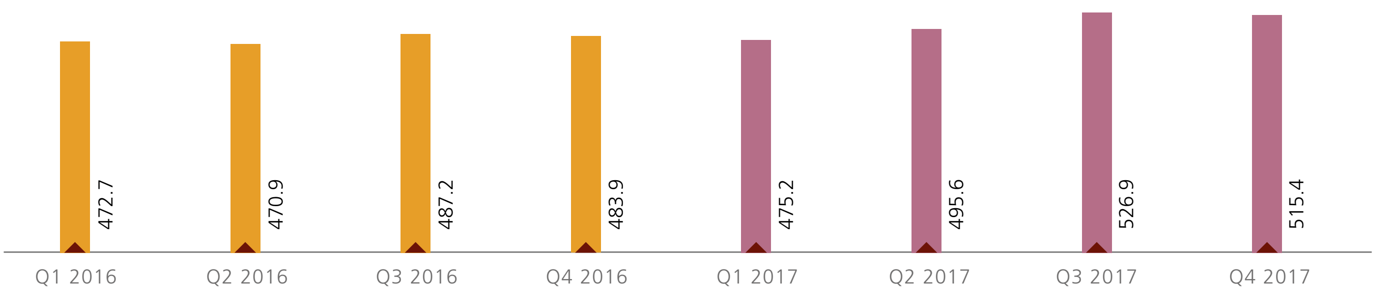
In 2017, net fee and commission income amounted to PLN 2,013.1m and increased by 5.1% YoY.

PLN m

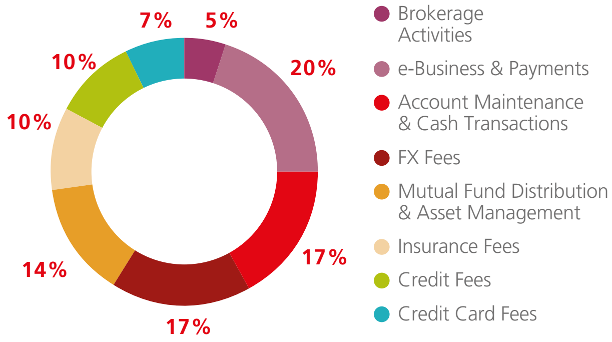
Net Fee and Commission Income of BZ WBK Group	2017	2016	YoY Change
E-Business and payments [1)]	401.9	377.0	6.6%
FX fees	346.1	320.0	8.2%
Account maintenance and ,cash transactions [2)]	337.6	335.7	0.6%
Asset management and distribution	288.0	233.5	23.3%
Credit fees [3)]	206.8	199.1	3.9%
Insurance fees [4)]	196.0	244.8	-19.9%
Credit cards	136.3	121.5	12.2%
Brokerage activities	77.0	61.2	25.8%
Other [5)]	23.4	21.9	6.8%
Total	**2 013.1**	**1 914.7**	**5.1%**

1) Fees for foreign and mass payments, Western Union transfers, trade finance, debit cards, services for third party institutions as well as other electronic and telecommunications services.
2) Fee income from account maintenance and cash transactions has been reduced by corresponding expenses which in Note 7 of the "Consolidated Financial Statements of Bank Zachodni WBK Group for 2017" are included in the line item "Other" (PLN 0.7m for 2017 vs. PLN 2.6m for 2016).
3) Fee and commission income from lending, factoring and lease activities which is not amortised to interest income. This line item includes, inter alia, the cost of credit agency.
4) Pursuant to the Act of 11 September 2015 on insurance and reinsurance activity (effective as of 1 April 2016) banks – acting as insurance parties – must not collect insurance fees in relation to group insurance plans (e.g. linked with payment cards).
5) Fees on guarantees, issue arrangement and other.

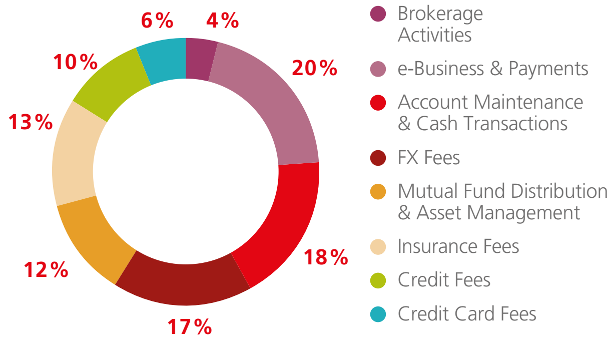
Net Fee & Commission Income of BZ WBK Group by Quarter in Years 2016-2017 (PLN m)



Net Commission Income Structure of BZ WBK Group for 2017



Net Commission Income Structure of BZ WBK Group for 2016



The highest YoY growth in net fee and commission income was reported in relation to brokerage services (+25.8% YoY), which reflect higher volumes of trading in the secondary market amid favourable trends in the stock market (highest peaks in WSE indices in a long time) and the management of initial public offerings.

Higher net fee and commission income from fund distribution and asset management (+23.3% YoY) reflects an increase in the average net value of assets managed by BZ WBK TFI, and namely equity, corporate bond and stable growth funds, driven by stronger management results and an improvement in investor sentiment compared with the corresponding period last year. Furthermore, the structure of sales of investment funds changed in 2017, with a bigger share of high-margin solutions, such as equity funds or mixed funds with the equity component.

Net fee and commission income aggregated under the "eBusiness and payments" line item rose by 6.6% YoY as a result of an increase in income from issuance and management of debit cards driven by the growth of this instrument base (+6.2 YoY) and an increasing number of cash and non-cash transactions made with such cards as well as the revision of fees and charges applicable to card services for individuals and companies (August 2016).

An improvement in FX fee income (+8.2% YoY) is attributed to higher turnover driven by the Group's comprehensive measures taken to support foreign trade and develop e-FX services in iBiznes24.

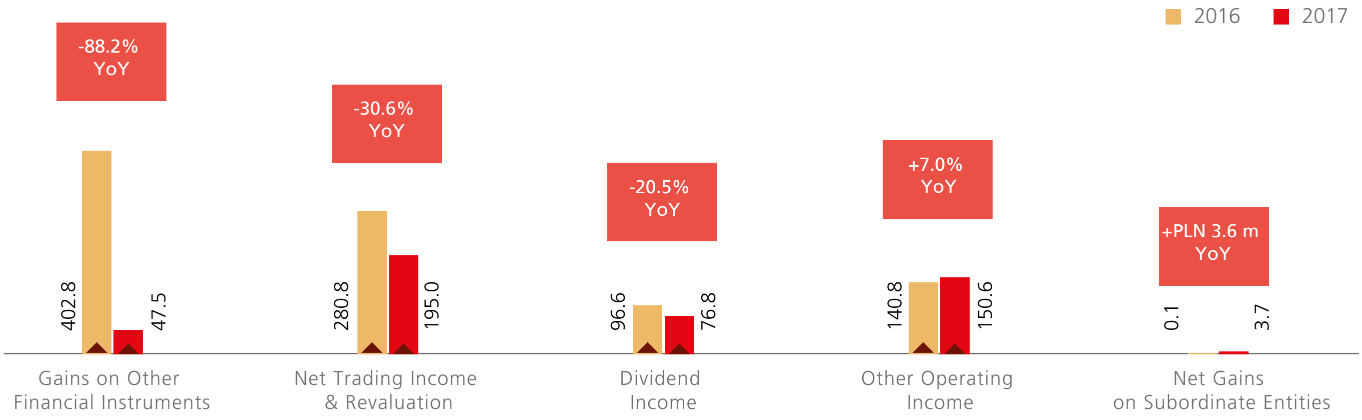
Net fee and commission income from issuance and management of credit cards went up by 12.2% YoY on account of a 4.1% YoY increase in the size of the combined credit card portfolio of Bank Zachodni WBK and SCB, a higher volume of credit card transactions and last year's revision of selected credit card fees and charges by both banks.

Credit fees increased slightly by 3.9% YoY due to a significant increase in one-off credit intermediation costs connected with the maintenance and development of the SCB sales network (up 69.5% YoY), which partly offset the increase in fee income related to the management of the Group's credit exposure (up 18.3% YoY).

The decline of 19.9% YoY in net fee and commission income from insurance business was connected with the legal and regulatory regime of the bancassurance market, in particular the statutory ban imposed by the Act of 11 September 2015 on insurance and reinsurance activity (effective as of 1 April 2016) regarding the collection of insurance fees by banks acting as insuring parties in relation to group insurance plans (e.g. linked with payment cards). At the same time, a decrease was noted in the ratio of the credit portfolio value to insured value.

Other Income of the Group

Components of Other Income of BZ WBK Group (PLN m) in 2017 vs. 2016



The Group's other income indicated above totalled PLN 473.6m and decreased by 48.6% YoY. Adjusted for the impact of the one-off transaction of 2016, the decrease was 21.7% YoY.

Net Trading Income and Revaluation ("Net trading income")

Net trading income reported by Bank Zachodni WBK Group for 2017 was PLN 195.0m, down 30.6% YoY.

In the derivatives and FX interbank transactions market, the Group generated a profit of PLN 153.0m vs. PLN 254.4m in 2016. This component of net trading income excludes net interest income from the CIRS and IRS transactions designated as hedging instruments under the cash flow hedge accounting (PLN 224.4m for 2017 vs. PLN 274.2m for 2016), which is disclosed under "Interest income".

Other FX related income was PLN 43.7m, up PLN 23.5m on a YoY basis.

Debt and equity securities trading brought in a total loss of PLN 1.7m compared to a gain of PLN 6.2m in the corresponding period.

Gains on Other Financial Instruments

The gains on other financial instruments decreased by 88.2% YoY to PLN 47.5m.

In 2017, gains on equity instruments available for sale were PLN 26.4m, including PLN 13.5m arising from the sale of all shares in PBG, PLN 10.8m representing the sale of all shares in Polimex Mostostal and PLN 2.1m is connected with the sale of the entire stake in WSE from the bank's available-for-sale portfolio of equity investments. Corresponding gains in 2016 reached PLN 317.8m, including PLN 316.1m on account of the total remuneration for BZ WBK and SCB as a result of a settlement of the acquisition of Visa Europe Ltd by Visa Inc. with a cash payment, preference shares and an earn-out.

Gains on disposal of available-for-sale debt instruments (mainly treasury bonds and BGK bonds) were PLN 20.8m, down PLN 72.4m YoY. The decisions regarding the volume and structure of the portfolio of available-for-sale debt securities are determined by various internal and external factors, such as availability of securities, expectations of interest rate cycle movements and fluctuations of yield curves. The measures taken as part of duration management were in line with market conditions and took into account the Group's objectives with regard to risk and liquidity management.

Gains on Subordinate Entities

The consolidated income statement for 2017 includes a gain of PLN 3.7m on interest in related entities, arising from the settlement of liquidation of AKB Marketing Services, a member of SCB Group until struck off the court register.

Dividends

In 2017, the Group disclosed dividend income of PLN 76.8m, i.e. down PLN 19.8m YoY on account of lower dividends from Aviva Group companies from the bank's portfolio of equity investments.

Other Operating Income

Other operating income was PLN 150.6m, up 7% YoY.

During the year, a pronounced increase in a provision for legal disputes (+192.0% YoY) was observed, including PLN 22m of the legacy operating provision of SCB. In addition, in 2017, disputed claims of PLN 24.2m were recognised as operating income on the basis of relevant legal decisions.

An increase was also noted in revenue from the sale of services (+30.2% YoY) and a gain on the sale/liquidation of fixed assets and assets for disposal (+72.8% YoY), primarily properties.

The above increases were offset by a decrease of PLN 53.8m YoY in reimbursements of fees from the Bank Guarantee Fund (BFG) as a result of a change in presentation of such revenues, which are now disclosed as fee and commission income following ratification of the Act of 10 June 2016 on the Bank Guarantee Fund, deposit guarantee scheme and resolution, which introduced a new methodology for calculating BFG contributions.

Impairment Charges

PLN m

Impairment Losses of BZ WBK Group on Loans and Advances	2017	2016	YoY Change
Collective and individual impairment charge	(668.2)	(828.2)	-19.3%
Impaired but not reported losses charge	(65.4)	(27.0)	142.2%
Recoveries of loans previously written off	43.5	45.2	-3.8%
Off-balance sheet credit related facilities	(0.4)	25.4	–
Total	**(690.5)**	**(784.6)**	**-12.0%**

In 2017, the loan impairment charge to the income statement of Bank Zachodni WBK Group was down 12.0% YoY to PLN 690.5m, including the impairment charge posted by SCB Group of PLN 110.8m vs. PLN 181.8m a year before.

The charge for incurred and reported losses (on individual and collective exposures) was PLN 668.2m for 2017 and decreased by 19.3% YoY amid strong growth in the Group's credit portfolio: loans to enterprises and the public sector increased by 5.8% YoY (including factoring receivables), personal loans by 2.7% YoY and lease receivables by 12.3% YoY. Compared with the corresponding period of 2016, impairment charges decreased especially on individually assessed exposures to business customers and collectively assessed debts owed by retail customers.

The impairment charge for incurred but not reported losses was PLN 65.4m, up 142.2% YoY due to the low base in the corresponding period.

In 2017, Bank Zachodni WBK sold non-performing receivables of PLN 1,088.2m vs. PLN 1,383.6m in the corresponding period (including the principal amount of PLN 1,008.0m and PLN 1,281.4m, respectively), which contributed PLN 172.7m and PLN 103.9m to the profit before tax in both periods, respectively. Receivables sold included claims on retail and business customers.

Santander Consumer Bank sold the written-off portfolio of cash loans, instalment loans, credit cards and car loans of PLN 382.7m, which brought in a profit before tax of PLN 51.5m. Last year, SCB sold the credit portfolio of PLN 326.6m, generating a profit before tax of PLN 51.9m.

The changes in the value and structure of impairment charges reflect the prudential approach of Bank Zachodni WBK Group to credit risk management.

Bank Zachodni WBK Group's NPL ratio decreased considerably from 6.6% as at 31 December 2016 to 5.8% as at 31 December 2017. The cost of credit totalled 0.63% in 2017 vs. 0.75% in 2016.

Total Costs

PLN m

Total costs of BZ WBK Group	2017	2016	YoY Change
Staff, general and administrative expenses, of which:	(2 939.4)	(2 935.2)	0.1%
– Staff expenses	(1 562.6)	(1 510.3)	3.5%
– General and administrative expenses	(1 376.8)	(1 424.9)	-3.4%
Depreciation/amortisation	(318.9)	(277.2)	15.0%
Other operating expenses	(114.1)	(155.3)	-26.5%
Total costs	**(3 372.4)**	**(3 367.7)**	**0.1%**

The total costs of BZ WBK Group for 2017 amounted to PLN 3,372.4m, and were stable compared with the previous year (+0.1% YoY), despite the significant cost of transformation projects resulting from strategic, business and legal/regulatory requirements.

In 2017, staff expenses increased by 3.5% YoY and depreciation and amortisation went up by 15% YoY due to the development and extension of IT infrastructure. The growth of the above items was fully counterbalanced by the drop in general and administrative expenses (-3.4% YoY) and other operating expenses (-26.5% YoY), which reflects the reduction of regulatory fees and a lower provision for legal disputes.

Excluding gains on a one-off equity transaction from total income for 2016, the Group's cost-to-income ratio decreased from 46.2% to 43.4% in 2017.

Staff Expenses

Staff expenses of Bank Zachodni WBK Group for 2017 totalled PLN 1,562.6m and increased by 3.5% YoY. SCB Group's contribution to consolidated staff expenses was PLN 243.8m and up 5.9% YoY following the extension of the scope of consolidation of SCB Group on 1 October 2016 to include PSA Finance Polska and PSA Consumer Finance Polska.

The key staff expense line items, i.e. "Salaries and bonuses" and "Statutory deductions from salaries" increased by 4.0% YoY to PLN 1,510.0m in total as a result of an increase in the average headcount in the Group, and an increase in salaries and bonuses following the salary and bonus schemes reviews conducted in H2 2017 and 2017, respectively.

Even though the employment level fell year-on-year, average employment increased; this was because for most of 2016 the bank's headcount did not include employees of the Multichannel Communication Centre (which operated as an outsourced function until September 2016), PSA Finance Polska and PSA Consumer Finance Polska, which came under control of SCB as of 1 October 2016.

General and Administrative Expenses

In 2017, general and administrative expenses of Bank Zachodni WBK Group declined by 3.4% YoY to PLN 1,376.8m. Costs incurred by SCB Group totalled PLN 270,3m and were 8.6% higher YoY, mainly on account of IT usage costs and also marketing and entertainment costs.

In the reporting period, fees payable by BZ WBK Group to market regulators declined by 20.3% YoY to PLN 224.2m as in 2017 neither Bank Zachodni WBK nor SCB had any obligations resulting from their participation in the deposit guarantee scheme (vs. PLN 13.5m in 2016). In addition, the two banks paid lower contributions to the BFG guarantee fund and the bank resolution fund (PLN 211m in 2017 vs. PLN 252.4m in 2016).

A significant decrease in marketing and entertainment costs (-8.7% YoY) in 2017 results from a smaller number of wide-ranging marketing initiatives carried out by the bank. In the reporting period, a mass campaign was held for a consolidation loan and the Account As I Want It (Konto Jakie Chcę), while in 2016 four large advertising campaigns were held.

Renegotiation of line rental and data transmission service contracts brought significant savings in the cost of data transmission (-21.0% YoY), while branch network rationalisation measures led to the reduction of building maintenance and lease costs (-2.0% YoY). The cost of the repair of machines decreased (-19.2% YoY) mainly as a result of the high base connected with the commissioning and fit-out of the bank's new Business Support Centre building in Poznań in 2016.

Costs increased as a result of numerous business and development initiatives, including IT projects undertaken by SCB Group, (which led to a growth in IT usage costs by 7.9% YoY), strategic programmes (increasing consulting costs by 8.6% YoY), and mailing communication campaigns on the Account As I Want It (Konto Jakie Chcę), which generated the growth in postal and telecommunications fees (+10.1% YoY).

Tax on Financial Institutions

Pursuant to the Act on tax imposed on certain financial institutions, bank assets above PLN 4bn are subject to tax of 0.0366% per month. Due to the above regulations effective from 1 February 2016, the taxable period in the corresponding period of 2016 covered eleven rather than twelve months, as a result of which the ensuing charge to the income statement increased by PLN 36.6m YoY to PLN 423.8m.

Effective Tax Rate

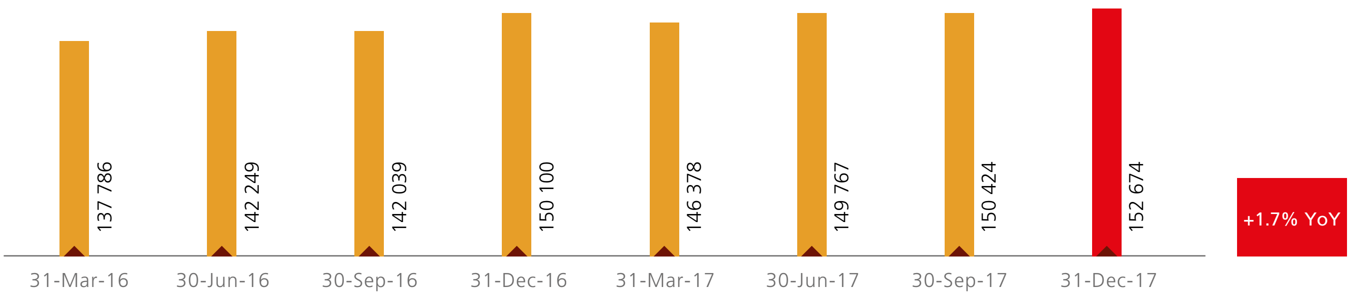
The effective tax rate for 2017 was 24.5% vs. 23.6% in 2016 due to changes in the regulations which govern the tax treatment of BFG costs, a higher loss on the sale of credit receivables and the Group's higher charge on account of the banking tax, and items which are not tax deductible.

2. Financial Position of Bank Zachodni WBK Group

Consolidated Assets

As at 31 December 2017, the total assets of Bank Zachodni WBK Group were PLN 152,674.4m, an increase of 1.7% YoY. The value and structure of the Group's financial position is determined by the parent entity, which accounts for 87.0% of consolidated total assets vs. 87.6% as at the end of December 2016.

Total Assets of BZ WBK Group at the End of Consecutive Quarters in 2016-2017 (PLN m)



Structure of Consolidated Assets

PLN m

Assets of BZ WBK Group (condensed presentation for analytical purposes)		Structure		Structure	YoY Change
	31.12.2017	31.12.2017	31.12.2016	31.12.2016	
	1	2	3	4	1/3
Loans and advances to customers [1]	107 839.9	70.6%	103 068.5	68.7%	4.6%
Financial assets available for sale	28 415.8	18.6%	29 307.9	19.5%	-3.0%
Cash and operations with central banks	4 146.2	2.7%	4 775.7	3.2%	-13.2%
Financial assets held for trading and hedging derivatives	3 634.1	2.4%	3 248.6	2.2%	11.9%
Fixed assets, intangibles and goodwill	3 133.1	2.1%	3 053.6	2.0%	2.6%
Loans and advances to banks [2]	2 136.5	1.4%	3 513.3	2.3%	-39.2%
Other assets [3]	3 368.8	2.2%	3 132.1	2.1%	7.6%
Total	**152 674.4**	**100.0%**	**150 099.7**	**100.0%**	**1.7%**

1) Loans and advances to customers take into account an impairment charge and exclude receivables from repurchase transactions which are disclosed under other assets, whereas in the full version of financial statements they are disclosed in a separate line item together with the corresponding loans and advances to banks.
2) Excludes receivables from repurchase transactions disclosed under other assets.
3) Other assets include the following items of the full version of financial statements: receivables from repurchase transactions, investments in associates, net deferred tax assets, assets classified as held for sale and other assets.

As at 31 December 2017, consolidated net loans and advances to customers totalled PLN 107,839.9m, up 4.6% on the end of December 2016 on account of credit delivery to business and retail customers. SCB Group contributed PLN 14,331.4m to this line (after intercompany and consolidation adjustments), up 3.8% YoY.

In the condensed statement of financial position a pronounced increase of 11.9% YoY was also noted in the aggregated line item "Financial assets held for trading and hedging derivatives", an effect of the growth of the trading bond portfolio. Fixed assets, intangibles and goodwill increased by 2.6% YoY on account of PLN 23.5m goodwill arising from the settlement of the acquisition of a controlling stake in PSA Finance Polska by SCB as well as growth in other components of this line item driven by capital expenditure and development initiatives connected with the Group's transformation.

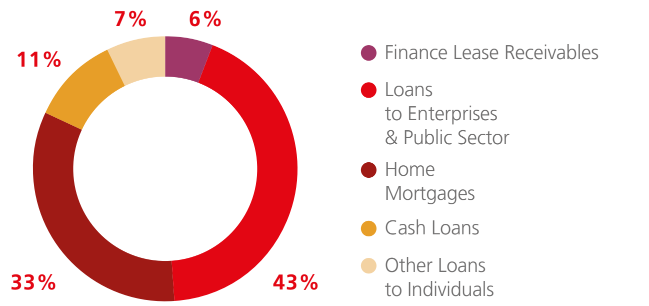
As part of the Group's ongoing liquidity management, the balance of funds placed with NBP and in the interbank market decreased, which caused the "Cash and operations with central banks" and "Loans and advances to banks" to fall by 13.2% YoY and 39.2% YoY, respectively. A decline of 3.0% YoY in financial assets available for sale reflects a lower share of NBP bills in the debt securities portfolio. SCB Group contributed PLN 2,608.4m to this item, which is a decline of 11.9% YoY.

CREDIT PORTFOLIO OF BANK ZACHODNI WBK GROUP

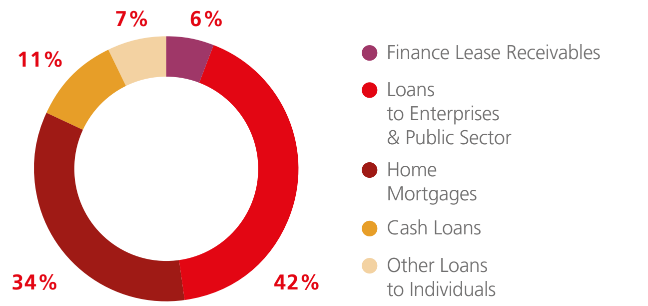
PLN m

Gross Loans and Advances to Customers of BZ WBK Group	31.12.2017	31.12.2016	Change
	1	2	1/2
Loans and advances to individuals	57 822.4	56 291.4	2.7%
Loans and advances to enterprises and public sector customers	48 005.2	45 375.7	5.8%
Finance lease receivables	6 849.0	6 098.5	12.3%
Other	9.4	181.8	-94.8%
Total	**112 686.0**	**107 947.4**	**4.4%**

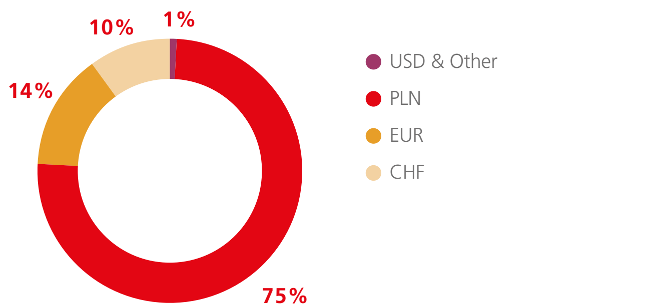
Product Structure of Consolidated Loans & Advances to Customers as at 31 December, 2017



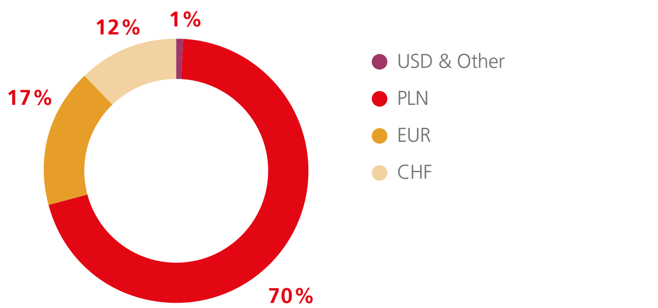
Product Structure of Consolidated Loans & Advances to Customers as at 31 December, 2016



FX Structure of Consolidated Loans and Advances to Customers as at 31 December, 2017



FX Structure of Consolidated Loans and Advances to Customers as at 31 December, 2016

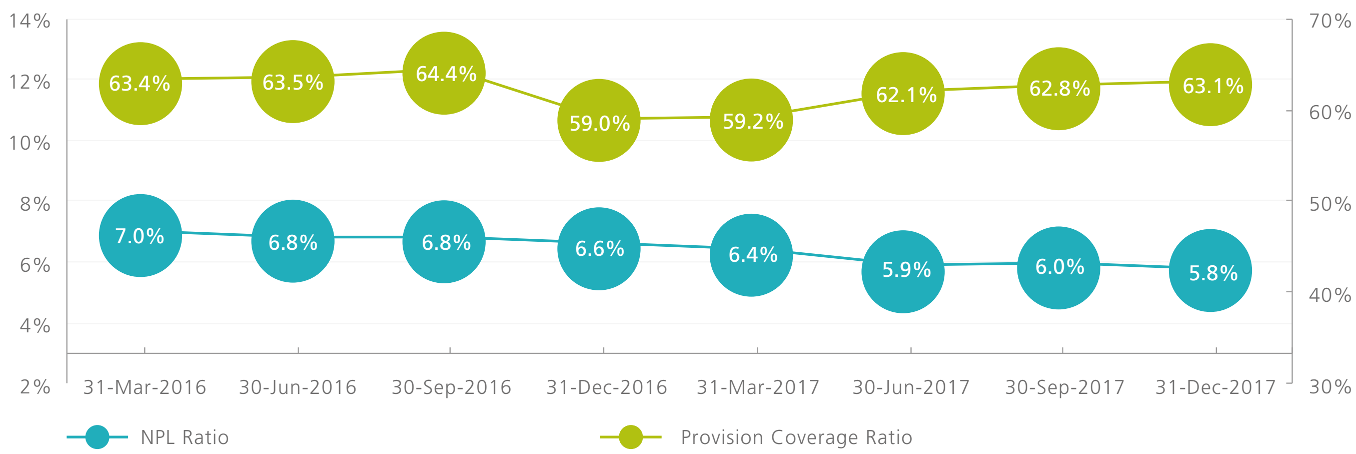


As at 31 December 2017, consolidated gross loans and advances to customers were PLN 112,686.0m and higher by 4.4% YoY. On a constant currency basis, the figure increased by 4.6% YoY.

Loans and advances to individuals increased by 2.7% YoY to PLN 57,822.4m as at 31 December 2017. Home loans, which represent the major portion of loans and advances to individuals, increased by 0.8% YoY to PLN 37,293.3m, with home loans of Bank Zachodni WBK growing by 3.1% YoY and SCB's mortgage portfolio decreasing by 17% YoY. The second significant constituent item, i.e. cash loans, went up by 9.4% YoY to PLN 13,051.3m.

Loans and advances to enterprises and public sector entities were PLN 48,005.2m, 5.8% higher vs. 31 December 2016, mainly driven by lending to SME and large corporate customers. Finance leases, which include the portfolios of BZ WBK Leasing, Santander Consumer Multirent and PSA Finance Polska, increased by 12.3% to PLN 6,849.0m on account of dynamic growth in the sale of machines and equipment. Loans granted by BZ WBK Leasing to finance machines and vehicles for business customers, which totalled PLN 2,027.7m as at 31 December 2017 (vs. PLN 1,642.4m as at 31 December 2016), are disclosed outside the lease portfolio, as loans and advances to enterprises.

Credit Quality Ratios by Quarters in 2016 and 2017



As at 31 December 2017, non-performing (impaired) loans to customers accounted for 5.8% of the gross portfolio of Bank Zachodni WBK Group vs. 6.6% twelve months before. The provision coverage ratio for impaired loans was 63.1% compared with 59.0% as at 31 December 2016.

STRUCTURE OF CONSOLIDATED EQUITY AND LIABILITIES

PLN m

Liabilities & Equity of BZ WBK Group S.A. (condensed presentation for analytical purposes)	31.12.2017	Structure 31.12.2017	31.12.2016	Structure 31.12.2016	YoY Change
	1	2	3	4	1/3
Deposits from customers [1]	111 481.1	73.0%	112 522.5	75.0%	-0.9%
Subordinated liabilities and debt securities in issue	7 384.4	4.9%	5 969.6	4.0%	23.7%
Deposits from banks [1]	2 783.1	1.8%	2 561.3	1.7%	8.7%
Sell-buy-back transactions	2 650.9	1.7%	1 632.6	1.1%	62.4%
Financial liabilities held for trading and hedging derivatives	1 816.5	1.2%	3 832.4	2.5%	-52.6%
Other liabilities [2]	3 214.8	2.1%	2 562.8	1.7%	25.4%
Total equity	23 343.6	15.3%	21 018.5	14.0%	11.1%
Total	**152 674.4**	**100.0%**	**150 099.7**	**100.0%**	**1.7%**

1) Deposits from customers and banks do not include sell-buy-back transactions which are reported as a separate line item.
2) Other liabilities include current income tax, provisions and other liabilities.

In the condensed consolidated statement of financial position of Bank Zachodni WBK Group, significant YoY changes occurred within the line item composed of subordinated liabilities and debt securities in issue, which increased as an aggregate by 23.7% YoY on account of securities issued in 2017. The contribution of SCB Group to this line item was PLN 3,955.5m, up 5.6% YoY.

In the reporting period, Bank Zachodni WBK issued three series of certificates of deposit with a total nominal value of PLN 1,420.0m and issued subordinated debt in the form of green bonds with a nominal value of EUR 137.1m. BZ WBK Faktor issued bonds with a nominal value of PLN 700m and SCB issued bonds with a nominal value of PLN 873.5m as part of a debt securities issuance programme guaranteed by Santander Consumer Finance.

In 2017, Bank Zachodni WBK and SCB redeemed matured bonds and certificates of deposit for a total amount of PLN 1,430m and PLN 665m, respectively.

Pursuant to the KNF decision, two Bank Zachodni WBK issues of 10Y bonds for a nominal value of EUR 120.0m (issued on 2 December 2016) and EUR 137.1m (green bonds issued on 22 May 2017) were reclassified from debt securities in issue to subordinated liabilities.

A significant increase was also reported in liabilities due to sell-buy-back transactions (+62.4% YoY), driven by deals with Bank Zachodni WBK customers.

Compared with 31 December 2016, a downward trend was observed in financial liabilities held for trading and hedging derivatives, which fell 52.6% YoY under the impact of hedging and interest swap transactions. Deposits from banks reduced by 8.7% YoY, whereas deposits from customers were broadly stable (-0.9% YoY).

The total equity of Bank Zachodni WBK Group increased by 11.1% as the bank's profit generated in the current period and the whole profit for 2016 were retained in accordance with guidelines issued by the regulator.

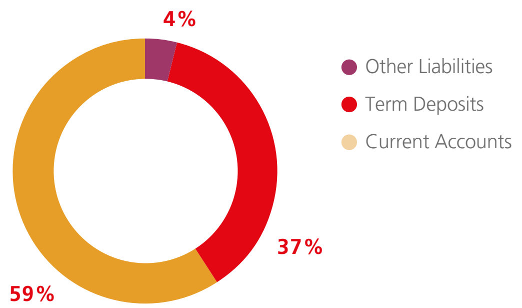
DEPOSIT BASE OF BANK ZACHODNI WBK GROUP

PLN m

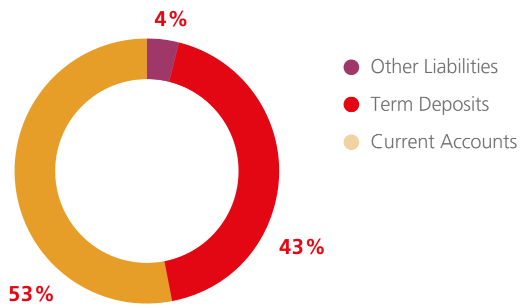
Deposits of BZ WBK Group from Customers	31.12.2017	31.12.2016	Change
	1	2	1/2
Deposits from individuals	64 987.7	63 547.9	2.3%
Deposits from enterprises and public sector customers	46 493.4	48 974.6	-5.1%
Total	**111 481.1**	**112 522.5**	**-0.9%**

Consolidated deposits from customers were generally stable YoY (-0.9% YoY) and amounted to PLN 111,481.1m as at the end of December 2017, including PLN 8,148.6m relating to SCB Group after intercompany transactions (vs. PLN 8,224.7m as at the end of December 2016).

Structure of Consolidated Customer Deposits as at 31 December 2017



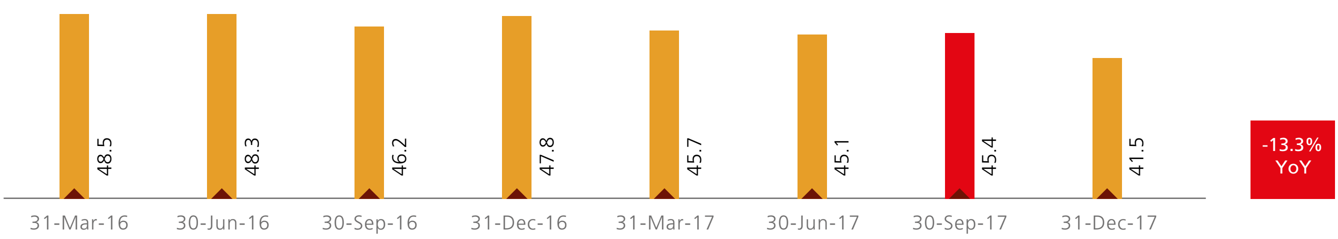
Structure of Consolidated Customer Deposits as at 31 December 2016



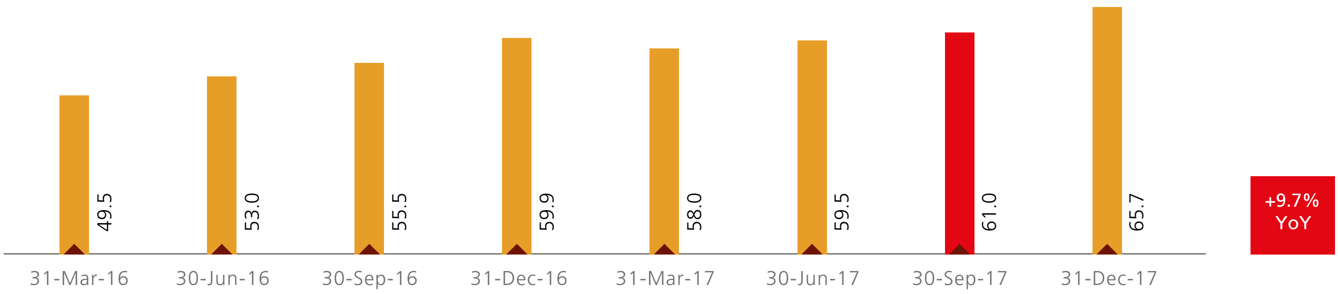
In 2017, the management of deposit products focused on increasing the strength of relationship with deposit customers and building deposit volumes and structure on the back of an optimised product range. During the year, balances of low-interest bearing current and savings accounts gradually increased, while balances of term deposits reduced. Investment funds offered by the Group became more popular among customers due to record low interest rates and improved stock market conditions. In effect, the transfer of deposits to BZ WBK TFI investment funds increased significantly.

The Group's total term deposits from customers amounted to PLN 41,483.5m and decreased by 13.3% YoY. Current account balances increased by 9.7% YoY to PLN 65,663.4m, and other liabilities were PLN 4,334.2m, down 10.4% on 31 December 2016.

Term Deposits at the End of Consecutive Quarters of 2016 and 2017 (PLN bn)



Current Account Balances*at the End of Consecutive Quarters of 2016 and 2017 (PLN bn)



** Including savings accounts*

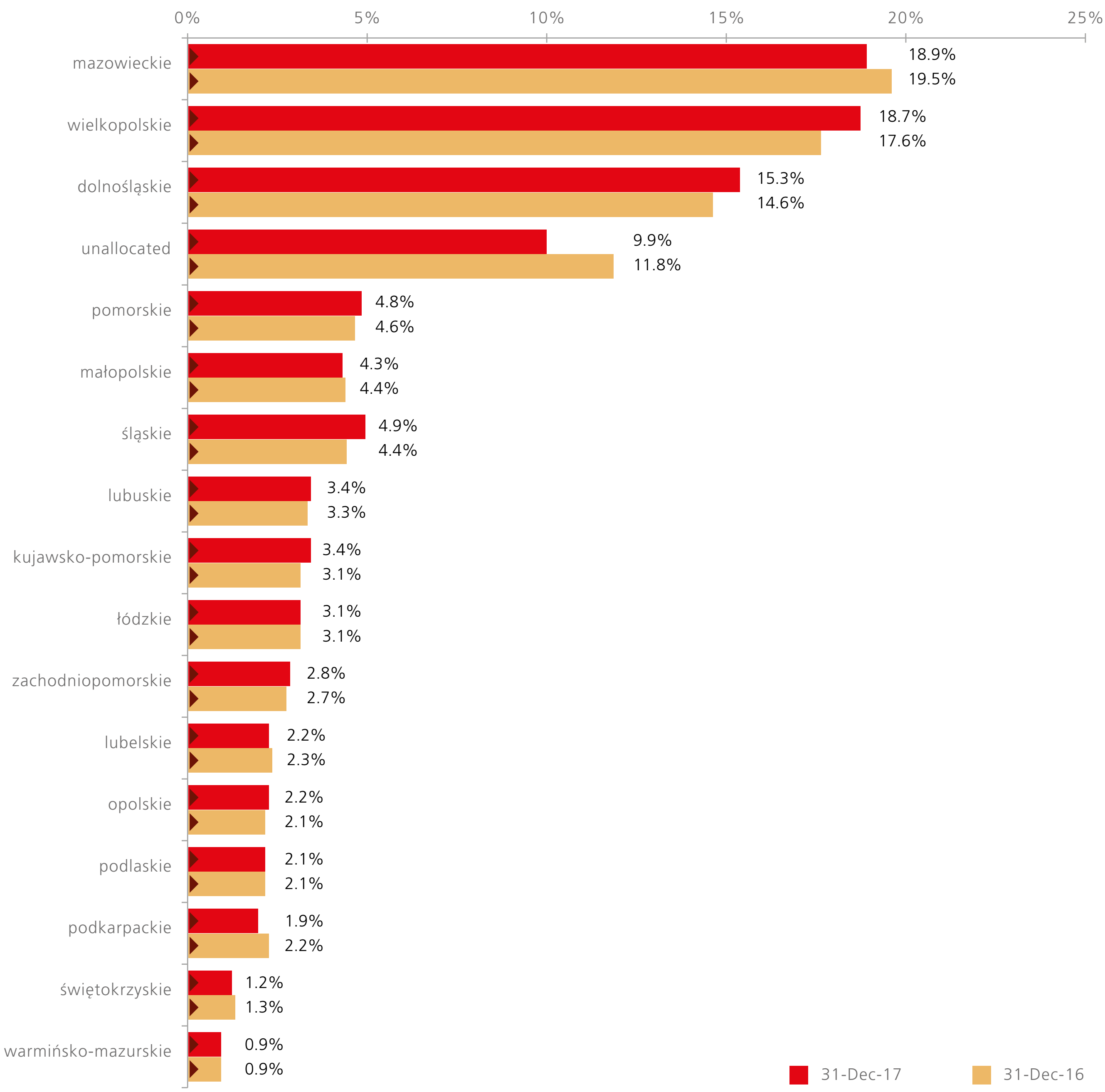
The retail deposit base stood at PLN 64,987.7m, higher by 2.3% YoY as a result of an increase in current account balances (+8.3% YoY), including savings accounts. During the year, the acquisition of new money was supported by special deals on savings accounts, including the campaign for Max Savings Account (Konto Max Oszczędnościowe) and the campaign for the Account As I Want It (Konto Jakie Chcę), with a possibility of opening the Regular Savings Account (Konto Systematyczne).

In 2017, deposits from enterprises and the public sector decreased by 5.1% YoY to PLN 46,493.4 at the end of 2017 (-18.8% YoY), outpacing the growth of current account balances (+12.4% YoY).

The largest constituent of other liabilities were loans and advances (PLN 3,552,4m vs. PLN 4,075.9m as at 31 December 2016), reported under deposits from enterprises which included loans granted by international financial organisations (the European Investment Bank, the European Bank for Reconstruction and Development and the Council of Europe Development Bank) to finance the bank's credit delivery and the lease business of the bank's subsidiaries.

A decrease in loans and advances is the combined effect of scheduled repayments of matured loans from the European Investment Bank, disbursement of the second tranche of PLN 42.2m by the Council of Europe Development Bank under an agreement signed on 13 June 2016 and the financing of EUR 100m obtained by BZ WBK Leasing from the Council of Europe Development Bank.

GEOGRAPHICAL STRUCTURE OF DEPOSITS (BY PROVINCES) AS AT 31 DECEMBER 2016 AND 31 DECEMBER 2017



Diversification of Funding Sources of Bank Zachodni WBK and Bank Zachodni WBK Group

In 2017, measures continued to diversify the funding sources of Bank Zachodni WBK Group.

Measure	Date	Funding Provided by Banks and International Financial Institutions
		Bank Zachodni WBK
Agreements of BZ WBK	10.02.2017	• A guarantee agreement signed with the European Investment Bank (EIB) providing security for lending up to EUR 300m to be granted by BZ WBK. • In order to activate the guarantee, the bank undertook to provide financing of up to EUR 600m to SMEs (including lease facilities) and mid-caps (as per the EU definition).
	10.11.2017	• An agreement signed with the EIB providing for EUR 80m to finance projects under the bank's Digital Transformation.
Drawdowns/ repayments/other measures	15.09.2017	• Full repayment of a EUR 50m facility granted to the former Kredyt Bank by the EIB under an agreement signed on 4.01.2010.
	27.12.2017	• The 2nd tranche of PLN 42.2m drawn under a credit agreement signed with the Council of Europe Development Bank (CEB) for EUR 100m (13.06.2016).
		Subsidiaries
Agreements of BZ WBK Leasing [1]	01.06.2017	• A EUR 100m financing agreement signed with the CEB to promote lending to SMEs for their growth and investments. • Disbursement of two tranches of EUR 50m each (June and September 2017) under the above facility agreement.
	05.12.2017	• A EUR 50m agreement signed with the EBRD to finance improvements that increase efficiency and reduce energy consumption.
Agreements of BZ WBK Faktor [1]	20.10.2017	• A EUR 100m loan granted to BZ WBK Faktor by Industrial and Commercial Bank of China, Branch in Poland (ICBC), maturing on 20.10.2018.
Repayments	24.02.2017	• Repayment of a PLN 324m credit facility to PKO BP granted to BZ WBK Leasing based on the agreement of July 2013.
	19.10.2017	• Repayment of a EUR 100m loan granted on 19 October 2016 to BZ WBK Faktor by ICBC.
	19.12.2017	• Repayment of EUR 15m loan granted to BZ WBK Leasing S.A. by EBRD on 19.12.2012.

1) Agreements secured by guarantees issued by Bank Zachodni WBK

	Date	Own issues of securities and major redemptions
		Bank Zachodni WBK
Issues of BZ WBK		• Issues of certificates of deposits as part of the Issuance Programme of 18.03.2015, for a total value of PLN 3bn, aimed at financing the bank's general corporate purposes:
	17.02.2017	• series D certificates of deposit with a nominal amount of PLN 420m, an interest rate of 1.81% and a maturing date of 17.08.2017;
	17.03.2017	• series E certificates of deposit with a nominal amount of PLN 250m, an interest rate of 1.81% and a maturing date of 17.10.2017;
	18.08.2017	• series F certificates of deposit with a nominal amount of PLN 750m, an interest rate of 1.81% and a maturing date of 19.02.2018.
	22.05.2017	• Issuance of subordinated debt in the form of variable-rate green bonds of EUR 137.1m (equivalent of USD 150m) taken up by the International Finance Corporation (IFC). The funds raised were used to finance projects promoting efficient energy use.
Bonds taken to subordinated liabilities		• Consent granted by the Polish Financial Supervision Authority (KNF) to allocate the following items to subordinated bonds:
	24.02.2017	• bonds issued on 2.12.2016, with a total nominal value of EUR 120m and a maturity date of 3.12.2026;
	19.10.2017	• green bonds issued on 22.05.2017, with a total nominal value of EUR 137.1m and a maturity date of 22.05.2027.
		Subsidiaries
Issues of Santander Consumer Bank	04.08.2017 06.10.2017 07.12.2017	• Nine issues of variable-rate bonds with a nominal value of PLN 873.5m and maturity ranging from three to five years as part of the debt securities issuance programme underwritten by Santander Consumer Finance, with funds earmarked to finance the bank's general corporate purposes:
Issues of BZ WBK Faktor	18.10.2017	• Issuance of bonds with a nominal value of PLN 700m (as a private placement), a WiBOR1M-based floating interest rate and maturity date of 18.02.2018. Proceeds from the issue have been earmarked for reducing the overdraft balance of the company.

3. Income Statement of Bank Zachodni WBK

Profit of Bank Zachodni WBK

PLN m

Condensed Unconsolidated Income Statement of BZ WBK (for analytical purposes)	2017	2016	YoY Change
Total income	**6 123.0**	**6 311.5**	**-3.0%**
– Net interest income	3 785.6	3 480.4	8.8%
– Net fee & commission income	1 726.6	1 604.7	7.6%
– Other income [1)]	610.8	1 226.4	-50.2%
Total costs	**(2 679.3)**	**(2 722.7)**	**-1.6%**
– Staff, general and administrative expenses	(2 323.2)	(2 360.2)	-1.6%
– Depreciation/amortisation	(274.9)	(234.1)	17.4%
– Other operating expenses	(81.2)	(128.4)	-36.8%
Impairment losses on loans and advances	**(540.4)**	**(583.5)**	**-7.4%**
Tax on financial institutions [2)]	(388.0)	(356.1)	9.0%
Profit before tax	**2 515.3**	**2 649.2**	**-5.1%**
Tax charges	(599.1)	(567.5)	5.6%
Net profit for the period	**1 916.2**	**2 081.7**	**-8.0%**

1) Other income includes the following items of the full income statement: dividend income, net profit/loss on shares in subordinate entities, net trading income and revaluation, gains on other financial instruments, other operating income.
The figure for 2016 includes one-off gains of PLN 305.9m reported by BZ WBK as a result of the settlement of acquisition of Visa Europe Ltd. by Visa Inc. (in the full version of the income statement this amount is reported as part of gains on other financial instruments).
2) The banking tax is calculated in accordance with the Act on tax imposed on certain financial institutions that became effective on 1 February 2016.

The unconsolidated profit before tax of Bank Zachodni WBK for 2017 was PLN 2,515.3m and 5.1% lower YoY as an effect of high base arising from the recognition of the remuneration of PLN 305.9m in respect of the settlement of the merger between Visa Inc. and Visa Europe Ltd. and substantial dividend income, including:

- dividends from subsidiaries: SCB (PLN 260.8m in 2016 vs. PLN 108.3m in 2017), BZ WBK TFI as a legal successor of BZ WBK Asset Management (PLN 52.2m in 2016 vs. PLN 37.5m in 2017);
- dividends from Aviva Group companies from the bank's portfolio of equity investments (PLN 88.6m in 2016 vs. PLN 68.6m in 2017).

Excluding dividend income and one-off gains on equity instruments from the current and corresponding periods, the underlying profit before tax of Bank Zachodni WBK increased by 16.4% YoY as the combined effect of the following:

- a major improvement in net interest income (+8.8% YoY) driven by lending to retail and corporate customers and the optimisation of a deposit range focused on the development of current account balances and long-term relationships with deposit customers;
- an increase in net fee and commission income (+7.6% YoY) attributed to higher volumes in the majority of product lines (in particular investment funds, brokerage services, loans and credit and debit cards) which were partly offset by a decrease in insurance fee income arising from regulatory and statutory changes in the insurance services model;
- lower impairment losses on loans and advances (-7.4% YoY) supported by economic growth, favourable labour market conditions, effective risk management mechanisms and decision making tools as well as the sale of debt owed by retail and business customers;
- lower total operating costs (-1.6% YoY) resulting from a decrease in general and administrative expenses and other operating costs with a concurrent increase in staff expenses and amortisation/depreciation (on account of the development of IT infrastructure);
- a decrease in net trading income (-31.2% YoY) mainly in relation to derivatives and interbank FX transactions;

- lower gains on other financial instruments (-53.2% YoY) amid lower trading in bonds;

Profit for 2017 was PLN 1,916.2m and 8.0% lower YoY. On a comparable basis, profit increased by 4.5% YoY (including dividend income) and 15.9% (excluding dividend income). An effective tax rate increased from 21.4% in 2016 to 23.8% in 2017 as a result of changes in regulations which govern the tax treatment of BFG costs, a higher loss on the sale of a portion of debt, a longer taxable period in 2017 in relation to the tax on financial institutions and lower dividend income.

Components of Total Income of Bank Zachodni WBK.

Total income of Bank Zachodni WBK for 2017 decreased by 3.0% YoY to PLN 6,123.0m. Adjusting the base period for one-off gains from the settlement of the sale of Visa Europe Ltd., the bank's underlying total income went up by 2.0% YoY. Excluding also dividend income from both periods under review, the figure increased by 4.6% YoY.

Net Interest Income

In 2017, the bank posted net interest income of PLN 3,785.6m, up 8.8% YoY on account of the growth of credit and deposit portfolios driven by effective management of product parameters, sales structure and balance sheet as well as favourable macroeconomic environment. In 2017, cumulative net interest margin was 3.2% compared with 3.1% a year before.

PLN m

Interest Revenue of BZ WBK due to:	2017	2016	YoY Change
Loans and advances to individuals	2 140.4	1 922.9	11.3%
Loans and advances to enterprises and the public sector	1 661.2	1 614.4	2.9%
Debt securities	609.5	576.0	5.8%
Interest on hedging IRS	204.4	284.4	-28.1%
Other revenues 1)	87.7	72.2	21.5%
Total	**4 703.2**	**4 469.9**	**5.2%**
Interest Expense of BZ WBK due to:	2017	2016	YoY Change
Deposits from individuals	(433.9)	(495.9)	-12.5%
Deposits from enterprises and the public sector	(345.8)	(379.0)	-8.8%
Subordinated liabilities and issue of securities	(73.1)	(65.0)	12.5%
Other expenses 2)	(64.8)	(49.6)	30.6%
Total	(917.6)	(989.5)	-7.3%
Net Interest Income	3 785.6	3 480.4	8.8%

1) Other interest revenue due to deposits from banks and buy-sell-back transactions.
2) Other interest expense due to deposits from banks and sell-by-back transactions.

Net Fee and Commission Income

In 2017, Bank Zachodni WBK earned net fee and commission income in the total amount of PLN 1,726.6m, up 7.6% YoY.

PLN m

Net Fee and Commission Income of BZ WBK	2017	2016	YoY Change
E-Business and payments 1)	402.5	378.2	6.4%
Account maintenance and cash transactions 2)	329.2	326.7	0.8%
FX fees	346.1	320.0	8.2%
Credit fees 4)	238.3	192.9	23.5%
Asset management and distribution	167.5	133.8	25.2%
Insurance fees 3)	61.5	85.0	-27.6%
Credit cards	72.8	67.2	8.3%
Guarantees	62.4	65.6	-4.9%
Brokerage activities	77.0	61.3	25.6%
Other 5)	(30.7)	(26.0)	18.1%
Total	**1 726.6**	**1 604.7**	**7.6%**

1) Fees for foreign and mass payments, Western Union transfers, trade finance, debit cards, services for third party institutions as well as other electronic and telecommunications services.
2) Fee and commission income from account maintenance and cash transactions has been reduced by the corresponding expenses which in Note 6 of the Financial Statements of Bank Zachodni WBK for 2017 are included in the line item "Other" (PLN 0.7m for 2017 vs. PLN 2.6m for 2016).
3) Pursuant to the Act of 11 September 2015 on insurance and reinsurance activity (effective as of 1 April 2016) banks – acting as insurance parties – must not collect insurance fees in relation to group insurance plans (e.g. linked with payment cards).
4) Fee and commission income from lending which is not amortised to net interest income. This line item includes inter alia the cost of credit agency fees..
5) Issue arrangement fees and others.

The highest YoY growth in net fee and commission income was generated by brokerage services (+25.6% YoY), which reflected higher volumes of trading in the secondary market and increased demand for IPO services amid favourable stock exchange trends.

Higher net fee and commission income from fund distribution and asset management (+25.2% YoY) reflects an increase in the sales of units of investment funds managed by BZ WBK TFI, mainly equity, corporate bond and stable growth funds, driven by stronger management results and an improvement in investor sentiment compared with the previous year. The structure of sales of investment funds changed in 2017, with a bigger share of high-margin solutions, such as equity funds or mixed funds with an equity component.

Net fee and commission income aggregated under the "eBusiness and payments" line item rose by 6.4% YoY as a result of an increase in income from issuance and management of debit cards driven by their growing portfolio (+6.2 YoY), higher non-cash turnover initiated with such instruments and the revision of fees and charges applicable to card services for individuals and companies (August 2016).

Net income from credit fees went up by 23.5% YoY on account of satisfactory growth of credit exposures and changes to the collection and classification of reimbursed BFG fees.

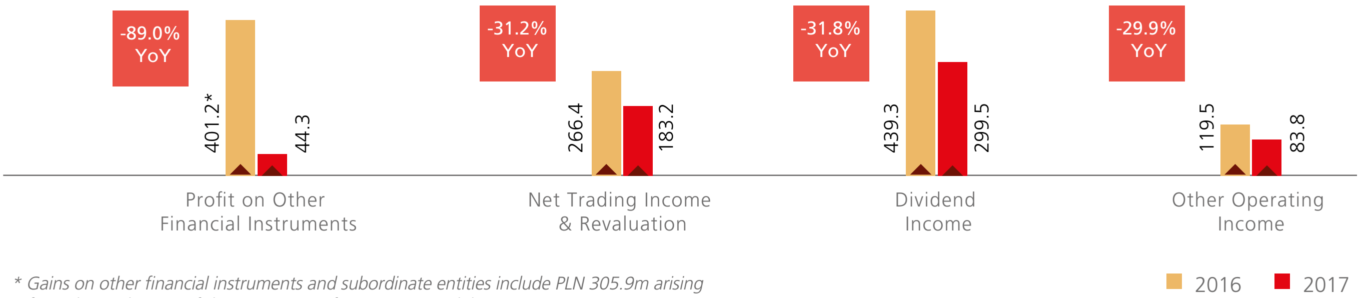
An improvement in net FX fee income (+8.2% YoY) is attributed to higher foreign trade volumes and the development of e-FX services in the iBiznes24 platform.

Net fee and commission income from issuance and management of credit cards went up by 8.3% YoY on account of a 3.0% YoY increase in the size of the credit card portfolio, a higher volume of credit card transactions and the last year's revision of selected credit card fees and charges.

A decline of 27.6% YoY in net fee and commission income from insurance results from regulatory and statutory changes to the bancassurance model and lower insurance coverage for cash loans.

Components of Other Income of Bank Zachodni WBK (other than net interest income or net fee and commission income)

Components of Other Income (PLN m) of BZ WBK in 2016 vs. 2017



* *Gains on other financial instruments and subordinate entities include PLN 305.9m arising from the settlement of the acquisition of Visa Europe Ltd. by Visa Inc. in June 2016.*

The bank's other income totalled PLN 610.8m and decreased by 50.2% YoY. Adjusted for the impact of the one-off equity transaction of 2016, the decrease was 33.6% YoY.

Gains on other financial instruments and subordinate entities were PLN 44.3m in 2017 and down 89.0% YoY as an effect of a high base including, among other things, a gain of PLN 307.7m on equity instruments available for sale (including PLN 305.9m on account of the settlement of the acquisition of Visa Europe Ltd. by Visa Inc.) and a relatively high gain on debt securities (PLN 92.8m) which is dependent on developments in the financial markets and the bank's risk and balance sheet structure management strategy. In the current reporting period, the corresponding figures were as follows: PLN 26.4m on account of the sale of shares of Polimex-Mostostal, PBG and WSE, and PLN 20.5m on account of the sale of bonds.

In 2017, Bank Zachodni WBK generated net trading income of PLN 183.2m, down 31.2% YoY due to derivatives, interbank FX transactions and debt instruments.

Dividend income from the equity related entities of Bank Zachodni WBK decreased by PLN 139.8m YoY to PLN 299.5m because of lower dividends from the bank's subsidiaries (particularly SCB and BZ WBK TFI) and from the portfolio of financial assets available for sale (notably Aviva Group companies), which were down 35.2% and 19.8%, respectively.

Other operating income fell by 29.9% YoY to PLN 83.8m due to a decrease of PLN 53.8m YoY in reimbursements of fees from the Bank Guarantee Fund (BFG) as a result of changed reclassification of such revenues, which are recognised as fee and commission income following ratification of the Act of 10 June 2016 on the Bank Guarantee Fund, deposit guarantee scheme and resolution, which introduced a new methodology for calculating BFG contributions.

Impairment Charge

PLN m

Impairment Losses of BZ WBK on Loans and Advances	2017	2016	YoY Change
Collective and individual impairment charge	(513.0)	(609.6)	-15.8%
Impaired but not reported losses charge	(28.1)	(0.2)	13950.0%
Recoveries of loans previously written off	(2.1)	(1.1)	90.9%
Off-balance sheet credit related facilities	2.8	27.4	-89.8%
Total	**(540.4)**	**(583.5)**	**-7.4%**

In 2017, the loan impairment charge to the income statement of Bank Zachodni WBK was PLN 540.4m, and decreased by 7.4% YoY as a result of reduction in loan loss provisions on individually assessed business loans and collectively assessed retail loans.

In 2017, Bank Zachodni WBK sold non-performing matured receivables of PLN 1,088.2m vs. PLN 1,383.6m in the corresponding period (including the principal amount of PLN 1,008.0m and PLN 1,281.4m, respectively), which contributed PLN 172.7m and PLN 103.9m to the profit before tax in both periods, respectively. Receivables sold included claims on retail and business customers.

The YoY decrease in impairment losses was combined with a 3.8% YoY increase in the gross loan book and steady improvement in the credit risk ratio from 0.67% in 2016 to 0.59% in 2017.

Staff and General Expenses of Bank Zachodni WBK

PLN m

Total costs of BZ WBK	2017	2016	YoY Change
Staff, general and administrative expenses, of which:	(2 323.2)	(2 360.2)	-1.6%
– Staff expenses	(1 255.0)	(1 220.8)	2.8%
– General and administrative expenses	(1 068.2)	(1 139.4)	-6.2%
Depreciation/amortisation	(274.9)	(234.1)	17.4%
Other operating expenses	(81.2)	(128.4)	-36.8%
Total costs	**(2 679.3)**	**(2 722.7)**	**-1.6%**

The total costs of Bank Zachodni WBK for 2017 amounted to PLN 2,679.3m, and were 1.6% lower YoY. In the period under review, there was a drop in general and administrative expenses (-6.2% YoY) and other operating expenses (-36.8% YoY), which reflects the reduction of BFG fees (PLN 184.1m in 2017 vs. PLN 220.8m in 2016), lower cost of marketing and entertainment (-19.7% YoY) and lower provisions for legal disputes (-55.1% YoY). On the other hand, staff expenses went up by 2.8% YoY as a result of an increase in the average headcount following the incorporation of the Multichannel Communication Centre in the bank's structures in September 2016, and salary and bonus schemes reviews conducted in H2 2016 and 2017. Depreciation and amortisation went up by 17.4% YoY due to the extension of IT infrastructure.

Excluding gains on a one-off equity transaction from total income for 2016, the Group's cost to income ratio decreased from 45.3% to 43.8% in 2017.

4. Financial Position of Bank Zachodni WBK

PLN m

Assets of BZ WBK (condensed presentation for analytical purposes)	31.12.2017	31.12. 2016	YoY Change
Loans and advances to customers [1]	90 537.0	87 102.4	3.9%
Financial assets available for sale	25 784.0	26 322.4	-2.0%
Cash and operations with central banks	4 114.8	4 696.6	-12.4%
Financial assets held for trading and hedging derivatives	3 568.3	3 265.0	9.3%
Fixed assets, intangibles and goodwill	2 970.0	2 932.7	1.3%
Loans and advances to banks [2]	2 012.1	3 308.8	-39.2%
Other assets [3]	3 877.1	3 790.1	2.3%
Total	**132 863.3**	**131 418.0**	**1.1%**
Liabilities & Equity of BZ WBK (condensed presentation for analytical purposes)	31.12.2017	31.12. 2016	YoY Change
Deposits from customers [4]	102 155.5	103 381.2	-1.2%
Subordinated liabilities and debt securities in issue	2 728.9	2 223.8	22.7%
Financial liabilities held for trading and hedging derivatives	1 842.7	3 771.8	-51.1%
Deposits from banks [4]	1 414.4	1 212.8	16.6%
Sell–buy–back transactions	1 479.7	–	–
Other liabilities [5]	2 403.3	1 798.9	33.6%
Total equity	20 838.8	19 029.5	9.5%
Total	**132 863.3**	**131 418.0**	**1.1%**

1) Loans and advances to customers take into account impairment charge and exclude receivables from repurchase transactions which are reported under other assets, whereas in the full version of financial statements they are disclosed in a separate line item together with the corresponding loans and advances to banks.
2) Excludes receivables from repurchase transactions disclosed under other assets.
3) Other assets include the following items of the full version of financial statements: receivables from repurchase transactions, investments in associates, net deferred tax assets, assets classified as held for sale and other assets.
4) Deposits from customers and banks do not include liabilities due to repurchase transactions which are reported under a separate line item.
5) Other liabilities include current income tax, provisions and other liabilities.

As at 31 December 2017, the total assets of Bank Zachodni WBK were PLN 132,863.3m, an increase of 1.1% YoY. With its 87.0% contribution to the total consolidated assets, the bank sets development directions for the Group's core business. Consequently, YoY movements reported in the Bank Zachodni WBK's statement of financial position are also reflected in the consolidated statement presented in Section 2 of this chapter.

In terms of the bank's assets, there was an increase in net loans and advances to customers (+3.9% YoY), and a decline in the following line items: loans and advances to banks (-39.2% YoY), cash and balances with central banks (-12.4% YoY) and financial assets available for sale (-2.0% YoY).

The unconsolidated liabilities reported sell-buy-back transactions (+PLN 1.5bn) which went down to nil a year before and subordinate debt and debt securities in issue which grew by 22.7% YoY on account of two new bond issues, including three series of certificates of deposit with a total nominal value of PLN 1,420.0m and subordinated debt in the form of green bonds with a nominal value of EUR 137.1m. YoY increase in total equity by 9.5% was driven by the current period profit and the entire profit for 2016 retained by the bank in with a regulatory requirement. Deposits from customers decreased by 1.2% YoY and so did financial liabilities held for trading (-30.2% YoY) and hedging derivatives (-70.5% YoY), which fell by 51.1% in an aggregated line item presented in the table above.

Gross Loans and Advances to BZ WBK Customers

PLN m

Gross Loans and Advances to BZ WBK Customers	31.12.2017	31.12.2016	YoY Change
Loans and advances to individuals	44 322.8	42 995.9	3.1%
Loans and advances to enterprises and public sector customers	49 239.0	47 007.3	4.7%
Other	7.3	181.6	-96.0%
Total	**93 569.1**	**90 184.8**	**3.8%**

As at 31 December 2017, gross loans and advances to customers were PLN 93,569.1m and higher by 3.8% YoY. The business loan portfolio grew by 4.7% YoY due to increased lending to SME and large corporate customers. Solid YoY growth rate was also witnessed in home loans (+3.1% YoY) and cash loans for retail customers (+5.8% YoY), which totalled PLN 33,723.9m and PLN 7,628.5m, respectively.

As at 31 December 2017, non-performing (impaired) loans and advances to customers accounted for 5.0% of the gross portfolio of Bank Zachodni WBK vs. 6.0% twelve months before. The provision coverage ratio for impaired loans was 56.6% vs. 50.9% as at 31 December 2016.

Deposits from BZ WBK Customers

PLN m

Deposits of BZ WBK Customers	31.12.2017	31.12. 2016	YoY Change
Deposits from individuals	59 310.8	57 845.4	2.5%
Deposits from enterprises and public sector customers	42 844.7	45 535.9	-5.9%
Total	**102 155.5**	**103 381.3**	**-1.2%**

In 2017, deposits from customers decreased by 1.2% to PLN 102,155.5 as at 31 December 2017. A decline in term deposits from retail and corporate customers (-15.7% YoY) was combined with an increase in current account balances (+9.7% YoY), often resulting from the transfer of funds from the time deposit facilities to current and savings accounts. Other deposits from customers dropped by 21.6% YoY as a result of the repayment of loans from the European Investment Bank, which reduced the balance of loans and advances.

5. Selected Financial Ratios of Bank Zachodni WBK and BZ WBK Group

Selected Financial Ratios of BZ WBK Group	2017	2016[1]
Total costs/Total income	43.4%	46.2%
Net interest income/Total income	68.0%	65.4%
Net interest margin [2]	3.84%	3.68%
Net commission income/Total income	25.9%	26.3%
Customer net loans/Customer deposits	96.7%	91.6%
NPL ratio	5.8%	6.6%
NPL coverage ratio	63.1%	59.0%
Credit risk ratio [3]	0.63%	0.75%
ROE [4]	12.2%	12.8%
ROTE [5]	14.3%	15.3%
ROA [6]	1.5%	1.5%
Capital ratio [7]	16.69%	15.05%
Tier I ratio [8]	15.28%	14.56%
Book value per share (in PLN)	235.0	211.8
Earnings per share (in PLN) [9]	22.3	19.4
Selected Financial Ratios of BZ WBK	**2017**	**2016[1]**
Total costs/Total income	43.8%	45.3%
Net interest income/Total income	61.8%	58.0%
Net interest margin [2]	3.2%	3.1%
Net commission income/Total income	28.2%	26.7%
Customer net loans/Customer deposits	88.6%	84.3%
NPL ratio	5.0%	6.0%
NPL coverage ratio	56.6%	50.9%
Credit risk ratio [3]	0.59%	0.67%
ROE [4]	11.0%	12.6%
ROTE [5]	13.0%	15.1%
ROA [6]	1.5%	1.6%
Capital ratio [7]	18.95%	16.52%
Tier I ratio [8]	17.37%	16.08%
Book value per share (in PLN)	209.8	191.8
Earnings per share (in PLN) [9]	19.3	18.6

1) The calculations of the following ratios for 2016 use the Group's total income or profit (as the case may be) after adjustment for one-off gains on equity transactions: cost/income, net interest income/total income, net fee and commission income/total income and earnings per share.
2) Net interest income for the accounting year (excluding interest income from the portfolio of trading securities) to average net interest-bearing assets as at the beginning and end of the reporting period (excluding the trading portfolio).
3) Impairment losses (for the accounting year) to average gross loans and advances to customers (as at the beginning and end of the reporting period).
4) Profit attributable to the parent's shareholders (for the accounting year) to average equity (as at the beginning and end of the reporting period), net of non-controlling interests, current period profit and the undistributed portion of the profit.
5) Profit attributable to the parent's shareholders (for the accounting year) to average tangible equity (as at the beginning and end of the reporting period) defined as common equity attributable to the parent's shareholders less revaluation reserve, current period profit, undistributed portion of the profit, intangible assets and goodwill.
6) Profit attributable to BZ WBK shareholders (for the accounting year) to average total assets (as at the beginning and end of the reporting period).
7) The capital adequacy ratio was calculated on the basis of own funds and the total capital requirements established for the individual risk types by means of the standardised approach, in line with the CRD IV/CRR package.
8) Tier 1 capital ratio is Tier 1 capital expressed as a percentage of risk weighted assets for credit, market and operational risk.
9) Net profit for the period attributable to shareholders of BZ WBK (after adjustment for one-off gains on equity transactions) divided by the number of ordinary shares.

6. Additional Financial Information on Bank Zachodni WBK and BZ WBK Group

Selected Transactions with Related Entities

Key Intercompany Transactions with Subsidiaries

Transactions between Bank Zachodni WBK and its related entities are banking operations carried out on an arm's length basis as part of their ordinary business and mainly represent loans, bank accounts, deposits, guarantees and leases.

As at 31 December 2017, the bank's total exposure in respect of loans to subsidiaries (e.g. BZ WBK Faktor, BZ WBK Leasing) amounted to PLN 8,816.5m compared with PLN 7,952.3m as at 31 December 2016.

The deposits held with the bank by its subsidiaries (e.g. BZ WBK Finanse, BZ WBK TFI) totalled PLN 154.5m vs. PLN 152.9m as at 31 December 2016.

Contingent financial liabilities totalled PLN 1,185.4m compared with PLN 1,837.6m as at 31 December 2016. Guarantees to subsidiaries amounted to PLN 63.5m vs. PLN 67.0m as at 31 December 2016.

These intercompany items are excluded from the consolidated accounts.

Leaseback

On 16 April 2016, Bank Zachodni WBK signed an agreement with BZ WBK Leasing regarding finance leaseback of the existing properties (building, land and perpetual usufruct) and the lease of the planned property (office building to be developed within three years) located in Wrocław.

The final total value of the assets arising from the lease agreement (building and land) was estimated at PLN 156.3m as at the start date of the transaction. As at 31 December 2017, the current value of the fixed assets under the finance leaseback agreement was PLN 39m, and the value of fixed assets under construction totalled PLN 78m.

The basic lease period was set at 153 months. The purchase of the assets and construction of the office building by BZ WBK Leasing is financed with a loan from Bank Zachodni WBK.

Intercompany Transactions with Parent Entity

The bank's receivables from the parent entity (Banco Santander) were PLN 308.7m compared with PLN 594.0m as at 31 December 2016, while obligations were PLN 63m compared with PLN 271.3m as at 31 December 2016.

A full disclosure on related party transactions is available in Note 48 of the Consolidated Financial Statements of Bank Zachodni WBK Group for 2017 and in Note 46 of the Financial Statements of Bank Zachodni WBK for 2017.

Selected Off-Balance Sheet Items

Guarantees and Derivatives

The tables below present contingent liabilities of Bank Zachodni WBK Group and nominal amounts of derivative transactions.

PLN m

Guarantees and Commitments of BZ WBK Group	31.12.2017	31.12. 2016
Financial commitments:	**24 642.3**	**23 243.1**
– credit lines	20 279.5	19 134.4
– credit cards debits	3 730.7	3 419.0
– import letters of credit	624.2	655.6
– term deposits with future commencement term	7.9	34.1
Guarantees	**4 885.7**	**4 182.8**
Allowance for impairment	**(50.7)**	**(50.7)**
Total	**29 477.3**	**27 375.2**

PLN m

Nominal Value of Derivatives of BZ WBK Group	31.12.2017	31.12. 2016
Derivatives – Forward (hedging)	25 301.4	32 810.5
Derivatives – Forward (trading)	282 611.4	289 441.5
Current FX transactions	2 894.1	1 540.2
Trading in equities	817.7	1 335.7
Total	**311 624.6**	**325 127.9**

Description of Guarantees Issued

Bank Zachodni WBK guarantees obligations arising from customers' operating activities. These are: payment guarantees, performance bonds, warranty bonds, bid bonds, loan repayment guarantees and customs guarantees. In justified cases, the bank issues counter- guarantees and standby letters of credit.

All guarantees are granted in accordance with the Polish Banking Law and the Polish Civil Code. Guarantees issued by the bank to secure cross-border transactions may be subject to applicable rules as agreed by the parties (e.g. Uniform Rules for Demand Guarantees) or to foreign law if a guarantee is governed by such law.

The process and information required in the case of guarantees are similar to the lending process. The bank adopts the same approach to credit risk here as in the case of balance sheet exposures.

Operating Lease

Bank Zachodni WBK and Santander Consumer Bank lease offices under operating lease agreements. Typically, Bank Zachodni WBK signs its lease agreements for a term of 5-10 years, while lease agreements of Santander Consumer Bank are signed for a term of 3–5 years (except for lease agreements for the premises of mobile units which are entered for an indefinite period subject to one to three months' notice).

PSA Finance Polska – together with its subsidiary PSA Consumer Finance Polska – generally operates from the premises leased under an agreement which expires in 2021. Both companies lease printers/photocopiers, laptops and personal computers from Banque PSA Finance.

The table below shows total liabilities arising from irrevocable operating leases (including the value of land in perpetual usufruct).

PLN m

Lease payments by maturity	31.12.2017	31.12. 2016
less than 1 year	208.0	235.7
between 1 and 5 years	474.2	494.5
over 5 years	384.5	467.6
Total	**1 066.7**	**1 197.8**

Collateral

As at 31 December 2017, the value of borrowers' accounts, assets or leased assets pledged as collateral to Bank Zachodni WBK Group amounted to PLN 89,730.0m, of which PLN 69,462.5m was pledged to Bank Zachodni (+5.8% YoY).

7. Factors which May Affect Financial Results of Bank Zachodni WBK and BZ WBK Group in 2018

The following external developments will have a significant impact on the financial performance and activity of Bank Zachodni WBK and Bank Zachodni WBK Group in 2018:

- The policy pursued by the US president and possible reshuffles in the US Congress following the elections in November 2018;
- Possible changes in the monetary policy of the ECB and Federal Reserve;
- Effects of the negotiations regarding the British exit from the European Union;
- Conflict between the USA and North Korea, and other geopolitical risks;
- Price changes in commodity markets;
- Stabilisation of the economic growth in Poland;
- Growth in real disposable income of households on account of the continued employment and wage growth;
- Possible rise of labour market tension due to the lack of qualified workforce and the reduction of retirement age;
- Growth of consumer prices;
- Possible changes to the monetary policy by NBP, entry into force of NBP resolutions amending the rate of the minimum reserve requirement to 0.50% (January 2018) and reducing it to 0% for funds raised for at least two years (March 2018);
- Low financing costs for households and businesses should stimulate demand for bank debt. At the same time, low interest on deposits should encourage bank customers to seek alternative savings/investment options.
- Changes in asset funding costs dependent on the pace and degree of changes in base rates, movements in the PLN exchange rate, liquidity position of the banking sector and the degree of price competition between banks seeking to attract customer deposits;
- A possible increase in volatility in financial markets in the event of a more negative outlook for global economic growth, growing concerns about potential monetary policy tightening by the Federal Reserve or about outcomes of the elections to be held in Italy in March 2018 (the latest polls see eurosceptic party on the rise);
- Further developments in the global equity markets and their impact on demand for investment fund units or safe bank deposits;
- Possible new bills e.g. on foreign exchange loans, causing banks to incur additional costs;
- Further developments in relation to Article 7 of the EU Treaty.

IX. Investor Relations

1. Investor Relations at Bank Zachodni WBK

As a listed company with an established market position, Bank Zachodni WBK is required to actively communicate with its stakeholders in order to satisfy their information requirements in accordance with the highest market standards and prevailing laws.

Particularly important is communication with capital market participants: shareholders, investors and analysts. Bank Zachodni WBK is committed to providing the above stakeholders with regular and timely access to high quality and clear information in order to facilitate the accurate assessment of the bank's financial standing, market position and the effectiveness of its strategy and business model.

The BZ WBK Investor Relations Office maintains relationships with institutional investors and stock market analysts, informing them proactively of the bank's development, performance and other relevant aspects which may affect their decisions. This is to ensure adequate transparency of the company, build trust and promote the bank's image in capital markets.

In 2017 – as part of standard activities in the area of investor relations investors – shareholders and stock market analysts had the opportunity to meet representatives of the bank's Management Board at numerous brokers' conferences in Poland and abroad as well as investor road-shows and individual meetings.

In 2017, Bank Zachodni WBK was present at five international investor conferences. As usual, four conferences were held to present market analysts with the bank's quarterly performance. In line with best practice, they were broadcast online in both Polish and English, and recordings were made available on the bank's website (www.bzwbk.pl/investor-relations/bz-wbk-investor-relations.html).

Up-to-date information on key developments regarding Bank Zachodni WBK is published at (www.bzwbk.pl/investor-relations/bz-wbk- investor-relations.html).

2. Share Capital, Ownership Structure and Share Price

Share Capital and Ownership Structure of Bank Zachodni WBK

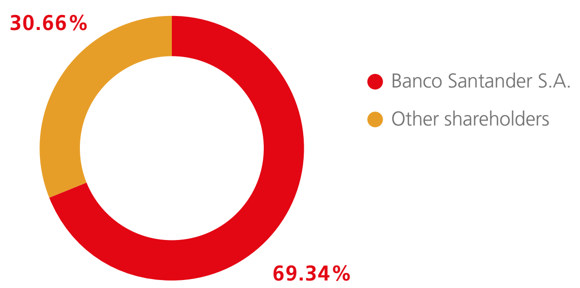
As at 31 December 2017, the share capital of Bank Zachodni WBK totalled PLN 993,334,810, divided into 99,333,481 ordinary bearer shares with a nominal value of PLN 10 each.

As the criteria for granting awards under the share-based 5th Incentive Programme had been satisfied, the bank's share capital was increased by way of issuing 98,947 series M shares without pre-emptive rights, with a nominal value of PLN 10 each.

The newly issued shares were taken up and paid up by eligible participants of the above-mentioned programme. The increase in the share capital was approved by the bank's Annual General Meeting of 17 May 2017 and recorded in the National Court Register on 3 August 2017. The above-mentioned shares were registered in the Central Securities Depository of Poland (KDPW) on 14 September 2017. On 1 December 2017, the shares were admitted to trading on the main floor of the Warsaw Stock Exchange starting from 19 December 2017.

Chapter XI "Statement on Corporate Governance in 2017" (part 4 "Equity Securities of the Issuer") presents general information about shares of Bank Zachodni WBK, respective share issues, as well as the number of shares and voting power held by shareholders with more than a 5% stake in the bank's share capital as at the end of 2016 and 2017.

Ownership Structure of Bank Zachodni WBK Share Equity as at 31.12.2017

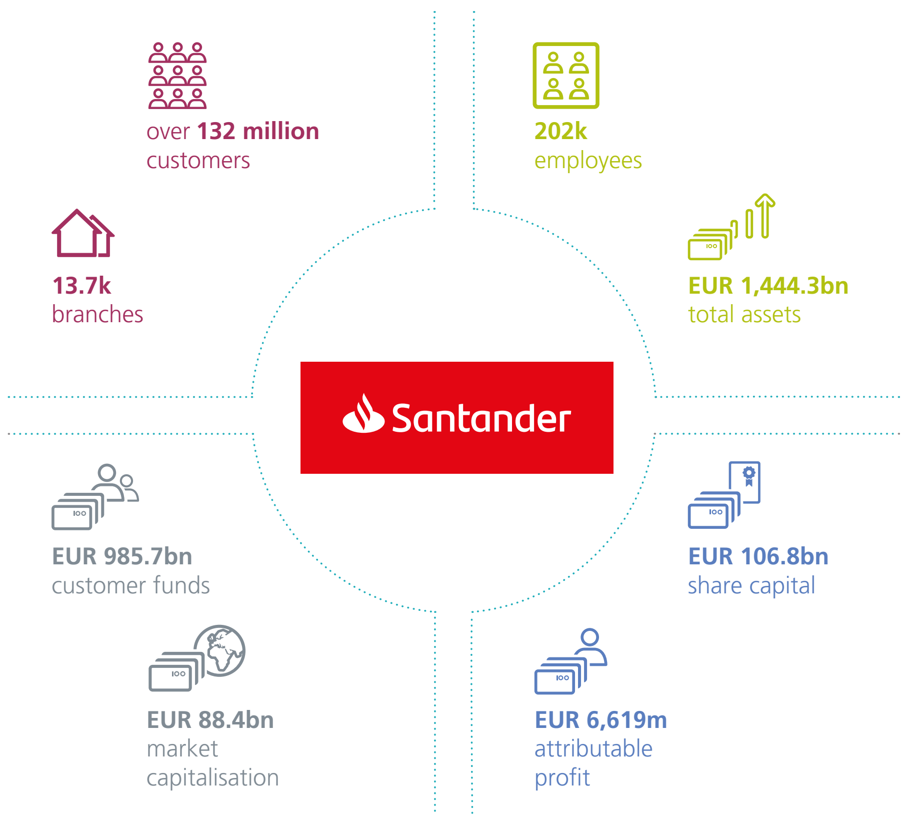


Majority Shareholder

Banco Santander, the parent entity of Bank Zachodni WBK, is a commercial bank with a history of nearly 160 years, having its registered office in Santander and operational headquarters in Madrid (Spain). While it specialises in retail banking services, the bank is also very active in the private banking, business and corporate banking, asset management and insurance markets. Banco Santander, which is characterised by the significant geographic diversification of its business, currently focuses on its 10 core markets, both developed and emerging. It has a strong market position in Spain, Argentina, Brazil, Chile, Mexico, the USA, Poland, Portugal and the UK. It is also present in consumer finance markets in Europe (Germany, France, Italy, Poland and the Scandinavian countries).

According to the data published on the statistical portal (www.statista.com) as at 25 April 2017, Banco Santander was the second largest bank in Europe and the 12th bank globally in terms of capitalisation.

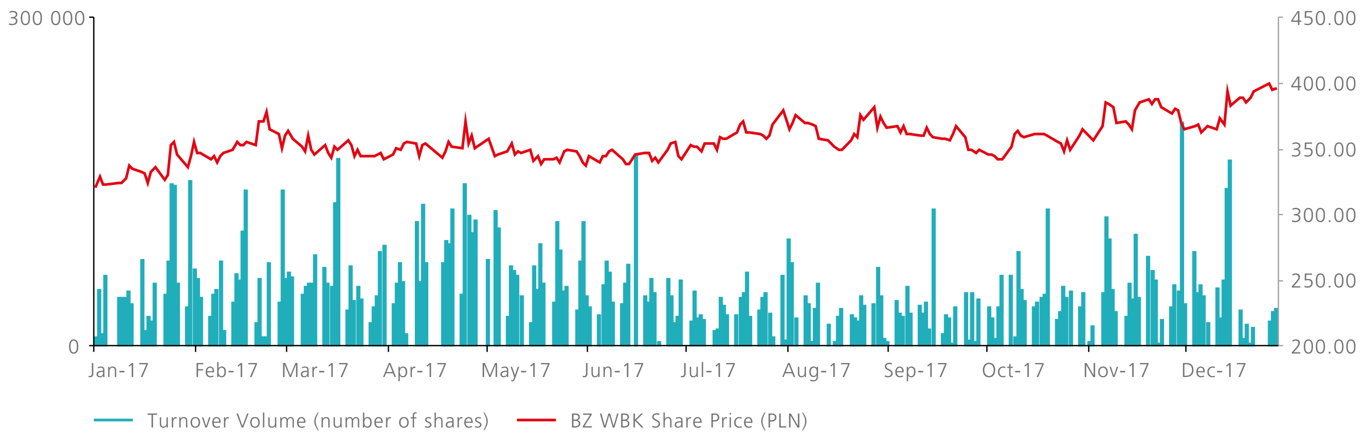
KEY FIGURES PRESENTING THE SCALE OF CONSOLIDATED ACTIVITY OF BANCO SANTANDER GROUP AS AT 31 DECEMBER 2017



Banco Santander has been listed on the Warsaw Stock Exchange since 3 December 2014. A total of 16,136.2m ordinary shares of the bank with a nominal value of EUR 0.50 each are traded there. In addition to the WSE, Banco Santander shares are quoted on stock exchanges in Madrid, Milan, Lisbon, London, New York, Buenos Aires and in other cities

Share Price of Bank Zachodni WBK vs. Indices

BZ WBK Share Price and their Stock Exchange Trading Volumes in 2017



Key Data on BZ WBK Shares	2017	2016
Share price at the year-end (in PLN)	396.25	316.00
Maximum closing share price over the year (in PLN)	400.00	331.50
Date of maximum closing share price	27.12.2017	13.12.2016
Minimum closing share price over the year (in PLN)	319.90	232.50
Date of minimum closing share price	02.01.2017	18.01.2016
Price per earning ratio (P/E) at the year-end	20.54	15.06
Number of shares at the year-end (items)	99 333 481	99 234 534
Market capitalisation at the year-end (PLN m)	39 360.9	31 358.1
Dividend per share [1] (PLN)	5.40	13.00

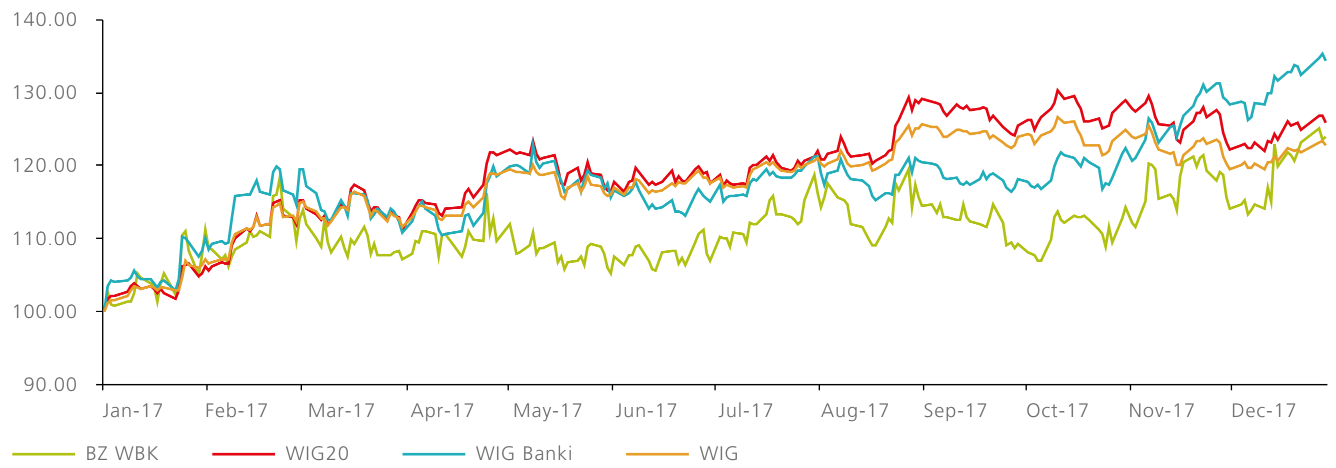
1) Details in "Dividend per Share" section below.

The share price of Bank Zachodni WBK rose by more than 25.4% over the last 12 months, ranging from PLN 319.90 on 2 January 2017 to PLN 400.00 on 27 December 2017. The highest peaks were observed during the first and last months of the year. The bank's market capitalisation increased from PLN 31,358.1m as at 31 December 2016 to PLN 39,360.9m as at 31 December 2017 due to buoyant stock market conditions, in particular improved sentiment in the banking sector, with the WIG-Banks index gaining more than 35% at that time. Adjusting for a dividend of PLN 5.40 per share paid out in the first half of the year (from retained earnings for 2014 and 2015) and dividends paid in the previous years, the share price of Bank Zachodni WBK hit an all-time high at the close of 2017. Aside from solid growth in domestic consumption, the increase in the bank's stock price was stimulated by a stronger Polish zloty, which improved the structure of BZ WBK's credit portfolio. Rising inflation and the dovish policy kept by the Monetary Policy Council also had a positive effect on the price of BZ WBK shares amid expectations for interest rate hikes in 2018.

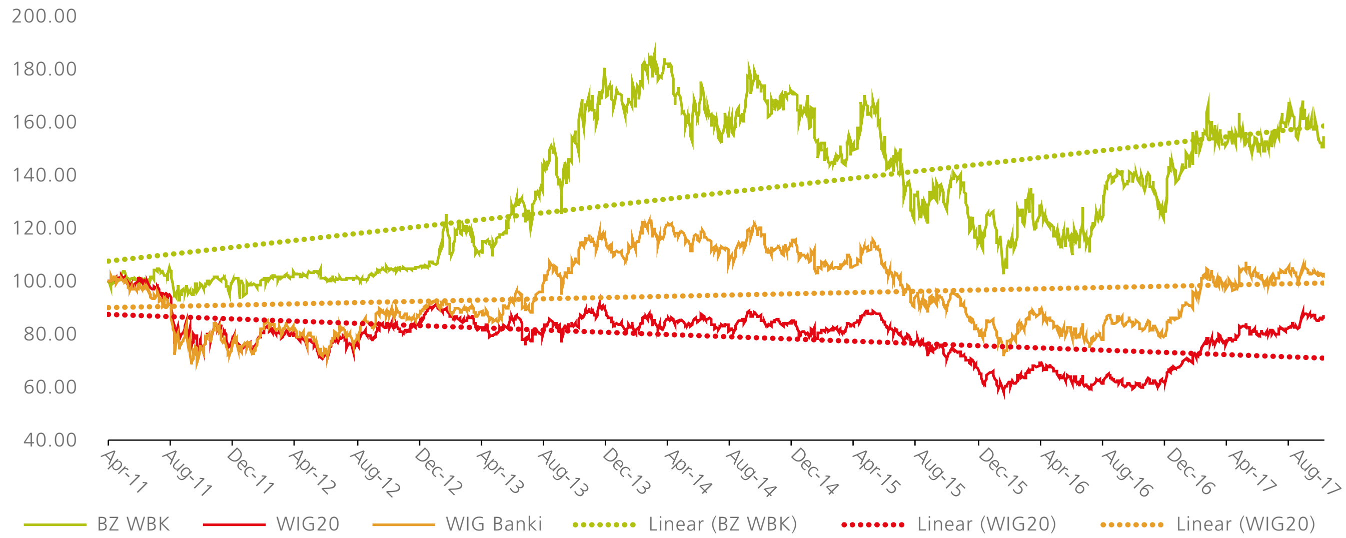
Due to strong liquidity and high market capitalisation, BZ WBK shares are traded in a number of stock market indices, including WIG– Banks (industry index), WIG20 (index of blue chip companies), and RESPECT (index of socially responsible companies).

The charts below show the BZ WBK share price against main stock exchange indices throughout 2017 and from the acquisition of a controlling stake by Banco Santander on 1 April 2011.

BZ WBK Share Price vs. Indices in 2017 (BZ WBK Share Price, WIG20, WIG Banks and WIG as at 02.01.2017 = 100)



BZ WBK Share Price vs. Main Local SE Indexes from 2011 to 2017 (Price as at 01.04.2011=100)



Dividend per Share

On the basis of a proposal from the Management Board and the Supervisory Board, and in accordance with the recommendation of the Polish Financial Supervision Authority (KNF) of 21 December 2016 on the principles of banks' dividend policies in 2017, and the individual recommendation for the bank of 9 March 2017, the bank's AGM of 17 May 2017 approved the distribution of the net profit for 2016 without making any dividend allocation.

Taking into account the strong capital position of the bank and its Group, the Management Board and the Supervisory Board made a proposal, subsequently approved by the AGM of 17 May 2017, to allocate to dividend an amount of PLN 535.9m from the retained profit for 2014 and 2015. The dividend of PLN 5.4 per share was paid out on 14 June 2017.

Last year, the AGM of 20 April 2016 decided to allocate PLN 702.5m of the net profit earned by Bank Zachodni WBK in 2015 and PLN 587.6m of the undistributed net profit for 2014 for a dividend payment. The dividend of PLN 13 per share was paid on 16 May 2016.

Dividend payments for the last five years are summarised in "Development of Bank Zachodni WBK Group over 5 Years" in Chapter I "Overview of Bank Zachodni WBK and BZ WBK Group Performance for 2017".

3. Bank Zachodni WBK Rating

Bank Zachodni WBK Rating

Bank Zachodni WBK has bilateral credit rating agreements with Fitch Ratings and Moody's Investors Service.

Rating Actions by Fitch Ratings

The table below shows rating actions taken by Fitch Ratings in relation to Bank Zachodni WBK in 2016 and 2017.

Fitch Rating	Ratings[1] confirmed as at 9.11.2016 and 20.10.2017	Ratings[1] updated as at 4.08.2016	Ratings confirmed as at 29.02.2016
		International Ratings	
Long-term Issuer Default Rating (long-term IDR)	BBB+	BBB+	BBB+
Outlook for the long-term IDR rating	stable	stable	stable
Short-term Issuer Default Rating (short-term IDR)	F2	F2	F2
Viability rating (VR)	bbb+	bbb+	bbb+
Support rating	2	2	2
		National Ratings	
National long-term rating	AA(pol)	AA(pol)	AA-(pol)
Outlook for the national long-term rating	stable	stable	stable
Senior unsecured debt national long-term rating	AA(pol)	AA(pol)	AA-(pol)

1) BZ WBK Ratings as at 31 December 2017 and 31 December 2016

Ratings of Bank Zachodni WBK as at 31 December 2017 were affirmed by Fitch Ratings on 20 October 2017 due to the lack of major changes to the bank's financial metrics over the past 12 months.

Fitch believes that Bank Zachodni WBK is a strategically important subsidiary for Banco Santander and there is a high probability of support from the parent entity if need be. This view is reflected in the Support Rating (SR) of 2 assigned to the bank.

The IDR of BZ WBK is driven by the bank's intrinsic strength, as reflected in its VR of bbb+. The IDR is also underpinned by potential shareholder support from Banco Santander rated A-/ Stable/a-.

The Stable Outlook on BZ WBK reflects broadly balanced risks related to the credit profile of the bank and Banco Santander.

The individual rating takes into account the bank's strengths such as a well-established domestic market franchise, stable business model, conservative risk appetite, strong capitalisation, sound asset quality and robust liquidity and funding.

Rating Actions by Moody's Investors Service

The table below shows rating actions taken by Moody's Investors in relation to Bank Zachodni WBK in 2016 and 2017.

Category of Moody's Ratings	Ratings updated as at 29.01.2018	Ratings updated as at 1.03.2017 i 9.08.2017[1)]	Ratings confirmed as at 9.09.2016
Bank Deposit	A3/P-2	A3/P-2	A3/P-2
Baseline Credit Assessment	baa3	baa3	baa3
Adjusted Baseline Credit Assessment	baa2	baa2	baa2
Outlook	positive	stable	stable
Counterparty Risk Assessment	A2 (cr)/ P-1 (cr)	A2 (cr)/ P-1 (cr)	A2 (cr)/ P-1 (cr)

1) BZ WBK Ratings as at 31 December 2017 and 31 December 2016

Ratings of Bank Zachodni WBK as at 31 December 2017 were affirmed by Moody's Investors Service in the credit opinion dated 9 August 2017.

Bank Zachodni WBK A3/Prime-2 deposit ratings incorporate the bank's standalone basic credit assessment (BCA) of baa3, the results of the Advanced Loss Given Failure (LGF) analysis, the assumption of parental support from Banco Santander and the low likelihood of support from the Polish Government if need be.

BZ WBK's BCA of baa3 is supported by Poland's Macro Profile of Strong-, and reflects the bank's expanding franchise in the Polish market, improved asset quality, strong profitability and good liquidity profile. At the same time, the bank's capitalisation, although at a good level, may come under pressure from rapid lending growth and potential Government initiatives on CHF mortgages.

On 29 January 2018 r. Moody's Investors Service changed the outlook to positive from stable on BZ WBK's long-term deposit ratings and affirmed the existing ratings. This rating action reflects improving asset quality, resilient capitalization and strong profitability. It also factors in positive impact of BZ WBK's upcoming acquisition of a carved-out business of Deutsche Bank's and the assessment of the costs associated with the draft legislation regarding foreign currency mortgages.

X. Risk and Capital Management

1. Risk Management Principles and Structure in Bank Zachodni WBK and BZ WBK Group

Risk Management Principles

Bank Zachodni WBK and other members of BZ WBK Group are exposed to various risks within their day-to-day activities which adversely affect the delivery of strategic priorities of the organisation. The main types of risks include: credit risk, concentration risk, market risk (in the banking book and in the trading book), liquidity risk, operational risk, compliance risk and reputational risk.

The main objective of risk management in the bank and BZ WBK Group is to ensure effective and safe operations to support development within approved risk parameters. Risk management practice is in keeping with the industry benchmark, regulatory guidance and recommendations from supervisory authorities, and covers operational risk, credit risk, market risk and liquidity risk, among other things.

Risk management in the bank and BZ WBK Group is consistent with the risk profile which corresponds to the general risk appetite defined by the Group. Risk appetite is expressed as quantitative limits and captured in the Risk Appetite Statement approved by the Management Board and the Supervisory Board. Limits are set using stress tests and scenario analyses to ensure the stability of the bank's position even if adverse circumstances materialise. Global limits are used to set watch limits and shape risk management policies.

The integrated risk management structure contains separate units responsible for identification, measurement, monitoring and mitigation of risks in a way that ensures independence of risk management functions from risk-taking units. The responsibilities of risk management units are defined by the risk management framework that governs the process of identifying, measuring and reporting the risks taken. Furthermore, limits are set on a regular basis to mitigate exposure to individual risks.

Risk Management Structure

The bank's Supervisory Board is responsible for ongoing supervision of the risk management system in Bank Zachodni WBK, supported by the Audit and Compliance Committee of the Supervisory Board and the Risk Committee. The Supervisory Board approves the strategy, key risk management policies and risk appetite, and monitors the use of internal limits from the perspective of current business strategy and the macroeconomic environment. It conducts reviews of key risk areas, the identification of threats and the process of defining and monitoring remedial actions. The Supervisory Board also assesses the effectiveness of measures taken by the Management Board.

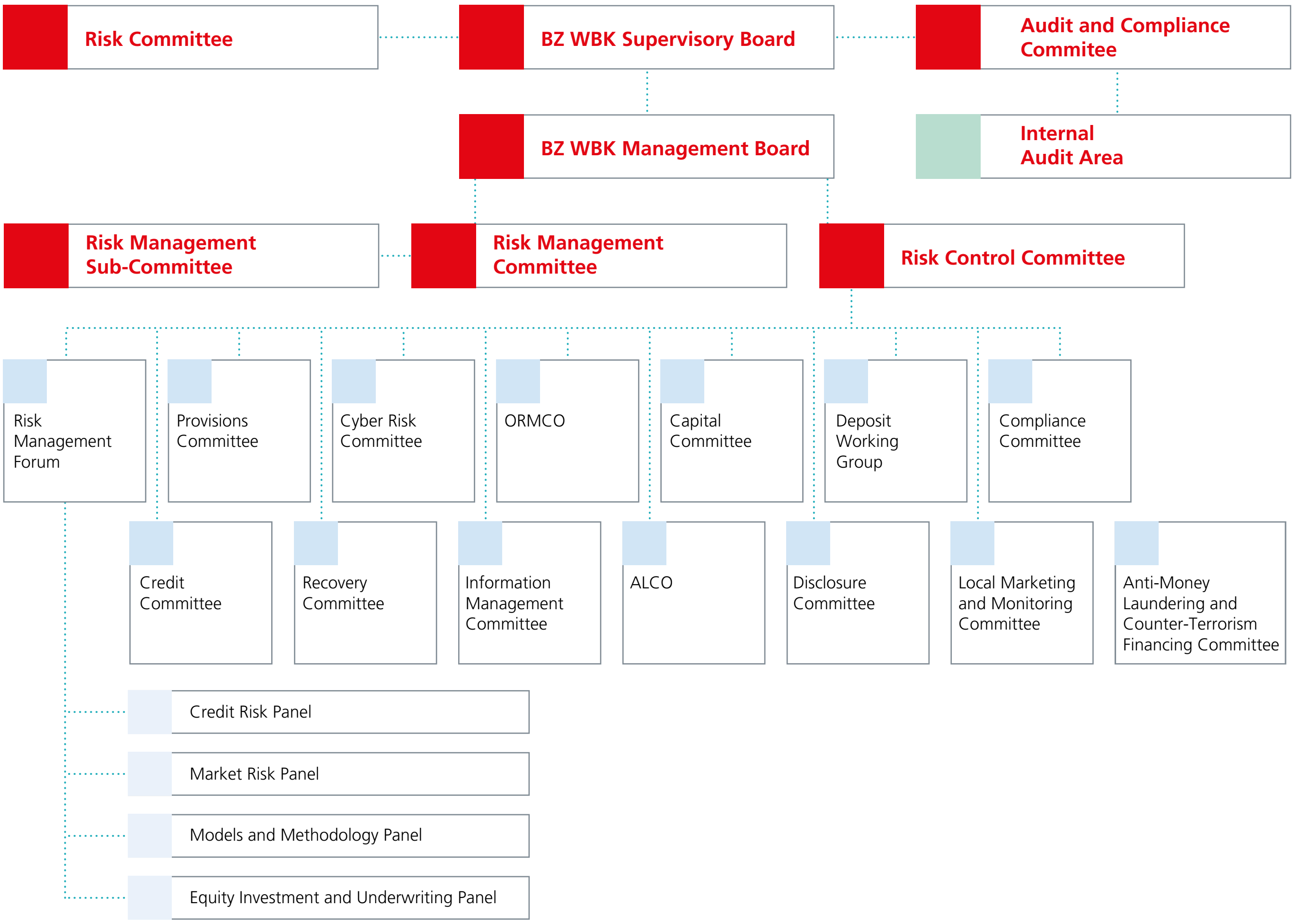
The bank's Management Board is responsible for implementing an effective risk management system compliant with the bank's regulatory obligations and internal regulations. Specifically, the bank's role in this regard is to set up an organisational structure tailored to the size and profile of the risks taken, to segregate responsibilities in order that risk assessment and control functions remain independent of operational functions, to introduce and update a risk management strategy and ensure an adequate information policy.

The Management Board fulfils its risk management role through the following three committees:

- The Risk Management Committee, which is an executive committee responsible for taking key decisions concerning risk management across the Group;
- The Risk Management Sub-Committee, which was set up as part of the Risk Management Committee to approve the key decisions taken by the main lower-level risk committees;

- The Risk Control Committee, which monitors the risk level across different areas of the bank's operations and supervises the activities of lower-level risk management committees set up by the Management Board.

Corporate Governance Structure for Risk Supervision and Management



The Risk Control Committee supervises the following committees responsible for risk management in the Group:

- The Risk Management Forum composed of panels dedicated to credit risk, market risk, models and methodology and equity investment and underwriting
- Credit Committee
- Recovery Committee
- Provisions Committee
- Information Management Committee
- Operational Risk Management Committee / ORMCO
- Cyber Risk Committee
- Assets and Liabilities Management Committee / ALCO
- Capital Committee
- Disclosure Committee
- Deposit Working Group
- Local Marketing and Monitoring Committee
- Compliance Committee
- Anti-Money Laundering and Counter-Terrorism Financing Committee

These committees, acting within the respective remits defined by the Management Board, are directly responsible for developing risk management methods and monitoring risk levels in specific areas. Through these committees, the bank also supervises the risk attached to the operations of its subsidiaries.

The subsidiaries have risk management policies and procedures in place that reflect the approach adopted by Bank Zachodni WBK, which ensures that risk management processes are consistent across the Group.

Acting under the applicable law, the bank exercises oversight of risk management in Santander Consumer Bank (SCB) in line with the same oversight rules as applied to other Bank Zachodni WBK Group companies. Bank Zachodni WBK Management Board members in charge of the Risk Management Division and Retail Banking Division (respectively) sit on the Supervisory Board of SCB.

Pursuant to the BZ WBK strategy of investments in capital market instruments, they are responsible for supervision over SCB and they ensure, together with the SCB Supervisory Board, that the company operates in line with the adopted plans and operational security procedures. The bank monitors the profile and level of SCB risk via BZ WBK risk management committees.

2. Credit Risk Management

Credit Risk

Credit risk is defined as the possibility of suffering a loss if the borrower fails to meet their credit obligation, including payment of interest and fees. It results in the impairment of credit assets and contingent liabilities as a consequence of the borrower's worsening credit quality. Credit risk measurement is based on the estimation of credit risk weighted assets, with the relevant risk weights representing both the probability of default and the potential loss in the event of the borrower's default.

Credit risk in the bank and BZ WBK Group arises mainly from lending activities on the retail, corporate and interbank markets. This risk is managed as part of the policy approved by the Management Board on the basis of the adopted credit procedures and discretionary limits. The internal system of credit grading and monitoring used by the bank and BZ WBK Group allows for the early identification of potential defaults that might impair the loan book. Additionally the bank and the Group use a large set of credit risk mitigation tools, both collateral (financial and non-financial) and specific credit provisions and clauses (covenants).

Credit risk management in the bank and BZ WBK Group involves actions taken as a result of the ongoing analysis of the macroeconomic environment and internal reviews of particular credit portfolios. These advanced credit risk assessment tools allow quick remedial actions to be effected in response to the first signs of any change in the portfolio's quality or structure.

Credit Policy

The credit policy adopted by the bank and BZ WBK Group is a set of principles and guidelines included in credit policies and procedures which are reviewed on a regular basis. Internal limits are crucial components of the lending policy because they facilitate the monitoring of exposure concentration within individual sectors, geographical regions and foreign currencies. Pursuant to the policy, the bank and BZ WBK Group ensure adequate diversification of the credit portfolio in terms of exposure towards individual customers and sectors.

In 2017, the bank and the Group continued their existing credit risk management policy, keeping credit risk at a safe level while ensuring the high profitability of loan portfolios, the growth of business volumes and an increase in market share. Credit policies were optimised in response to macroeconomic developments.

The most important measures taken by the bank to manage credit risk included:

- Intensive work done to implement a new approach to the calculation of provisions for credit risk under IFRS 9;
- Alignment of the bank's risk appetite through the amendment of the BZ WBK Business Lending Policy and the BZ WBK Lending Policy for Construction Sector Companies, significantly reducing provisions in the corporate portfolio;
- Optimisation of the lending policy for retail and SME customers with substantial credit exposure by extending the scope of credit risk assessment to include the expected loss arising from the recovery process.

The lending activity of subsidiaries is modelled on the bank's credit policies. In the decision making process, the bank and BZ WBK Group follow a consistent approach to credit risk and use the same IT platform to assign rating/scoring (this does not apply to SCB). Subsidiaries have credit risk management procedures in place which are consistent with the regulations applied by the bank.

Credit Risk Management Process

	Key elements of the credit risk management process in the bank and BZ WBK Group
Credit decision making process	• Discretionary limits are governed by the Guidelines on Discretionary Limits in Bank Zachodni WBK. The guidelines define roles and responsibilities of individual units and staff members involved in the credit delivery process. • The credit decision making process is based upon individual credit discretions vested in credit officers, commensurate with their knowledge and experience relating to particular activities and specific needs of respective segments (branch banking, SME banking, business banking and corporate banking). • Large credit exposures in excess of PLN 25m are referred to the Credit Committee composed of senior management and top executives. Transactions above PLN 187.5m are additionally signed off by the Management Board's Risk Management Sub-Committee. The existing system of credit discretion ensures segregation of the credit risk approval function from the sales function.
Credit grading	• The credit risk assessment tools conform to KNF guidelines, International Accounting Standards/International Financial Reporting Standards (IAS/IFRS) and best market practice. • The Group uses credit risk grading models for its key credit portfolios, including corporate customers, SMEs, home loans, property loans, cash loans, credit cards and personal overdrafts. • Credit grading is subject to regular monitoring which is carried out in accordance with the rules described in the lending manuals. Additionally, for selected models, automated processing of credit grade verification is carried out based on the number of overdue days or an analysis of behavioural factors. Credit grade is also verified at subsequent credit assessments.
Credit reviews	• The Group performs regular reviews to determine the actual quality of the credit portfolio, confirm that adequate credit grading and provisioning processes are in place and verify compliance with procedures and credit decisions.
Collateral	• The Collateral and Credit Agreements Department is a central unit responsible for ensuring that security covers are duly established and held effective in line with the lending policy for respective business segments. The unit develops standardised internal procedures with respect to collateral and ensures that the establishment, monitoring and release of security covers is duly effected. In addition, the Collateral and Credit Agreements Department provides assistance to credit units in credit decision making, development of credit policies, the collection of data on security covers and also ensuring adequate management information.
Credit risk stress testing	• Stress testing is a part of the credit risk management process used to evaluate the potential effects of specific events, movements in financial and macroeconomic ratios or changes in the risk profile on the condition of the bank and BZ WBK Group. Stress tests are conducted to assess potential changes in credit portfolio quality when faced with adverse conditions. The process also delivers management information about the adequacy of the agreed limit and internal capital allocation.
Calculation of impairment	• Impairment charges reflect credit impairment, which is recognised if the bank or the Group presents objective evidence that such amounts cannot be recovered in line with the signed loan agreement. • Impairment is calculated on the basis of the estimated recoverable amount. Impairment analysis is performed using both an individual (for individually significant exposures with objectively evidenced impairment) and collective approach (individually insignificant exposures with objectively evidenced impairment, and incurred but not reported losses). • Twice a year, the Group compares the assumptions and parameters used for impairment calculations with the actual situation, including changes of economic conditions, and amendments to the Group's credit policies and recovery process. This process provides assurance that impairment charges are recognised correctly. The responsibility for ensuring the adequacy of impairment charges rests with the Provisions Committee.
Forbearance	• As part of proactive management of credit risk and credit portfolio quality, Bank Zachodni WBK Group takes measures aimed at the early implementation of debt restructuring (forbearance solutions) with respect to customers in financial difficulty. The purpose of debt restructuring is to better match repayment terms with the current and projected financial standing of the customer, minimise default risk and/or maximise recovery. • A portfolio subject to restructuring is monitored on a regular basis. The debt is classified as restructured until the customer's circumstances stabilise. For more on forbearance, see Note 4 "Risk Management" in "Consolidated Financial Statements of Bank Zachodni WBK Group for 2017".

Credit Portfolio Quality

BZ WBK GROUP LOANS AND ADVANCES TO CUSTOMERS BY IMPAIRED AND NON-IMPAIRED LOAN PORTFOLIOS

PLN m

BZ WBK Group Loans and Advances to Customers by Impaired and Non–Impaired Loan Portfolios	31.12.2017	31.12.2016
Individually impaired (gross amount)	2 378.3	2 641.2
Allowance for impairment	(1 225.2)	(1 266.0)
Net amount (individually impaired)	**1 153.1**	**1 375.2**
Collectively impaired (gross amount)	4 129.3	4 460.5
Allowance for impairment	(2 882.4)	(2 921.9)
Net amount (collectively impaired)	**1 246.9**	**1 538.6**
IBNR portfolio (gross amount)	106 169.0	100 664.0
– non–past due	102 153.8	94 535.4
– past due	4 015.2	6 128.6
IBNR provisions	(738.5)	(691.1)
Net amount (non–impaired)	**105 430.5**	**99 972.9**
Other receivables	9.4	181.8
Total net loans and advances to customers	**107 839.9**	**103 068.5**
Impaired loan ratio	**5.8%**	**6.6%**
Impaired loan coverage ratio	**63.1%**	**59.0%**

BZ WBK LOANS AND ADVANCES TO CUSTOMERS BY IMPAIRED AND NON-IMPAIRED LOAN PORTFOLIOS

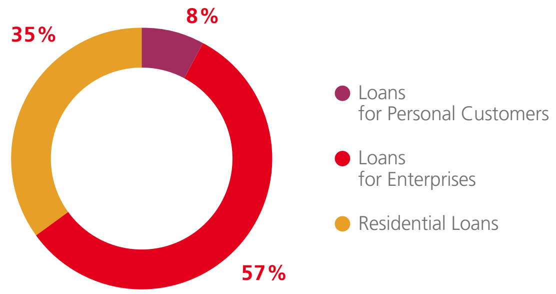
PLN m

BZ WBK Loans and Advances to Customers by Impaired and Non–Impaired Loan Portfolios	31.12.2017	31.12.2016
Individually impaired (gross amount)	2 246.0	2 501.4
Allowance for impairment	(1 144.5)	(1 196.4)
Net amount (individually impaired)	**1 101.5**	**1 305.0**
Collectively impaired (gross amount)	2 477.6	2 883.6
Allowance for impairment	(1 530.2)	(1 544.5)
Net amount (collectively impaired)	**947.4**	**1 339.1**
IBNR portfolio (gross amount)	88 838.2	84 497.9
– non–past due	85 800.6	80 792.5
– past due	3 037.6	3 705.4
IBNR provisions	(357.4)	(341.6)
Net amount (non–impaired)	**88 480.8**	**84 156.3**
Other receivables	7.3	181.6
Total net loans and advances to customers	**90 537.0**	**86 982.0**
Impaired loan ratio	**5.0%**	**6.0%**
Impaired loan coverage ratio	**56.6%**	**50.9%**

VALUE AND STRUCTURE OF BZ WBK GROUP DEBT SUBJECT TO FORBEARANCE

Loans and Advances to Customers Subject to Forbearance Arrangements (PLN m)	31.12.2017	31.12.2016
Loans and advances to customers in the gross amount	3 460.8	4 041.7
Allowance for impairment	(847.6)	(954.6)
amount	2 613.2	3 087.1

Structure of Gross Loans and Advances Subject to Forbearance Arrangements by Customer Type as at 31.12.2017



3. Market Risk and Liquidity Risk Management

Market Risk

Market risk within the bank's and Group's operations is derived mainly from customer service operations, transactions effected to maintain liquidity on the money market and the capital market as well as proprietary trading in debt, FX and equity instruments.

The key objective of the market risk policy adopted by the bank and BZ WBK Group is to reduce the impact of interest and FX rates movements on the Group's profitability and market value as well as to increase income within strictly defined risk limits and to ensure the Group's liquidity.

Market Risk Management

The Risk Management Forum approves market risk management strategies and policies as well as limits that define the maximum acceptable exposure to individual risk types, in accordance with the Risk Appetite Statement.

The Management Board takes its strategic decisions on the basis of recommendations put forward by the Risk Management Forum, to which direct supervision of market risk management has been delegated.

ALCO – supported by the Financial Management Division – is responsible for managing market risk in the banking book, while the market risk in the trading book is managed by the bank's Global Corporate Banking Division.

Identification and Assessment of Market Risk

Interest rate and FX risks associated with the banking book are managed by the Financial Management Division, which is also responsible for managing open positions in interest rate and FX risks of companies from BZ WBK Group.

The Global Corporate Banking Division, which includes the Brokerage Office of Bank Zachodni WBK, is responsible for managing market risk in the trading book.

The responsibility for measurement, monitoring and reporting of market risk and compliance with risk limits is vested in the Risk Management Division, which is responsible for regular reviews of market risk exposure and reporting results to the Risk Management Forum.

With the division of roles, the management of risk in the banking book is fully separate from the management of risk in the trading book, and the risk measurement and reporting functions are separate from the risk managing and taking units.

The market risk management policies adopted by the bank and the Group set out a number of measures in the form of obligatory and watch limits and ratios. Limits are reviewed and risk appetite is updated on an annual basis. The process is coordinated by the Financial Risk Department in the Risk Management Division.

To control the banking book risk, the following maximum sensitivity limits have been set for the risk of interest rate changes:

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

SENSITIVITY OF BANKING BOOK TO INTEREST RATE MOVEMENTS AS AT 31.12.2017 AND 31.12.2016

PLN k	NII Sensitivity		MVE Sensitivity	
1 day holding period	31.12.2017	31.12.2016	31.12.2017	31.12.2016
Maximum	238	218	377	250
Average	211	184	267	198
As at the end of period	238	218	347	218
Limit	**310**	**280**	**380**	**340**

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

The bank and BZ WBK Group use the following measures and limits to mitigate and control exposure to market risk in the trading book:

- daily VaR limit for interest rate risk, FX risk and the repricing risk of equity instruments held by the Brokerage Office;
- PV01 limit set for individual currencies and transaction repricing dates;
- stop-loss mechanism used to manage the risk of loss on trading positions subject to fair value measurement through profit or loss;
- maximum limit of the total position and an open position for individual currencies.

As these measures relate to the calculation of a potential loss under normal market conditions, the bank and BZ WBK Group also use stress tests which show the estimated potential losses in the event of the materialisation of adverse market conditions.

VAR AS AT 31.12.2017 AND 31.12.2016 FOR INTEREST RATE, CURRENCY AND EQUITY RISK IN THE TRADING BOOK OF BANK ZACHODNI WBK GROUP

PLN k	Interest Rate Risk VAR		FX Risk VAR		Equity Securities Risk VAR	
1 day holding period	31.12.2017	31.12.2016	31.12.2017	31.12.2016	31.12.2017	31.12.2016
Average	1 559	1 706	414	393	304	301
Maximum	4 777	3 681	1 725	3 096	694	742
Minimum	373	659	50	30	46	50
as at the end of the period	839	1 509	175	319	90	77
Limit	**6 266**	**7 523**	**2 611**	**3 134**	**3 621**	**4 346**

Financial Instruments Used for the Management of Market and Other Risks

The bank and the Group use the following financial instruments in relation to repricing risk, credit risk, cash flow risk and liquidity risk:

- derivative instruments held for trading – proprietary transactions in connection with treasury services rendered to bank customers in order to mitigate market risk, maintain liquidity or as part of underwriting services;
- other financial instruments, including investment securities held for sale, hedging derivatives and equity instruments.

Market risk associated with open positions in financial instruments is mitigated through a set of limits (defined separately for the trading book and the banking book). The credit risk of such positions is curbed using concentration limits in respect of individual counterparties. In order to mitigate liquidity risk, the bank and the Group keep an adequate level of liquid financial assets bearing low credit risk (in particular treasury bonds and NBP money market bills) in line with the liquidity risk appetite defined by the bank and the Group.

No derivative instruments were used by the bank or the Group to hedge credit risk, while FX options, interest rate options and commodity derivatives were executed on a back-to-back basis and therefore did not expose the bank or the Group to market risk.

The market risk of the balance sheet is managed by the bank and the Group using, among other things, derivative instruments and hedge accounting with respect to:

- mortgage loans bearing the WIBOR rate – interest rate swaps are used to receive fixed interest and pay floating interest thus hedging the risk of movements in cash flows relating to floating interest loans;
- mortgage loans in CHF and EUR – basis swaps are used to hedge the risk of movements in interest rates (CHF LIBOR, EURIBOR) and exchange rates (CHF/PLN and EUR/PLN);
- fixed interest cash loans – interest rate swaps are used to receive floating interest and pay fixed interest thus hedging the fair value of positions;
- selected fixed coupon bonds – interest rate swaps are used to hedge the fair value of bonds whereby the bank and the Group receive floating interest and pay fixed interest.

Liquidity Risk

Liquidity risk is the risk of failure to meet contingent and non-contingent obligations made to customers and counterparties.

The Liquidity Management Policy adopted by the bank and the Group is to ensure that all outflows expected in the short term are fully covered by anticipated inflows or liquid assets. In addition, the aim of the policy is to ensure an adequate structure of funding for the bank's and the Group's operations by maintaining medium- and long-term liquidity ratios at a pre-defined level and monitoring stress testing results. This policy covers all assets and liabilities as well as off-balance sheet items impacting the liquidity level.

Liquidity Risk Management

ALCO and the Risk Management Forum have overall responsibility for the supervision of liquidity risk on behalf of the Management Board. As part of their roles, they make recommendations to the Management Board on appropriate strategies and policies for strategic liquidity management. Liquidity risk reports and stress test results are regularly reviewed by senior management.

ALCO also supervises the liquidity management process in subsidiaries.

Liquidity management is the role of the Financial Management Division, which is responsible for the development and maintenance of appropriate strategies. The Risk Management Division is responsible for the independent measurement and reporting of liquidity risk and defining liquidity risk management policies. The Financial Risk Department in the Risk Management Division is also responsible for the regular performance of stress tests with respect to liquidity, and for the review of the Contingency Liquidity Plan approved by the Management Board and the Supervisory Board.

Identification and Assessment of Liquidity Risk

Liquidity risk is identified and measured daily, mainly using modified liquidity gap reports, intraday liquidity reports and regulatory reports. These reports include a number of internal and regulatory limits. Cyclical liquidity measurement reports are supported by stress test results. The bank regularly calculates the measures laid down in CRD IV/CRR (LCR and NSFR) and in KNF Resolution No. 386/2008. As at 31 December 2017, LCR was 144.6% and NSFR was 115.0%.

ECONOMIC LIQUIDITY GAP ANALYSIS AS AT 31.12.2017 AND IN THE COMPARABLE PERIOD

31.12.2017 PLN m	On demand	up to 1 month	from 1 to 3 months	from 3 to 6 months	from 6 to 12 months	from 1 to 2 years	from 2 to 5 years	over 5 years
Contractual liquidity mismatch/ gap	(2 557.6)	(22 395.2)	(13 701.1)	(1 661.3)	(1 247.2)	5 374.2	19 057.2	17 131.0
Cumulative liquidity gap	(2 557.6)	(24 952.8)	(38 653.9)	(40 315.2)	(41 562.4)	(36 188.2)	(17 131.0)	–
Net derivatives	–	(64.0)	13.8	(76.8)	(33.3)	12.9	(6.0)	(119.7)
31.12.2016 PLN m	On demand	up to 1 month	from 1 to 3 months	from 3 to 6 months	from 6 to 12 months	from 1 to 2 years	from 2 to 5 years	over 5 years
Contractual liquidity mismatch/ gap	(39 223.2)	(9 705.7)	(9 534.1)	(5 191.2)	1 026.7	13 768.0	24 440.9	24 418.5
Cumulative liquidity gap	(39 223.2)	(48 928.9)	(58 463.0)	(63 654.2)	(62 627.5)	(48 859.5)	(24 418.6)	–
Net derivatives	–	12.2	(145.3)	(11.5)	(51.2)	(173.8)	(187.4)	(1 018.8)

According to the Group's policy, the bank should have sufficient funds to cover in full the outflows expected over a one-month horizon, including that of the selected stress test scenarios. The liquidity position over a longer time horizon and the level of qualified liquid assets are also monitored.

In 2017, the bank's funds significantly exceeded the level required to cover the expected outflows. The bank also met the regulatory quantitative requirements for liquidity. Key regulatory indicators (i.e. the short term liquidity ratio and ratio of coverage of non-liquid assets and assets of limited liquidity with own funds and core external funds and relationship between liquid assets and net inflows/LCR) comfortably exceeded the required levels.

4. Operational Risk Management

According to the definition of the Basel Committee, operational risk is the risk of loss resulting from external factors or inadequacy or failure of internal processes, human resources and systems.

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

Employees across the bank and BZ WBK Group are involved in operational risk management – this process covers a number of interrelated concepts. Operational risk is inherent in all the bank's and Group's business processes, including outsourced functions or services delivered jointly with third parties.

The bank and the Group apply the Operational Risk Management Strategy.

The Operational Risk Management Committee (ORMCO) established by the Management Board is responsible for setting operational risk management standards for BZ WBK Group. ORMCO is the main forum for discussions on operational risk. It sets the strategic direction for operational risk management, and determines and monitors objectives for managing operational risk, including business continuity, information security, outsourcing/insourcing and money laundering risk in all business areas of Bank Zachodni WBK. As part of ORMCO, there are dedicated forums which deal with specific operational risk aspects: the Anti-Money Laundering Forum and the Insurance Forum. The results of ORMCO's work are reported to the Risk Control Committee.

In view of the growing cyber threat, the Cyber Risk Committee was set up as a forum for direct cooperation and communication among all organisational units involved in the processes related to cyber security in a broad sense. The Committee also supervises the adherence to the cyber security strategy in Bank Zachodni WBK.

OPERATIONAL RISK MANAGEMENT TOOLS

Tools used by the bank and the Group to manage operational risk

Identification and assessment of operational risk	• In the self-assessment process, the bank and BZ WBK Group identify the risks they may be exposed to when delivering their functions, assess inherent and residual risks in terms of their likelihood and impact, and evaluate the design and effectiveness of existing controls. • The process of identification and assessment of operational risk is additionally supported by such tools as: scenario analyses, business impact analyses and an analysis of risk in new initiatives.
Reporting	• Each organisational unit is required to report operational risk events identified in its area of responsibility. Relevant operational risk events are escalated to senior management using a fast-track procedure. The bank and the Group run a database of operational risk events identified across the organisation with data utilised to analyse the root cause and consequences of such events, so as to capture lessons learned and take preventive and corrective measures. • The Group contributes inputs to the external database of operational risk events run by the Polish Banks Association and uses information about external events from a number of sources. The analysis of external events allows for benchmarking and lesson learning from events identified outside the Group.
Analysis of risk indicators	• Bank Zachodni WBK Group monitors financial, operational and technological risk indicators. Risk indicators provide an early warning of emerging threats and operational losses and support the monitoring of risk in the bank's and Group's operations.
Business continuity management (BCM)	• Each organisational unit is required to develop and update its business continuity management plans to ensure that critical business processes remain uninterrupted following an unplanned disruption. BCM plans are tested on a regular basis to provide assurance to Bank Zachodni WBK Group that critical business processes may be restored at the required service level and within the agreed time frame. The bank and the Group have backup locations in place where critical processes can be restored and continued should an incident occur.
Information security	• Bank Zachodni WBK has the Information Security Management System in place which has a certificate of compliance with the ISO/IEC 27001:2013 standard. The purpose of the system is to supervise information security in BZ WBK Group's business environment, and assess specific information and system security requirements.
Insurance	• For the purpose of operational risk mitigation, Bank Zachodni WBK Group has an insurance scheme in place which covers various financial risks, plus motor, property and professional indemnity insurance.
Reporting to the Risk Management Committee and Supervisory Board	• The aim of operational risk reporting is to provide up-to-date and adequate information to the management team. Operational risk reports record details on operational risk events and losses, information security incidents, risk indicators and defined mitigants.

5. Legal and Compliance Risk Management

Bank Zachodni WBK and BZ WBK Group companies provide a wide array of specialist financial services and are exposed to legal and compliance risks mainly in the following areas:

- general regulations regarding labour law, taxes, accounting and personal data protection;
- domestic and international (mainly: EU) trade regulations in the area of reporting, prudential standards, prevention of money laundering and counter-terrorism financing, etc.;
- domestic and international regulations concerning the types of products offered and service delivery methods applied by the bank and BZ WBK Group (in particular: the legislation on consumer and competition protection, capital markets, financial markets, etc.);
- codes of good practice and other regulations implemented by the Group, including in relation to the membership of domestic or international trade associations.

One of the main objectives of compliance risk management in the Group is to ensure that general laws and domestic and international reporting regulations are adhered to in order to strengthen the perception of Bank Zachodni WBK Group as a dependable organisation.

At the bank and BZ WBK Group, legal and compliance risks are managed as part of a number of processes, which are coordinated and executed by relevant organisational units:

- Responsibilities of the Legal and Compliance Division relate to "conduct of business" compliance obligations, in particular with regard to: the protection of consumer rights, the implementation and sale of new products, the prevention of money laundering, ethical issues, the protection of sensitive information, the protection of personal data, and conflict management.
- The identification, interpretation and communication roles relating to other legal and regulatory obligations for the bank as a legal entity (non-conduct of business) have been assigned to functions with specialist knowledge in those areas:
  - compliance with labour law – Business Partnership Division;
  - compliance with taxation law and reporting requirements – Financial Accounting and Control Division;
  - compliance with prudential regulation – Risk Management Division.

In July 2017, the bank's Management Board adopted the new Compliance Policy approved by the Supervisory Board. The policy provides the Compliance Area and the Anti-Money Laundering Department, which form the Compliance Function within the Legal and Compliance Division, with the relevant mandate to support managers in the effective management of compliance risk and to escalate issues to the Risk Management Committee and the Audit and Compliance Committee of the Supervisory Board. These Committees ensure the fulfilment of regulatory obligations and approve internal control principles and the compliance policy framework. They also provide necessary resources to the Compliance Function and ensure that it is independent of business units. The Audit and Compliance Committee regularly reviews key compliance issues identified by the Compliance Area and the Anti-Money Laundering Department based on test monitoring exercises, the monitoring of new products and transactions in financial instruments executed by employees, information about regulatory measures and pending legislation and the review of anti-money laundering and ethical issues as well as customer complaints.

The Compliance Function delivers its tasks through:

- independent identification, monitoring and assessment of compliance risk that the bank and the Group are exposed to (with particular focus on new products and services, protection of confidential information, conflicts of interest or share dealing by employees);
- preventing the use of the financial system for money laundering and terrorist financing;
- providing advice and reporting to the Risk Management Committee, the bank's Management Board and Audit and Compliance Committee on the effectiveness of processes established to ensure compliance with laws and regulations;
- communication of policies and procedures, providing the management and staff with guidance on compliance risk management;
- coordination of contacts with market regulators (KNF, UOKiK, GIIF, GIODO);
- coordination of the approval of new products;
- coordination and support for compliance processes regarding a model for the sale of investment products and the MiFID Directive;
- strengthening the principles of ethical business conduct;
- cooperation with the compliance functions in BZ WBK Group and Santander Group.

The Compliance Function also actively cooperates with the Communications, Marketing and Quality Management Area in relation to the monitoring of reputational risk, and coordinates the activities of specialised committees supporting the management of compliance risk in specific areas: the Compliance Committee, the Local Marketing and Monitoring Committee, the Local Volcker Steering Committee, the Anti-Money Laundering and Counter-Terrorism Financing Committee and the Business Ethics Commission.

In 2017, the Compliance Function worked on adapting the bank's regulations in line with the Regulation of the Minister of Development and Finance dated 6 March 2017 on the risk management system and the internal control system, remuneration policy and detailed method of internal capital estimation in banks, and Recommendation H on the internal control system in banks issued by the KNF in April 2017.

6. Reputational Risk Management

Reputational risk is defined as the risk arising from any negative perception of the bank and other members of Bank Zachodni WBK Group by customers, counterparties, shareholders, investors or regulators.

Potential sources of this risk are internal operational incidents and external events, such as adverse publicity, dissemination of negative feedback from customers, e.g. via the Internet, social media or other mass media, as well as customer complaints and claims. They may refer directly to BZ WBK Group and its products as well as the bank's shareholders and the entire banking and financial sectors (both domestic and international).

Other sources of reputational risk are customer complaints and claims related to the process of offering banking products, including complaints about the lack of sufficient (i.e. complete, true, reliable and non-misleading) information about products and related risks, the complexity of products, improper sales practices or loss of capital.

The owners of reputational risk are the Corporate Communication and Marketing Area and the Compliance Area.

The objective of the reputational risk management process is to protect the image of the bank and BZ WBK Group with a view to limiting and eliminating negative events which affect the reputation and financial results of Bank Zachodni WBK Group.

The key risk mitigation measures include:

- The information policy of Bank Zachodni WBK;
- The monitoring of local, nationwide and certain international mass media sources;
- Daily monitoring of social media sources (in particular: Facebook, Twitter) in the context of references to BZ WBK;
- Analysis of image-sensitive information by the Press Office;
- Response to information which poses a threat to public perception of the bank's image;
- Keeping the representatives of national and local media up to date about new products and changes to terms of existing products;
- Customer satisfaction surveys;
- Recommendations and preventive actions arising from the analysis of complaints;
- Preparation and control by relevant Bank Zachodni WBK units of all important communiqués and reports for shareholders, the Polish Financial Supervision Authority (KNF) and the Warsaw Stock Exchange and the timely publication of such communiqués and reports;
- Evaluation of new products or their modifications, procedures, communication, commercial materials, initiatives addressed to customers (promotions, contests) and training materials for sales staff in respect of their compliance with laws and regulatory guidelines;
- Participation in the process of handling customer complaints, especially those addressed to the regulators;
- Supervision of after-sales control of investment products;
- Mystery shopping surveys for investment products;
- Regular monitoring of reputational risk associated with products offered by Bank Zachodni WBK Group through the analysis of customer complaints, sales volumes, the number of customers and rate of return.

7. Capital Management

It is the policy of Bank Zachodni WBK Group to maintain a level of capital adequate to the type and scale of operations and the level of risk. The level of own funds required to ensure the safe operation of the bank and capital requirements estimated for any unexpected loss is determined in accordance with the CRD IV / CRR package implemented on 1 January 2014 by the European Parliament and EBA, plus the KNF recommendation regarding the use of national options.

The Management Board is accountable for capital management, calculation and maintenance processes, including the assessment of capital adequacy in different economic conditions and the evaluation of stress test results and their impact on internal capital and capital adequacy. Responsibility for the general oversight of internal capital estimation rests with the Supervisory Board.

The Management Board has delegated ongoing capital management to the Capital Committee which conducts a regular assessment of the capital adequacy of the bank and the Group, including in extreme conditions, the monitoring of the actual and required capital levels and the initiation of transactions affecting these levels (e.g. by recommending the value of dividends to be paid). The Capital Committee is the first body that defines capital policy, principles of capital management and principles of capital adequacy assessment. However, ultimate decisions regarding any increase or decrease in capital are taken by relevant authorities within the bank and its subsidiaries in accordance with the applicable law and the bank's Statutes.

Pursuant to the bank's information strategy, details about the level of own funds and capital requirements are presented in the annual report entitled "Information on capital adequacy of Bank Zachodni WBK Group as at 31 December 2017".

In 2017, Bank Zachodni WBK Group met all regulatory requirements regarding capital management.

Capital Policy

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

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

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

for Bank Zachodni WBK

- a Tier 1 capital ratio of 11.16%;
- a total capital ratio of 14.29%.

for Bank Zachodni WBK Group

- Tier 1 capital ratio of 11.08%;
- a total capital ratio of 14.19%.

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

Pursuant to the KNF decisions of 15 December 2017 and 20 November 2017, Bank Zachodni WBK and Bank Zachodni WBK Group maintain own funds to cover an additional capital requirement for risk attached to foreign currency home mortgages for households. As at 31 December 2017, the buffer was set at 0.54 p.p. above the total capital ratio for Bank Zachodni WBK and at 0.44 p.p. for Bank Zachodni WBK Group. The buffer includes at least 75% of Tier 1 capital and at least 56% of the Common Equity Tier 1 capital.

The Act of 5 August 2015 on macroprudential oversight of the financial system and crisis management in the financial sector transposes CRD IV into the Polish law with regard to, among other things, additional capital buffers to be maintained by banks. As of 1 January 2016, the minimum capital ratios for the banking sector in Poland will be increased by 1.25 p.p. due to the introduction of a conservation buffer.

On 4 October 2016, the KNF identified Bank Zachodni WBK as an other systemically important institution and imposed an additional capital buffer of 0.5 p.p. In accordance with the KNF decision of December 2017, BZ WBK Group maintained its capital buffer at the same level as in previous periods.

From 1 January 2018, Bank Zachodni WBK and the Group will have to comply with the systemic risk buffer of 300 p.p. and the conservation buffer of 1.875 p.p., which in turn will affect the minimum ratios.

More information on the subject is provided in note 4 of Consolidated Financial Statement of Bank Zachodni WBK Group.

Regulatory Capital

The capital requirement for Bank Zachodni WBK Group is determined in accordance with Part 3 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR), which formed a legal basis as at 31 December 2017.

Bank Zachodni WBK uses a standardised approach to calculate the capital requirement for credit risk, market risk and operational risk. According to this approach, the total capital requirement for credit risk is calculated as the sum of risk-weighted exposures multiplied by 8%. The exposure value for these assets is equal to the balance sheet total, while the value of off-balance sheet liabilities corresponds to their balance sheet equivalent. Risk-weighted exposures are calculated by means of applying risk weights to all exposures in accordance with the CRR.

CALCULATION OF CAPITAL RATIO FOR BANK ZACHODNI WBK GROUP AND BANK ZACHODNI WBK AS AT 31.12.2017 AND 31.12.2016

PLN m

	BZ WBK Group (including SCB)	31.12.2017	31.12.2016
I	**Total capital requirement (Ia+Ib+Ic+Id), of which:**	**9 520.3**	**8 816.6**
Ia	– due to credit risk	8 361.5	7 713.6
Ib	– due to market risk	107.8	93.3
Ic	– due to settlement / counterparty risk	42.4	42.7
Id	– due to operational risk	1 008.6	967.0
II	Total own funds [1)]	22 314.6	19 179.7
III	Reductions	2 454.1	2 594.9
IV	**Own funds after reductions (II–III)**	**19 860.5**	**16 584.8**
V	**Capital Ratio [IV/(I*12.5)]**	**16.69%**	**15.05%**
VI	**Tier 1 Ratio**	**15.28%**	**14.56%**

PLN m

	Bank Zachodni WBK S.A	31.12.2017	31.12.2016
I	**Total Capital requirement (Ia+Ib+Ic+Id), of which:**	**7 542.3**	**7 068.6**
Ia	– due to credit risk & counterparty credit risk	6 606.7	6 183.4
Ib	– due to market risk	120.6	103.6
Ic	– due to credit valuation ajdustment risk	38.3	41.2
Id	– due to operational risk	776.6	740.4
II	Total own funds [1)]	20 931.0	18 078.7
III	Reductions	3 067.6	3 481.8
IV	**Own funds after reductions (II–III)**	**17 863.4**	**14 596.9**
V	**CAD [IV/(I*12.5)]**	**18.95%**	**16.52%**
VI	**Tier I ratio**	**17.37%**	**16.08%**

1) On 30 September 2017, the bank allocated part of its current year profit of PLN 519,865k for the period between 1 January 2017 and 30 June 2017 to own funds in accordance with consent granted by the KNF on 11 September 2017.

CALCULATION OF THE CAPITAL RATIO FOR SANTANDER CONSUMER BANK AS AT 31.12.2017 AND 31.12.2016

	Santander Consumer Bank S.A.	31.12.2017	31.12.2016
I	Capital Ratio	17.19%	16.22%
II	Tier 1 Ratio	17.19%	16.22%

Internal Capital

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

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

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

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

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

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

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

Subordinated Liabilities

As part of its strategy aimed at increasing Tier 2 capital, on 2 December 2016, the bank issued bonds worth EUR 120m and allocated them to the above mentioned capital based on the KNF consent granted on 24 February 2017.

On 22 May 2017, the bank issued additional subordinated bonds with a nominal value of EUR 137.1m, which were allocated to Tier 2 capital pursuant to the KNF decision of 19 October 2017.

A year before, the bank amended the issue agreement for subordinated bonds issued on 5 August 2010 (a maturity extension to 5 August 2025) and taken up by the European Bank for Reconstruction and Development, and was granted a consent by the KNF (decision of 18 May 2016) to allocate the bonds of EUR 100m to Tier 2 capital.

For more on subordinated liabilities, see Note 33 of the Consolidated Financial Statement of Bank Zachodni WBK Group for 2017.

XI. Statement on Corporate Governance in 2017

1. Legal Basis

The corporate governance framework applicable in Bank Zachodni WBK is based on existing laws (in particular the Commercial Companies Code, Banking Law and capital market regulations) as well as recommendations included in the following documents: the "Code of Best Practice for WSE Listed Companies" and "Rules of Corporate Governance for Supervised Institutions".

This Statement on Corporate Governance in 2017 was prepared in accordance with Paragraph 91(5)(4) of the Finance Minister's Ordinance of 19 February 2009 on current and financial reports published by the issuers of securities and the rules of equal treatment of the information required by the laws of a non-member state.

2. Code of Best Practice

Code of Best Practice for WSE Listed Companies

In 2017, Bank Zachodni WBK was subject to the rules of corporate governance and conduct applicable to the relationship between listed companies and their market environment as conveyed in the 2016 Code of Best Practice for WSE Listed Companies, and appended to WSE Supervisory Board Resolution No. 26/1413/2015 of 13 October 2015.

This version of the Code became effective on 1 January 2016 with approval for use by Bank Zachodni WBK by virtue of the decision of the Management Board (resolution No. 160/2015 of 2 December 2015) accepted by the Supervisory Board (resolution No. 61/2015 of 16 December 2015). The full text is available on the WSE website (www.gpw.pl), "Companies"/"Best Practice" tab, and the bank's website (www.bzwbk.pl), "Investor Relations"/"Corporate Governance" tab.

Bank Zachodni WBK has complied with the official corporate governance rules since 2002 when the first issue of the code of best practice was published (Best Practice for Public Companies in 2002).

Corporate Governance Rules for Supervised Institutions

Bank Zachodni WBK also abides by the Rules of Corporate Governance for Supervised Institutions as published by the KNF on 22 July 2014. The document describes internal and external relations of supervised institutions, including the relationship with shareholders and customers, their organisation, corporate governance framework and key internal systems and functions, as well as statutory bodies and the rules of their cooperation. The aforementioned Rules are available on the KNF's website (www.knf.gov.pl), "About the market"/"Corporate Governance Rules for Supervised Institutions" tab, and on the bank's website (www.bzwbk.pl), "Investor Relations"/"Corporate Governance" tab.

Rules of Corporate Governance for Supervised Institutions were adopted by Bank Zachodni WBK as of 1 January 2015 by virtue of Management Board Resolution No. 116/2014 of 9 October 2014 and Supervisory Board Resolution No. 58/2014 of 17 December 2014. As the above guidelines are also applicable to shareholders, they were submitted to and approved by the General Meeting (GM) of Bank Zachodni WBK on 23 April 2015.

In order to ensure compliance with obligations arising from corporate governance rules, the bank selected business units responsible for the implementation of individual rules according to the scope of their operations. In addition, an appropriate control system was put in place.

Since 2016, the application of corporate governance rules for supervised institutions by Bank Zachodni WBK has been regularly assessed in the Annual Report on the activities of the Supervisory Board. The results of the assessment are published in a current report containing resolutions adopted by the bank's General Meeting of Shareholders.

3. Management Board's Statement on Corporate Governance

In 2017, Bank Zachodni WBK duly complied with all corporate governance rules set out in the existing version of the Code of Best Practice for WSE Listed Companies. In that period, no corporate governance breaches were reported.

4. Equity Securities of the Issuer

Structure of Share Capital

THE TABLE BELOW PRESENTS ENTITIES WITH SIGNIFICANT HOLDINGS OF BANK ZACHODNI WBK SHARES AS AT 31.12.2017 AND 31.12.2016.

Shareholder	Number of Shares and Voting Rights Held		% in the Share Capital & Voting Power at AGM	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016
Banco Santander S.A.	68 880 774	68 880 774	69.34%	69.41%
Nationale Nederlanden OFE	n/a	5 110 586	n/a	5.15%
Others	30 452 707	25 243 174	30.66%	25.44%
Total	**99 333 481**	**99 234 534**	**100.0%**	**100.0%**

According to information held by the BZ WBK Management Board, as at 31 December 2017, Banco Santander was the only shareholder holding at least 5% of the total number of votes at the BZ WBK General Meeting of Shareholders, with a shareholding of 69.34%. Compared with the end of 2016, this shareholding has been diluted as a result of the issuance of 98,947 own shares as part of the 5th Incentive Programme.

On 7 August 2017, Nationale Nederlanden OFE sold part of its holding of BZ WBK shares, reducing its stake in the bank's capital and voting power to a level below 5%.

AS AT 31.12.2017, THE STRUCTURE OF SHARE CAPITAL OF BANK ZACHODNI WBK BY SHARE SERIES WAS A FOLLOWS:

Series/ issue	Type of share	Type of preferences	Limitation of rights to shares	Number of shares	Nominal value of series/issue (in PLN)
A	bearer	none	none	5 120 000	51 200 000
B	bearer	none	none	724 073	7 240 730
C	bearer	none	none	22 155 927	221 559 270
D	bearer	none	none	1 470 589	14 705 890
E	bearer	none	none	980 393	9 803 930
F	bearer	none	none	2 500 000	25 000 000
G	bearer	none	none	40 009 302	400 093 020
H	bearer	none	none	115 729	1 157 290
I	bearer	none	none	1 561 618	15 616 180
J	bearer	none	none	18 907 458	189 074 580
K	bearer	none	none	305 543	3 055 430
L	bearer	none	none	5 383 902	53 839 020
M	bearer	none	none	98 947	989 470
	Total			**99 333 481**	**993 334 810**

Rights and Restrictions Attached to the Issuer's Securities

The shares of Bank Zachodni WBK are ordinary bearer shares. Each share carries one vote at the General Meeting of Shareholders. The nominal value is PLN 10 per share. All the shares issued have been fully paid up.

The bank did not issue any series of shares that would give their holders any special control rights towards the issuer or would limit their voting power or other rights. Neither are there any restrictions on the transfer of title to the issuer's shares.

The control rights of Banco Santander as a parent entity of Bank Zachodni WBK arise from the number of shares and the resulting share of the capital and voting power at a General Meeting of Shareholders of Bank Zachodni WBK.

5. Governing Bodies

General Meeting of Shareholders

Annual General Meeting of 2017

The Annual General Meeting of Shareholders of Bank Zachodni WBK held on 17 May 2017 (AGM) approved the reports for 2016 submitted by the Management Board and the Supervisory Board, granted discharge to members of these governing bodies for the performance of their duties in the previous year and agreed on the distribution of the net profit for 2016 and dividend payment from retained earnings for 2014 and 2015 (see Chapter IX "Investor Relations"). The AGM appointed the Supervisory Board, including the Supervisory Board Chairman, for a new term of office and set remuneration of the Supervisory Board members. The AGM also approved the application of a higher maximum ratio between fixed and variable components of remuneration for individuals holding managerial positions in Bank Zachodni WBK Group. As the criteria for exercising awards by participants of the 5th Incentive Programme had been satisfied, the AGM adopted a resolution increasing the bank's share capital by way of issuing series M ordinary shares, depriving the existing shareholders of all their pre-emptive rights to those shares and undertaking actions to ensure introduction of the newly issued shares to trading in the regulated market of the Warsaw Stock Exchange. In addition, the AGM approved the 6th Incentive Programme for 2017–2019, providing for a conditional entitlement of its participants to acquire a stated number of shares of a new issue at a price equal to their nominal value. The AGM also approved changes to the bank's Statutes concerning the scope of business and share capital, as described in the section "Method of Changing the Statutes" below.

Organisation and powers of the General Meeting of Shareholders

The General Meeting of Bank Zachodni WBK Shareholders (GM) is held as provided for in the Commercial Companies Code of 15 September 2000, BZ WBK Statutes and Terms of Reference for the BZ WBK GM. The Statutes as well as the Terms of Reference are available on the bank's website.

The GM agrees on the issues within its remit, as defined by the above laws and internal regulations.

The resolutions are voted on using an electronic voting system which returns the number of votes ensuring that they correspond to the number of shares held and, in the case of a secret ballot, allows shareholders to remain anonymous. Each share carries one vote.

Candidates for the Supervisory Board are voted on individually, in the alphabetical order.

The General Meeting is broadcast live online to all interested parties and a recording is available on the bank's website for later review.

Shareholders' Rights

The rights of shareholders of Bank Zachodni WBK are set out in the Terms of Reference of BZ WBK GM in line with the Commercial Companies Code.

In particular, shareholders have the following rights with respect to the GM:

- Each shareholder may request that a list of shareholders be e-mailed free-of-charge to a valid address. Each shareholder may have access to the list of shareholders in the bank's MB office and request a copy of the list at their own expense.
- Shareholders may:
  - demand copies of requests included in the GM agenda one week before the GM;
  - have access to the GM's minutes and request copies of resolutions confirmed by the bank's Management Board as true copies;
  - request voting by secret ballot;
  - appeal against resolutions made by the GM in cases permitted in the Commercial Companies Code;
  - seek information from the Management Board regarding issues on the GM agenda, as provided for by the Commercial Companies Code;
  - exercise their voting rights (each share equates to one vote at the GM).
- Shareholders may attend the GM and vote personally or through proxies. In line with the Terms of Reference, shareholders may also participate in the GM via electronic communication channels.

Method of Changing the Statutes

Bank Zachodni WBK changes its Statutes through the method prescribed by the applicable law.

Pursuant to the resolutions of the Annual General Meeting of 17 May 2017, the bank's Statutes were changed with respect to:

- the scope of business:
  - The provisions of § 7(2)(6a) of the Statutes re activities of the bank were changed to reflect the amendment to the provisions of Article 6(1)(6a) of the Banking Law and the obligation arising from Article 136 of the Act of 5 September 2016 on trust services and electronic identification;
  - The amendment of § 54 of the Statutes enabled the bank to confirm the ePUAP trusted profile and perform ePUAP authorisations through electronic identification means used for authorisation purposes in the bank's ICT system, as required by the Act of 17 February 2005 on informatization of entities performing public tasks;
- share capital:
  - In § 10 of the Statutes, the amount of the bank's share capital was increased as a result of the issuance of series M ordinary bearer shares.

The bank was granted consent from the KNF to amend the Statutes as indicated above. Changes related to the scope of business were registered with the National Court Register on 26 July 2017, while those connected with the share capital increase – on 3 August 2017.

Supervisory Board

BELOW IS THE COMPOSITION OF THE BANK ZACHODNI WBK SUPERVISORY BOARD AS AT 31 DECEMBER 2017 VS. 31 DECEMBER 2016.

Role in the Supervisory Board	Ref.	Composition as at 31.12.2017	Ref.	Composition as at 31.12.2016
Chairman of the Supervisory Board:	1	Gerry Byrne	1.	Gerry Byrne
Vice Chairman of the Supervisory Board:	2	José Luis de Mora	2.	José Luis de Mora
Members of the Supervisory Board:	3.	José Manuel Campa	–	–
	4.	José Garcia Cantera	3.	José Garcia Cantera
	5.	Danuta Dąbrowska	4.	Danuta Dąbrowska
	6.	David R. Hexter	5.	David R. Hexter
	7.	Witold Jurcewicz	6.	Witold Jurcewicz
	8.	John Power	7.	John Power
	9.	Jerzy Surma	8.	Jerzy Surma
	10.	Marynika Woroszylska–Sapieha	9.	Marynika Woroszylska–Sapieha
	–	–	10.	José Manuel Varela

The bank's Supervisory Board, in its composition as at 31 December 2017, was appointed for a new term of office by the Annual General Meeting held on 17 May 2017. Compared with the Supervisory Board composition as at 31 December 2016, the Supervisory Board was joined by Mr José Manuel Campa, while Mr José Manuel Varela stepped down as a Supervisory Board member.

Detailed information about the qualifications, academic background and professional experience of the bank's Supervisory Board members can be found on the bank's website: https://www.bzwbk.pl/investor-relations/company/supervisory-board/supervisory- board.html and https://static3.bzwbk.pl/asset/r/a/p/raport-13-2017-Zyciorysy_Czlonkow_RN_78174.pdf.

As at 31 December 2017, the following members of the Supervisory Board held independent status: Ms Danuta Dąbrowska, Mr David R. Hexter, Mr Witold Jurcewicz, Mr Jerzy Surma and Ms Marynika Woroszylska-Sapieha.

In the period from 1 January to 31 December 2017, 9 Supervisory Board meetings were held at which 96 resolutions were passed. The average attendance of the Supervisory Board Members was 94.4%.

Role of the Supervisory Board

The Supervisory Board of Bank Zachodni WBK operates strictly under the Banking Law of 29 August 1997, the Commercial Companies Code of 15 September 2000, the bank's Statutes and the Terms of Reference of the Supervisory Board, available on the bank's website.

The Supervisory Board consists of at least five members appointed for a joint, three-year term of office. The Supervisory Board members, including the Chairman of the Supervisory Board, are appointed and removed by the General Meeting of Shareholders. The Management Board notifies the Polish Financial Supervisory Authority (KNF) about Supervisory Board membership.

Pursuant to the bank's Statutes, at least half the members of the Supervisory Board should have an independent status.

The Supervisory Board exercises ongoing supervision over all aspects of the bank's activities. The Supervisory Board takes decisions in the form of resolutions which are adopted by an absolute majority of votes in open voting. Resolutions are voted upon in a secret ballot in cases stipulated by law, in personal matters or at the request of any Supervisory Board member accepted by the Supervisory Board in a secret vote. The Supervisory Board's meetings are held as and when required and at least three times in any financial year. The Supervisory Board's members convene in a single location, or in different locations communicating via telephone or video links.

Supervisory Board Committees

The Supervisory Board may establish committees and designate individuals responsible for managing the work of such committees. These committees are designed to facilitate the current activities of the Supervisory Board by preparing draft Supervisory Board recommendations and decisions with regard to their own motions or the motions presented by the Management Board.

The following Supervisory Board committees operate in Bank Zachodni WBK: Audit and Compliance Committee, Risk Committee and Remuneration and Nominations Committee. The responsibilities of the Committees are set out in their respective Terms of Reference introduced by virtue of Supervisory Board resolutions.

The membership of the Supervisory Board committees is presented below.

Role in the Supervisory Board	Ref.	Composition as at 31.12.2017	Supervisory Board Committees as at 31.12.2017			
			Audit and Compliance Committee	Risk Committee	Nominations Committee	Remuneration Committee
Chairman of the Supervisory Board:	1.	Gerry Byrne			Member	Member
Vice Chairman of the Supervisory Board	2.	José Luis de Mora			Member	Member
Members of the Supervisory Board:	3.	José Manuel Campa		Member		
	4.	José Garcia Cantera				
	5.	Danuta Dąbrowska	Member		Member	Chairman
	6.	David R. Hexter	Chairman	Member		
	7.	Witold Jurcewicz	Member		Chairman	Member
	8.	John Power		Member		
	9.	Jerzy Surma	Member	Chairman	Member	
	10.	Marynika Woroszylska-Sapieha	Member		Member	Member

● Chairman ● Members

The **Audit and Compliance Committee** evaluates the adequacy, scope and effectiveness of the accounting, internal control and financial/non-financial risk management systems. Together with the Management Board and internal auditors, it reviews significant controls of the Group, including internal financial controls. The Committee supervises the bank's financial reporting process, ensuring the adequate quality of financial reports and compliance of disclosure practices with the law, KNF requirements and accounting principles. Furthermore, the Committee reviews the work performed by the statutory auditor, ensuring that the entity is independent and effective. It also monitors the effectiveness of risk, capital and liquidity management model. In addition, it reviews the actions undertaken by the Management Board in terms of their compliance with legal and regulatory requirements, the bank's by-laws, codes of conduct and business ethics.

The majority of the Audit and Compliance Committee is comprised of independent Supervisory Board members.

The **Risk Committee** is responsible for providing a comprehensive opinion about the bank's current and prospective risk-bearing capacity. It examines and reviews the Management Board's risk management strategy and its delivery, supports the Supervisory Board in supervising the process of implementing the risk management strategy by senior management and checks compliance of the bank's risk policy with its strategy and financial plan. The Risk Committee also checks if the bank's business model and risk strategy are duly reflected in the prices of liabilities and assets offered to customers. If the result is negative, it makes a proposal to the Management Board to ensure adequacy of asset and liability prices vis-à-vis different risk types.

The Audit and Compliance Committee and the Risk Committee convene at least four times per year at dates corresponding to the reporting and audit cycle. Additional meetings are held if the Chairman or members consider it necessary.

The **Nominations Committee** presents the Supervisory Board with recommendations with regard to appointing and removing members of the Supervisory Board and the Management Board as well as other senior managers. It defines the policy on the selection and suitability assessment of Supervisory Board and Management Board members and participates in the competence assessment of candidates for members of these governing bodies. The Committee analyses succession plans for the Management Board and recommends them to the Supervisory Board.

The **Remuneration Committee** supervises and reviews the bank's remuneration system, including policy on variable components of remuneration paid to individuals holding managerial positions at the bank. In particular, the Committee defines the remuneration policy and the individual pay packages for Management Board members and performs annual reviews of the remuneration payable to Management and Supervisory Board members. The Committee has oversight of the bonus scheme for Management Board members, and carries out analyses of incentive solutions and other bonus schemes proposed for implementation at the bank and its subsidiaries.

The Remuneration Committee and Nominations Committee convene at least three times a year. Additional meetings are held at the request of the Chairman.

The Annual Reports on activities of the Supervisory Board and its committees, the Supervisory Board's reports on the examination of the bank's and the Group's annual report along with an assessment of the Group's operations, including internal control and the risk management system, are included in materials submitted to shareholders before the General Meeting of Bank Zachodni WBK and published in current reports containing the resolutions passed by this body.

Management Board

THE TABLE BELOW PRESENTS THE COMPOSITION OF THE BANK ZACHODNI WBK MANAGEMENT BOARD AS AT 31 DECEMBER 2017 AND THE ROLES AND RESPONSIBILITIES OF ITS MEMBERS

Role in the Management Board	Ref.	Composition as at 31.12.2017	Reporting Areas as at 31.12.2017	Role in the Management Board	Ref.	Composition as at 31.12.2016	Reporting Areas as at 31.12.2016
President:	1.	Michał Gajewski	Units reporting directly to the President: Internal Audit Area, Corporate Communications, Marketing and Service Quality Management Area, Business Model Transformation Area, Board Office, Strategic Transformation Office	President:	1.	Michał Gajewski	Units reporting directly to the President: Internal Audit Area, Corporate Communications & Marketing Area, Business Model Transformation Area, Board Office, Strategic Transformation Office Business Partnership Division
Vice Presidents:	2.	Andrzej Burliga	Risk Management Division, Business Intelligence Area	Board Members:	2.	Andrzej Burliga	Risk Management Division
	3.	Michael McCarthy	Business & Corporate Banking Division		3.	Michael McCarthy	Business & Corporate Banking Division
	4.	Juan de Porras Aguirre	Global Corporate Banking Division		4.	Juan de Porras Aguirre	Global Corporate Banking Division
	5.	Mirosław Skiba	Wealth Management Programme		5.	Mirosław Skiba	Retail Banking Division
	6.	Feliks Szyszkowiak	Digital Transformation Division		6.	Feliks Szyszkowiak	Digital Transformation Division
Board Members:	7.	Artur Chodacki	Small & Medium Enterprise Banking Divsion		7.	Artur Chodacki	Small & Medium Enterprise Banking Divsion
	8.	Maciej Reluga	Financial Management Division		8.	Eamonn Crowley	Financial Management Division
	9.	Carlos Polaino Izquierdo	Financial Accounting & Control Division		9.	Carlos Polaino Izquierdo	Financial Accounting & Control Division
	10.	Marcin Prell	Legal & Compliance Division, Classified Data Protection Unit		10.	Marcin Prell	Legal & Compliance Division, Classified Data Protection Unit
	11.	Arkadiusz Przybył	Retail Banking Division		–	–	–
	12.	Dorota Strojkowska	Business Partnership Division		–	–	–

In the period from 31 December 2016 to 31 December 2017, the following changes took place in the Bank Zachodni WBK Management Board:

- On 16 February 2017, Mr Eamonn Crowley resigned with an immediate effect as a Management Board member. On the same day, the bank's Supervisory Board appointed Mr Maciej Reluga as a Management Board member, effective as of 16 February 2017.
- Following the expiry of her previous employment commitments, on 1 April 2017 Ms Dorota Strojkowska took up the position of a member of the bank's Management Board to which she was appointed on 14 December 2016. Until that time, Mr Michał Gajewski, the President of the Management Board, was in charge of the Business Partnership Division.
- On 10 March 2017, the Supervisory Board nominated Mr Arkadiusz Przybył as a Management Board member and appointed the existing Management Board members: Mr Andrzej Burliga, Mr Michael McCarthy, Mr Juan de Porras Aguirre, Mr Mirosław Skiba and Mr Feliks Szyszkowiak as Vice Presidents of the Management Board. Mr Arkadiusz Przybył, the newly appointed Management Board member, was initially in charge of the Retail Distribution Area. Since October 2017, he has been the head of the Retail Banking Division. The former head of the Retail Banking Division Mr Mirosław Skiba is now in charge of the Wealth Management Programme, including the Private Banking Department.

THE TABLE BELOW PRESENTS ACADEMIC BACKGROUND AND KEY PROFESSIONAL EXPERIENCE OF BANK ZACHODNI WBK MANAGEMENT BOARD MEMBERS.

Role in the Management Board	Ref.	Composition as at 31.12.2017	Major Educational Background	Main Areas of Professional Experience
President:	1.	Michał Gajewski	university degree in law, legal attorney traineeship, specialist studies	Banking
Vice-Presidents:	2.	Andrzej Burliga	university degree in maths, specialist programmes and studies	Banking
	3.	Michael McCarthy	MBA Banking, financial services	Banking, financial services
	4.	Juan de Porras Aguirre	university degree in law, MBA, specialist studies	Banking
	5.	Mirosław Skiba	degree from the university of technology, specialist studies	Banking
	6.	Feliks Szyszkowiak	degree from the university of technology and the university of economics, specialist studies	Banking
Board Members:	7.	Artur Chodacki	university degree in finance and banking and in English philology	Banking
	8.	Maciej Reluga	university degree in economics, specialist programmes and studies	Banking
	9.	Carlos Polaino Izquierdo	university degree in business management	Banking, consultancy
	10.	Marcin Prell	university degree in law, specialist programmes and studies	Banking
	11.	Arkadiusz Przybył	university degree in management and marketing, and finance and banking, specialist studies	Banking, consultancy
	12.	Dorota Strojkowska	university degree in philology, specialist programmes and studies	Banking

Detailed information about the qualifications, academic background and professional experience of the bank's Management Board members can be found on the bank's website: https://www.bzwbk.pl/investor-relations/company/management-board/management- board.html.

Appointment and Removal of Executives

Members of the Bank Zachodni WBK Management Board are appointed and removed in accordance with the Commercial Companies Code, Banking Law and the bank's Statutes.

The bank's Management Board consists of at least three persons (including the Management Board President) appointed for a joint three-year term of office by the Supervisory Board. At least half of the Management Board's members, including the President, are required to have completed higher education, be permanent residents of Poland, speak Polish, have good knowledge of the Polish banking market and sufficient experience of the home market to manage a Polish banking institution. Two Management Board members, including the Management Board President, are appointed with the approval of the Polish Financial Supervision Authority (KNF). Management Board members may be removed by the Supervisory Board or General Meeting at any time.

Powers of Executives

The Bank Zachodni WBK Management Board manages and represents the bank. The Management Board possesses comprehensive powers that are not otherwise governed or stipulated by law or Statutes within the remit of other governing bodies of the bank.

The Management Board takes decisions to raise obligations or transfer assets where the total value for one entity exceeds 5% of the bank's own funds. The Management Board can also, by way of resolution, delegate its powers to refer such decisions to other committees or persons in the bank. The Management Board members run the bank's affairs jointly, and in particular: define the bank's mission, set long-term action plans and strategic objectives, prepare assumptions for the bank's business and financial plans, approve proposed plans and monitor their performance, regularly report to the Supervisory Board on the bank's position in the scope and at the dates agreed with the Supervisory Board, appoint permanent or ad hoc committees and designate individuals responsible for managing the work of such committees. The committees are composed of both Management Board members and persons from outside the Management Board.

Permanent committees operating at the bank include: Credit Committee, Provisions Committee, Risk Management Forum, Credit Policy Forum for Retail Portfolios, Credit Policy Forum for SME Portfolios, Credit Policy Forum for Business and Corporate Portfolios, Assets and Liabilities Committee (ALCO), Capital Committee, Operational Risk Management Committee (ORMCO), Cyber Risk Committee, Deposit Working Group, Customer Value Committee, Investment Advisory Committee, Electronic Banking Steering Committee, CRM Committee, Settlement Committee, Anti-Money Laundering and Counter-Terrorism Financing Committee, Compliance Committee, Marketing Forum, Local Marketing and Monitoring Committee, Transformation Committee, Special Situations Management Committee, Information Management Committee, Disclosure Committee, CSR and Sustainability Committee.

Management Board members acting severally do not have any specific powers and cannot take decisions on issuing or redeeming shares.

Role of the Management Board

The Management Board's operations are primarily governed by Banking Law, the Commercial Companies Code, the bank's Statutes and the Terms of Reference of the Management Board, available on the bank's website.

The Management Board is responsible for running the bank's affairs and representing the bank. According to the bank's Statutes, the following individuals are authorised to represent and bind the bank: a) the Management Board President acting individually, and b) two members of the Management Board acting jointly, or a member of the Management Board acting jointly with a commercial representative (proxy), or two commercial representatives (proxies) acting jointly. Representatives may be appointed and authorised to act individually or jointly with any of the persons indicated in b) or with another appointed and authorised representative.

The Management Board deals with all issues which have not been restricted to the remit of the General Meeting of Shareholders or the Supervisory Board. The Management Board takes decisions in the form of resolutions which are adopted by an absolute majority of votes in open voting. Secret ballots may be held in cases stipulated by law, in personal matters or at the request of any Management Board member accepted by the Management Board in a secret vote. Management Board meetings are held as required. Management Board members convene at the same time in a single location, or in different locations communicating via telephone or video links.

Remuneration of Management and Supervisory Boards

Remuneration of Supervisory Board Members

As at 31 December 2017, the remuneration for BZ WBK Supervisory Board members was set by virtue of Resolution No. 41 of the General Meeting of Shareholders of Bank Zachodni WBK of 17 May 2017. The remuneration was determined in accordance with EU guidelines, latest domestic laws, corporate governance rules for supervised entities and the Remuneration Policy for BZ WBK Supervisory Board Members. Mr Gerry Byrne, Mr José Manuel Campa, Mr José García Cantera and Mr José Luis de Mora did not receive remuneration for their membership of the Supervisory Board.

THE TABLE BELOW PRESENTS THE REMUNERATION PAID TO BZ WBK SUPERVISORY BOARD MEMBERS IN 2016 AND 2017.

First and last name	Position	2017 [2]		2016	
		Period	PLN k	Period	PLN k
Gerry Byrne [1]	Chairman of the Supervisory Board	01.01.2017-31.12.2017	–	01.01.2016-31.12.2016	–
José Luis de Mora [1]	Vice Chairman of the Supervisory	01.01.2017-31.12.2017	–	01.01.2016-31.12.2016	–
José Manuel Campa [1]	Member of the Supervisory Board	17.05.2017-31.12.2017	–		
José Garcĩa Cantera [1]	Member of the Supervisory Board	01.01.2017-31.12.2017	–	01.01.2016-31.12.2016	–
Danuta Dąbrowska	Member of the Supervisory Board	01.01.2017-31.12.2017	234	01.01.2016-31.12.2016	244
David Hexter	Member of the Supervisory Board	01.01.2017-31.12.2017	263	01.01.2016-31.12.2016	275
Witold Jurcewicz	Member of the Supervisory Board	01.01.2017-31.12.2017	240	01.01.2016-31.12.2016	247
John Power	Member of the Supervisory Board	01.01.2017-31.12.2017	272	01.01.2016-31.12.2016	303
Jerzy Surma	Member of the Supervisory Board	01.01.2017-31.12.2017	244	01.01.2016-31.12.2016	256
Marynika Woroszylska-Sapieha	Member of the Supervisory Board	01.01.2017-31.12.2017	214	01.01.2016-31.12.2016	194
José Manuel Varela	Member of the Supervisory Board	01.01.2017-17.05.2017	89	01.01.2016-31.12.2016	193

1) Mr Gerry Byrne, José Manuel Campa, Mr José García Cantera and Mr José Luis de Mora did not receive remuneration for their membership of the Supervisory Board.
2) Changes to the composition of the Supervisory Board in 2017 are presented in the "Supervisory Board" item of Section 5 "Governing Bodies".

Mr John Power received additional remuneration for the supervision over acquisition of a carved-out business of Deutsche Bank Poland by BZ WBK in the amount of PLN 84.0 k and PLN 28.7 from a subsidiary for his membership in its Supervisory Board (PLN 35 k in 2016).

Except for Mr John Power, no other Supervisory Board member sat on the boards of the subsidiaries or associates of Bank Zachodni WBK.

Remuneration of Management Board members

Agreements between Bank Zachodni WBK and its Executives

The Management Board members signed employment contracts with Bank Zachodni WBK for the current term of office. The terms and conditions of employment comply with general laws and internal regulations, including the Remuneration Policy for

BZ WBK Management Board members and the Remuneration Policy of Bank Zachodni WBK Group.

BZ WBK Management Board members also signed agreements prohibiting competitive activity after termination of their employment with Bank Zachodni WBK.

A Management Board member who is not appointed for a new term of office or is removed from the Board is entitled to one-off severance pay. It does not apply to Management Board members who accept a new role in the bank, are removed due to gross negligence, resign or are not granted discharge.

Changes to Internal Regulations Concerning Remuneration for Executives

On 20 April 2017, BZ WBK Group Remuneration Policy was adopted, containing the provisions for Management Board members and material risk takers, and repealing the Remuneration policy for individuals holding managerial positions in Bank Zachodni WBK Group and the Policy on variable components of remuneration paid to individuals holding managerial positions in Bank Zachodni WBK Group.

Fixed Remuneration

Pursuant to the Statutes of Bank Zachodni WBK and the BZ WBK Group Remuneration Policy, the remuneration of the President and members of the Management Board is set by the Supervisory Board, having due regard to recommendations of the Remuneration Committee. The Committee establishes a remuneration policy for Management Board members and individual terms and conditions as part of remuneration packages for each Management Board member.

THE TABLE BELOW PRESENTS THE TOTAL REMUNERATION AND ADDITIONAL BENEFITS RECEIVED BY BZ WBK MANAGEMENT BOARD MEMBERS IN 2016 AND 2017 FOR THEIR MEMBERSHIP OF THE MANAGEMENT BOARD.

		2017 1)			2016 2)		
First and last name	Position	Period	Remuneration (PLN k)	Additional benefits 3) (PLN k)	Period	Remuneration (PLN k)	Additional benefits 3) (PLN k)
Michał Gajewski	President of the Management Board	01.01.2017-31.12.2017	1 931	92	29.11.2016-31.12.2016	176	6
Andrzej Burliga	Vice President of the Management Board	01.01.2017-31.12.2017	1 012	92	01.01.2016-31.12.2016	1 012	95
Artur Chodacki	Member of the Managemet Board	01.01.2017-31.12.2017	716	93	22.06.2016-31.12.2016	316	29
Eamonn Crowley	Member of the Managemet Board	01.01.2017-16.02.2017	167	3	01.01.2016-31.12.2016	1 004	9
Beata Daszyńska-Muzyczka	Member of the Managemet Board				01.01.2016-31.10.2016	637	126
Michael McCarthy	Vice President of the Management Board	01.01.2017-31.12.2017	1 162	23	01.01.2016-31.12.2016	1 161	21
Carlos Polaino Izquierdo	Member of the Managemet Board	01.01.2017-31.12.2017	1 347	246	01.01.2016-31.12.2016	1 319	226
Juan de Porras Aguirre	Vice President of the Management Board	01.01.2017-31.12.2017	1 222	99	01.01.2016-31.12.2016	1 221	55
Marcin Prell	Member of the Managemet Board	01.01.2017-31.12.2017	912	93	01.01.2016-31.12.2016	912	94
Arkadiusz Przybył	Member of the Managemet Board	10.03.2017-31.12.2017	978	69			
Maciej Reluga	Member of the Managemet Board	16.02.2017-31.12.2017	631	71			
Mirosław Skiba	Vice President of the Management Board	01.01.2017-31.12.2017	1 032	93	01.01.2016-31.12.2016	1 032	93
Dorota Strojkowska	Member of the Managemet Board	01.04.2017-31.12.2017	632	69			
Feliks Szyszkowiak	Vice President of the Management Board	01.01.2017-31.12.2017	1 032	93	01.01.2016-31.12.2016	1 032	94
Paweł Wieczorek	Member of the Managemet Board				01.01.2016-20.06.2016	339	44

1) Changes to the composition of the Management Board in 2017 are presented in the "Management Board" item of section 5 "Governing Bodies".
2) Changes in the membership of the Management Board in 2016 result from the resignation of Mr Paweł Wieczorek and Ms Beata Daszyńska -Muzyczka as Management Board members as of 20 June 2016 and 31 October 2016, respectively.
3) Additional benefits received by the Management Board members include, among other things, life insurance cover without pension option and, in case of Mr Juan de Porras Aguirre and Mr Carlos Polaino Izquierdo, also medical cover, accommodation, travel expenses and school fees.

In 2017, Management Board members were paid an allowance of PLN 124.7k in lieu of annual leave (PLN 199k in 2016).

In both periods, no Management Board member received remuneration for their membership in the governing bodies of the subsidiaries or associates.

In 2016, Mr Paweł Wieczorek and Ms Beata Daszyńska-Muzyczka received PLN 708k and PLN 384k, respectively, in relation to the termination of their employment contracts and the non-competition clause.

Awards Paid

The rules for determining variable remuneration for Management Board members and material risk takers are laid down in the BZ WBK Group Remuneration Policy adopted on 20 April 2017, which has superseded the Remuneration policy for individuals holding managerial positions in Bank Zachodni WBK Group and the Policy on variable components of remuneration paid to individuals holding managerial positions in Bank Zachodni WBK Group. These rules are regularly (at least annually) reviewed by the Remuneration Committee of the Supervisory Board.

Management Board members are paid variable remuneration once a year following the end of the settlement period and release of the bank's results. Variable remuneration is awarded in accordance with the applicable bonus regulations for Management Board members (adopted by virtue of the Supervisory Board's resolution), which set out the principles for determination of a bonus and a bonus pool depending on the achievement of personal objectives as well as business and financial objectives of an organisational unit and the bank. The performance is assessed against the financial and non-financial criteria for the period of minimum three years to take into account the bank's economic cycle and business risk.

The total variable remuneration paid to Management Board members and material risk takers for a given calendar year cannot exceed 100% of the total fixed remuneration paid. However, in exceptional cases, this limit may be increased up to 200% of fixed remuneration subject to the approval of the General Meeting of Shareholders.

Variable remuneration is awarded in accordance with bonus regulations and paid in cash and phantom stock. The latter shall represent min. 50% of the total amount of variable remuneration. Payment of min. 40% of variable remuneration is conditional and deferred for the period of three years. It is paid in arrears in equal annual instalments depending on the individual performance in the analysed period and the value of the phantom stock.

THE TABLE BELOW PRESENTS AWARDS PAID TO THE MANAGEMENT BOARD MEMBERS IN 2017 AND 2016.

PLN k

		2017 [1]		2016 [2]	
First and last name	Position	Period	Benefits (in PLN k)	Period	Benefits (in PLN k)
Michał Gajewski	President of the Management Board	01.01.2017-31.12.2017	–	29.11.2016-31.12.2016	–
Andrzej Burliga	Vice President of the Management Board	01.01.2017-31.12.2017	1 049	22.06.2016-31.12.2016	888
Artur Chodacki	Member of the Managemet Board	01.01.2017-31.12.2017	198	22.06.2016-31.12.2016	–
Eamonn Crowley	Member of the Managemet Board	01.01.2017-16.02.2017	930	01.01.2016-31.12.2016	843
Beata Daszyńska-Muzyczka	Member of the Managemet Board			01.01.2016-31.10.2016	200
Michael McCarthy	Vice President of the Management Board	01.01.2017-31.12.2017	1 077	01.01.2016-31.12.2016	874
Carlos Polaino Izquierdo	Member of the Managemet Board	01.01.2017-31.12.2017	635	01.01.2016-31.12.2016	243
Juan de Porras Aguirre	Vice President of the Management Board	01.01.2017-31.12.2017	1 291	01.01.2016-31.12.2016	1 047
Marcin Prell	Member of the Managemet Board	01.01.2017-31.12.2017	849	01.01.2016-31.12.2016	707
Arkadiusz Przybył	Member of the Managemet Board	10.03.2017-31.12.2017	–		
Maciej Reluga	Member of the Managemet Board	16.02.2017-31.12.2017	–		
Mirosław Skiba	Vice President of the Management Board	01.01.2017-31.12.2017	1 074	01.01.2016-31.12.2016	955
Dorota Strojkowska	Member of the Managemet Board	01.04.2017-31.12.2017	–		
Feliks Szyszkowiak	Vice President of the Management Board	01.01.2017-31.12.2017	1 083	01.01.2016-31.12.2016	953
Paweł Wieczorek	Member of the Management Board			01.01.2016-20.06.2016	200

1) The awards paid in 2017 include part of award for 2016, 2015 and 2014, which was conditional and deferred in time.
2) The awards paid in 2016 include part of award for 2015, 2014 and 2013, which was conditional and deferred in time.

Pursuant to the remuneration system applicable at the bank, Management Board members may be conditionally entitled to a bonus for 2017 which would be paid in part in 2018 and thereafter, if specific criteria are met. As at the date of these financial statements, the Supervisory Board did not take a decision in this respect.

Performance Share Programme

The Annual General Meeting of 17 May 2017 launched the sixth edition of the three-year incentive programme (6th Incentive Programme) for the employees of the bank and the subsidiaries that have a key contribution to the value of the organisation. The main objective of the programme is to retain and motivate top-performing executives.

The Incentive Programme covers no more than 250 key employees of Bank Zachodni WBK Group indicated by the Management Board and approved by the Supervisory Board, inclusive of all Management Board members. The participants include a specific group of material risk takers (identified participants) to whom separate vesting criteria apply. For the purpose of the Programme, the bank will issue up to 250,000 performance shares.

Having executed an agreement with the bank and satisfied the vesting criteria set out in an agreement, the participants will be eligible to subscribe for and acquire a stated number of the bank's shares at a nominal value of PLN 10 each. The award and its amount depends on the satisfaction of the economic criteria, i.e. the level of the compound annual growth rate of PAT and the annual average RoRWA in 2017-2019. The award for material risk takers is granted at the time of execution of an agreement and is either retained or reduced on the basis of the analysis of economic (PAT growth rate, RoRWA) and qualitative criteria (customer satisfaction, employee engagement) in the consecutive years of the programme.

The three-year long 6th Incentive Scheme is monitored on a monthly basis to verify if any employees have lost their participant status. The usual reason for the loss of such status is termination of employment, either with the bank or another entity of BZ WBK Group. Furthermore, the Business Partnership Division monitors the underlying financial ratios in cooperation with the Financial Accounting and Control Division.

Shares and Conditional Rights Held by Supervisory and Management Board members

As at the release dates of the Annual Reports of Bank Zachodni WBK Group for 2017 and 2016, respectively, none of the members of the Supervisory Board held any Bank Zachodni WBK shares or attached conditional rights.

The table below shows Bank Zachodni WBK shares and attached conditional rights held by Management Board members as at 31 December 2016 and 31 December 2017.

	13.02.2018		17.02.2017	
Management Board Members	No. of BZ WBK shares	Rights (6th Incentive Scheme)	No. of BZ WBK shares	Rights (5th Incentive Scheme)
Michał Gajewski	–	5 420	–	–
Andrzej Burliga	4 389	2 820	3 000	2 204
Artur Chodacki	790	2 030	–	1 253
Michael McCarthy	1 528	3 250	–	2 424
Carlos Polaino Izquierdo	631	2 820	–	1 000
Juan de Porras Aguirre	1 397	2 240	–	2 217
Marcin Prell	1 250	2 540	–	1 983
Arkadiusz Przybył	–	3 390		
Maciej Reluga	505	2 030	–	800
Mirosław Skiba	2 474	2 880	1 057	2 248
Dorota Strojkowska	635	2 370		
Feliks Szyszkowiak	1 621	2 880	204	2 248
Total	**15 220**	**34 670**	**4 261**	**16 377**

The Relationship between the Remuneration paid to Management Board Members and Key Managers and Long-term Business and Financial Objectives of the Company

The Remuneration Policy of Bank Zachodni WBK Group governing variable components of remuneration paid to material risk takers (identified employees) has an overall objective to incentivise employees, and is strictly connected with the achievement of strategic goals, short- and long-term operational objectives and the financial and non-financial results of the company.

Variable remuneration is awarded to material risk takers of Bank Zachodni WBK on the basis of an assessment of individual performance, results of the reporting organisational unit or the area of responsibility, and business performance of the bank, taking into account the bank's business cycle and risk arising from its operations. The assessment is made as part of the performance review system applicable at the bank.

In addition to financial ratios, the annual objectives of the bank's Management Board include qualitative (customer satisfaction, employee engagement) and risk metrics which reflect the sustainable management strategy. The objectives are described in detail in the balanced scorecard. They are communicated at the beginning of the year and monitored accordingly.

Pursuant to the policy on variable components of remuneration, min. 40% of variable remuneration to executives (min. 60% if above EUR 1m) is deferred for the period of three years and paid in three equal annual instalments, unless there are reasons for reduction or non-payment. Furthermore, min. 50% of remuneration is paid in the form of financial instruments, mainly phantom stock based on the bank's shares.

In addition, Management Board members and key employees may receive awards under long-term incentive programmes (and take up the bank's shares at their nominal value). The purpose of these programmes is to retain the above-mentioned staff and improve the efficiency and value of the organisation. The programmes set out in detail the criteria that must be met by Management Board members and other participants for an award to be granted, and the right of the bank's Supervisory Board to change the terms and conditions of the incentive programme, e.g. in the event of any substantial deterioration of the financial standing or the risk profile. For more on the 6th Incentive Programme, see the "Performance Share Programme" section.

Other Transactions with the Bank's Executives

Loans and Advances

Loans and advances granted by Bank Zachodni WBK to the bank's executives totalled PLN 11,054k as at 31 December 2017 vs. PLN 7,158k as at 31 December 2016. These facilities were sanctioned on the regular terms and conditions.

Deposits placed with Bank Zachodni WBK by the bank's executives totalled PLN 17,328k as at 31 December 2017 vs. PLN 13,312k as at 31 December 2016.

Provisions for Employee Benefits

Provisions for employee benefits disclosed in Note 51 of Consolidated Financial Statement of Bank Zachodni WBK Group for 2017 include the provision of PLN 797k for unused holidays related to members of the bank's Management Board (PLN 567k in 2016).

6. Diversity Policy

Diversity Policy at Bank Zachodni WBK

Management of Diversity within the Bank's Activities

For many years now, Bank Zachodni WBK has been committed to promoting diversity in accordance with best practice and ensuring equal treatment of employees and other stakeholders regardless of their gender, age, health conditions, race, religion, national or ethnic origin, political beliefs, trade union membership, family status or sexual orientation.

Aspects such as respect for individuality, promotion of equal treatment and the prevention of discrimination have been addressed by a number of policies and procedures applicable at the bank, including but not limited to:

- The BZ WBK Sustainability (CSR) Policy, which sets out the following principles with respect to employee relationships:
    - to respect diversity and prevent discrimination because of gender, race, age or on any other grounds;

- to encourage equal treatment of employees and aspire to have a balanced representation between men and women in all functions and responsibilities.

- The BZ WBK Human Rights Policy, which establishes a set of principles regarding the relationships with various stakeholders, including commitment to:

  - ensure equal access to employment and promotion, and protection against discrimination based on age, gender, race, religion, origin, marital status or financial situation;

  - prevent and eliminate disrespect and abuse at work.

- The BZ WBK Speak Up Policy and the Dignity and Respect at Work Policy, which set out preventive measures and establish channels and procedures for reporting/analysing suspected violation of law, procedures, standards and employee relationships.

The principles promoting diversity and equal treatment are applied at each stage of the employee lifecycle, starting from recruitment and throughout each employee's time with the organisation (terms of employment, access to training and development initiatives, promotion opportunities) to the termination of employment with the bank.

As part of its diversity agenda, the bank takes measures to provide barrier-free banking for disabled customers and raise their awareness of existing facilities and enhancements (in cooperation with the Polska bez Barrier Foundation). The bank also has processes in place to recruit employees with disabilities.

On 24 May 2017, Bank Zachodni WBK signed up to the Diversity Charter as a testament to its commitment to:

- creating a corporate culture that encourages respect for diversity;

- developing policies and mechanisms that effectively support equal treatment and diversity management at work;

- promoting benefits of diversity among stakeholders (employees, communities, shareholders and customers);

- reporting on measures taken and their outcome.

Diversity Policy with Respect to Supervisory, Management and Administration Bodies

The BZ WBK Appointment and Succession Policy for Management Board members and key function holders is to ensure the continuity of business processes delivered by senior managers, while achieving the best possible balance of gender, knowledge, skills and experience. The promotion of diversity is also one of the objectives of the BZ WBK Policies on the selection and suitability assessment of members of the Management and Supervisory Boards and key function holders. Aside from relevant academic background, professional experience and impeccable reputation, these policies require that candidates for members of Supervisory and Management Boards have a wide range of skills and be able to offer independent judgements and opinions.

Bank Zachodni WBK makes every effort to ensure appropriate gender diversity on its Supervisory and Management Boards, having full regard to the applicable qualification criteria and diversity considerations. As at 31 December 2017, there were two women on the bank's Supervisory Board: Ms Danuta Dąbrowska and Ms Marynika Woroszylska-Sapieha, and one woman on the Management Board: Ms Dorota Strojkowska, Head of the Business Partnership Division.

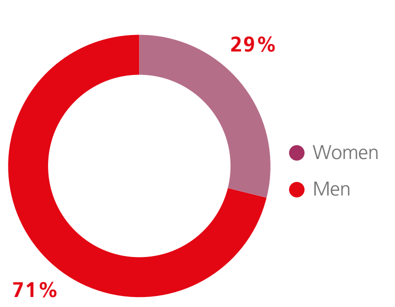
The current composition of the Supervisory and Management Boards as well as the population of other key function holders ensure diversity in terms of gender, age, experience and academic background. The tables and graphs below show diversity levels at the bank:

Sex	Women	Men
Supervisory Board	2	8
Management Board	1	11
Key Managers	33	69

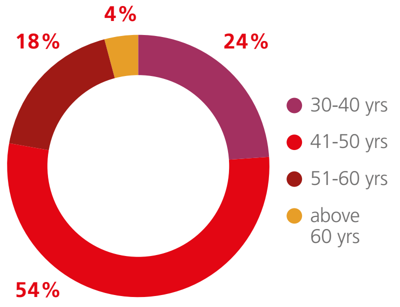
Age	30-40	41-50	51-60	over 60
Supervisory Board	–	–	6	4
Management Board	–	6	4	–
Key Managers	29	61	12	1

Years of employment with BZ WBK	up to 5	6-10	11-15	16-20	21-25	over 20
Supervisory Board	5	3	–	2	–	–
Management Board	3	3	–	2	3	1
Key Managers	15	12	15	25	26	9

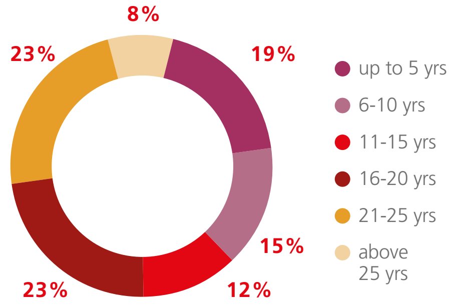
Sex of supervising staff and key executives of BZ WBK Group



Age of supervising staff and key executives of BZ WBK Group



Work experience of supervising staff and key executives of BZ WBK Group



7. Control System of Financial Statements

Internal Control and Risk Management System

Internal Control System

Bank Zachodni WBK Group operates an internal control system which supports decision-making processes, compliance with management rules and operational efficiency, and ensures the reliability of financial reporting and compliance with laws, international standards, internal regulations and best practice. The internal control system is tailored to the Group's organisational structure and risk management system, and covers the Business Support Centre, branches, Partner outlets and subsidiaries. The Management Board of the bank is charged with developing and implementing the internal control system, and ensuring that an adequate and effective internal control system is in place in each organisational unit. The Management Board is also responsible for updating the documented procedures and establishing adequacy and effectiveness criteria for evaluating the internal control system. Oversight of the implementation and the annual assessment of the internal control system is exercised by the Audit and Compliance Committee of the Supervisory Board of Bank Zachodni WBK.

The bank has adopted an Internal Control Policy which defines, inter alia, the purpose, structure and scope of the internal control system and lists related roles and responsibilities. In particular, the policy and other regulations describe the bank's internal control system, defining the rules and organisation of the process of identifying the risks that are material from the point of view of the control environment, along with their controls. The system includes monitoring, testing and reporting to ensure an effective control environment, both in terms of design and operation of the controls, and to strengthen the control culture at all levels within the organisation. The elements of the internal control system include: risk models, controls, tasks, organisational units and activities.

The internal control and risk management systems are based on three lines of defence:

First line	Controls embedded in processes delivered by each staff member and their line manager
Second line	Units supporting the management team in risk identification and management as well as units assessing the effectiveness of the first line Units assessing the effectiveness of the first line
Third line	Internal audit unit, which reviews the adequacy and efficiency of the first and second lines

CONTENTS

Each organisational unit operates in line with their Terms of Reference approved by the head of the division. The document defines the roles and responsibilities within each business area, including the quality and processing of financial data. The internal control model in place allows for a systematic verification of controls in terms of their effectiveness. The results are regularly escalated to and reviewed by the bank's Management Board and the Audit and Compliance Committee of the Supervisory Board of Bank Zachodni WBK.

Controls in Financial Reporting Processes

One of the key objectives of the internal control system is to ensure full credibility of financial reporting.

Financial data preparation for the purpose of reporting is automated and based on the consolidated General Ledger and Data Warehouse. The underpinning IT systems are strictly controlled in terms of integrity and security of information.

Data inputs in the source systems are subject to formal operational and approval procedures which state the responsibilities of individual staff members. Data processing for the purpose of financial reporting is subject to a suite of specialist controls. Any manual corrections or management overrides are also under strict control. BZ WBK Group has a BCM plan in place, which covers all IT systems used to prepare financial reports. The plan is updated on an ongoing basis.

In order to manage risk associated with the preparation of financial statements, the bank follows legal and regulatory changes related to reporting obligations and updates its accounting rules and disclosures accordingly. The bank, through its representatives sitting on the supervisory boards of individual subsidiaries, exercises oversight of its consolidated subsidiaries.

Financial statements are approved by the Disclosure Committee, which is responsible for ensuring that the financial disclosures of BZ WBK Group comply with all legal and regulatory requirements before they are released.

The bank's management confirms that the controls in place effectively mitigate the risk of any failure to identify any material error in the financial statements.

The effectiveness of controls in financial reporting is additionally assessed by an independent external auditor as part of the annual certification process for compliance with the Sarbanes-Oxley Act.

Internal Control Compliant with the Sarbanes-Oxley Act and other regulations

In the light of the Sarbanes-Oxley Act, Bank Zachodni WBK Group operates as a material and independent organisation within the structure of Santander Group and as such is required to implement, maintain and assess the effectiveness of the internal control environment pursuant to the above-mentioned act.

The certification process for compliance with the Sarbanes-Oxley Act in 2017 covered all key business areas of Bank Zachodni WBK and was carried out using solutions and methodology based on Santander Group's approach. The scope of testing included risk factors which were particularly significant for the reliability and accuracy of financial statements, taking into account the local control environment.

In view of the requirements arising from external regulations, Bank Zachodni WBK took measures to adjust the internal control system to satisfy the Volcker Rule (section 619 of Dodd-Frank Wall Street Reform and Consumer Protection Act) and ensure compliance with RDA/RRF (Basel Committee on Banking Supervision 239: Principles for effective risk data aggregation and risk reporting), the Regulation of the Minister of Development and Finance on the risk management system, the internal control system, remuneration policy and detailed method of internal capital estimation in banks, and KNF Recommendation H on the internal control system in banks.

The assessment of the design and effectiveness of the internal control system covers all available information and related recommendations, including those concerning audit and post-inspection. Results of assessments and tests form the basis for the bank's management to make representations on the effectiveness of the control environment.

As part of the SOX certification process for 2017, the bank's management confirmed that no incidents were identified in Bank Zachodni WBK Group which could significantly affect the relevant processes and threaten the effectiveness of the internal control over financial reporting.

Auditor

In accordance with the bank's Statutes and applicable regulations, on 19 April 2017 the bank's Supervisory Board passed a resolution appointing PricewaterhouseCoopers as the entity to:

- review the bank's unconsolidated financial statements and the Group's consolidated financial statements for H1 2017 and the entire year 2018;
- audit the bank's unconsolidated financial statements and the Group's consolidated financial statements for 2017 and 2018.

The bank signed agreements with PricewaterhouseCoopers Polska for the terms required to carry out the specified work.

The bank also contracted PricewaterhouseCoopers and other companies from PricewaterhouseCoopers Group for consulting services. In the bank's view, the above services do not affect the impartiality and independence of the auditor.

Employing the auditor from the same network for both Bank Zachodni WBK and Banco Santander ensures a consistent approach to the audit process across Santander Group.

Bank Zachodni WBK selects the entity authorised to audit financial statements pursuant to the Policy of Auditor Selection adopted on 4 October 2017 which is compliant with the EU law (Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities) and the Polish law (Act of 11 May 2017 on statutory auditors, audit firms and public supervision), in particular with regard to the principle of rotation of auditors.

Remuneration of external auditor

The table below shows the remuneration paid to PricewaterhouseCoopers Polska in 2017 and 2016 for audit/review of the financial statements of Bank Zachodni WBK Group pursuant to concluded agreements.

PLN k

Remuneration of External Auditors	Reporting Year ended on 31.12.2017	Reporting Year ended on 31.12.2016
Audit fees in respect of the parent bank [1]	2 363	2 350
Audit fees in respect of the subsidiaries	2 107	1 659
Audit fees related to assurance services, including the review of the parent bank and subsidiaries [1]	870	908
Fees for non-assurance services [2]	461	865

1) Remuneration for audit and review services performed in 2017 and 2016 based on the Agreement with BZ WBK on the audit of financial statements of 19 June 2017 and the Agreement with BZ WBK on the review and audit of financial statements of 23 July 2016 and an annex of 16 November 2016.
Audit fees related to assurance services are attributable in both periods to BZ WBK and include PLN 600 k for review of the financial statements and other assurance services of PLN 270 k in 2017 and 308 k in 2016.
2) Fees for non-assurance services include fees for BZ WBK of PLN 30 k in 2017 and PLN 716 k in 2016.

8. Pending Court Proceedings

As at 31 December 2017, no case was pending before any court or state administration agencies with regard to any claims made by or against Bank Zachodni WBK or its subsidiaries amounting to a minimum of 10% of the Group's equity.

PLN m

Court Proceedings with BZ WBK Group as a Party	31.12.2017	31.12.2016
Amounts claimed by the Group	717.6	518.3
Claims against the Group [1]	359.4	221.6
Receivables due to bankruptcy or arrangement cases	3.8	40.9
Value of all litigation	**1 080.8**	**780.8**
Share [%] of all litigation in equity	**4.6%**	**3.7%**
Completed significant court proceedings	532.5	451.7

1) On 20.10.2017, Bank Zachodni WBK was notified of a class action instituted by the borrowers with loans indexed to the CHF, granted by the former Kredyt Bank. The total value of the claim, estimated as at the reporting date, was PLN 32.3m. This amount may change if new borrowers join the class action.

XII. Statement on Non-Financial Information of Bank Zachodni WBK and BZ WBK Group

1. Legal Basis

This statement is based on the Accounting Act, particularly Article 49b and Article 55. In addition to the statement which is a separate part of the Management Board Report on Bank Zachodni WBK and BZ WBK Group Performance, the bank also publishes its CSR Report for 2017, which gives a full picture of the bank's social and environmental impact.

The statement has been prepared using the Global Reporting Initiative Standards, notably with regard to selection of the topics relating to employees, social and environmental matters, human rights and anti-corruption, and the presentation of selected ratios.

2. Business Model and Key Non-Financial Ratios

Bank Zachodni WBK is a universal bank which provides services to personal customers, businesses and institutions. The services provided by members of Bank Zachodni WBK Group are complementary to the bank's services as they provide customers with access to mutual fund units (shares), asset portfolios, insurance, leasing and factoring products.

The bank's (and the Group's) strategy and business model are founded upon the concept of "customer-centricity" or looking at each banking activity and process with the customer's eyes. In this model, the bank and the Group leverage their many different capitals to produce financial and non-financial results and affect the quality of people's lives and the social and economic growth.

Value Creation by the Bank and the Group

Capital | Activity | Results

Financial
Human
Social
Intellectual
Environmental

Mission
Help people and businesses prosper

Vision
To be the best retail and commercial bank, and earn the lasting loyalty of people, customers, shareholders and communities

Values
Simple, Personal, Fair

Strategy for 2018–2020

1. People

- ... to be **top 1 employer**
- ...have strong internal culture **Simple | Personal | Fair**

2. Customers

- ...significantly **outperform the banking sector**
- **...simplify and transform our channel(s) proposition**
- ...develop **best modern bank** proposition and customer experience
- ...grow our market **share** to **11%**
- ...materially **increase activity per loyal customer**

...a bank that strives to be **Simple | Personal | Fair**
helping individuals and businesses prosper

- ...be renowned as a **local Community Bank**
- ...develop cooperation within **Santander Universidades**

3. Communities

- ...be the **best governed** and **stable bank**
- ...earn sustainable **superior returns for** our **shareholders**

4. Shareholders

Policies
Risk management system
Services

Shareholders
Maximising shareholder value

Customers
Delivering important goals through financial services Enhancement of the bank's image as a trusted partner to customers which provides innovative and high quality solutions

People
Staff development and engagement Friendly working environment

Community
Commitment to the well-being and development of local communities

The adopted business model facilitates the achievement of satisfactory financial and non-financial results while allowing the bank's and the Group's customers to reach their objectives.

Key Ratios Depicting Business Activity of the Entity	2017	2016
Total number of bank customers in k (Group)	6 454	6 415
Total number of bank customers in k (Bank), including:	4 412	4 381
Number of BZWBK24 users in k, including:	3 388	3 221
Profit attributable to shareholders in PLN m	2 213.1	2 166.8
Profit for the period in PLN m	1 916.2	2 081.7
ROE (Group)	12.2%	12.8%
ROE (Bank)	11.0%	12.6%
Loans/Deposits (Group)	96.7%	91.6%
Loans/Deposits (Bank)	88.6%	84.3%
Capital ratio (Group)	16.69%	15.05%
Capital ratio (Bank)	18.95%	16.52%

3. Risk Management

The bank and the Group have a risk management system in place, which complies with the banking industry benchmark and legal and regulatory guidelines and recommendations. Selected units of the bank and BZ WBK Group are responsible for the identification, measurement, monitoring and mitigation of risks. The established risk profile is approved by the Risk Management Committee. Risk appetite is reflected in the **Risk Appetite Statement** approved by the Management Board and the Supervisory Board.

The risk management system includes the following significant risks: credit risk, market risk, liquidity risk, operational risk and compliance risk, which in turn encompasses regulatory risk, conduct risk, money laundering and terrorism financing risk and reputational risk. From the point of view of the negative impact of those risks on society, environment, employees, human rights, and anti-corruption measures, particular importance is attached to operational risk and reputational risk. In addition, the bank has identified social and environmental risks related to financing.

Risk	Risk description	Risk management	Possible significant negative impact on: S	Em	En	HR	AC
Operational risk	Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.	The bank and the Group apply the Operational Risk Management Strategy. In addition, detailed procedures and guidelines are used to define how risks are identified, estimated, monitored and mitigated. The responsibility for setting operational risk management standards rests with the Operational Risk Management Committee (ORMCO).	●	●	●	●	●
Compliance risk (regulatory risk, conduct risk, money laundering and terrorism financing risk and reputational risk).	Compliance risk is defined as the risk of legal or regulatory sanctions, significant financial loss or a negative impact on reputation that the bank may suffer due to its failure to comply with the law, internal regulations and market standards.	Compliance risk is managed at the bank and in the Group as part of several processes, namely: • Identification of compliance risk • Assessment of identified risk • Use of controls • Monitoring the risk size and profile • Results reporting. • Compliance assurance, as part of the control function, encompasses implementation of controls, independent monitoring of their observance and reporting. The control function is performed under the so-called three lines of defence: At the first line of defence, compliance risk is managed as part of business areas (conduct of business), and in other areas (non conduct of business). The second line of defence includes ongoing vertical verification and vertical testing, the scope of which is adapted to the process characteristics and the risk level. The tasks of the second line of defence are carried out by the compliance function or another organisational unit operating in accordance with internal regulations, and in particular: • for labour law responsibilities – HR unit • for commercial companies law responsibilities – corporate supervision unit • for health and safety responsibilities – the health and safety unit • for accounting,reporting and tax responsibilities –financial, accounting and tax units • for prudential requirements' responsibilities – risk units. The third line of defence is the internal audit function. In addition, risk management is supported by specialist committees, such as the Compliance Committee, the Local Marketing and Monitoring Committee, the Local Volcker Steering Committee, the Anti-Money Laundering and Counter-Terrorism Financing Committee and the Business Ethics Commission. The key policies are the General Code of Conduct and the Rules for preventing criminal responsibility.	●	●			●
Reputational risk (an element of compliance risk)	The risk of deterioration of the bank's and Santander Group's image, as seen by customers, employees, shareholders and the community at large, resulting from materialisation of other risk types, including individual categories of compliance risk.	Reputational risk is owned by the Communications, Marketing and Quality Management Area and by the Compliance Area, which employs a number of mechanisms, including the bank's Disclosure Policy, the Reputational Risk Management Policy, media monitoring, customer satisfaction surveys or mystery shopping.	●	●			

Social and environmental risks related to financing	Social and environmental risks resulting from customers' activities in sensitive sectors, constituting elements of reputational risk.	The key document on social and environmental risks is the BZ WBK Sustainability (CSR) Policy, which covers the whole Bank Zachodni WBK Group. The Policy is supplemented by policies on sectoral risk management for such "sensitive sectors" as defence, energy or soft commodities. Each sectoral policy defines the scope of its application, prohibited or restricted activities in relation to individual sectors, and the responsibility for each policy and its maintenance. Furthermore, the bank respects international best practices concerning social aid and environmental protection, particularly the Equator Principles.	●	●	●	●	

S – Society, Em – Employees, En – Environment, HR – Human Rights, AC – Anti-Corruption

The bank's and the Group's risk management system is described in Chapter X "Risk Management".

4. CSR Policies and their Outcomes

Anti-Corruption Policies and their Outcomes

Due to the nature of their operations, the bank and BZ WBK Group have the status of public trust institutions. For this reason, their activities are regulated by a number of domestic and EU guidelines, which ensure the safety of customer funds and stability of the banking system. Anti-corruption is high on the agenda. Both the bank and the Group have an efficient ethical infrastructure founded upon the **General Code of Conduct** (the "Code"), which is binding on all employees. It lays down ethical standards applied across Santander Group, and thus to BZ WBK Group as its member, covering specific situations, some of which are specifically related to corruption prevention. They are contained in the following sections of the Code:

- Conflicts of interest covering relations with the Group, banking transactions, investing into companies, relationships with suppliers and customers, gifts, commissions and other financial benefits. Both the bank and BZ WBK Group operate the General Conflict of Interest Policy, which supplements the Code.
- Cooperation with third parties and regulatory relations.
- Prevention of money laundering and terrorism financing.
- Corrupt practices.

The General Code of Conduct also determines the organisation and responsibilities of units. Implementation of the Code is the responsibility of compliance function's management, Committee for Compliance with Santander Group's Regulatory Requirements, Internal Audit, Audit and Compliance Committee, Supervisory Board, the HR function and the Business Ethics Commission. The Code also lays down the roles of heads of units, areas and divisions, and clearly defines the consequences for breaching its provisions.

The General Code of Conduct lays the foundations for a culture of openness, and facilitates whistleblowing. A part of the Code is dedicated to confidential reporting and dealing with complaints.

The bank's and the Group's approach is fleshed out in the **Anti-Corruption Programme**. The document emphasises the policy of "zero tolerance" for corruption, and sets out anti-corruption rules. The following elements make up the Anti-Corruption Programme:

- Controls
  - Register of gifts and invitations to public officials
  - Action taken by agents, intermediaries, advisers and business partners
  - Activities in high-risk countries
  - Accounting controls
  - Offering gifts or entertainment to the bank's employees and managers
- A reporting channel
- Training
- Responsibility of the corporate compliance area.

Corruption prevention is also covered by the umbrella document **BZ WBK Sustainability (CSR) Policy**, which refers to the bank's (and the Group's) approach to running the business responsibly and in keeping with sustainable development principles.

As a result of implementation of the Code and its supporting documents, the bank's and the Group's employees participate in training on the anti-corruption policy and procedures.

Anti-corruption policy indicators in BZ WBK Group	2017
Percentage share of employees who are familiar with the anti-corruption policy and procedures.	
Group	100%
Bank	100%
Percentage share of employees who completed anti-corruption training	
Group	97%
Bank	97%

Employee Policies and their Outcomes

The employment at Bank Zachodni WBK was 11,291 in FTEs, while Bank Zachodni WBK Group reported 14,383 FTE employees. To be able to develop the business successfully and in compliance with law, the bank and the Group have a number of documents regulating employee matters.

The key aspects relating to the internal organisation of work and rights and obligations of the employees and the employer are set out in the bank's **Labour Regulations**. All members of the Group employing more than 50 people have their own Labour Regulations. The approach to workplace matters is laid down in HR Policies. The bank's and the Group's growth depends on developing staff competencies, and goals in this regard are outlined in the Training Policy. The bank is a signatory to the "Diversity Charter", an initiative administered by the Responsible Business Forum, designed to promote diversity management in Poland. Adoption of the "**Diversity Charter**" means that its provisions became applicable in the bank's working environment. In this context, particularly important is the **Respect and Dignity Policy**, which relates to building a diversified working environment with respect for ethical standards and the dignity of each employee, which prevents such negative behaviours as discrimination, bullying and harassment. Attached to the Policy is a document "**Support for new parents**", which describes the bank's and the Group's actions addressed to employees who have been absent for a long time due to pregnancy, or who are on maternity or parental leave.

Another key document, in addition to the Labour Regulations, is the **General Code of Conduct**, which sets out ethical standards and rules of conduct for all the bank's and the Group's employees, particularly in relation to special situations, such as conflicts of interest or corrupt practices. Each employee must be familiar with (and follow) the General Code of Conduct.

The General Code of Conduct is supplemented by the **BZ WBK Sustainability (CSR) Policy**, which applies both to the bank and the Group. It sets out the bank's (and the Group's) responsibilities in their relationships with stakeholders, including employees. It requires that the bank and the Group should comply with the following rules in respect of its employees:

- Full regard for diversity – preventing discrimination because of gender, race, age or on any other grounds;
- Promoting employment stability, flexible working hours and a work-life balance, and ensuring health and safety in the workplace;
- Encouraging equal opportunities among employees, aspiring to have a balanced representation between men and women in all functions and responsibilities;
- Making efforts to ensure that employees follow the rules of ethics and responsible behaviour based on the General Code of Conduct;
- Encouraging employees to engage in corporate volunteering to support the well-being of local communities and strengthen employee pride in being part of the organisation.

The bank's and the Group's employees participate in many social activities as volunteers. Corporate volunteering is understood as any initiatives promoted and supported by Bank Zachodni WBK, in which the bank's employees are involved voluntarily and in their free time (and partly during working hours), using their skills to support non-profit initiatives, projects or organisations for the good of local communities. Corporate volunteering is governed by the **BZ WBK Corporate Volunteering Policy**; this applies to all employees of Bank Zachodni WBK Group. The Policy determines three volunteering areas: 1. Supporting education; 2. Promoting equality of opportunity; 3. Building a civil society. In addition, the BZ WBK Corporate Volunteering Policy defines traceable volunteering indicators with their related procedures, including responsible units, i.e. the Bank Zachodni WBK Foundation and the Public Relations Department, acting in coordination with the HR function.

HR policies indicators	2017	
	Female	Male
Number of employees:		
Bank	8 330	3 159
Employee turnover: [1]		
Group (without SCB Group)	17.3%	17.2 %
Bank	17.6%	17.3%
Average number of training hours per employee:		
Group	57.1	56.5
Bank	58.0	62.5

1) Number of terminations during the period per total employment at the end of the period

Human Rights Policies and their Outcomes

The overarching document which defines the bank's (and the Group's) approach to human rights is the **BZ WBK Sustainability (CSR) Policy**. In accordance with this Policy, the bank, as part of its business, "shall respect and promote the observance of human rights in relation to employees, customers, shareholders, suppliers and local communities."

The key document which establishes details of the bank's and the Group's approach is the **BZ WBK Human Rights Policy**. In this Policy, the bank sustains the obligation to respect and protect human rights. It applies to the bank's employees, its customers, suppliers and the local communities to which the bank provides its services. The policy relates to the bank's and the Group's activity, processes, services and operations. The **BZ WBK Human Rights Policy** establishes detailed rules and obligations relating to the observance of human rights.

BZ WBK Human Rights Policy	Areas covered
Relationship with Bank employees	• Preventing discrimination and practices against personal dignity • Forced labour and child labour • Respecting the right to form trade unions and enter into collective agreements • Protecting employees' health • The working environment
Cooperation with customers and suppliers	• Obligations to customers • Obligations to suppliers • Obligations to business partners
Cooperation with local communities	• Respecting, supporting and promoting the observance of human rights in local communities • Monitoring the impact of the business on local communities • Respecting human rights by ensuring safety • Taking anti-corruption measures

The bank's Management Board is responsible for the human rights policy, while the bank's employees are obliged to report any breaches of the policy. In accordance with the General Code of Conduct, such cases are reported to etyka@bzwbk.pl, with an assurance of protection against any reprisal or similar negative consequences.

The BZ WBK Human Rights Policy is supplemented by the **Respect and Dignity Policy**, which relates to building a diversified working environment with respect for ethical standards and dignity for each employee, and the prevention of such negative behaviour as discrimination, bullying and harassment (including sexual harassment). The Respect and Dignity Policy establishes methods of reporting breaches of ethical standards and irregularities, including discrimination, bullying and harassment. It also determines the responsibility of management and each employee for its implementation. **Appendix 1 to the Respect and Dignity Policy** lays down the **Rules for dealing with alarming incidents relating to breaches of law, banking procedures, standards and employee relations reported by employees**.

Human rights issues are also covered by the sectoral document BZ WBK Environment and Social Policy. Defence Sector. It introduces exclusions and limitations to the bank's relationship with customers dealing with defence and dual-use technologies. The bank also notes risks related to projects carried out in countries which have not ratified key UN legal documents on human rights and those which are subject to UN/EU sanctions for violating human rights or using internal repressions, as defined in the Universal Declaration of Human Rights, the International Covenant on Civil and Political Rights, and the Additional Protocol 14 to the European Convention on the Rights of the Child pertaining to the involvement of children in armed conflict.

Human rights policies indicators	2017
Percentage share of employees who agree that the organisation respects and promotes diversity:	
Group	87%
Bank	84%

Social Policies and their Outcomes

In terms of social matters, two areas are of particular importance for the bank's (and the Group's) operations, namely: the customers and business partners area and the general public, including local communities.

The overarching document which defines the bank's and the Group's approach to social matters is the **BZ WBK Sustainability (CSR) Policy**. It sets out the bank's (and the Group's) responsibilities in their relations with stakeholders: employees, shareholders, local communities and suppliers. The bank and the Group also respect international best practices concerning social aid and environmental protection, particularly the Equator Principles. They relate to such issues as social health and security, the purchase of land and voluntary resettlement, the rights of indigenous peoples and cultural heritage.

The priority areas in the bank's (and the Group's) social activity are education and science development, support for social initiatives, equalisation of opportunities, and prevention of social exclusion.

The bank's and the Group's employees participate in social activities in accordance with the **BZ WBK Corporate Volunteering Policy**, which provides for three volunteering areas: 1. Supporting education; 2. Promoting equality of opportunity; 3. Building a civil society. In addition, the BZ WBK Corporate Volunteering Policy defines traceable volunteering indicators with their related procedures, including responsible units, i.e. the Bank Zachodni WBK Foundation and the Public Relations Department, acting in coordination with the function of HR.

The bank's and the Group's social activity is carried out through the Bank Zachodni WBK Foundation, in accordance with the bank's Statutes. In addition to the corporate volunteering programme, the Foundation is also engaged in such grant programmes as: "The Bank of Young Sports Champions" ("Bank Młodych Mistrzów Sportu"), "Here I live, here I make changes" ("Tu mieszkam, tu zmieniam"), "The Bank of Children's Smiles" ("Bank Dziecięcych Uśmiechów") and "The Bank of the Ambitious Youth" ("Bank Ambitnej Młodzieży"). The Public Relations Department is another unit engaged in social activities. For example, it maintains an educational portal for children, parents and teachers known as finansiaki.pl. Furthermore, the bank and the Group are engaged in Santander Group projects, including Santander Universidades, which covers universities from the whole of Poland.

Supplier relationship management is the responsibility of the Contracts and Procurement Management Department. All suppliers are subject to uniform selection criteria. The main documents governing the purchase process are the **BZ WBK Procurement Policy** and the **Supplier Selection Procedure**. The rules used vis-à-vis suppliers also take into account social criteria, and the observance of human rights and environmental commitments. Bidders are required to fill in a CSR questionnaire with questions relating to employment practices, human rights or environmental criteria. Following the supplier selection stage, both the **Policy on Cooperation with Suppliers** and the **Suppliers Management Policy** apply for the supplier qualification and the rules of entering into relevant agreements.

The bank and the Group have a number of documents which establish **customer relationship standards** in relation to communication, service, complaint-handling and data security. These areas are the responsibility of individual units dealing with retail and business customers. The bank runs the "Entrepreneur Academy", an initiative that includes conferences held across Poland and the portal firmoweewolucje.pl.

Social policies indicators	2017
Number of staff volunteers:	
Group	1 080
Bank	580
Donations made by the BZ WBK Foundation towards corporate volunteering projects in PLN k	130
Propensity to recommend the bank's services (NPS)	32%

Environmental Policies and their Outcomes

Environmental issues relating to the bank's and the Group's activities are looked at from two perspectives: 1) in terms of direct impact, e.g. the use of paper, and 2) in terms of indirect impact through the financial services provided. This is reflected in the **BZ WBK Sustainability (CSR) Policy**, which stipulates that the bank and the Group attach great importance to environmental protection, particularly in the context of climate change, and undertake to:

- minimise the environmental impact of their branches and business;
- promote environmentally-friendly products and services;
- take into account and assess the impact that their financed projects have on climate change.

The Policy is supplemented by the **BZ WBK Climate Change Policy,** applicable across Bank Zachodni WBK Group. It lays down the action and initiatives that support environmental protection and seeks to mitigate the impact of climate change, including:

- control of resource consumption and emission levels by all the bank's facilities;
- financial activity;
- other environmental protection activities, including awareness-raising among employees, and in the supply chain through initiatives aimed at suppliers and by means of product and service selection rules.

Regarding resource consumption, the bank and the Group monitor the use of energy, paper and other resources. With regard to financial services, the BZ WBK Climate Change Policy operates by financing renewable energy and energy efficiency projects; selected products and services for the agricultural and livestock breeding sector; financing electric, hybrid and low-emission cars; water and waste management infrastructure; support for products and services enabling sustainable construction; activity in the market of trading in emission allowances; developing products for the agricultural and livestock breeding sector (including weather risks and other natural disaster risks) or financing socially responsible investments.

The BZ WBK Climate Change Policy is supplemented by sectoral policies on financing projects and customers from "sensitive sectors", notably the **BZ WBK Environment and Social Policy. Energy Sector, BZ WBK Environment and Social Policy. Soft Commodities and BZ WBK Environment and Social Policy. Defence Sector.**

The bank respects international best practices concerning social aid and environmental protection, particularly the Equator Principles. These principles relate to environmental issues, such as biodiversity protection, long-term natural resource management, pollution and toxic emissions prevention and climate changes.

Environmental policies indicators	2017
Total energy consumption of the bank (MWh)	36 555
Paper consumption of the bank (kg)	301 805

XIII. Representations of the Management Board

True and Fair Presentation of the Financial Statements

To the best of the Management Board's knowledge, the financial figures and the comparable data presented in the financial statements incorporated in the "Annual Report 2017 of Bank Zachodni WBK" and "Annual Report 2017 of Bank Zachodni WBK Group" were prepared in keeping with the applicable accounting policies and give a true and fair view of the state of affairs and earnings of Bank Zachodni WBK Group. The Management Board's Report contained in this document shows a true picture of the development, achievements and position of the parent entity and the Bank Zachodni WBK Group (including the underlying risks) in 2017.

Unbiased and Independent Audit

The auditing firm responsible for auditing the "Financial Statement of Bank Zachodni WBK Group for 2017" and "Consolidated Financial Statement of Bank Zachodni WBK Group for 2017" was selected in compliance with the applicable legislation. The auditing firm and its auditors satisfied the necessary conditions to ensure they provide an unbiased and independent registered auditor report compliant with Polish law and professional standards.

Signatures of the Management Board Members

Date	Name	Function	Signature
12.02.2018	Michał Gajewski	President of the Board	
12.02.2018	Andrzej Burliga	Vice-President of the Board	
12.02.2018	Michael McCarthy	Vice-President of the Board	
12.02.2018	Juan de Porras Aguirre	Vice-President of the Board	
12.02.2018	Mirosław Skiba	Vice-President of the Board	
12.02.2018	Feliks Szyszkowiak	Vice-President of the Board	
12.02.2018	Artur Chodacki	Member of the Board	
12.02.2018	Carlos Polaino Izquierdo	Member of the Board	
12.02.2018	Marcin Prell	Member of the Board	
12.02.2018	Arkadiusz Przybył	Member of the Board	
12.02.2018	Maciej Reluga	Member of the Board	
12.02.2018	Dorota Strojkowska	Member of the Board	

Annual
Report
2017

CONSOLIDATED FINANCIAL STATEMENTS OF BANK ZACHODNI WBK GROUP FOR 2017

Bank Zachodni WBK
Grupa Santander

pwc

Independent Registered Auditor's Report

To the General Shareholders' Meeting and the Supervisory Board of Bank Zachodni WBK S.A.

Report on the audit of consolidated financial statements

Our opinion

In our opinion, the attached annual consolidated financial statements of the Bank Zachodni WBK S.A. group ("the Group") in which Bank Zachodni WBK S.A is the parent company ("the Parent Company"):

- give a true and fair view of the consolidated financial position of the Group as at 31 December 2017 and its consolidated financial performance and its consolidated cash flow statements for the year then ended in accordance with the applicable International Financial Reporting Standards as adopted by the European Union and the adopted accounting policies;
- comply in terms of form and content with the laws applicable to the Group and the Parent Company's Articles of Association.

Our opinion is consistent with our additional report to the Audit Committee issued on the date of this report on 12 February 2018.

What we have audited

We have audited the annual consolidated financial statements of the Bank Zachodni WBK S.A. Group which comprise:

- the consolidated statement of financial position as at 31 December 2017;

and following prepared for the financial year from 1 January to 31 December 2017:

- the consolidated income statement;
- the consolidated statement of comprehensive income;
- the consolidated statement of changes in equity;
- the consolidated statement of cash flows, and
- the notes comprising a description of the adopted accounting policies and other explanations.

TRANSLATORS' EXPLANATORY NOTE

The English content of this report is a free translation of the independent registered auditor's report to the General Shareholders' Meeting and the Supervisory Board of the above-mentioned Polish Company. In Poland statutory accounts as well as auditor's report must be prepared and presented in Polish and in accordance with Polish legislation and in accordance with the accounting principles and practices generally used in Poland.

The accompanying translation has not been reclassified or adjusted in any way to conform to accounting principles generally accepted in countries other than Poland, but certain terminology current in Anglo-Saxon countries has been adopted to the extent practicable. In the event of any discrepancy in interpreting the terminology, the Polish language version is binding.

PricewaterhouseCoopers Sp. z o.o., International Business Center, Lecha Kaczyńskiego 14 str, *00-638 Warsaw, Poland, T: +48 (22) 746 4000, F: +48 (22) 742 4040, www.pwc.com*

Basis for opinion

Basis for opinion

We conducted our audit in accordance with the International Standards on Auditing as adopted as National Standards on Auditing by Resolution no. 2783/52/2015 of the National Council of Statutory Auditors dated 10 February 2015; International Standards on Auditing issued by IAASB (together "Auditing Standards") and pursuant to the Act of 11 May 2017 on Registered Auditors, Registered Audit Companies and Public Oversight ("the Act on Registered Auditors" – Journal of Laws of 2017, item 1089) and Regulation (EU) No. 537/2014 of 16 April 2014 on specific requirements regarding the statutory audit of public-interest entities ("the EU Regulation" – Journal of Laws EU L158). Our responsibilities under those Auditing Standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence and ethics

We are independent of the Group in accordance with the International Federation of Accountants' *Code of Ethics for Professional Accountants* ("the IFAC Code") as adopted by resolutions of the National Council of Statutory Auditors and other ethical requirements that are relevant to our audit of the financial statements in Poland. We have fulfilled our other ethical responsibilities in accordance with these requirements and the IFAC's Code. During the audit, the key registered auditor and the registered audit firm remained independent of the Group in accordance with the independence requirements set out in the Act on Registered Auditors and in the EU Regulation.

Our audit approach

Overview

- The overall materiality level adopted for the purposes of our audit was set at PLN 185,000 thousand, which represents 5% of the profit before tax adjusted by the tax on financial institutions.

- We have audited the annual consolidated financial statements of the Group for the period ended 31 December 2017.
- We have audited the Parent Company and consolidation packages of the subsidiaries that have significant impact on the consolidated financial statements.
- The scope of our audit covered 95% of the Group's revenue (understood as the sum of interest income and commission income), 97% of the absolute value of its profit or loss, 97% of the sum of total assets and 97% of net value of loans to customers of all the consolidated Group companies before consolidation eliminations.

- Impairment of loans and advances.
- IFRS 9 *Financial Instruments* related disclosure.

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As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where the Parent Company's Management Board made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operated.

Materiality

The scope of our audit was influenced by the adopted materiality level. Our audit was designed to obtain reasonable assurance that the consolidated financial statements as a whole are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the consolidated financial statements as a whole, as presented below. These thresholds, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the consolidated financial statements as a whole.

The concept of materiality is used by the registered auditor both in planning and conducting an audit, as well as in assessing the effect of the misstatements identified during the audit and the unadjusted misstatements (if any), on the consolidated financial statements, and also when forming the registered auditor's report. Therefore, all opinions, assertions and statements contained in the registered auditor's report have been made taking into consideration the quantitative and qualitative materiality levels determined in accordance with the auditing standards and the registered auditor's professional judgement.

Overall Group materiality	PLN 185,000 thousand (in prior year PLN 160,000 thousand)
Basis for determination	5% of profit before tax adjusted by the tax on financial institutions
Rationale for the materiality benchmark applied	We have adopted profit before tax as the primary base for determining materiality because, in our opinion, it is an indicator commonly used by the users of financial statements to evaluate the Group's operations and is a generally adopted benchmark. We have adjusted profit before tax by tax on financial institutions because it is treated by the Parent Company and users of financial statements as a specific tax burden. We adopted the materiality threshold at 5% because it is within the quantitative materiality thresholds acceptable by the auditing standards.

We agreed with the Parent Company's Audit and Compliance Committee that we would report to them misstatements identified during our audit of the consolidated financial statements above PLN 9,000 thousand, as well as any misstatements below that amount, that in our view, warranted reporting for qualitative reasons.

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Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. They include the most significant identified risks of material misstatements, including the identified risks of material misstatement resulting from fraud. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon. We summarized our response to these risks and, when deemed appropriate, presented the most important observations relating to these risks. We do not provide a separate opinion on these matters.

Key audit matter	*How our audit addressed the key audit matter*
Impairment of loans and advances to customers We focused on completeness and valuation of impairment allowances as required by International Accounting Standards 39 – Financial Instruments: Recognition and Measurement (IAS 39) because the Management's judgements in this respect have the significant impact on the financial statements and are complex (as described in the financial statements note 2.6 *Main estimates and judgments made by Bank Zachodni WBK Group*). Impairment allowances represent Management's best estimate of the credit losses incurred that relates to the loan portfolios at the balance sheet date. They are calculated either on a collective basis for portfolios of loans with similar characteristics or on an individual basis for individually significant exposures. The balance of collective allowances amounted to PLN 3.620.943 thousand and allowances for individually significant loans amounted to PLN 1.225.187 thousand as at 31 December 2017. The estimate of allowances for portfolios and for individual loans requires a significant degree of judgement to determine the timing and amount of the impairment to be recognised. Collective impairment allowances are calculated using statistical models, based on historical data, which approximate possible recoveries for each of the homogeneous (from the risk perspective) portfolios identified by the Group. Assumptions used in the models (such us the emergence period, the probability of default and the loss given default) are subject to management judgement, and may be affected by specific events, like portfolio sales that would not be captured by past performance. For impairment allowances analysed using an	We started our audit of this area by obtaining understanding of the Group's policies and procedures related to impairment. These include, among others, assessment of key elements of impairment identification and measurement (timing, completeness, consistency, accuracy, collateral assessment, early warning monitoring, backtesting). We then assessed the design and tested operating effectiveness of key controls to identify loss events and determine the extent to which impairments should be recognised considering the potential for management override of controls. These internal controls include among others: • Monitoring of loans, • Regular credit portfolio reviews, • Completeness and accuracy of data used in rating process and impairment calculation, • Assessment and approval of material impairment provisions including valuation of collaterals, • Governance over the impairment process, including assessment of suitability of models and assumptions, and • Model verification and challenge of assumptions and calculation accuracy. For individually significant exposures, we tested a sample of performing loans to establish our own view as to whether any IAS 39 loss indicators were present. For non-performing loans, we tested a sample of loans, focusing on high risk sectors such as coal and cement industry, health care and commercial real estate. We analysed valuation of collaterals and examined other cash flow assumptions developed by management. We

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individual method, judgement is required to determine when an impairment event has occurred and then to estimate the expected future cash flows related to that loan. The cash flows are estimated based on financial performance and probability of continuing operational activity, collaterals valuation and other factors which are estimated by management.

also assessed the reasonableness of the estimated timing of the expected cash flows.

We also performed a set of procedures on the collectively calculated impairment. We verified the correctness of calculations of model parameters to selected portfolios. We analysed the results of the Group's backtesting procedures, including impact of expert adjustments, if any. We also verified cured exposures, whether they were reclassified to performing portfolio according to the Group's policies. Finally, we recalculated the impairment allowances on the whole loan portfolio.

We have not identified material misstatements as a result of our work. We have found management estimates reasonable in the areas where application of judgment is required.

IFRS 9 *Financial Instruments* related disclosure

International Financial Reporting Standards 9, Financial Instruments (IFRS 9) becomes effective for annual reporting periods beginning on or after 1 January 2018. Given the significance of the impact of the new standard, the Group has already put relevant systems, processes and controls in place .

International Accounting Standards 8 Accounting Policies, Changes in Accounting Estimates and Errors (IAS 8), requires disclosure of the *'known or reasonably estimable information relevant to assessing the possible impact'* of new standards issued but not yet effective. The Polish Financial Supervision Authority (KNF) following the European Securities and Markets Authority (ESMA) indicated that they expect these disclosures to include both qualitative and detailed quantitative information explaining the impact of the adoption in order to enable users of the financial statements to understand the impact that the future application of the new standard will have on the financial position and performance of the Group.

Refer to the chapter *IFRS9 Financial Instruments* of the accompanying financial statements, which provides quantitative and qualitative information enabling to the users to

In auditing the disclosure of the impact of the new standard on the Group, we were focussing our work on:

- appropriate classification and measurement of the financial instruments; and
- calculation of the loan loss impairment allowances using the new expected credit loss methodology.

We have obtained an understanding of Group's implementation process for determining the impact of adoption of the new standard, including understanding of the changes to the Group's systems, processes and controls. Additionally, we obtained an understanding of the credit risk modelling methodologies.

We have performed, among others, the following substantive audit procedures:

- We analysed the accounting policies and framework methodology developed by the Group in order to evaluate its compliance with the new standard;
- We verified the analyses of contracts prepared by the Group for the purpose of financial instruments classification and tested such analyses to the underlying contracts on a sample basis. We assessed and tested, on a sample basis, the measurement of financial instruments.

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understand the expected impact of the new standard and the areas in which management has made significant assumptions and judgements in applying the new standard.

Given the complexity of the requirements of IFRS 9 and significance of the disclosure of the impact of the new standard on the Group's financial position as at 1 January 2018 we paid a particular attention to the related disclosures.

- We assessed the methodology developed to calculate loan loss provision under IFRS 9, concentrating on such aspects as: factors for determining a 'significant increase in credit risk' and allocating the loans to stages, estimation of key provisioning parameters and forward-looking information.
- We recalculated impairment provisions on a sample basis.

We have also performed procedures that involved assessment and validation of the Group's controls and substantive testing to verify accuracy and completeness of the data flow in and out of the credit models, to test the integrity of the data used during the process and consistency between the sources/systems.

While testing how management made the accounting estimate and the data, on which it is based, we have verified the appropriateness of the estimation method and completeness and accuracy of the data used, mathematical accuracy of management's model, and the reasonableness of the management assumptions.

In some areas we developed an independent estimate or a range to evaluate management's point estimate and analysed the way the management considered assumptions or outcomes or how management otherwise addressed estimation uncertainty in making the accounting estimate.

Our work did not lead to a material adjustment of the audited financial statements disclosure.

Responsibility of the Management and Supervisory Board for the consolidated financial statements

The Management Board of the Parent Company is responsible for the preparation of annual consolidated financial statements that give a true and fair view of the Group's financial position and results of operations, in accordance with the International Financial Reporting Standards as adopted by the European Union, the adopted accounting policies, the applicable laws and the Parent Company's Articles of Association, and for such internal control as the Management Board determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Parent Company's Management Board is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Management Board either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

The Parent Company's Management Board and members of its Supervisory Board are obliged to ensure that the consolidated financial statements comply with the requirements specified in the Accounting Act of 29 September 1994 ("the Accounting Act" – Journal of Laws of 2017, item 2342, as amended). Members of the Supervisory Board are responsible for overseeing the financial reporting process.

Auditor's responsibility for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence economic decisions of users taken on the basis of these consolidated financial statements.

The scope of the audit does not cover an assurance on the Group's future profitability or the efficiency and effectiveness of the Parent Company's Management Board conducting its affairs, now or in future.

As part of an audit in accordance with the Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Parent Company's Management Board.
- Conclude on the appropriateness of the Parent Company's Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence

obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the Audit and Compliance Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Audit and Compliance Committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated to the Audit and Compliance Committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Other information, including the report on the operations

Other information

Other information comprises a Management Board Report on Bank Zachodni WBK Group Performance in 2017 including Management Board Report on Bank Zachodni WBK Performance ("the Report on the operations") and the corporate governance statement and the statement on non-financial information referred to in Article 55.(2b) of the Accounting Act which are a separate parts of the Report on the operations.

Responsibility of the Management and Supervisory Board

The Management Board of the Parent Company is responsible for preparing Other Information in accordance with the law.

The Parent Company's Management Board and the members of the Supervisory Board are obliged to ensure that the Report on the Group's operations including its separate parts complies with the requirements of the Accounting Act.

Registered auditor's responsibility

Our opinion on the audit of the consolidated financial statements does not cover Other Information.

In connection with our audit of the consolidated financial statements, our responsibility is to read Other Information and, in doing so, consider whether it is materially consistent with the information in the consolidated financial statements, our knowledge obtained in our audit, or otherwise appears to be materially misstated. If, based on the work performed, we identified a material misstatement in Other Information, we are obliged to inform about it in our audit report. In accordance with the requirements of the Act on the Registered Auditors, we are also obliged to issue an opinion on whether the Report on the operations has been prepared in accordance with the law and is consistent with information included in annual consolidated financial statements.

Moreover, we are obliged to issue an opinion on whether the Group provided the required information in its corporate governance statement and to inform whether the Group prepared a statement on non-financial information.

The financial information included in chapter VIII of the Report on the Group's operations have been audited in accordance with the scope described in this audit report and the requirements of the Banking Law ("the Banking Law" – Journal of Laws of 2015, item 128, as amended).

Opinion on the Report on the operations

Based on the work we carried out during the audit, in our opinion, the Report on the Group's operations:

- has been prepared in accordance with Article 49 of the Accounting Act and para 92 of the Regulation of the Minister of Finance dated 19 February 2009 on current and periodical information submitted by issuers of securities and conditions for considering as equivalent the information required under the legislation of a non-Member State ("Regulation on current information" – Journal of Laws 2014, item 133, as amended) and Article 111(1–2) of the Banking Law of 29 August 1997;
- is consistent with the information in the consolidated financial statements.

Moreover, based on the knowledge of the Group and its environment obtained during our audit, we have not identified any material misstatements in the Report on the Group's operations.

Opinion on the corporate governance statement

In our opinion, in its corporate governance statement, the Group included information set out in paragraph 91(5)(4) (a), (b), (g), (j), (k) and (l) of the Regulation on current information. In addition, in our opinion, information specified in paragraph 91(5)(4)(c)–(f) and (i) of the said Regulation included in the corporate governance statement are consistent with the applicable provisions of the law and with information included in the consolidated financial statements.

Information on non-financial information

In accordance with the requirements of the Act on the Registered Auditors, we confirm that the Group has prepared a statement on non-financial information referred to in Article 55(2b) of the Accounting Act as a separate section of the Report on the operations.

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We have not performed any assurance work relating to the separate report on non-financial information and we do not provide any assurance with regard to it.

Report on other legal and regulatory requirements

Information on compliance with prudential regulations

The Management Board of the Group is responsible for complying with the applicable prudential regulations set out in separate legislation, and in particular, for correct determination of the capital ratios.

The capital ratios as at 31 December 2017 have been presented in Note 5 of the consolidated financial statements and include core Tier 1 capital ratio, Tier 1 capital ratio and the total capital requirement.

We are obliged to inform in our report on the audit of the consolidated financial statements whether the Group has complied with the applicable prudential regulations set out in separate legislation, and in particular, whether the Group has correctly determined its capital ratios. For the purposes of the said information, the following legal acts are understood as separate legislation: Regulation (EU) no. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, as amended ("CRR"), the Banking Law and the Act of 5 August 2015 on macro-prudential supervision over the financial system and on crisis management in the financial system ("the Act on macro-prudential supervision" – Journal of Laws of 2015, item 1513).

It is not the purpose of an audit of the financial statements to present an opinion on compliance with the applicable prudential regulations specified in the separate legislation specified above, and in particular, on the correct determination of the capital ratios, and therefore, we do not express such an opinion.

Based on the work performed by us, we inform you that we have not identified:

- any cases of non-compliance by the Group with the applicable prudential regulations set out in separate legislation referred to above, in the period from 1 January to 31 December 2017;
- any irregularities in the determination by the Group of the capital ratios as at 31 December 2017 in accordance with the separate legislation referred to above;

which would have a material impact on the consolidated financial statements.

Statement on the provision of non-audit services

To the best of our knowledge and belief, we declare that the non-audit services we have provided to the Group are in accordance with the laws and regulations applicable in Poland and that we have not provided any non-audit services prohibited under Article 5(1) of the EU regulation and Article 136 of the Act on Registered Auditors.

The non-audit services which we have provided to the Group in the audited period are disclosed in the Report on the Group's operations.

Appointment

We have been appointed for the first time to audit the annual consolidated financial statements of the Group by resolution of the Supervisory Board dated 22 March 2016 and re-appointed by resolution dated 19 April 2017. We have been auditing the Group's financial statements without interruption since the financial year ended 31 December 2016, i.e. for 2 consecutive years.

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The Key Registered Auditor responsible for the audit on behalf of PricewaterhouseCoopers Sp. z o.o., a company entered on the list of Registered Audit Companies with the number 144., is Anna Bączyk.

Anna Bączyk
Key Registered Auditor
No. 11810

Warsaw, 12 February 2018

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CONTENTS

CONSOLIDATED FINANCIAL STATEMENTS OF BANK ZACHODNI WBK GROUP FOR 2017

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Consolidated income statement

for the reporting period:		01.01.2017–31.12.2017	01.01.2016 – 31.12.2016
Interest income		6 529 307	6 060 920
Interest expenses		(1 252 410)	(1 290 548)
Net interest income	**Note 6**	**5 276 897**	**4 770 372**
Fee and commission income		2 526 814	2 388 464
Fee and commission expenses		(513 688)	(473 744)
Net fee and commission income	**Note 7**	**2 013 126**	**1 914 720**
Dividend income	Note 8	76 816	96 582
Net gains on subordinated entities	Note 49	3 757	100
Net trading income and revaluation	Note 9	194 974	280 820
Gains (losses) from other financial securities	Note 10	47 502	402 774
Other operating income	Note 11	150 587	140 764
Impairment losses on loans and advances	Note 12	(690 473)	(784 590)
Operating expenses incl.:		(3 372 414)	(3 367 721)
Bank's staff, operating expenses and management costs	Notes 13, 14	(2 939 432)	(2 935 229)
Depreciation/amortisation		(318 933)	(277 220)
Other operating expenses	Note 15	(114 049)	(155 272)
Operating profit		**3 700 772**	**3 453 821**
Share in net profits of entities accounted for by the equity method		58 264	55 439
Tax on financial institutions		(423 815)	(387 206)
Profit before tax		**3 335 221**	**3 122 054**
Corporate income tax	Note 16	(816 707)	(737 962)
Consolidated profit for the period		**2 518 514**	**2 384 092**
of which:			
attributable to owners of BZ WBK S.A.		2 213 054	2 166 847
attributable to non–controlling interests		305 460	217 245
Net earnings per share (PLN/share)	Note 17		
Basic earnings per share		22.29	21.84
Diluted earnings per share		22.25	21.80

Notes presented on pages 164 – 269 constitute an integral part of these Financial Statements.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Consolidated statement of comprehensive income

for the reporting period:	01.01.2017 31.12.2017	01.01.2016 31.12.2016
Consolidated profit for the period	**2 518 514**	**2 384 092**
Other comprehensive income which can be transferred to the profit and loss account:	**452 578**	**(510 064)**
Available–for sale financial assets valuation, gross	533 774	(738 327)
Deferred tax	(101 417)	140 282
Cash flow hedges valuation, gross	24 964	108 618
Deferred tax	(4 743)	(20 637)
Other comprehensive income which can't be transferred to the profit and loss account	**(7 622)**	**5 556**
Provision for retirement allowances – actuarial gains/losses, gross	(9 410)	6 859
Deferred tax	1 788	(1 303)
Other comprehensive income for the period, net of income tax	**444 956**	**(504 508)**
TOTAL COMPREHENSIVE INCOME FOR THE PERIOD	**2 963 470**	**1 879 584**
Attributable to:		
owners of BZ WBK	2 651 427	1 666 087
non–controlling interests	312 043	213 497

Notes presented on pages 164 – 269 constitute an integral part of these Financial Statements.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Consolidated statement of financial position

as at:		31.12.2017	31.12.2016
ASSETS			
Cash and balances with central banks	Note 18	4 146 222	4 775 660
Loans and advances to banks	Note 19	2 136 474	3 513 278
Financial assets held for trading	Note 20	3 416 108	3 180 985
Hedging derivatives	Note 21	218 061	67 645
Loans and advances to customers	Note 22	107 839 897	103 068 538
Financial assets available for sale	Note 23	28 415 812	29 307 878
Investments in associates	Note 24	889 372	871 491
Intangible assets	Note 25	490 327	486 762
Goodwill	Note 26	1 712 056	1 688 516
Property, plant and equipment	Note 27	930 717	878 298
Net deferred tax assets	Note 28	1 414 227	1 534 322
Assets classified as held for sale	Note 29	103	629
Other assets	Note 30	1 065 068	725 714
Total assets		152 674 444	150 099 716
LIABILITIES AND EQUITY			
Deposits from banks	Note 31	2 783 083	2 561 281
Hedging derivatives	Note 21	578 798	2 023 344
Financial liabilities held for trading	Note 20	1 237 704	1 809 060
Deposits from customers	Note 32	111 481 135	112 522 457
Sell–buy–back transactions	Note 42	2 650 846	1 632 613
Subordinated liabilities	Note 33	1 488 602	440 457
Debt securities in issue	Note 34	5 895 814	5 529 187
Current income tax liabilities		192 925	84 151
Provisions	Note 35	153 134	130 128
Other liabilities	Note 36	2 868 774	2 348 562
Total liabilities		129 330 815	129 081 240
Equity			
Equity attributable to owners of BZ WBK		21 907 220	19 780 827
Share capital	Note 37	993 335	992 345
Other reserve capital	Note 38	16 920 129	15 791 555
Revaluation reserve	Note 39	714 466	276 093
Retained earnings		1 066 236	553 987
Profit for the current period		2 213 054	2 166 847
Non–controlling interests in equity	Note 40	1 436 409	1 237 649
Total equity		23 343 629	21 018 476
Total liabilities and equity		**152 674 444**	**150 099 716**

Notes presented on pages 164 – 269 constitute an integral part of these Financial Statements.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Consolidated statement of changes in equity

Consolidated statement of changes in equity	Equity attributable to equity holders of BZ WBK SA					Non-controlling interests in equity	Total equity
	Share capital	Other reserve capital	Revaluation reserve	Retained earnings and profit for the period	Total		
Note	37	38	39			40	
Opening balance as at 31.12.2016	**992 345**	**15 791 555**	**276 093**	**2 720 834**	**19 780 827**	**1 237 649**	**21 018 476**
Total comprehensive income	–	–	438 373	2 213 054	2 651 427	312 043	2 963 470
Consolidated profit for the period	–	–	–	2 213 054	2 213 054	305 460	2 518 514
Other comprehensive income	–	–	438 373	–	438 373	6 583	444 956
Issue of shares	990				990		990
Distributions of profits and losses	–	1 123 497	–	(1 123 497)	–	–	–
Share scheme charge		(2 512)			(2 512)	–	(2 512)
Dividends	–	–	–	(535 866)	(535 866)	(110 962)	(646 828)
Equity adjustment due to merger and liquidation of subsidiaries and controlling stake at the subsidiaries	–	7 589	–	4 765	12 354	(2 321)	10 033
As at 31.12.2017	**993 335**	**16 920 129**	**714 466**	**3 279 290**	**21 907 220**	**1 436 409**	**23 343 629**

The revaluation reserve of PLN 714,466k comprises valuation of debt securities of PLN 245,104k, equity shares of PLN 557,499k, cash flow hedges of PLN (88,574)k and the provision for retirement allowances with cumulative actuarial gains of PLN 437k.

Notes presented on pages 164 – 269 constitute an integral part of these Financial Statements.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Consolidated statement of changes in equity	Equity attributable to equity holders of BZ WBK SA					Non-controlling interests in equity	Total equity
	Share capital	Other reserve capital	Revaluation reserve	Retained earnings and profit for the period	Total		
Note	37	38	39			40	
Opening balance as at 31.12.2015	**992 345**	**14 685 919**	**776 914**	**2 936 851**	**19 392 029**	**1 176 101**	**20 568 130**
Total comprehensive income	–	–	(500 760)	2 166 847	1 666 087	213 497	1 879 584
Consolidated profit for the period	–	–	–	2 166 847	2 166 847	217 245	2 384 092
Other comprehensive income	–	–	(500 760)	–	(500 760)	(3 748)	(504 508)
Distributions of profits and losses	–	1 177 730	–	(1 177 730)	–	–	–
Share scheme charge	–	16 213	–	–	16 213	–	16 213
Dividends	–	–	–	(1 290 049)	(1 290 049)	(226 025)	(1 516 074)
Equity from acquisition of controlling interest in PSA Finanse sp. z o.o. and PSA Consumer Finanse sp. z o.o.	–	–	–	–	–	74 076	74 076
Settlement on account of merger of subsidiaries and other	–	(88 307)	(61)	84 915	(3 453)	–	(3 453)
As at 31.12.2016	**992 345**	**15 791 555**	**276 093**	**2 720 834**	**19 780 827**	**1 237 649**	**21 018 476**

The revaluation reserve of PLN 276,093k comprises valuation of debt securities of PLN (145,039)k, equity shares of PLN 521,877k, cash flow hedges of PLN (108,768)k and the provision for retirement allowances with cumulative actuarial gains of PLN 8,023k.

Notes presented on pages 164 – 269 constitute an integral part of these Financial Statements.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Consolidated statement of cash flows

for the period	01.01.2017–31.12.2017	01.01.2016–31.12.2016
Profit before tax	3 335 221	3 122 054
Total adjustments:		
Share in net profits of entities accounted for by the equity method	(58 264)	(55 439)
Depreciation/amortisation	318 933	277 220
Impairment losses	8 765	22 077
Profit from investing activities	(62 297)	(417 631)
	3 542 358	2 948 281
Changes:		
Provisions	23 006	(2 442)
Trading portfolio financial instruments	(1 506 362)	957 785
Hedging derivatives	(1 594 962)	40 671
Loans and advances to banks	(95)	4 589
Loans and advances to customers	(4 771 359)	(8 154 654)
Deposits from banks	110 032	164 897
Deposits from customers	(781 067)	10 336 381
Buy–sell/ Sell–buy–back transactions	1 018 233	(3 608 458)
Other assets and liabilities	277 134	683 114
	(7 225 440)	421 883
Interest accrued excluded from operating activities	(414 692)	(436 651)
Dividend	(76 270)	(96 051)
Paid income tax	(693 049)	(1 016 330)
Net cash flows from operating activities	**(4 867 093)**	**1 821 132**
Inflows	**4 461 677**	**6 069 162**
Sale of subordinated entities	–	100
Sale/maturity of financial assets available for sale	3 673 594	5 327 990
Sale of intangible assets and property, plant and equipment	45 342	26 800
Dividend received	76 270	95 903
Interest received	666 471	618 369
Outflows	**(4 206 618)**	**(10 406 768)**
Purchase of subordinated entities net of cash acquired	–	(61 197)
Purchase of financial assets available for sale	(3 792 409)	(9 991 588)
Purchase of intangible assets and property, plant and equipment	(414 209)	(353 983)
Net cash flows from investing activities	**255 059**	**(4 337 606)**
Inflows	**4 983 948**	**6 037 678**
Debt securities in issue	3 562 288	2 762 880
Proceeds from issuing/shares	990	–
Drawing of loans	1 420 670	3 274 798

Notes presented on pages 164 – 269 constitute an integral part of these Financial Statements.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

for the period	01.01.2017–31.12.2017	01.01.2016–31.12.2016
Outflows	**(4 548 345)**	**(4 360 097)**
Debt securities buy out	(2 095 000)	(1 554 700)
Repayment of loans	(1 568 408)	(1 108 976)
Dividends and other payments to shareholders	(646 828)	(1 516 074)
Interest paid	(238 109)	(180 347)
Net cash flows from financing activities	435 603	1 677 581
Total net cash flows	(4 176 431)	(838 893)
Cash and cash equivalents at the beginning of the accounting period	11 838 799	12 677 692
Cash and cash equivalents at the end of the accounting period	7 662 368	11 838 799

Cash and cash equivalents are presented in Note 47.

The information regarding liabilities arising from financial activities in loans received, subordinated liabilities and the issue of debt securities were presented respectively in notes 31-34.

Notes presented on pages 164 – 269 constitute an integral part of these Financial Statements.

Additional notes to consolidated financial statements

1. General information about the issuer

Bank Zachodni WBK S.A. is a bank seated in Poland, 50-950 Wrocław, Rynek 9/11, TIN 896-000-56-73, National Official Business Register number (REGON) 930041341, registered in the District Court for Wrocław-Fabryczna, VI Economic Unit of the National Court Registry under 0000008723 number.

The consolidated financial statements of Bank Zachodni WBK S.A. Capital Group (further: BZ WBK Group) includes Bank Zachodni WBK's stand-alone financial information as well as information from its subsidiaries (all together called the Group) and shares in associated entities.

The immediate and ultimate parent entity of Bank Zachodni WBK is Banco Santander S.A., having its registered office in Santander, Spain.

BZ WBK Group offers a wide range of banking services for individual and business customers and operates in domestic and interbank foreign markets. Additionally, it offers also the following services:

- intermediation in trading securities,
- leasing,
- factoring,
- asset/ fund management,
- insurance services,
- trading in stock and shares of commercial companies,
- brokerage activity.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

BZ WBK Group consists of the following entities:

SUBSIDIARIES:

	Subsidiaries	Registered office	% of votes on AGM 31.12.2017	% of votes on AGM 31.12.2016
1.	BZ WBK Finanse sp. z o.o.	Poznań	100.00	100.00
2.	BZ WBK Faktor sp. z o.o.	Warszawa	100% of AGM votes are held by BZ WBK Finanse sp. z o.o.	100% of AGM votes are held by BZ WBK Finanse Sp. z o.o.
3.	BZ WBK Leasing S.A. 1)	Poznań	100% of AGM votes are held by BZ WBK Finanse sp. z o.o.	100% of AGM votes are held by BZ WBK Finanse Sp. z o.o.
4.	BZ WBK Lease S.A. 1)	Warszawa	–	100% of AGM votes are held by BZ WBK Finanse Sp. z o.o.
5.	BZ WBK Inwestycje sp. z o.o.	Poznań	100.00	100.00
6.	Giełdokracja sp. z o.o. w likwidacji	Poznań	100.00	100.00
7.	BZ WBK F24 S.A. / BZ WBK Nieruchomości S.A. 2)	Poznań	100% of AGM votes are held by BZ WBK Finanse sp. z o.o.	99.99
8.	BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A. 3)	Poznań	50.00	50.00
9.	Santander Consumer Bank S.A.	Wrocław	60.00	60.00
10.	Santander Consumer Finanse sp. z o.o.	Wrocław	100% of AGM votes are held by Santander Consumer Bank S.A.	100% of AGM votes are held by Santander Consumer Bank S.A.
11.	PSA Finance Polska sp. z o.o. 4)	Warszawa	50% of AGM votes are held by Santander Consumer Bank S.A. and 50% of AGM votes are held by Banque PSA Finance S.A.	50% of AGM votes are held by Santander Consumer Bank S.A. and 50% of AGM votes are held by Banque PSA Finance S.A.
12.	PSA Consumer Finance Polska sp. z o.o. 4)	Warszawa	100% of AGM votes are held by PSA Finance Polska sp. z.o.o.	100% of AGM votes are held by PSA Finance Polska Sp. z.o.o.
13.	Santander Consumer Multirent sp. z o.o.	Wrocław	100% of AGM votes are held by Santander Consumer Bank S.A.	100% of AGM votes are held by Santander Consumer Bank S.A.
14.	AKB Marketing Services Sp. z o.o. 5)	Poznań	–	100% of AGM votes are held by Santander Consumer Bank S.A.
15.	S.C. Poland Consumer 15–1 sp.zo.o. 6)	Warszawa	subsidiary of Santander Consumer Bank S.A.	subsidiary of Santander Consumer Bank S.A.
16.	S.C. Poland Consumer 16–1 sp.zo.o. 6)	Warszawa	subsidiary of Santander Consumer Bank S.A.	subsidiary of Santander Consumer Bankb S.A.

1) Details about the merger of BZ WBK Leasing S.A. and BZ WBK Lease S.A. are provided in Note 49.

2) On 18.10.2017, BZ WBK Nieruchomości S.A. with its registered office in Zakrzewo changed name to BZ WBK F24 SPÓŁKA AKCYJNA with its registered office in Poznań. On 24.11.2017, BZ WBK S.A. made contribution in kind of BZWBK F24 S.A. (formerly BZ WBK Nieruchomości S.A.) shares to BZWBK Finanse sp. z o.o. to cover the acquisition of BZWBK Finanse sp. z o.o. shares by BZWBK S.A. On 12.01.2018. in the Nation Court Register was registered increase of share capital BZWBK Finanse sp. z o.o to PLN 1,630k. Share capital was fully paid.

3) As at 30.09.2017, Bank Zachodni WBK was a co-owner of BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A., together with Banco Santander S.A. Both owners are members of Santander Group and each holds an equal stake of 50% in the company's share capital. Bank Zachodni WBK exercises control over BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A. Consequently, the company is treated as a subsidiary.

4) Details about the controlling stake at the companies PSA Finance Polska sp. z o.o. and indirectly, PSA Consumer Finance Polska sp. z o.o. are provided in Note 2 and 50.

5) Details about the liquidation of AKB Marketing Services sp. z o.o. in liquidation are provided in Note 49.

6) SC Poland Consumer 16-1 sp. z o.o. set up for the purpose of securitisation of a part of the loan portfolio; its shareholder is polish legal entity who has no ties with the Group; the company is controlled by Santander Consumer Bank, in accordance with the control criteria set out in IFRS 10.7.

ASSOCIATES:

	Subsidiaries	Registered office	% of votes on AGM 31.12.2017	% of votes on AGM 31.12.2016
1.	POLFUND – Fundusz Poręczeń Kredytowych S.A.	Szczecin	50.00	50.00
2.	BZ WBK – Aviva Towarzystwo Ubezpieczeń Ogólnych S.A.	Poznań	49.00	49.00
3.	BZ WBK – Aviva Towarzystwo Ubezpieczeń na Życie S.A.	Poznań	49.00	49.00

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

2. Basis of preparation of the consolidated financial statements

2.1. Statement of compliance

These annual consolidated financial statements of BZ WBK Group were prepared in accordance with the International Financial Reporting Standards (IFRS) adopted by the European Union, which are applied on a consistent basis, as at 31 December 2017 and, in the case of matters not governed by the above Standards, in accordance with the provisions of the Accounting Act of 29 September 1994 (consolidated text: Journal of Law of 22 November 2017, item 2342, as amended) and related implementing acts as well as the requirements imposed on issuers whose securities are admitted to trading on regulated markets or issuers who have applied to have securities admitted to trading on regulated markets outlined in Act dated 29 July 2005 on Public Offering, on Conditions for the Introduction of Financial Instruments to the Organized Trading System and on Public Companies.

These consolidated financial statements have been approved for publication by Bank Zachodni WBK's Management Board on 12 February 2018.

2.2. New standards and interpretations or changes to existing standards or interpretations which can be applicable to BZ WBK Group and are not yet effective or have not been implemented earlier

IFRS	Nature of changes	Effective from	Influence on BZ WBK Group
IFRIC 22 Foreign Currency Transactions and Advance Consideration *	IFRIC Interpretation 22 clarifies the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income when an entity has received or paid advance consideration in a foreign currency. The Interpretation relates to the situation when the transaction is in foreign currency and the entity pays or receives consideration in advance in a foreign currency before the recognition of the related asset, expense or income.	1 January 2018	The amendment will not have a significant impact on the financial statements.
IFRS 9 Financial Instruments	The changes refer to the following areas: • Classification and measurement – introduction of three classification categories for debt instruments, i.e. measured at: amortised cost, fair value through other comprehensive income and fair value through profit or loss. Changes were made in the measurement of equity instruments by limiting the possibility of measurement at historical cost; • Expected credit losses – introduction of a new model for recognition of impairment (ECL): impairment charge is required to be measured as lifetime expected credit losses rather than 12–month expected credit losses; • Hedge effectiveness testing and eligibility for hedge accounting – replacement of the precise effectiveness range (80–125%) with a requirement that there is an economic relationship between the hedged item and the hedging instrument and that the hedge ratio is the same as the one used for risk management purposes. Ineffective hedges continue to be taken to a profit and loss account; • Hedged items – new requirements allow appointment of new hedged items in relation to certain economically viable hedging strategies, which, to date, were not eligible under IAS 39; • Hedging instruments – relaxation of requirements pertaining to certain hedging instruments listed in IAS 39. The standard allow recognition of the time value of options purchased and implementing non–derivative financial instruments as hedging instruments; • Recognition of change in the fair value of financial liability arising from changes in the liability's credit risk in other comprehensive income (in principle).	1 January 2018	IFRS 9 implementation is described below.
Amendment to IFRS 9 Financial Instruments Prepayment right with negative compensation *	Amendment to IFRS 9 is effective for annual periods starting from 1 January 2019 or later with a possibility of earlier application. As a result of amendment to IFRS 9, companies will be able to measure pre–payable financial assets with negative compensation at amortised cost or at fair value through other comprehensive income if a specified condition is met, instead of at fair value a valuation at fair value through profit or loss.	1 January 2019	BZ WBK Group is currently in the process of analysing the amendment of the Standard and the assessment of the impact of the amendment

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

IFRS 15 – Revenue from Contracts with Customers	Changes relate to the following areas: • Transfer of control – recognition of revenue only when the customer gains control over a good or service. The amendment makes the definition of the transfer of control more precise. Introducing regulations allowing to define the legitimacy of recognising the revenue over time or at a point in time; • Variable consideration – the amendment takes into account variable consideration in prices of goods or services arising, for example, as a result of penalties or performance bonus; • Allocation of the transaction price on the basis of an adequate sales price per unit – introduction of the requirement to allocate the payment for goods or services in the case of sale under a single contract; • Licences – introduction of the requirement for entities to define the time for which a licence is transferred and specifying more precisely the revenue calculation in the case of transferring a licence at a point in time or over time; • Time value of money – the transaction price is adjusted for the time value of money. The entity may choose not to account for the time value of money when the interval between transfer of the promised goods or services and payment by the customer is expected to be less than 12 months; • Costs of obtaining a contract – introducing the conditions which determine if the given costs of obtaining a contract are subject to capitalization and can be amortised parallel to revenue recognition; • Disclosures – introduction of a requirement to disclose qualitative and quantitative information relating to judgements and changes in the judgements related with revenue recognition.	1 January 2018	IFRS 15 implementation is described below.
Commentary on IFRS 15 Revenue from Contracts with Customers	The commentary is a source of additional information and guidance re: the key assumptions of IFRS 15, including the identification of unit–specific commitments, the establishment of the unit's role (agent vs. principal) and the mode of recording revenue generated under the licence. Apart from additional guidance, there are exemptions and simplified rules for first time adopters.	1 January 2018	IFRS 15 implementation is described below.
IFRS 16 Leases	The new standard establishes principles for the recognition, measurement, presentation and disclosure of leases. All lease transactions results in the lessee's right to use the assets and the obligation to make a payment. Accordingly, the classification of leases into operating lease and finance lease as per IAS 17 no longer applies under IFRS 16, as the new standard introduces a single model for accounting for leases by the lessee. The lessee will be required to present the following: (a) assets and liabilities in respect of all leases executed for more than 12 months, except where an asset is of low quality; and (b) depreciation charge for the leased asset separately from the interest expense on the lease liability in the statement of profit or loss and other comprehensive income. The principles of accounting for leases by the lessee established in IFRS 16 are largely the same as in IAS 17. As a consequence, the lessee continues to use the classification into operating lease and finance lease and accounts for them accordingly.	1 January 2019	IFRS 16 implementation progress is described below.
Annual Improvements to IFRS 2014–2016*	In December 2016, the International Accounting Standards Board published 'Annual Improvements to IFRS Standards 2014–2016 Cycle' which amended 3 standards, i.e. IFRS 12 'Disclosure of Interests in Other Entities', IFRS 1 'First–time Adoption of International Financial Reporting Standards' and IAS 28 'Investments in Associates'. The improvements feature guidelines and amendments re: the scope of applicability, recognition and valuation as well as terminology and editing changes.	1 January 2018 for improvements to IFRS 1 and IAS 28	The amendment will not have a significant impact on financial statements.
Amendments to IAS 28 Long–term Interests in Associates and Joint Ventures*	The amendment is effective for annual periods starting from 1 January 2019 or later with a possibility of earlier application. The amendments to IAS 28 Investments in Associates and Joint Ventures clarify that companies accounting for long–term interests in an associate or joint venture where the equity method is not applied, have to use IFRS 9. The IASB has also published an example that illustrates how companies apply the requirements in IFRS 9 and IAS 28 to long–term interests in an associate or joint venture.	1 January 2019	BZ WBK Group is currently in the process of analysing the amendment of the Standard and the assessment of impact of the amendment
Improvements to IAS 40 'Investment Property'*	Improvements to IAS 40 specify the requirements for transfers to or from investment property classification. According to the amended standard, a change in management intention to use the property is not evidence of change in the use of the property. The amendment applies to all changes in use that are introduced after the effective date of the amendment and to all investment properties held at that date.	1 January 2018	The amendment will not have a significant impact on the financial statements.
Amendments to IFRS 2: Classification and measurement share–based payment transactions*	Changes relate to the following areas: • Guideliness on fair value measurement of liability due to cash–settled share–based payment transaction; • Guideliness on classification modification from cash–based to equity–settled payment transactions and also • Guideliness on employees tax liabilities recognition relating to share–based payment transactions.	1 January 2018	The amendment will not have a significant impact on the financial statements.
Improvements to IFRS 4: Applying IFRS 9 'Financial Instruments' with IFRS 4 'Insurance Contracts'	Improvements to IFRS 4 'Insurance Contracts' address the issue of adopting a new standard, i.e. IFRS 9 'Financial Instruments'. Improvements to IFRS 4 supplement the existing options and are aimed to prevent temporary fluctuations in the insurance industry results arising from the implementation of IFRS 9.	1 January 2018	The amendment will not have a significant impact on the financial statements.
Improvements to IFRS 10 and IAS 28*	Improvements to IFRS 10 and IAS 28 cover sales or contributions of assets between an investor and its associate/joint venture. The improvements eliminate the inconsistencies between IFRS 10 and IAS 28. The accounting treatment hinges on whether the nonmonetary assets sold or contributed to an associate/joint venture constitute a business. Should the assets constitute a business, the investor shall recognize the profit or loss in full. Should the assests not constitute a business, the profit or loss shall be recognised only to the extent of unrelated investors' interests in the associate or joint venture. The improvements were published on 11 September 2014.	The International Accounting Standards Board has not established the validity date of the amended regulations.	The amendment will not have a significant impact on the financial statements.

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IFRS 17 Insurance Contracts*	IFRS 17 replaces IFRS 4, which was brought in as an interim Standard in 2004. IFRS 4 has given companies dispensation to carry on accounting for insurance contracts using national accounting standards, resulting in a multitude of different approaches. As a consequence, it is difficult for investors to compare and contrast the financial performance of otherwise similar companies. IFRS 17 solves the comparison problems created by IFRS 4 by requiring all insurance contracts to be accounted for in a consistent manner, benefiting both investors and insurance companies. Insurance obligations will be accounted for using fair value – instead of historical cost.	1 January 2021	The standard will not have a significant impact on the financial statements.
IFRIC 23 Uncertainty over Income Tax Treatments*	Interpretation clarifies how the recognition and measurement requirements of IAS 12 „Income taxes" are applied where there is uncertainty over income tax treatments. An uncertain tax treatment is any tax treatment applied where there is uncertainty over whether that treatment will be accepted by the tax authority. The impact of the uncertainty should be measured using the method that best predicts thre resolution of the uncertainty – either the most likely amount method or the expected value method when measuring an uncertainty.	1 January 2019	The amendment will not have a significant impact on the financial statements.

**New standards and amendments to the existing standards issued by the IASB, but not yet authorized for use in the EU.*

IFRS 9 Financial Instruments

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

IFRS 9 introduces changes that affect the following areas of financial instruments accounting:

- classification and measurement of financial instruments
- recognition and calculation of impairment and
- hedge accounting.

In mid 2016, BZ WBK Group launched a project aimed at the implementation of IFRS 9. The project is delivered in liaison with an external consultant and involves BZ WBK Group departments responsible for accounting policy, reporting, management information, taxes, impairment charges for financial instruments, IT systems and operations related to loan sanction and monitoring. The first stage of the project was completed in early 2017. The differences between IAS 39 and IFRS 9 were identified and an action plan was defined to ensure the compliance with the new standard. The second stage was launched in February 2017 and is aimed at implementing changes arising from IFRS 9. In particular, BZ WBK Group's objective was:

- to develop and implement models aimed at calculating impairment charges based on the expected credit loss (ECL) method. A particular focus was placed on defining a significant credit risk increase, rules for classifying financial instruments into stages and the impact of macroeconomic scenarios considered in individual risk parameters,
- to develop and implement models for determining fair value of financial instruments unquoted on the active market in the form of loans and debt financial instruments that must be, due to the contractual cash flow test failure, valued at fair value through profit or loss,
- to design and implement new processes related to the test of contractual cash flows, assessment of business model and modification of contractual cash flows,
- to develop and implement IT solutions,
- to modify the existing internal regulations (policies, terms of references, processes etc.).

Classification and measurement

The categories of financial instruments introduced by IAS 39, specifically held-to-maturity and available-for-sale financial instruments, no longer apply under IFRS 9. Pursuant to the new standard, the classification of financial assets depends on the business model of financial assets management and the nature of contractual cash flows. In accordance with the standard, financial instruments can be classified, on the basis of assessment of business models and the test of contractual cash flows, to the following groups only:

- financial assets measured at fair value through profit or loss,
- financial assets measured at fair value through other comprehensive income or
- financial assets measured at amortised cost.

Business models

The business model describes how BZ WBK Group manages its financial assets in order to generate cash flows. This means that, the business model determines whether cash flows will result from collecting contractual cash flows, selling financial assets or both.

The business model assessment involves the analysis of qualitative and quantitative criteria.

Qualitative criteria are assessed by the key management personnel of the units which are members of BZ WBK Group. The following aspects are taken into account during the assessment:

a) how the performance of the business model and the financial assets held within that business model are evaluated and reported to the key management personnel for the management accounting purposes.

b) the risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way in which those risks are managed.

c) the method of remunerating the persons who manage the financial instruments portfolio.

The purpose of the analysis of quantitative criteria of business model assessment is to determine if the sale of financial assets during the analysed period exceeds the pre-determined threshold values (in percentage terms) defined in internal regulations.

In the analysis of the quantitative criteria of the business model assessment, BZ WBK Group determines that a business model whose objective is to hold assets in order to collect contractual cash flows enables the sale of those assets, without affecting the current business model, in the following cases:

- if the sale is due to the increase in credit risk related to the assets
- if the sale is infrequent (even if its value is significant)
- if the value of the sale is insignificant (even if the sale is frequent)
- if the assets are sold to improve liquidity in a stress case scenario
- if the sale is required by third parties (it applies to the assets which have to be sold owing to e.g. the requirements of supervisory authorities, but were originally held to collect contractual cash flows)
- if the sale results from exceeding the concentration limits specified in internal procedures and is a part of the credit risk management policy
- if the sale is made close to the maturity date of the financial assets and the proceeds from the sale are an approximation of the contractual cash flows that the BZ WBK Group would have collected if it had held the assets until their maturity date.

Other forms of the sale of assets as part of the business model whose objective is to hold assets in order to collect contractual cash flows (e.g. frequent sales of significant value) result in the need to change the business model, and reclassify the financial assets which were originally allocated to that model.

BZ WBK Group has assessed the business models, and on the basis of the analysis determined the business model whose objective is to hold assets in order to collect contractual cash flows as the prevailing financial assets management model. This is with the exception of:

- Available-for-sale debt instruments which BZ WBK Group holds for liquidity management purposes in a portfolio for which the business model whose objective is achieved by both collecting contractual cash flows and selling financial assets was determined as the appropriate business model;
- Held-for-trading instruments for which another (residual) business model was determined as the appropriate business model which reflects the method of their management.

Contractual cash flows test

In accordance with IFRS 9, only the contracts whose contractual cash flows include:

- the contractual principal (principal amount) and
- contractual interest

meet the requirements of the contractual cash flows test, and may be measured at:

  - amortised cost, in the case of the assets classified to the business model whose purpose is to hold assets to collect contractual cash flows, or
  - fair value through other comprehensive income with regard to the assets classified to the business model whose purpose is both to collect contractual cash flows and sell financial assets.

The assets which do not meet the contractual cash flows test must be measured at fair value through profit or loss regardless of the adopted business model.

Contractual principal is the fair value of the financial asset at initial recognition. However, that principal amount may change over the life of the financial asset (for example, if there are repayments of principal). In turn, interest includes a payment for:

- the time value of money;
- credit risk associated with the principal amount outstanding during a particular period of time;
- other basic lending risks and costs;
- as well as a profit margin.

For the purpose of this disclosure BZ WBK Group takes into account the portfolio of financial assets, whose interest construction is based on a multiplier greater than one, at amortized cost.

Given the pending discussions regarding the classification and measurement of financial instruments whose interest rate structure is based on a multiplier higher than 1, the above approach may change and portfolio of credit cards offered to retail banking customers may have to be measured at fair value through profit or loss.

As part of analyses of the cash flows to which BZ WBK Group is entitled under an agreement with the customer, a particular note was taken of the prepayment option and the impact of that option on the result of the contractual cash flows test.

According to BZ WBK Group, the assessment of whether the prepayment option is in line with the contractual cash flows test criteria depends both on the nature of the circumstances which give one of the parties the right to make a prepayment, and on the prepayment amount. As a rule, these two factors are taken into account when assessing whether contractual cash flows include only repayment of principal and interest on the outstanding principal, which may also include reasonable additional compensation for the early termination of the contract.

A contractual term that permits the issuer (i.e. the debtor) to prepay a debt instrument or permits the holder (i.e. BZ WBK Group) to put a debt instrument back to the issuer before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the early termination of the contract, is contractual cash flows which are only repayment of the principal amount and interest on the outstanding principal amount, and as such meet the SPPI test criteria.

Identified changes in classification and measurement

In order to ensure correct classification and measurement of the financial assets held as at 31 December 2017, BZ WBK Group analysed its assets portfolios whereby it:

- determined and allocated financial assets to the business models which reflect the asset management method through how the portfolio results are reported to the key management personnel, an analysis of the risk types affecting the profitability and effectiveness of portfolios, the method of managing the risk related to the given portfolio and the method of remunerating portfolio managers;
- analysed the value, frequency and reasons for selling the assets in the years prior to implementation of IFRS 9;
- determined the expectations and plans of the key management personnel as to the method of managing the assets portfolio, including the value and frequency of financial asset sales;
- analysed the contractual terms relating to financial assets to determine if the contractual cash flows to which BZ WBK Group is entitled represent payment of principal and interest.

Based on the results of the analyses performed by BZ WBK Group, supported by the outcome of tests of contractual cash flows and assessment of the business model, additional changes in the classification and measurement of financial assets concern the following:

- profit sharing agreements identified in certain tranches of debt instruments that have additional cash flows, other than solely payments of principal and interest, representing a contractually determined share in the customer's profit or loss. The adjustment to the fair-value measurement has been set at PLN (64 726) k, without the deferred tax effect.
- financial instruments whose contractual cash flows are not payments of principal and interest, which applies to debt instruments classified as "Loans and advances" whose interest is accrued on the subscription price and capitalised over the life of the product (until maturity) whereas interest payments to BZ WBK Group will be calculated on the nominal price so these cash flows do no represent interest payments as defined in IFRS 9. The adjustment to the fair-value measurement has been set at PLN (15,897)k and unsettled provision amounted PLN (106) k without the deferred tax effect,
- a different recognition method for interest income from assets held, depending on the level of credit risk. Until the end of 2017, the interest income from exposures measured at amortised cost, for which IBNR impairment charge was calculated, was recognised at the net carrying amount, whereas from 1 January 2018 at the gross carrying amount of the exposure. IFRS 9 provides for two exceptions from this rule:

a) POCI (Purchased or Originated Credit Impaired) assets. The interest income from these exposures is calculated on the net carrying amount based on the credit risk-adjusted effective interest rate.

b) financial assets impaired after the initial recognition (stage 3) The interest income from these exposures is calculated based on the effective interest rate and the net carrying amount.

Considering the differences in the recognition of interest income from financial assets classified into stages 1 and 2, for which until end of 2017 the IBNR provision charge was calculated, on the effective date of IFRS 9, BZ WBK Group recognised an interest income adjustment of PLN (23,787) k without deferred tax effect.

- non-listed equity instruments classified as available for sale, due to a significant limitation of the ability to measure such assets at historical cost less impairment charges, if any. By default, equity instruments are measured at fair value through profit or loss unless an irrevocable election is made at initial recognition to measure subsequent fair value changes at fair value through other comprehensive income. Using the option permitted by IFRS 9, BZ WBK Group took an irrevocable decision to designate strategic equity investments from the portfolio of financial assets other than those held for trading as instruments measured at fair value through other comprehensive income. The equity investments for which BZ Group chose the option of fair value measurement through other comprehensive income were acquired to be maintained in the investment portfolio for a long term and strategically, without the intention to make a profit on selling them in the short or medium term. If the equity instrument designated to be measured at fair value through other comprehensive income is sold, the gain (loss) on the transaction is not recycled to profit or loss at the time of the sale.

The adjustment to the fair-value measurement of equity instruments has been set at PLN (17,078) k and amount of reversed impairment charges at PLN 1,984 k, without the deferred tax effect.

As at 31 December 2017, BZ WBK Group has not identified any financial assets which it would intend to designate, as of 1 January 2018, to be measured at fair value through profit or loss to reduce the accounting mismatch, which would otherwise emerge as a result of measuring financial assets at amortised cost or at fair value through other comprehensive income.

Financial liabilities will continue to be measured in accordance with the existing rules laid down in IAS 39, i.e. at amortised cost or at fair value through profit or loss. BZ WBK Group has not chosen the option of measuring financial liabilities at fair value. Should this option be chosen, changes in the fair value arising from changes in BZ WBK Group credit risk will be taken to other comprehensive income, and once a financial liability is derecognised, the value previously recognised in other comprehensive income will not be recycled to profit or loss.

Comparative data

The use of IFRS 9 requires a change in presentation and the scope of disclosure, including in the first year after adoption, when a wide range of information is needed to allow financial statement users to understand the impact that the IFRS 9 might have in terms of classification, measurement and impairment of financial instruments on the financial position and the financial results of BZ WBK Group.

BZ WBK Group elected to use the IFRS 9 provisions which provide for exemption of the obligation to restate comparative information for prior periods in relation to the changes arising from classification, measurement and impairment. Differences in the carrying amount of financial assets and liabilities resulting from the application of IFRS 9 are reported in retained earnings in equity as at 1 January 2018.

Hedge accounting

The standard expands the list of eligible hedged items and allows entities to designate as hedging instruments financial assets or liabilities measured at fair value through profit or loss. The retrospective effectiveness test and the 80-125% bright line are removed, and the prerequisite for applying hedge accounting is the existence of an economic relationship between the hedged item and the hedging instrument. Furthermore, the standard expands the scope of disclosures concerning risk management strategies, cash flows arising from hedging transactions and impact of hedge accounting on financial statements.

Pursuant to paragraph 7.2.21 of IFRS 9, BZ WBK Group chose to continue to apply the hedge accounting requirements and hedging relationships arising from IAS 39.

For this reason, implementation of IFRS 9 will have no impact on the financial position of BZ WBK Group with regard to hedge accounting.

Impairment of credit exposures

IFRS 9 introduced a new approach to estimating losses related to credit exposures measured at amortised cost. The new approach is based on expected credit loss instead of the incurred loss model that is currently used under IAS 39. In accordance with IFRS 9, the recognition of expected credit losses depends on changes in risk after recognition of the exposure.

IFRS 9 makes the method of recognizing expected losses dependent on the change in the level of risk that occurred since the exposure was recognized. The standard introduced three main stages for recognising expected credit losses:

- stage 1 – exposures with no significant increase in risk since initial recognition, i.e. the likelihood of the exposure being downgraded to the impaired portfolio (Stage 3 exposures) has not increased. For such exposures, 12-month expected credit losses is recognised.
- stage 2 – exposures with a significant increase in risk since initial recognition, but with no objective evidence of default. For such exposures, lifetime expected credit losses is recognised.
- stage 3 – exposures for which the risk of default has materialised. For such exposures, lifetime expected credit losses is recognised.

In addition, for exposures classified as POCI (purchased or originated credit impaired), expected losses are recognized over the remaining life time horizon.

One of the key aspects of implementation of IFRS 9 was to work out a definition of a significant increase in credit risk that determines the classification of an exposure into Stage 2. BZ WBK Group developed the definition of detailed criteria for a significant increase in risk. BZ WBK Group developed detailed criteria for the definition of a significant increase in the level of risk based on the following main assumptions:

- qualitive:
  - customer coverage with dedicated monitoring strategies as a consequence of identifying early warning signals indicating a significant increase in credit risk,
  - restructuring measures related to providing clients with facilities forced by their difficult financial situation,
- quantitative:
  - the risk buffer method based on a comparison of the probability of insolvency curves in the horizon of the current remaining lifetime of exposures according to the risk level assessment at the moment of the exposure recognition and the reporting date,
  - delay in payment in accordance with the criteria of the standard, ie 30 days of delay in payment combined with materiality threshold consistent with the classification to stage 3.

Another key feature introduced by IFRS 9 is the approach to the estimation of risk parameters. For the purpose of estimating impairment losses, BZ WBK Group continues using own estimates of risk parameters that are based on internal models, however with the necessary modifications in the context of IFRS 9 requirements (such as estimating the parameters over the life of the exposure or taking into account future macroeconomic conditions). BZ WBK Group has defined a methodology for parameters modelling and has developed models compliant with IFRS 9.

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Expected credit losses are the product of the individual for each exposure of estimated values of PD, LGD and EAD parameters, and the final value of expected losses is the sum of expected losses in individual periods (depending on the basket over a 12 month horizon or lifetime) discounted by the effective interest rate. The estimated parameters in accordance with the assumptions of IFRS 9 are subject to adjustment for macroeconomic scenarios. Group BZ WBK uses internally developed scenarios.

The models and parameters created for the needs of IFRS 9 are subject to the process of model management and regular calibration and validation.

BZ WBK Group has developed IT solutions for the purpose of implementation of a new method for calculation of impairment in the systems. The changes were implemented in production systems in January 2018.

The implementation of IFRS 9 requirements caused increase in impairment losses in BZ WBK Group. The total value of additional impairment charges recognised in retained earnings for previous years is PLN 193,864 k, without the deferred tax effect, of which PLN 240,637 k relates to balance sheet items, PLN 15,034 k the increase in provisions for off-balance sheet liabilities presented in the line "Provisions" and the reclassifications of financial instruments from the category of assets measured at amortized cost to measured at fair value through profit or loss triggered impairment charge reversal in the amount of PLN 61,807 k.

In addition, BZ WBK Group expects higher volatility of impairment charges due to changes in the classification of exposures between stage 1 and 2 and material changes in the coverage of the exposure resulting in write-offs due to different horizons for recognizing expected losses. An important element affecting the volatility of estimates is also the use of macroeconomic forecasts in the calculation expected credit losses.

Impact of IFRS 9 on financial position

The table below presents the impact of IFRS 9 implementation on financial assets as at 1 January 2018:

Item	Measurement category – IAS 39	Measurement category – IFRS 9	Carrying amount – IAS 39	IFRS 9 implementation impact * Classsification and measurement impact	IFRS 9 implementation impact * Impairment impact	Carrying amount – IFRS 9
ASSETS						
Loans and advances to customers	Amortised cost	Amortised cost	107 715 574	(23 787)	(240 637)	107 451 150
Loans and advances to customers	Amortised cost	Fair value through profit or loss	124 323	(80 729)	61 807	105 401
Financial assets available for sale	Historic cost/purchase price less impairment charges	Fair value through OCI	52 157	(17 078)	1 984	37 063
Total assets			**107 892 054**	**(121 594)**	**(176 846)**	**107 593 614**

** without deferred tax effect*

The value of other financial assets presented in the consolidated statement of financial position did not change significantly as a result of implementation of IFRS 9.

The table below presents the impact of IFRS 9 implementation on liabilities as at 1 January 2018:

Item	Measurement category	Measurement category	Carrying amount	IFRS 9 implementation impact * Classsification and measurement impact	IFRS 9 implementation impact * Impairment impact	Carrying amount – IFRS 9
LIABILITIES						
Provisions	IAS 37	IFRS 9	50 652	–	15 034	65 686
Total liabilities			**50 652**	**–**	**15 034**	**65 686**

** without deferred tax effect*

The value of other liabilities presented in the consolidated statement of financial position did not change as a result of implementation of IFRS 9.

As at 1 January 2018, the total value of the impact of IFRS 9 implementation PLN (313,474) k, and the deferred tax effect in the form of deferred net tax asset increase PLN 59,020 k decreased the balance of retained earnings and revaluation reserve by the amount of PLN (254,454) k.

However, as indicated in the section on classification and measurement of financial instruments, the impact of changes in the classification and measurement rules is presented for information only. As at the date of this report, there are different opinions as to the potential impact of a multiplier higher than 1 on the classification and measurement of financial assets other than held-for-trading instruments. For financial asset portfolios which include such a multiplier, the total impact might differ from the impact presented above.

Impact of IFRS 9 on capital adequacy

On 12 December 2017, the European Parliament and the Council adopted Regulation No 2017/2395 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any Member State. This Regulation entered into force on the next day following its publication in the Official Journal of the European Union and has been applicable since 1 January 2018. The European Parliament and the Council concluded that the application of IFRS 9 may lead to a sudden significant increase in expected credit loss provisions and consequently to a sudden decrease in institutions' Common Equity Tier 1 capital.

The regulation regarding the mitigation of impact of IFRS 9 on Tier 1 capital provides for the following:

- Where an institution's opening balance sheet on the day that it first applies IFRS 9 reflects a decrease in Common Equity Tier 1 capital as a result of increased expected credit loss provisions, including the loss allowance for lifetime expected credit losses for financial assets that are credit-impaired, compared to the closing balance sheet on the previous day, BZ WBK Group should be allowed to include in its Common Equity Tier 1 capital a portion of the increased expected credit loss provisions for a transitional period. That transitional period should have a maximum duration of 5 years and should start in 2018. The portion of expected credit loss provisions that can be included in Common Equity Tier 1 capital should decrease over time down to zero to ensure the full implementation of IFRS 9 on the day immediately after the end of the transitional period.
- The multipliers that can be applied in consecutive years of the transitional period are as follows: 95%, 85%, 70%, 50%, 25%.
- If BZ WBK Group decides to apply the IFRS 9 transitional arrangements, it should publicly disclose its own funds, capital ratios and leverage ratio both with and without the application of those arrangements in order to enable the recipients of financial statements to determine the impact of those arrangements.
- BZ WBK Group should decide whether to apply those transitional arrangements and inform the KNF accordingly.
- During the transitional period, BZ WBK Group may reverse once its initial decision, subject to the prior permission of the KNF, which should ensure that such decision is not motivated by considerations of regulatory arbitrage.
- Institutions that decide to apply transitional arrangements should be required to adjust the calculation of regulatory items which are directly affected by expected credit loss provisions to ensure that they do not receive inappropriate capital relief. For example, the specific credit risk adjustments by which the exposure value is reduced under the standardised approach for credit risk should be reduced by a factor which has the effect of increasing the exposure value. This would ensure that an institution would not benefit from both an increase in its Common Equity Tier 1 capital due to transitional arrangements as well as a reduced exposure value.

Having analysed Regulation No. 2017/2395, BZ WBK Group has decided to apply the transitional arrangements provided for therein, which means that the full impact of the introduction of IFRS 9 will not be taken into account for the purpose of capital adequacy assessment of BZ WBK Group.

As a result of the adjustment of the regulatory capital requirements calculation, which include transitional arrangements for mitigating the impact of the introduction of IFRS 9 referred in the Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017, the Tier 1 capital ratio and total capital ratio on BZ WBK Group level decreased by 2 bps. In the case of non- application of the transitional arrangements related to IFRS 9 specified in this regulation and taking into account the full impact of the implementation of IFRS 9, the above-mentioned ratios would decrease by 20 bps.

As presented above, as a result of IFRS 9 implementation, Tier 1 capital ratio and total capital ratio of BZ WBK Group decreased mainly due to the introduction of a new impairment model based on expected credit loss of Stage 2 exposures.

Due to the decision to apply the transitional provisions as of February 1, 2018, BZ WBK Group will disclose own funds, capital ratios, as well as the leverage ratio, both with and without the application of transitional solutions resulting from article 473a of Regulation (EU) No 575/2013 from the first quarter of 2018.

IFRS 15 Revenue from Contracts with Customers

Description of changes

IFRS 15 Revenue from Contracts with Customers was published on 28 May 2014 by the International Accounting Standards Board and applies to annual reporting periods beginning on or after 1 January 2018.

IFRS 15 introduced a new, 5-step model to be applied to revenue-generating contracts with customers, excluding the contracts which are covered by a separate standard. The standard was introduce to harmonise the rules used by enterprises and to eliminate inconsistencies with previous standards.

As of 1 January 2018, IFRS 15 replaces the following standards and interpretations:

- IAS 18 Revenue
- IAS 11 Construction contracts
- SIC-31 Revenue – Barter Transactions Involving Advertising Services
- IFRIC 13 Customer Loyalty Programmes
- IFRIC 15 Agreements for the Construction of Real Estate
- IFRIC 18 Transfers of Assets from Customers

The new standard is applied to almost all contracts with customers. The main exceptions include leases (IAS 17), financial instruments and other contractual rights or obligations (IFRS 9, IFRS 10, IFRS 11, IAS 27 and IAS 28), insurance contracts (IFRS 4) and guarantees covered by other standards.

The previous standards (IAS 11/IAS 18) distinguished three separate models for revenue recognition, depending on the type of the sale transaction:

- construction contract
- sale of goods
- sale of services.

IFRS 15, introduced a single, five-step revenue recognition model, replacing the previous three separate models of revenue recognition. The new model applies to all transactions, enterprises and industries. The model will be used in two versions, depending on how the entity satisfies a performance obligation:

- over time or
- at a point in time.

The core principle of IFRS 15 is that an entity will recognise revenue to depict the transfer of promised assets to customers in an amount that reflects the consideration to which BZ WBK Group expects to be entitled in exchange for those assets.

The key criterion for the recognition of revenue is no longer the moment of transferring the "risks and rewards", which was considered as key under IAS 18, but the moment of satisfaction of a performance obligation, which takes place as control is passed. This determines the recognition of a revenue under IFRS 15. However, the expectation is that the moment will more often than not coincide with the moment of transfer of risks and rewards within the meaning of IAS 18.

Furthermore, in line with IFRS 15, costs incurred to obtain and secure a contract with a customer should be capitalised and amortised over time for as long as the benefits from the contract are consumed.

Each of those five steps of the revenue recognition model are described below:

Step 1:
Identify the contract with the customer The first step is to identify the contract with the customer. IFRS 15 defines a contract as an agreement between two or more parties that creates enforceable rights and obligations. However, not all contracts are covered by IFRS 15. BZ WBK Group recognises a contract with a customer within the scope of IFRS 15 if all the following conditions are met:

- the contract has been approved in writing, orally, or in accordance with other customary business practices and the parties are committed to perform their obligations in the contract,
- BZ WBK Group can identify each party's rights regarding the assets to be transferred,
- BZ WBK Group can identify payment terms for the assets to be transferred,
- the contract has commercial substance (i.e. the risk, timing or amount of the vendor's future cash flows to BZ WBK Group are expected to change as a result of the contract),
- it is probable that BZ WBK Group will collect the consideration to which it will be entitled in exchange for the assets that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, BZ WBK Group shall consider only the customer's ability and intention to pay that amount of consideration when it is due.

In the identification process, BZ WBK Group takes into account both combination and modification of contracts as this may affect the method of recognising revenue from contracts with customers.

BZ WBK Group combines two or more contracts entered into at or near the same time with the same customer (or related parties of the customer), and accounts for the contracts as a single contract if one or more of the following criteria are met:

- the contracts are negotiated as a package with a single commercial objective;
- the amount of consideration to be paid in one contract depends on the price or performance of the other contract or
- the assets promised in the contracts (or some assets promised in each of the contracts) are a single performance obligation.

Pursuant to the new accounting policy of BZ WBK Group, a contract modification is a change in the scope or price (or both) of a contract that is approved by the parties to the contract. A contract modification exists when the parties to a contract approve a modification that either creates new or changes existing enforceable rights and obligations of the parties to the contract. A contract modification could be approved in writing, by oral agreement or implied by customary business practices. If the parties to the contract have not approved a contract modification, BZ WBK Group continues to apply IFRS 15 to the existing contract until the contract modification is approved.

A contract modification may exist even though the parties to the contract have a dispute about the scope or price (or both) of the modification or the parties have approved a change in the scope of the contract but have not yet determined the corresponding change in price. In determining whether the rights and obligations that are created or changed by a modification are enforceable, BZ WBK Group considers all relevant facts and circumstances including the terms of the contract and other evidence. If the parties to a contract have approved a change in the scope of the contract but have not yet determined the corresponding change in price, BZ WBK Group estimates the change to the transaction price arising from the modification in relation to the estimation of variable consideration and constraining estimates of variable consideration.

Step 2:
Identify the performance obligations in the contract. The next step in the process of recognising revenue is to identify performance obligations (assets) under the contract which are distinct. An asset is distinct if the customer can benefit from the asset either on its own or together with other resources that are readily available to the customer, and at the same time an asset is separately identifiable from other promises in the contract. In such a case, BZ WBK Group is dealing with separate performance obligations.

Factors that indicate that BZ WBK Group promise to transfer an asset to a customer is separately identifiable include, but are not limited to, the following:

- BZ WBK Group does not provide a significant service of integrating the asset with other assets promised in the contract into a bundle of assets that represent the combined output for which the customer has contracted,
- the asset does not significantly modify or customise another assets promised in the contract,
- the asset is not highly dependent on, or highly interrelated with, other assets promised in the contract.

If a promised asset is not distinct, BZ WBK Group combines that asset with other promised assets until it identifies a bundle of assets that is distinct. In some cases, that would result in BZ WBK Group accounting for all the assets promised in a contract as a single performance obligation.

Step 3:
Determine the transaction price. In accordance with IFRS 15, the transaction price is the amount of consideration that BZ WBK Group expects to be entitled to in exchange for assets promised. It represents the amount of the revenue that will be recognised as a result of performance of the contract. In addition to the amount of consideration, the transaction price should also reflect any highly probably variable consideration (including bonuses or penalties), a discounting factor, amounts paid to customers or non- cash consideration. As the transaction price may be based to a large degree on estimates, BZ WBK Group reviews it as at each balance sheet date.

If the consideration promised in a contract includes a variable amount, BZ WBK Group estimates the amount of consideration to which it will be entitled in exchange for transferring the promised assets to a customer. An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items.

Step 4:
Allocate the transaction price to the performance obligations. As individual performance obligations may be recognised at different times and in different ways (at a point in time or over time), in the case of multiple performance obligations in a contract, the transaction price needs to be allocated to identified performance obligations. The allocation should be based on the stand-alone selling price, which is the price at which a vendor would sell an asset separately in similar circumstances and to similar customers. If the transaction price changes during the contract, the re-allocation is based on the original stand-alone selling prices.

Step 5:
Recognise revenue when each performance obligation is satisfied. Revenue is recognised when assets are transferred to a customer and the customer acquires control over the subject matter of the contract. IFRS 15 specifies the conditions under which a control is said to be transferred to the customer. Control may be transferred at a point in time or over time, which is determined on the basis of the criteria set out in the standard. Control is the ability to direct the use of, and obtain substantially all of the remaining benefits from an asset. This is a wider concept than the previously used moment of transfer of significant risks and rewards. Indicators that control has passed include that the customer has, for example: physical possession of the asset, legal title of the asset, or has accepted the effect of the performance obligation.

According to BZ WBK Group, the indicators of the transfer of control include the following:

- BZ WBK Group has a present right to payment for the asset – if a customer is presently obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange.
- The customer has legal title to the asset – legal title may indicate which party to a contract has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. Therefore, the transfer of legal title of an asset may indicate that the customer has obtained control of the asset. If BZ WBK Group retains legal title solely as protection against the customer's failure to pay, those rights of BZ WBK Group do not preclude the customer from obtaining control of an asset.
- BZ WBK Group has transferred physical possession of the asset – the customer's physical possession of an asset may indicate that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset or to restrict the access of other entities to those benefits. However, physical possession may not coincide with control of an asset.

For example, in some repurchase agreements a customer may have physical possession of an asset that BZ WBK Group controls.

- The customer has the significant risks and rewards of ownership of the asset – the transfer of the significant risks and rewards of ownership of an asset to the customer may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. However, when evaluating the risks and rewards of ownership of a promised asset, BZ WBK Group excludes any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset.

- The customer has accepted the asset – the customer's acceptance of an asset may indicate that it has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

Control may be transferred at a point in time or over time. The following criteria are used to determine when control is transferred and how income should be recognised:

- The customer receives the benefits as the contract is performed; if the service was discontinued, another service provider would not need to re-perform the work that the entity has completed to date if that other entity were to fulfil the remaining performance obligation to the customer already done;

- BZ WBK Group creates or enhances an asset that the customer controls as it is created or enhanced;

- BZ WBK Group does not create an asset with an alternative use and has a right to payment for performance completed to date.

If any of the above criteria is satisfied, income should be recognised over time. In other cases, income should be recognised when control is transferred.

BZ WBK Group applies IFRS 15 starting from 1 January 2018.

Status

In Q2 2017, BZ WBK Group launched a project aimed at analysing the impact of implementing a five-step model of revenue recognition. As a result of the analysis, a report was prepared by BZ WBK Group experts, indicating the types of revenue which, in principle, should be accounted for in accordance with IFRS 15:

- revenue from advisory services

- revenue from the sale of fixed assets used for operational activities or repossessed, which are presented together with cost of assets sold as the result on sale in line "Other operating income"

- loyalty programmes,

- success fee – i.e. contracts which do not guarantee the remuneration for BZ WBK Group or provide for the minimum level of remuneration during the term of the contract until a certain condition is met (e.g. a transaction is finalised), entitling BZ WBK Group to receive significant remuneration to compensate for the effort made by BZ WBK Group in a long term.

- revenue from asset management

- revenue from the sale of insurance products which show indications of a connection with financial instruments to an extent not covered by separate standards, and

- costs of contracts with customers.

In order to analyse the impact of the introduction of IFRS 15, BZ WBK Group applied the portfolio practical expedient for the purpose of analysis of contracts with customers, as described in paragraph (4) of IFRS 15. BZ WBK Group reasonably expects that the effects on the financial statements of applying this standard to the portfolio would not differ materially from applying this standard to the individual contracts (or performance obligations) within that portfolio. BZ WBK Group applied the portfolio approach to the majority of income categories indicated above.

BZ WBK Group , in cooperation with an independent external advisor, did not identify any significant categories of revenue and costs whose recognition would need to be changed due to the implementation of IFRS 15.

Impact of IFRS 15 on the financial standing and own funds

Impact of IFRS 15 implementation is not significant because revenue derived from financial instruments offered by BZ WBK Group such as loans or leases is recognised using an effective interest rate and the recognition and accounting method for revenue that is in the scope of IFRS 15 and corresponding costs, due to the applicable contractual provisions, will not be modified.

IFRS 16 Leases

Description of changes

IFRS 16 Leases was published by the International Accounting Standards Board on 13 January 2016 and approved by virtue of the Commission Regulation (EU) 2017/1986 of 31 October 2017 for application in the EU member states. The standard applies to financial statements for annual reporting periods beginning on or after 1 January 2019.

As of 1 January 2019, IFRS 16 replaces the following standards and interpretations:

- IAS 17 Leases

- IFRIC 4 Determining whether an Arrangement Contains a Lease

- SIC-15 Operating Leases – Incentives

- SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

The new standard applies to all leases, including leases of right-of use assets in a sublease, except for leases which are subject of other standards:

- Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
- Arrangements within the scope of IFRIC 12 Service Concession Arrangements;
- For lessors: licences of intellectual property granted by a lessor within the scope of IFRS 15 Revenue from Contracts with Customers; and
- For lessees: leases of biological assets within the scope of IAS 41 Agriculture and rights held under licensing agreements within the scope of IAS 38 Intangible Assets for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

The new standard presents the overall model for identification and accounting for leases in financial statements of lessors and lessees. Significant changes have been introduced to lessee accounting, e.g. the distinction between operating and finance lease is no longer applied. For the purpose of identification of leases, IFRS 16 introduces a control model which differentiates between leases and service agreements depending on the existence of an asset controlled by the lessee.

In accordance with IFRS 16, a contract is, or contains, a lease if it conveys the right to control the use of an identified asset, and to obtain economic benefits from that use, for a period of time in exchange for consideration.

Under IFRS 16, a contract may be considered a lease if it meets the following criteria:

- fulfilment of the lease conditions relates to a specified asset which is identified by being explicitly or implicitly specified in a contract, and the lessor may not have a substantive right of substitution;
- the contract conveys the right to control the use of the asset in exchange for consideration. It means that the lessee has the right to direct the use of the asset and to obtain substantially all the economic benefits from that use, taking into account the scope of such use.

A specified asset may be identified either directly or indirectly. A portion of an asset which can be physically separated meets the identification criterion, and a portion of an asset that cannot be physically separated may not be treated as a specified asset and may not be the subject of a lease under IFRS 16.

The contracts which give the lessor the substantive right to substitute the asset which is the subject of the lease may not be treated as leases as fulfilment of the contract conditions does not depend on the use of a specified asset. A lessor's right to substitute an asset is substantive only if the lessor has the practical ability to substitute alternative assets, the lessor would benefit economically from the exercise of its right to substitute the asset, and the substitution may take place without the lessee's consent. The contracts which give lessees the substantive right to substitute the asset do not meet the criteria of IFRS 16 and will continue to be recognised in accordance with IFRS 15.

The right to control the use of a specified asset is conveyed if the lessee has the ability both to direct the use of the asset and obtain benefits from its use. The contracts whereby the lessee obtains substantially all of the economic benefits from use of the asset, but does not have the ability to direct its use, are not treated as leases. A lessee has the right to direct the use of the asset if they can take decisions about how and for what purpose the asset is used, and the decisions materially affect the economic benefits to be derived from use.

The overall rule at inception of a lease the lessee will recognise a lease liability (obligation to make lease payments) and the asset which is the right to use the leased asset throughout the term of the lease (period of use) for all leases. At the same time, reporting entities have the right to use two simplifications for short-term leases and leases for which the underlying asset is of low value described below:

- IFRS 16 allows lessee to use the existing methods of accounting for operating leases to account for short-term leases. A short-term lease has a lease term of 12 months or less, including a renewal option. Whether or not a lease is a short-term lease is determined solely on the basis of the maximum lease term, which is the term in which exercisable rights and obligations arise. The above simplification is not available to the lessee in the case of short-term lease with an option to purchase the leased asset regardless of the lessor's intentions or expectations regarding the subject of the lease.
- To determine whether the leased asset is of low value, BZ WBK Group assesses the value of the asset when it is new, regardless of the actual age or wear and tear of the asset being leased. Even though the amount to be considered low was not indicated in the text of the standard, lessees may rely on the amount of USD 5,000 specified in the justification to the standard.

The lease liability is valued on the basis of the present value of lease payment during the term of the lease. The payments reflected in the valuation of lease liabilities include:

- fixed payments less any incentives paid or payable to the lessee;
- any other variable payments that depend on an index or a rate;
- amounts expected to be payable by the lessee under residual value guarantees;
- the price of exercising the payment option, if it is reasonably certain that the lessee will use that option;
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

In turn, the right-to-use asset should reflect:

- the amount of the initial measurement of the lease liability;
- any lease payments made at or before the commencement date, less any lease incentives received;
- any initial direct costs incurred by the lessee; and
- an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease.

The discount rate should be set separately for each lease. For a lessee, the discount rate for the lease is the interest rate implicit in the lease and, if that rate is not known, its incremental borrowing rate.

IFRS 16 approach to lessor accounting is not substantially changed. Lessors continue to classify leases as operating or finance and recognise them as two different types of lease.

Status

BZ WBK Group launched the work on the implementation of the new standard in the second half of 2017. The process is actively supported by the units specialised in reporting, taxes, accounting policy, IT as well as operational units which enter into lease or rental agreements.

First, BZ WBK Group focused on identification of all leases and agreements with a lease component as well as assets used by BZ WBK Group under such arrangements. So far, agreements have been identified that provide for the lease of the following assets:

- buildings and commercial units
- land and perpetual usufruct of land
- vehicles and
- technical equipment.

BZ WBK Group plans to apply two exemptions regarding:

- short-term leases (whose term is 12 months or less and which do not contain purchase option) and
- low-value assets (assets with the initial value of PLN 17,000 or less).

by taking them directly to costs, usually on a straight-line basis, over the lease term.

For the purpose of first-time adoption of the standard, BZ WBK Group plans to use a modified retrospective approach and measure a right-of-use asset at the amount of the lease liability adjusted for any prepayments or accrued lease payments relating to that lease only, recognised in the statement of financial position directly before the first-time adoption, and avoid the obligation to restate comparative data.

In addition, at the date of first adoption of the standard, BZ WBK Group plans to use additional simplifications available for first-time adopters, specifically:

- grandfather assessments regarding whether a contract existing at the date of initial application contains a lease;
- classify as short-term contracts the leases whose term ends 12 months after the first adoption;
- exclude any initial direct costs from measurement of the right-of-use asset;
- apply a single discount rate to the portfolio of leases with substantially similar characteristics (such as leases with a similar remaining lease term for a similar class of the underlying asset in a similar economic environment);
- adopt the requirements of the standard to the portfolio of leases with similar characteristics if BZ WBK Group reasonably expects that the impact on the financial statements resulting from application of the standard to the portfolio will not be substantially different from the impact of application of the standard to individual leases as part of that portfolio. When measuring the portfolio, the Group uses the estimates and assumptions which reflect the value and composition of the portfolio;
- determining the provisions for onerous leases as an alternative to performing an impairment review. The use of this expedient will entail an adjustment of the right-of-use asset at the date of initial application by the amount of any provision for onerous leases recognised in the statement of financial position immediately before the date of initial application.

Estimated impact of IFRS 16 on BZ WBK Group

BZ WBK Group expects that the application of the new standard will affect the recognition, presentation, measurement and disclosure of assets under operating lease and their corresponding liabilities in financial statements of BZ WBK Group as a lessee. The implementation of the new standard is not expected to have significant impact on recognition of finance lease in financial statements.

The value of lease payments by their maturity dates as at 31 December 2017 is presented in Note 46.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

2.3. Standards and interpretations or changes to existing standards or interpretations which were applied for the first time in the accounting year 2017

IFRS	Nature of changes	Effective from	Influence on BZ WBK Group
Amendments to IAS 7 Statement of Cash Flows	Amendments to IAS 7 introduce the requirements to disclose changes in liabilities arising from financing activities in statement of cash flows, including both changes arising from cash flows and non-cash changes. To fulfill the requirement the standard requires a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities in cash flow statement.	1 January 2017	Reconciliation of changes in liabilities arising from financing activities are presented in notes 31-34.
Amendment to IAS 12 Income Taxes	Amendments to IAS 12 clarify the requirements on recognition of deferred tax assets for unrealized losses on debt instruments measured at fair value. The amendments introduce the guidance on the identification of deductible temporary differences. Especially the standard confirms that decreases below cost in the carrying amount of a fixed-rate debt instrument measured at fair value for which the tax base remains at cost give rise to a deductible temporary difference. This applies irrespective of whether the debt instrument's holder expects to use it or sale it.	1 January 2017	The amendments did not have any material impact on the financial statements.
Annual Improvements to IFRS 2014–2016*	In December 2016, the International Accounting Standards Board published 'Annual Improvements to IFRS Standards 2014-2016 Cycle' which amended 3 standards, i.e. IFRS 12 'Disclosure of Interests in Other Entities', IFRS 1 'First-time Adoption of International Financial Reporting Standards' and IAS 28 'Investments in Associates'. The improvements feature guidelines and amendments re: the scope of applicability, recognition and valuation as well as terminology and editing changes.	1 January 2017 for improvements to IFRS 12	The amendment did not have a significant impact on financial statements.

2.4. Basis of preparation

The financial statements are presented in PLN, rounded to the nearest thousand.

The consolidated financial statements of BZ WBK Group have been prepared in accordance with the International Financial Reporting Standards (IFRS) adopted in the European Union, on a historical cost basis, taking into account measurement basis used for available-for-sale financial assets, financial assets and liabilities at fair value through profit and loss and all derivative contracts and liabilities for cash-settled share-based payment transactions, which are measured at fair value. Fixed assets available for sale and disposals groups of fixed assets designated as available for sale are recognised at the lower of their carrying amount and their fair value less costs of disposal.

2.5. Use of estimates and judgments

The preparation of financial statements in conformity with IFRSs requires the management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities, income and expenses.

The estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the given circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources.

The estimates and assumptions are reviewed on an ongoing basis. Changes to estimates are recognised in the period in which the estimate is changed if the change affects only that period, or in the period of the change and future periods if the change affects both current and future periods.

2.6. Main estimates and judgments made by BZ WBK Group

Loan impairment

The estimation of potential loan impairment charges is inherently uncertain and depends upon many factors in respect of credit risk, including loans' impairment charges trends, portfolio grade profiles, economic climates, conditions in various industries to which BZ WBK Group is exposed and other external factors such as legal and regulatory requirements. Impairment charges are posted for loans with indications of impairment if in the management's opinion the estimated recovery from the debtor, including value of the existing collateral, may be lower than the outstanding exposure. For all the impaired credit exposures, BZ WBK Group calculates an impairment charge as a difference between the credit exposure's book value and the present value of the estimated future cash flows, discounted using the effective interest rate as at the date of recognition of impairment.

The identification of exposures that require impairment charges to be posted is based on several independent review levels. Credit quality and impairment charges for loans receivables are independently monitored by head office personnel on a regular basis. A group-wide system for grading advances according to agreed credit criteria exists with an important objective being the timely identification of vulnerable loans so that remedial action can be taken at the earliest opportunity. The credit grading system plays a key role in the calculation of impairment charges in BZ WBK Group. This is the starting point of a process that ends in an impairment charge being posted against the individual exposures that are at the risk of default.

The analysis of impairment is carried out:

- with reference to individual credit exposures representing significant reporting items, for which indications of impairment have been identified; for the customers classified to global corporate banking segment, customers with a commercial grading, property customers and local authorities, and for significant retail exposures (individual analysis);
- with reference to the portfolio of individually insignificant credit exposures (collective analysis) or individually significant exposures, but with no identified indications of impairment.

BZ WBK Group regularly reviews the methodologies and assumptions underpinning estimation of cash flows and periods of time in which they occur; in particular BZ WBK Group compares estimated and actual cash flows to arrive at the best estimate of the recoverable amount.

Net impairment losses on loans and advances are presented in Note 12.

For other receivables impairment charge is recognised considering the expected recoverable amounts, and for other long-term receivables discounting is applied.

Impairment loss on non-financial assets

The valuation of the fixed-assets of BZ WBK Group is reviewed as at the end of the reporting period to specify whether there are indicators for write-down due to impairment. If there are such indicators, the recoverable value of assets should be determined.

Impairment charge is recognised if the book value of an asset exceeds its recoverable value and is presented in the income statement.

BZ WBK Group measures fixed assets available for sale and disposals groups of fixed assets designated as available for sale are recognised at the lower of their carrying amount and their fair value less costs of disposal.

The value of impairment losses on individual tangible and intangible fixed assets is presented in Notes 25 and 27.

Fair value of financial instruments

Some of BZ WBK Group's financial instruments are carried at fair value, including all derivatives, other financial assets at fair value through profit and loss and financial investments classified as available for sale. Financial instruments are either priced with reference to a quoted market price for that instrument or by using a valuation model. Where the fair value is calculated using financial-markets pricing models, the methodology is to calculate the expected cash flows under the terms of each specific contract and then discount these values back to a present value. These models use as their basis independently sourced market parameters including, for example, interest rate yield curves, securities and commodities prices, option volatilities and currency rates. Most market parameters are either directly observable or are implied from instrument prices.

In justified cases, for financial instruments whose carrying amount is based on current prices or valuation models, BZ WBK Group takes into account the need to identify additional adjustments to the fair value of the counterparty credit risk.

A summary of the carrying amounts and fair values of the individual groups of assets and liabilities is presented in Note 43.

Consolidation scope

The preparation of consolidated financial statements by Bank Zachodni WBK as a parent entity of BZ WBK Group requires an extensive use of judgement and multiple assumptions as to the nature of equity investments, including, above all, determination of whether Bank Zachodni WBK as a parent entity exercises control over the investee. The key judgements and assumptions regarding the bank's equity investments where the bank has 50% voting rights in the investee are presented below.

According to the Management Board of BZ WBK Group, investment in BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A. is an investment in a subsidiary for the purpose of preparation of the consolidated financial statement in the light of the strategy adopted by the ultimate parent entity. As at 31 December 2017, Bank Zachodni WBK co-owned BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A. with Banco Santander S.A. Both owners are members of Santander Group and each holds 50% of the shares in the company. In practice, Bank Zachodni WBK exercises control over the subsidiary company, BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A due to the fact that:

- Bank Zachodni WBK has rights to manage significant current operations,
- Bank Zachodni WBK has rights to variable returns due to its exposure,
- Bank Zachodni WBK may use its powers to affect the amount of its financial results.

The investment in POLFUND – Fundusz Poręczeń Kredytowych S.A., where 50% of the voting rights at the Annual General Meeting are held by Bank Zachodni WBK, was classified, in accordance with the best knowledge and estimates, as an investment in an associate as the ownership structure does not allow Bank Zachodni WBK to control or exercise joint-control over the company.

According to BZ WBK Group Management Board, investing in PSA Finance Polska Sp. z o.o., a subsidiary company, resulted from the need to draft consolidated financial statements due to the fact that Santander Consumer Bank has a direct control and Bank Zachodni WBK has indirect control over the investment. The need of controlling the company results from the fact that:

- Santander Consumer Bank exercises control over PSA Finance Polska Sp. z o.o. as it has existing rights that give it the current ability to direct the relevant activities, namely the activities which materially influence the returns made by PSA Finance Polska Sp. z o.o.. Taking into account the core business of PSA Finance Polska Sp. z o.o., which is leasing, activities supporting financial services, car lease and rental and activities of insurance agents and brokers, and the sector in which PSA Finance Polska Sp. z o.o. is active, Bank Zachodni WBK has decided that PSA Finance Polska Sp. z o.o. relevant activities are:

- funding and ALM activity;
- risk management activity
- commercial activity.

On the basis of an analysis of written agreements between the shareholders of PSA Finance Polska Sp. z o.o. , Santander Consumer Bank manages the first two types of activities indicated above, namely the activity connected with the provision of funding and risk management. The right to manage those activities results from the fact that committee members appointed by Santander Consumer Bank. have casting votes in the event of a tied vote, and the fact that Santander Consumer Bank has the right to shape the company's external funding policy in a manner consistent with the internal rules of Santander Consumer Bank.

- As Santander Consumer Bank plays a key role in funding the activities of PSA Finance Polska Sp. z o.o., the former is exposed to variable returns from its investment into the investee and
- Santander Consumer Bank may use its power to affect returns from its investment into PSA Finance Polska Sp. z o.o. as the former does not act for or on behalf of another entity (acts as a principal rather than as an agent).

The list of fully consolidated subsidiaries is presented in note 1 "Information about the issuer".

Revenues arising from insurance mediation

BZ WBK Group periodically performs the link assessment between financial instruments and insurance products distributed with them, using a questionnaire prepared in accordance with KNF Recommendation U.

BZ WBK Group performs the link assessment:

- in relation to new insurance products;
- at each change of terms of the existing insurance products and
- at least once a year, in the third quarter, taking into account the updated data about the product portfolio and the market data.

In 2017, the BZ WBK Group changed the estimation of the parameters of the relative-fair-value model which is applied by the BZ WBK Group to allocate the amount of intermediation remuneration services arising from insurance sale offered in conjunction with a financial instrument. Based on the parameters review, the following elements have been changed: a portion of remuneration arising from the offered financial instrument, remuneration for insurance mediation services and remuneration for additional activities carried out during the term of the insurance contract.

The changes in relative-fair-value model parameters were applied prospectively.

Classification of leases

BZ WBK Group uses judgement to classify leases as finance or operating leases, on the basis of an analysis of the economic substance of the transaction based on an assessment of whether or not all the risks and rewards of ownership of the leased asset have been transferred.

A lease is classified as a finance lease if it transfers substantially all the risks and rewards of ownership of the leased asset. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards of ownership of the leased asset.

Note 46 presents gross receivables in respect of finance leases by maturity dates, present value of due minimum lease payments by maturity dates, reconciliation of differences between finance lease receivables and the present value of due minimum lease payments, and operating lease payments by maturity dates.

Economic life of intangible and tangible fixed assets

At initial recognition of an intangible or tangible fixed asset, BZ WBK Group determines their estimated economic life. For the purpose of this process, BZ WBK Group takes into account in particular:

- objective criteria – beyond the control of BZ WBK Group, and arising from the very characteristics of the asset or from other conditions, mainly external ones, which are key to its potential economic life;
- criteria connected with the specific nature of activities of BZ WBK Group, which may cause extension or reduction of the economic life of an asset (e.g. intensity of use, including the number of changes being processed, capacity measured by the number of working hours, operating conditions, frequency and economic rationale for repairs).

The economic life of fixed assets is periodically reviewed by BZ WBK Group.

Other accounting estimates and judgements

Provisions for employee benefits paid on termination of employment, i.e. post-employment benefits, are estimated on the basis of an actuarial valuation. The actuarial valuation of those accruals is updated at least on an annual basis.

See Note 51 for details about provisions for staff benefits.

The fair value of awards granted under an incentive scheme is determined using the share based payments pricing models, which take into account the exercise price of the award, the share price at date of grant, discount rate – the risk free rate, the expected volatility of the share price over the life of the award and other relevant factors influencing fair value. The BZ WBK Group assesses probability of the programme vesting which affects the programme value in the costs of the reporting period. Description of the share-based incentive scheme is contained in Note 52.

Provisions for legal claims have been estimated considering the expected losses arising from individual cases. Provisions for cases disputed in court are presented in Note 35.

Changes in judgments and estimates

In 2017, the scope of data covered by estimates did not change in comparison with the consolidated financial statements of BZ WBK Group's for 2016 with the exception of those listed above.

2.7. Basis of consolidation

Subsidiaries

Bank Zachodni WBK defines the consolidation scope by assessing whether it controls an investee. Bank Zachodni WBK controls an entity if, due to its involvement, Bank Zachodni WBK is exposed or has rights to variable returns and can affect those returns through its power over the investee.

Bank Zachodni WBK, being the parent entity, controls directly or indirectly an investee when:

- Bank Zachodni WBK has power over the investee;
- Bank Zachodni WBK has exposure or rights to variable returns from its involvement with the investee;
- Bank Zachodni WBK has the ability to use its power over the investee to affect the amount of the investor's financial results.

When assessing whether it controls an investee, Bank Zachodni WBK considers all facts and circumstances, among other things following factors:

- the purpose and design of the investee;
- what the relevant activities are and how decisions about those activities are made;
- whether the rights of Bank Zachodni WBK give it the current ability to direct the relevant activities;
- whether Bank Zachodni WBK is exposed or has rights to variable returns from its involvement with the investee;
- whether Bank Zachodni WBK has the ability to use its power over the investee to affect the amount of the investor's returns.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Purchase method

BZ WBK Group applies the purchase method to account for acquisition of subsidiaries. Under this method, the acquirer has to:

- recognise and measure all identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree as at the acquisition date (the date on which the acquirer obtains control of the acquiree);
- recognise and measure goodwill or gain from a bargain purchase.

The acquirer measures:

- identifiable assets acquired and liabilities assumed – at fair value as at the acquisition date;
- any non-controlling interest – at fair value or pro-rata to their share in the identifiable net assets of the acquiree.

Joint ventures

Joint ventures are those entities over whose activities the BZ WBK Group has joint control, established by contractual agreement. In consolidated financial statements joint ventures are included using equity method.

Associates

Associates are those entities in which the BZ WBK Group has significant influence, but are not subsidiaries, neither joint ventures. They are accounted for in accordance with the equity method in consolidated financial statements.

The consolidated financial statements include BZ WBK Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the BZ WBK Group's share of losses exceeds its interest in an associate, the BZ WBK Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the BZ WBK Group has incurred legal or constructive obligations or made payments on behalf of an associate.

Transactions eliminated on consolidation

Intragroup balances and any unrealised gains and losses or incomes (including dividends) and expenses arising from intragroup transactions, are eliminated in the preparation of consolidated financial statements.

2.8. Accounting principles

The accounting policies set out below have been applied consistently to all periods presented in the financial statements. The accounting policies have been applied consistently by BZ WBK Group entities.

Changes in accounting policies

Except the new standards, changes to existing standards and the interpretations described in Section 2.3, BZ WBK Group has applied the same accounting principles as to the consolidated financial statements for 2016.

Comparability with results of previous periods

No major changes were introduced in respect of presentation of financial data for comparative periods of time.

Foreign currency

Foreign currency transactions

The Polish zloty (PLN) is the functional currency of the units which are members of BZ WBK Group.

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities arising from these transactions denominated in foreign currencies, are translated at the foreign exchange rate ruling at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into the reporting currency at the foreign exchange rates ruling at the dates on which the fair values were determined. Foreign exchange differences arising on translation are recognised in profit or loss except for differences arising on retranslation of available for sale equity instruments of other entities, which are recognised in other comprehensive income.

Financial assets and financial liabilities

Classification

BZ WBK Group classifies its financial instruments into the following categories:

- financial assets or financial liabilities measured at fair value through profit or loss;
- held-to-maturity investments;
- loans and receivables;
- available-for-sale financial assets;
- other financial liabilities.

Financial asset or financial liability measured at fair value through profit and loss

This is a financial asset or liability that meets either of the following conditions:

(a) Classified as held for trading.

A financial asset or financial liability is classified as held for trading if:

(i) it is acquired or incurred principally for the purpose of selling or repurchasing in the near term;

(ii) it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking;

(iii) derivatives are held for trading unless the derivative is a designated and effective hedging instrument.

(b) Upon initial recognition it is designated by the BZ WBK Group at fair value through profit and loss. As at the current balance sheet date and in previous financial year the BZ WBK Group did not hold financial instruments of this category.

Held-to-maturity investments

These are non-derivative financial assets with fixed or determinable payments and fixed maturity that the BZ WBK Group's management has the positive intention and ability to hold to maturity. If the BZ WBK Group were to sell or reclassify more than an insignificant amount of held to maturity investments before maturity, the entire category would be reclassified as available for sale and for a two year period the BZ WBK Group would not classify financial assets as held to maturity. As at the current balance sheet date and in the previous financial year BZ WBK Group did not hold this category of financial instrument.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

(a) those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition measures at fair value through profit or loss;

(b) those that the entity upon initial recognition designates as available for sale;

(c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

Loans and receivables comprise loans and advances to banks and customers including purchased receivables and investments in debt instruments provided that they are not quoted in an active market and receivables due to reverse repo transactions. Loans and receivables also include finance lease receivables of BZ WBK Leasing S.A., Santander Consumer Multirent Sp. z o.o. and PSA Finance Polska Sp. z o.o. and factoring receivables of BZ WBK Faktor Sp. z o.o.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as:

(a) loans and receivables;

(b) held-to-maturity investments;

(c) financial assets measured at fair value through profit and loss.

Other financial liabilities

Financial liabilities include financial liabilities not classified as those measured at fair value through income statement. Those liabilities are valued at amortised cost and comprise: deposits from banks, deposits from customers, liabilities due to reverse repo transactions, received credits and loans, debt securities in issue and subordinated liabilities.

Subordinated liabilities are recognised as liabilities which in the event of resolution of BZ WBK Group are repaid after satisfaction of claims of other BZ WBK creditors. Financial liabilities are classified as subordinated liabilities by the decision of the Polish Financial Supervision Authority issued at the request of BZ WBK Group.

Recognition

The BZ WBK Group recognises a financial asset or a financial liability in its statement of financial position when, and only when, it becomes a party to the contractual provisions of the instrument.

Lease receivables of BZ WBK Leasing S.A., Santander Consumer Multirent Sp. z o.o. and PSA Finance Polska Sp. z o.o. are accounted for in the statement of financial position as of the date from which the lessee is entitled to exercise its rights to use the leased asset. Other agreements where the leased assets have not yet been made available to the lessee are recognised as contingent liabilities.

A regular purchase of a financial asset is recognised in the statement of financial position as at the transaction settlement date. For assets that are carried at fair value, changes in the fair value between the trade date and the settlement date are recognised in profit or loss or in revaluation reserve. This method is applied consistently for all purchases and sales of financial assets. Loans are recognised in the statement of financial position when cash is advanced to the borrowers. At the time of signing the loan agreement, loans are recognised as contingent commitments.

Derecognition

Financial assets are derecognised from the statement of financial position when the contractual rights to the cash flows from the financial assets expire or when the BZ WBK Group transfers the contractual rights to receive the cash flows from a transaction in which substantially all risk and rewards of ownership of the financial asset are transferred.

A regular purchase or sale of a financial asset is derecognised using settlement date accounting. The method is applied consistently for all purchases and sales of financial assets.

The BZ WBK Group removes a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished — i.e. when the obligation specified in the contract is discharged, cancelled or expires.

Measurement

When a financial asset or financial liability is recognised initially, it is measured at fair value including (in the case of a financial asset or financial liability not classified at fair value through profit or loss) transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification) or based on a valuation technique whose variables include only data from observable markets.

After initial recognition, the BZ WBK Group measures financial assets, including derivatives that are assets, at their fair values, without any deduction for transaction costs it may incur on sale or other disposal, except for:

(a) loans and receivables which shall be measured at amortised cost using the effective interest rate method;

(b) held-to-maturity investments, which are measured at amortised cost using the effective interest rate;

(c) investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured.

The fair values of quoted financial instruments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities) the BZ WBK Group establishes fair value by using valuation techniques which include recent arm's length market transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Where a fair value cannot be reliably estimated, unquoted instruments that do not have a quoted market price in an active market are measured at cost and periodically reviewed for impairment.

After initial recognition, financial liabilities are measured at amortised cost using the effective interest rate method, except for:

(a) financial liabilities at fair value through profit and loss. Such liabilities, including derivatives that are liabilities, are measured at fair value;

(b) financial liabilities resulting from transferring a financial asset that is not to be derecognised.

Lease payment receivables of BZ WBK Leasing S.A., Santander Consumer Multirent Sp. z o.o. and PSA Finance Polska Sp. z o.o. are accounted for in the statement of financial position at an amount equal to the net investment in the lease. Receivables to clients are measured at amortised cost using the effective interest rate.

Financial assets and financial liabilities that are designated as hedged items are subject to measurement under hedge accounting requirements.

Gains and losses on subsequent measurement

A gain or loss arising from a change in the fair value of a financial asset or financial liability that is not part of a hedging relationship is recognised as follows:

- a gain or loss on a financial asset or financial liability classified at fair value through profit or loss is recognised in profit or loss presented in income statement in line "Net trading income and revaluation";

- a gain or loss on an available-for-sale financial asset, except for impairment losses, is recognised directly in other comprehensive income, until the financial asset is derecognised, at which time the comprehensive income previously recognised in equity is recognised in profit or loss. However, interest calculated using the effective interest rate method is recognised in profit or loss. Dividends on an available-for-sale equity instruments are recognised in profit or loss when the entity's right to receive payment is established.

Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when there is:

(a) a legally enforceable right to set off the recognised amounts;

(b) and when there is an intention either to settle on a net basis, or to realise the asset and settle the liability simultaneously,

Repurchase and reverse repurchase transactions

The BZ WBK Group also generates/invests funds by selling/purchasing financial instruments under repurchase/reverse repurchase agreements whereby the instruments must be repurchased/resold at the previously agreed price.

Securities sold subject to repurchase agreements ("repo and sell-buy-back transaction") are not derecognised from the statement of financial position at the end of the reporting period. The difference between sale and repurchase price is treated as interest cost and accrued over the life of the agreement.

Securities purchased subject to resale agreements ("reverse repo and buy-sell-back transactions") are not recognised in the statement of financial position at the end of the reporting period. The difference between purchase and resale price is treated as interest income and accrued over the life of the agreement.

Derivative financial instruments

Derivative financial instruments are initially recognised at fair value. After their initial recognition, derivatives are subsequently measured at their fair values without any deduction for transactions costs to be incurred on sale or disposal. The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received).

Certain derivatives embedded in other financial instruments shall be separated from the host contract and accounted for as a derivative if the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract and the host contract is not carried at fair value through profit or loss. Embedded derivatives are measured at fair value with changes recognised through the income statement.

The BZ WBK Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from BZ WBK Group activities. Derivatives that do not qualify for hedge accounting are accounted for as trading instruments and recognised at fair value.

Hedge accounting

Hedge accounting recognises the offsetting effects on the statement of comprehensive income of changes in the fair values of the hedging instrument and the hedged item.

At the inception of the hedge there is formal designation and documentation of the hedging relationship and the BZ WBK Group's risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction and the nature of the risk being hedged. The BZ WBK Group also documents, at inception and on ongoing basis, an assessment of the hedging instrument's effectiveness in offsetting the exposure to changes in the fair value of the hedged item.

The BZ WBK Group uses derivative financial instruments among others to hedge its exposure to interest rate risks arising from BZ WBK Group operational, financing and investment activities.

The BZ WBK Group discontinues hedge accounting when:

(a) it is determined that a derivative is not, or has ceased to be, highly effective as a hedge;

(b) the derivative expires, or is sold, terminated, or exercised;

(c) the hedged item matures or is sold, or repaid,

(d) the hedging relationship ceases.

Fair value hedge

This is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect the statement of comprehensive income.

A fair value hedge is accounted for as follows: the gain or loss from remeasuring the hedging instrument at fair value (for a derivative hedging instrument) shall be recognised in profit or loss; and the gain or loss on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedged item and be recognised in profit or loss. This applies also to the hedged item, which otherwise would be measured at amortised cost or presented as available-for-sale financial asset.

Cash flow hedge

This is a hedge of the exposure to variability in cash flows that:

- is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction; and
- could affect profits and losses.

A cash flow hedge is accounted for as follows: the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge shall be recognised directly in other comprehensive income and the ineffective portion of the gain or loss on the hedging instrument shall be recognised in income statement.

Interest income and expenses hedged and hedging instruments are recognised as net interest income.

Amounts recognised in 'Other comprehensive income' are reclassified to profit or loss during the period of time in which the hedged item affects the income statement.

If the hedging instrument expires or is sold or the hedge accounting relationship is terminated, the BZ WBK Group discontinues hedge accounting. All profits or losses on the hedging instrument pertaining to the effective hedge recognised in other comprehensive income remain an element of equity until the forecast transaction occurs, when it is recognised in income statement.

If the transaction is no longer expected to occur, the cumulative gain or loss relating to the hedging instrument recognised in other comprehensive income is reclassified to profit or loss.

Impairment of financial assets

Assets carried at amortised cost – loans and receivables

The BZ WBK Group assesses at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets are impaired. A financial asset or a group of financial assets are impaired and impairment charges are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "impairment event") and that impairment event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. It may not be possible to identify a single, event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognised. Objective evidence that a financial asset or group of assets is impaired includes observable data:

(a) significant financial difficulty of the issuer or debtor;

(b) a breach of contract, such as a default or delinquency in interest or principal payments;

(c) the BZ WBK Group, for economic or legal reasons relating to the debtor's financial difficulty, granting to the debtor a concession that the BZ WBK Group would not otherwise consider;

(d) it becoming probable that the debtor will enter bankruptcy, recovery, arrangement or other financial reorganisation;

(e) the disappearance of an active market for that financial asset because of financial difficulties; or

(f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets, including:

  (i) adverse changes in the payment status of debtors in the BZ WBK Group, or

  (ii) national or local economic conditions that correlate with defaults on the assets in the BZ WBK Group.

If there is objective evidence that an impairment charge on loans and receivables has been incurred, the amount of the impairment charges measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). If a loan or receivable has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. If a floating rate financial asset or floating rate financial liability is recognised initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or liability. The carrying amount of the asset shall be reduced through establishing an impairment charge. The amount of the impairment charge shall be recognised in profit or loss.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs in obtaining and selling the collateral.

The BZ WBK Group periodically reviews its loan portfolio to check whether there is any objective evidence that a financial asset or a group of financial assets are impaired.

With regard to impairment, the review of individual loan exposures is carried out once a quarter or more often, if needed. Impairment for the portfolio, which is assessed jointly (collective approach), is verified monthly. The BZ WBK Group carries out validation (so called "back tests") of parameters which are used to calculate impairment charges under collective approach, on the basis of historical observations, at least twice a year.

Impairment of individual loan exposures is based on the amount of prospective receivables (defined as the current value of expected cash flows discounted by the effective interest rate) using the scenario-based approach to the individually significant exposures. As part of the scenario analysis, the relationship manager selects the strategy that reflects the current recovery method. Within each strategy, consideration is given to other possible scenarios. The selected strategy affects the limitations of the value of other parameters that can be used in the model. In the individual approach, the impairment charge is determined based on the calculation of the total likelihood-weighted impairment charges estimated for all the possible recovery scenarios, depending on the recovery strategy currently employed vis-à-vis the customer.

In the scenario analysis, the key strategies / scenarios used are as follows:

- Recovery from the operating cash flows / refinancing / capital support;
- Recovery through the voluntary liquidation of collateral;
- Recovery through debt enforcement;
- Recovery through an arrangement / turnaround / bankruptcy;
- Recovery by take-over of the debt / assets / sale of receivables.

Under the collective approach, credit exposures are grouped into portfolios reflecting specific features of the client or product (property, commercial customers, SMEs, mortgages, overdrafts, cash loans, etc.). Each portfolio contains systematic pools based on similar characteristics of the credit risk, i.e.:

- Internal grade;
- Timeliness of debt service;
- Time that has elapsed from the moment of default, i.e. from identification of an indication of impairment;
- Time that has elapsed after an indication of impairment has ceased to exist;
- Time from the commencement of debt enforcement;
- Implementation of restructuring measures;
- Parameters specific to certain products (e.g. currency, distribution channel).

If the BZ WBK Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised by the BZ WBK Group are not included in a collective assessment of impairment.

For the purpose of the collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms (for example, on the basis of the BZ WBK Group's credit risk evaluation or the BZ WBK Group's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). The characteristics chosen are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

The rating systems have been internally developed and are continually being enhanced, e.g. externally benchmarked to help underpin the aforementioned factors which determine the estimates of impairment charges.

Future cash flows for a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical impairment charges experience for assets with credit risk characteristics similar to those in the group. Historical impairment charges experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical impairment charges experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows reflect and are directionally consistent with changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of impairment charges in the group and their magnitude). The BZ WBK Group reviews regularly the methodology and assumptions used for estimating future cash flows in order to reduce any differences between estimates and actual impairment charge experience.

IBNR (Incurred But Not Reported) impairment charges are also maintained to cover loans, which are impaired at the end of the reporting period and, while not separately identified, are known from experience to be present in any portfolio of loans.

IBNR impairment charges are maintained at levels that are deemed appropriate by management having considered: credit grading profiles and grading movements, historic loan impairment charges rates, changes in credit management, procedures, processes and policies, economic climates, portfolio sector profiles/industry conditions and current estimates of impairment charges in the portfolio.

Estimates of incurred but not reported losses (IBNR) take into account the following key factors:

- EP – Emergence Period i.e. time between the occurrence of event of default and its identification by the BZ WBK Group;
- PD – Probability of Default, based on historical observations together with EP is considered to be best indicator of incurred but not reported losses;
- LGD – Loss Given Default i.e. the fraction of the exposure amount that will be lost in the event of default;
- EAD – Exposure at Default;
- CCF – Credit Conversion Factor determining level to which liability to pay out cash will be realized (conversion of off-balance sheet items into on-balance sheet exposure).

These parameters are estimated based on historical experience of impairment charges on loans with a similar credit profile on account of the adopted granularity of the estimated risk parameters.

If, in a subsequent period, the amount of the impairment charge decreases and the decrease is related objectively to an event occurring after the impairment was recognised, the previously recognised impairment charge is reversed either directly or by adjusting the impairment charge. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed.

The amount of the reversal is recognised in income statement.

When a loan has been subject to a specific provision and the prospects of recovery do not improve, eventually it may be concluded that there is no real prospect of recovery. When this point is reached, the amount of the loan which is considered to be non- recoverable is written off against the related impairment charge for loan. Subsequent recoveries of amounts previously written off decrease the amount of the charge for loan impairment in the income statement.

Impairment calculation methods are standardised across the BZ WBK Group.

Available-for-sale financial assets

For financial assets classified as available-for-sale for which there is objective evidence that the asset is impaired, the cumulative impairment charge that had been recognised directly in other comprehensive income shall be removed and recognised in income statement. The amount of the cumulative impairment charge that is removed from other comprehensive income and recognised in income statement shall be the difference between the acquisition cost (net of any principal repayments and amortisation) and current fair value. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss shall be reversed, with the amount of the reversal recognised in income statement.

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment charges calculated in this way are not reversed through income statement.

Contingent liabilities

The BZ WBK Group creates provisions for impairment risk-bearing irrevocable contingent liabilities (irrevocable credit lines, financial guarantees, letters of credit, etc.). The value of the provision is determined as the difference between the estimated amount of available conditional exposure estimated using the Credit Conversion Factor (CCF) and the current value of expected future cash flows under this exposure.

Property, plant and equipment

Owned fixed assets

Property, plant and equipment are stated at cost or deemed cost less accumulated depreciation and impairment losses.

Leased assets

Leases for which the BZ WBK Group assumes substantially all the risks and rewards of ownership are classified as finance leases. The owner-occupied property acquired through finance lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses.

Subsequent expenditure

The BZ WBK Group recognises in the carrying amount of property, plant and equipment the cost of replacing part of such an asset when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the BZ WBK Group and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.

Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated economic useful lives of each part of an item of property, plant and equipment.

The estimated economic useful lives are as follows:

- buildings 22-40 years
- IT equipment 3 years
- transportation means 4 years
- other fixed assets 14 years

Depreciation rates are verified annually. On the basis of the verification outcomes, depreciation periods might be changed.

Fixed assets held for sale

On initial date of classification of non-current assets as assets held-for-sale, the BZ WBK Group measures them at the lower of carrying amount and fair value less cost to sell.

Any initial or subsequent write-down of assets held-for-sale to fair value less cost to sell is recognised in the income statement.

Goodwill and Intangible assets

Goodwill

Goodwill as of the acquisition date measured as the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities, contingent liabilities less impairment. Goodwill value is tested for impairment annually.

Licences, patents, licences and similar assets

Acquired computer software licences are recognized on the basis of the costs incurred to acquire and bring to use the specific software.

Expenditures that are directly associated with the production of identifiable and unique software products controlled by the BZ WBK Group, and that will probably generate economic benefits exceeding expenditures beyond one year, are recognised as intangible assets.

Other intangible assets

Other intangible assets that are acquired by the BZ WBK Group are stated at cost less accumulated amortisation and total impairment losses.

Expenditure on intangible assets

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated economic useful lives of intangible assets, which for the majority of intangibles equals to three years.

Amortisation rates are verified annually. On the basis of this verification, amortisation periods might be changed.

Other items of the statement of financial position

Other trade and other receivables

Trade receivables and other receivables payable within 12 months from the origination are measured at the initial recognition at par due to the immaterial effect of discounting. Trade receivables and other receivables payable within 12 months are at the balance sheet day recognised in the amount of the required payment less impairment loss.

Other liabilities

Other liabilities payable within 12 months from the initial recognition are measured at par due to the immaterial effect of discounting. Like other liabilities payable within 12 months, trade payables are recognised at the balance sheet day in the amount of the payment due.

Equity

Equity comprises capital and funds created in accordance with applicable law, acts and the Articless of Association. Equity also includes retained earnings and prior year losses carried forward.

Share capital is stated at its nominal value in accordance with the Articles of Association and the entry in the court register. Supplementary capital is created from profit allocations and share issue premiums.

Reserve capital is created from profit allocations and is earmarked for covering balance sheet losses. The result of valuation of management incentive program is included in reserve capital (IFRS 2.53).

The supplementary, reserve, general banking risk fund and share premium are presented jointly under category "Other reserve funds".

Revaluation reserve is comprised of adjustments relating to the valuation of available-for-sale financial assets and adjustments relating to the valuation of effective cash flow hedges taking into account deferred tax and actuarial gains from estimating provision for retirement. The revaluation reserve is not distributable.

Except for own equity, non-controlling interests are also recognised in BZ WBK Group capital.

On derecognition of all or part of financial assets available for sale the total effects of periodical change in the fair value reflected in the revaluation reserve are reversed. Total or part of the previous revaluation charge increases or decreases the value of the given financial asset available for sale. The effects of the fair value changes are removed from the revaluation reserve with a corresponding change in the income statement.

The net financial result for the accounting year is the profit disclosed in the income statement of the current year adjusted by the corporate income tax charge.

Custody services

Income from custody services is an element of the fee and commission income. The corresponding customer assets do not form part of the BZ WBK Group's assets and as such are not disclosed in the consolidated statement of financial position.

Capital payments (Dividends)

Own dividends for a particular year, which have been approved by the General Meeting of Shareholders but not paid at the end of the reporting period are recognised as dividend liabilities in "Other liabilities".

Employee benefits

Short-term employee benefits

The BZ WBK Group's short-term employment benefits which include wages, bonuses, holiday pay and social insurance payments are recognised as an expense as incurred.

Long-term employee benefits

The BZ WBK Group's obligation in respect of long-term employee benefits is the amount of future benefits that employees have earned in return for their service in the current and prior periods. The accrual for retirement bonus is estimated using actuarial valuation method. The valuation of those provisions is updated at least once a year.

Equity-settled share-based payment transactions

For equity-settled share-based payment transactions, the entity measures the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the BZ WBK Group cannot estimate reliable the fair value of the goods or services received, the BZ WBK Group measures their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.

Vesting conditions included in the terms of the grant are not taken into account in estimating fair value except where those terms are dependent on market conditions. Non-market vesting conditions are taken into account by adjusting the number of awards included in the measurement of the cost of employee services so that ultimately, the amount recognised in the income statement reflects the number of vested awards.

The expense related to share based payments is credited to shareholder's equity. Where the share based payment arrangements give rise to the issue of new shares, the proceeds of issue of the shares are credited to share capital (nominal amount) and share premium (if any) when awards are exercised.

Cash-settled share-based payment transactions

For cash-settled share-based payment transactions, the BZ WBK Group measures the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the BZ WBK Group remeasures the fair value of the liability at each reporting date and at the date of settlement, with any changes in fair value recognised in profit or loss for the period. The BZ WBK Group recognises the services received, and a liability to pay for those services, as the employees render the service. The liability is measured, initially and at each reporting date until settled, at the fair value of the share appreciation rights, by applying an option pricing model, taking into account the terms and conditions on which the share appreciation rights were granted, and the extent to which the employees have rendered the service to that date.

Provisions

A provision is recognised when the BZ WBK Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the amount is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Provisions for contingent liabilities such as guarantees, letters of credit, and unutilised irrevocable credit facilities are recognised in accordance with this policy.

Net interest income

Interest income from a financial asset is recognised when it is probable that the economic benefits will flow to the BZ WBK Group and the amount of income can be measured reliably.

Interest income and expenses for all financial instruments are recognised in the income statement at amortised cost using the effective interest rate method.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

When calculating the effective interest rate, the BZ WBK Group shall estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but does not consider future credit losses.

The calculation includes fees (e.g. arrangement, drawdown, renewal, restructure fees and fees for annexes which modify payments) transaction costs and all other premiums or discounts.

Costs that can be directly related to the sales of loan products are partly amortised according to the effective interest method, if there is a possibility of direct allocation to the specific loan agreement, and partly recognised in the fee income, at the moment of realisation, if there is no possibility of direct allocation to the specific loan agreement.

For the selected loan products, where linkage to the insurance product has been identified, the BZ WBK Group splits realised income into a portion recognised as interest income according to effective interest rate method and a portion recognised as fee income. The BZ WBK Group qualifies distributed insurance products as linked to loans in particular if the insurance product influences contractual provisions of a loan.

In case impairment is recognised for a financial asset, interest income is accrued based on the carrying value of the amount receivable (i.e. the value reduced by revaluation charge) using the interest rate according to which future cash flows were discounted for impairment valuation.

Net commission income

Fees and commissions settled under effective interest rate are described under section "Net interest income".

Fees on overdrafts, revolving loans, credit cards and off balance sheet liabilities are recognised on a straight-line basis in the income statement.

Other fees and charges, which are not settled according to the effective interest rate, are included in income statement in accordance with accrual method.

Net fee and commission income includes outcome from FX transactions in the branch network.

Net income on bancassurance

For the selected loan products, where linkage to the insurance product has been identified, the BZ WBK Group splits realised income into a portion recognised as interest income according to effective interest rate method and a portion recognised as fee income. The BZ WBK Group qualifies distributed insurance products as linked to loans in particular if the insurance product influences contractual provisions of a loan.

To determine which part of income is an integral part of the credit agreement recognised as interest income using the effective interest rate, the BZ WBK Group separates the fair value of the financial instrument offered and the fair value of the intermediation service of insurance product sold together with such an instrument. The portion that represents an element of the amortised cost of the financial instrument and the portion that represents remuneration for the agency services are split in proportion to the fair value of the financial instrument and the fair value of the agency service cost, respectively, relative to the sum of the two values.

The portion of income that is considered an agency fee for the sale of an insurance product linked to a loan agreement is recognised by the BZ WBK Group as fee income when the fee is charged for sales of an insurance product.

The BZ WBK Group verifies the accuracy of the assumed allocation of different types of income at least annually.

Net trading income and revaluation

Net trading income and revaluation include profits and losses resulting from changes in fair value of financial assets and liabilities classified as held for trading that are measured at fair value through profit and loss. Interest cost and income related to the debt instruments are also reflected in the net interest income.

Dividend income

Dividends are taken to the income statement at the moment of acquiring rights to them by shareholders provided that it is probable that the economic benefits will flow to the BZ WBK Group and the amount of income can be measured reliably.

Profit on disposal of subsidiaries, associates and joint ventures

Gain or loss on the sale of shares in subsidiaries is determined as the difference between the subsidiary's net asset value adjusted for unwritten-off portion of goodwill and the sale price.

Profit on the sale of interests in associates and joint ventures is the difference between their carrying amount and the sales price.

Gains on other financial instruments

Gains on other financial instruments include:

- gains and losses on disposal of equity instruments and debt instruments from the available-for-sale portfolio; and
- changes in the fair value of hedged and hedging instruments, including ineffective portion of cash flow hedges.

BZ WBK Group uses fair value hedge accounting and cash flow hedge accounting. Details are presented in Note 41 "Hedge accounting".

Other operating income and other operating costs

Other operating income and costs include operating expenses and revenues, which are not related directly to the statutory activity of the BZ WBK Group. These are primarily revenues and costs from the sale and liquidation of fixed assets, income from sale of other services, paid and received damages, penalties and fines.

Impairment losses on loans and advances

The line item "Net impairment losses on loans and advances" presents impairment losses on balance sheet and off-balance sheet exposures and the gains/losses on the sale of credit receivables.

The result on loan receivables' sale is computed at the assets' derecognition date in the difference between balance sheet amount and remuneration received.

Staff and general and administrative expenses of the bank

The "Staff expenses" line item presents the following costs:

- remuneration and social insurance (including pension benefit contributions);
- provisions for unused leaves;
- pension provisions;
- bonus provisions;
- the programme for variable components of remuneration paid to individuals holding managerial positions, a part of which is recognised as an obligation on account of share-based payment in cash, in accordance with IFRS 2 Share-Based Payment; and
- employee training and other salary and non-salary benefits for employees.

The line item "General and administrative expenses" presents the following costs:

- maintenance and lease of fixed assets;
- IT and ICT services;
- administrative activity;
- promotion and advertising;
- property protection;
- rental and operating lease;
- charges paid to the Bank Guarantee Fund, the Financial Supervision Authority, the National Depository of Securities;
- taxes and fees (property tax, payments to the National Fund for the Rehabilitation of the Disabled, municipal and administrative fees, perpetual usufruct fees);
- insurance;
- repairs not classified as fixed asset improvements.

Operating lease payments

Operating lease payments are taken to BZ WBK Group's costs in the income statement on a straight-line basis over the lease term.

Finance lease payments

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. Finance charge is allocated over lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Tax on financial institutions

Introduced by an act implemented on 1 February 2016, the tax on financial institutions is calculated on the excess of the entity's total assets over the PLN 4 billion level; in the case of banks the excess results from the statement of turnover and balances at the end of each month. Banks are permitted to reduce the tax base by e.g. the value of own funds and the value of treasury securities. In addition, banks reduce the tax base by the value of assets purchased from the National Bank of Poland held as collateral for a refinancing credit facility granted by the latter. The tax rate for all taxpayers is 0.0366% per month, and the tax is paid monthly by the 25th day of the month following the month it relates to.

BZ WBK Group reports the tax charge under "Tax on financial institutions", separately from the income tax charge.

Corporate income tax

Corporate income tax comprises current and deferred tax. Income tax is recognised in income statement except to the extent that it relates to items recognised in other comprehensive income.

Current tax is the tax payable on the taxable income for the year using tax rates enacted or substantively enacted at the end of the reporting period and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities are provided, using the balance sheet method, on temporary differences between the tax bases of assets and liabilities and their values arising from the statement of financial position. Deferred income tax is determined using tax rates based on legislation enacted or substantively enacted at the end of the reporting period and expected to apply when the deferred tax asset is realised or the deferred tax liability is settled. Deferred tax assets are recognised at realizable amount – it is to the extent that is probable that the BZ WBK Group generates taxable profit allowing partial or wholly realisation of deferred tax assets. The carrying value of deferred tax assets is verified at the end of each reporting period. The BZ WBK Group reduces the carrying amount of the deferred tax asset to the realizable value – that is, to the extent that it is probable that taxable income will be sufficient to partially or fully realize the deferred tax asset.

Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

3. Operating Segments reporting

The presentation of information about the business segments of Bank Zachodni WBK Group is based on the management information model which is used for preparing reports for the Management Board, which are used to assess performance and allocate resources. The operational activity of Bank Zachodni WBK Group has been divided into five segments: Retail Banking, Business & Corporate Banking, Global Corporate Banking, ALM (Assets and Liabilities Management) and the Centre, and Santander Consumer. They were identified based on customers and product types.

Profit before tax is a key measure which the Management Board of Bank Zachodni WBK Group uses to assess performance of business segments activity.

Income and costs assigned to a given segment are generated on the sale of products and provision of services in the segment, according to description presented below. Such income and costs are recognized in the profit and loss account for the Group and may be assigned to a given segment either directly or based on reasonable assumptions.

Interest and similar income split by business segments is assessed by the Management Board of Bank Zachodni WBK Group on the net basis including costs of internal transfer funds and without a distinction into interests income and costs.

Settlements among business segments relate to rewarding for delivered services and include:

- sale to and/or service of customers assigned to a given segment, via sale/service channels operated by another segment;
- sharing income and costs on transactions in cases where a transaction is processed for a customer assigned to a different segment;
- sharing of income and cost of delivery of common projects.

Income and cost allocations are regulated by agreements between segments, which are based on single rates for specific services or breakdown of total income and/or cost.

Assets and liabilities of a given segment are used for the operational activity and may be assigned to the segment directly or on a reasonable basis.

Bank Zachodni WBK Group focuses its operating activity on the domestic market.

In 2017 the following changes were introduced:

- customer resegmentation between business segments; Once a year, BZ WBK Group carries out the resegmentation / migration of customers between operating segments which results from the fact that customer meet the criteria of assignment for different operating segment than before. This change is intended to provide services at the highest level of quality and tailored to individual needs or the scale of customer operations;
- transfer of the largest corporate clients from the Business and Corporate Banking segment to the Global Corporate Banking Segment;
- transfer of results and volumes of subsidiary BZ WBK Inwestycje Sp. z.o.o from the Global Corporate Banking segment to ALM and Central Operations segment;
- change the methodology of Bank Guarantee Fund costs split by operating segments.

Comparable data have been adjusted accordingly.

The principles of income and cost identification, as well as assets and liabilities for segmental reporting purposes are consistent with the accounting policy applied in Bank Zachodni WBK Group.

The total result achieved by Bank Zachodni WBK SA from the transaction of acquisition of Visa Europe Limited by Visa Inc. in 2016 (described in note 10) is presented in ALM and Center Segment, whereas the result of the above described transaction for Santander Consumer Bank is the presented in Santander Consumer Segment.

Retail Banking

Retail Banking generates income from the sale of products and services to personal customers and small and medium companies. In the offer for customers of this segment there is a wide range of savings products, consumer and mortgage loans, credit and debit cards, insurance and investment products, clearing services, brokerage house services, GSM phone top-ups, international and Western Union payments and private-banking services. For small and medium companies, the segment provides, among others, lending and deposit taking services, cash management services, leasing, factoring, letters of credit and guarantees. Furthermore, the Retail Banking segment generates income through offering asset management services within investment funds and private portfolios. It also covers insourcing services provided to retail customers based on mutual agreements with other banks and financial institutions.

Business & Corporate Banking

Business & Corporate Banking segment covers products and activities targeted at business entities, local governments and the public sector. In addition to banking services covering lending and deposit activities, the segment provides services in the areas of cash management, leasing, factoring, trade financing and guarantees.

Global Corporate Banking

In the Global Corporate Banking segment, the Group derives income from the sale of products and services to the largest international and local corporations, including:

- transactional banking with such products as cash management, deposits, leasing, factoring, letters of credit, guarantees, bilateral lending and trade finance;
- lending, including project finance, syndicated facilities and bond issues;
- FX and interest rate risk management products provided to all the bank's customers (segment allocates revenues from this activity to other segments, the allocation level may be subject to changes in consecutive years);
- underwriting and financing of securities issues, financial advice and brokerage services for financial institutions .

Through its presence in the wholesale market, Global Corporate Banking also generates revenues from interest rate and FX risk positioning activity.

ALM and Centre

The segment covers central operations such as financing of other Group's segments, including liquidity, interest rate risk and FX risk management. It also includes managing the bank's strategic investments and transactions generating income and/or costs that cannot be directly or reasonably assigned to a given segment.

Santander Consumer

The Santander Consumer business segment includes activities of the Santander Consumer Group, which has been incorporated into the BZ WBK Group since 01.07.2014.

Activities of this segment focus on selling products and services addressed to both individual and business customers. This segment focuses mainly on loan products, i.e. car loans, credit cards, cash loans, installment loans and lease products. In addition, the Santander Consumer segment includes term deposits and insurance products (mainly related to loan products).

The transaction concerning the takeover of control by Santander Consumer Bank over the companies: PSA Finance Polska Sp. z o.o. and indirectly PSA Consumer Finance Polska Sp. z o.o on 1.10.2016 as well as the transaction regarding the redemption of shares of PSA Finance Polska Sp. z o.o. concluded on 05.04.2017 were both presented in the Santander Consumer business segment.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Consolidated income statement (by business segments)

01.01.2017–31.12.2017	Retail Banking Segment*	Business and Corporate Banking Segment	Global Corporate Banking Segment	ALM and Centre Segment	Santander Consumer Segment	Total
Net interest income	2 495 841	519 490	205 591	703 821	1 352 154	5 276 897
incl. internal transactions	(110 472)	(52 758)	1 167	161 533	530	–
Net fee and commission income	1 392 788	265 186	229 255	(2 504)	128 401	2 013 126
incl. internal transactions	96 172	44 897	(153 620)	14 550	(1 999)	–
Other income	74 153	70 304	86 560	99 116	66 687	396 820
incl. internal transactions	9 717	41 218	(46 929)	(45 447)	41 441	–
Dividend income	–	–	546	76 249	21	76 816
Operating costs	(1 916 292)	(285 103)	(217 611)	(88 933)	(545 542)	(3 053 481)
incl. internal transactions	(8 468)	(1 548)	(7)	14 022	(3 999)	–
Depreciation/amortisation	(199 422)	(21 917)	(16 680)	(45 617)	(35 297)	(318 933)
Impairment losses on loans and advances	(469 571)	(94 839)	(10 669)	(4 577)	(110 817)	(690 473)
Share in net profits (loss) of entities accounted for by the equity method	–	–	–	58 264	–	58 264
Tax on financial institutions	–	–	–	(387 988)	(35 827)	(423 815)
Profit before tax	1 377 497	453 121	276 992	407 831	819 780	3 335 221
Corporate income tax						(816 707)
Consolidated profit for the period						**2 518 514**

** Includes individual customers and small & micro companies.*

Consolidated statement of financial position (by business segment)

31.12.2017	Retail Banking Segment*	Business and Corporate Banking Segment	Global Corporate Banking Segment	ALM and Centre Segment	Santander Consumer Segment	Total
Loans and advances to customers	57 188 615	24 070 378	11 777 530	253 168	14 550 206	107 839 897
Investments in associates	–	–	–	889 372	–	889 372
Other assets	5 741 357	1 016 202	3 838 044	29 451 874	3 897 698	43 945 175
Total assets	62 929 972	25 086 580	15 615 574	30 594 414	18 447 904	152 674 444
Deposits from customers	73 092 023	17 691 913	8 087 291	4 454 998	8 154 910	111 481 135
Other liabilities and equity	4 958 454	3 065 934	5 348 294	17 527 633	10 292 994	41 193 309
Total equity and liabilities	**78 050 477**	**20 757 847**	**13 435 585**	**21 982 631**	**18 447 904**	**152 674 444**

**Includes individual customers and small & micro companies.*

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Consolidated income statement (by business segments)

01.01.2016–31.12.2016	Retail Banking Segment*	Business and Corporate Banking Segment	Global Corporate Banking Segment	ALM and Centre Segment	Santander Consumer Segment	Total
Net interest income	2 246 151	563 216	184 569	620 009	1 156 427	4 770 372
incl. internal transactions	(94 824)	(41 943)	227	133 417	3 123	–
Net fee and commission income	1 332 229	209 167	203 125	(6 804)	177 004	1 914 721
incl. internal transactions	90 149	33 991	(133 145)	10 781	(1 775)	1
Other income	68 930	90 043	138 046	495 583	31 856	824 458
incl. internal transactions	20 290	48 211	(54 270)	(18 330)	4 099	–
Dividend income	–	–	531	96 041	10	96 582
Operating costs	(1 935 000)	(300 735)	(195 019)	(155 490)	(504 257)	(3 090 501)
incl. internal transactions	(19 633)	(1 858)	(6)	24 044	(2 547)	–
Depreciation/amortisation	(172 112)	(20 174)	(20 318)	(30 090)	(34 526)	(277 220)
Impairment losses on loans and advances	(451 911)	(154 609)	4 874	(1 690)	(181 254)	(784 590)
Share in net profits (loss) of entities accounted for by the equity method	–	–	–	55 439	–	55 439
Tax on financial institutions	–	–	–	(356 078)	(31 128)	(387 206)
Profit before tax	1 088 287	386 908	315 808	716 920	614 131	3 122 054
Corporate income tax						(737 962)
Consolidated profit for the period						**2 384 092**

**Includes individual customers and small & micro companies.*

Consolidated statement of financial position (by business segment)

31.12.2016	Retail Banking Segment*	Business and Corporate Banking Segment	Global Corporate Banking Segment	ALM and Centre Segment	Santander Consumer Segment	Total
Loans and advances to customers	54 619 128	23 814 352	10 472 147	130 645	14 032 266	103 068 538
Investments in associates	–	–	–	871 491	–	871 491
Other assets	5 978 453	1 225 562	3 678 704	31 209 593	4 067 375	46 159 687
Total assets	60 597 581	25 039 914	14 150 851	32 211 729	18 099 641	150 099 716
Deposits from customers	70 895 234	19 119 628	9 405 610	4 874 584	8 227 401	112 522 457
Other liabilities and equity	4 724 836	3 013 479	3 484 623	16 482 081	9 872 240	37 577 259
Total equity and liabilities	**75 620 070**	**22 133 107**	**12 890 233**	**21 356 665**	**18 099 641**	**150 099 716**

**Includes individual customers and small & micro companies.*

4. Risk management

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

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

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

Supervisory Board continuously oversees the risk management system. The Supervisory Board approves the strategy, key risk management policies, the acceptable risk level and monitors the utilisation of the internal limits in relation to the current business strategy and macroeconomic environment. It conducts the reviews of the key risk areas, the identification of threats and the process of defining and monitoring of remedial actions. The Supervisory Board assesses if the Management Board control activities are effective and aligned with the Supervisory Board policy, including the assessment of the risk management system.

Audit and Compliance Committee supports the Supervisory Board in its supervisory activities. The Committee annually reviews the internal controls in financial reporting, accepts the reports on independent internal audit unit and compliance units. The Committee receives the regular quarterly reports on the status of the implementation of audit recommendations as the basis of the assessment of the quality of management actions. The Audit Committee assesses the efficiency of the internal control system and the risk management system. In addition, the Committee also monitors financial audit activities, particularly the reviews carried out by the audit firm, checks and monitors independence of the statutory auditor, informs the Supervisory Board of the audit results and evaluates the independence of the statutory auditor and the audit firm. Furthermore, the Committee is responsible for developing an auditor selection policy and procedure, and recommending to the Supervisory Board appointment, reappointment and removal of the external auditor, and the external auditor's fees.

Risk Committee supports the Supervisory Board in assessment of the effectiveness of the internal control system and risk management system and the resources, which were accepted and planned in order to provide the efficient management of the material risks of the Group.

In addition, the Supervisory Board is also supported by the **Remuneration Committee** and the **Nomination Committee**, however outside the risk management area.

Management Board is responsible for the effectiveness of the risk management. In particular, the Management Board introduces the organisational structure aligned with the level and profile of the risk being undertaken, split of the responsibilities providing the separation of the risk measurement and control function from the operational activity, is responsible for implementation and updating of the written risk management strategies, and transparency of the activities. The Management Board reviews the financial results of the Group. The Management Board established a number of committees directly responsible for the development of the risk management methodology and monitoring of risks in particular areas.

The Management Board fulfils its risk management role through the following three committees: Risk Management Committee, Risk Management Sub-Committee and Risk Control Committee.

Risk Management Committee, which is an executive committee responsible for developing a risk management strategy across the Group, including the identification of material risk types, setting the risk appetite and defining the methods of risk measurement, control, monitoring and reporting. **Risk Management Sub-Committee** constitutes part of the Risk Management Committee which approves the key decisions taken by the lower-level risk committees (above established limits).

Risk Control Committee set up to monitor the risk level across different areas of the bank's operations and supervise the activities of lower-level risk management committees set up by the Management Board. Those Committees, acting within the remits defined by the Board, are directly responsible for developing risk management methods and for on-going monitoring of risk levels.

The Risk Control Committee oversees the following risk committees:

Risk Management Forum, a body authorised to approve and supervise the risk measurement policy and methodology and to monitor the credit risk, market risk in the banking book, market risk in the trading book, structural balance sheet risk and liquidity risk. The Forum operates through 4 panels:

- **Credit Risk Panel;**
- **Market Risk Panel;**
- **Models and Methodology Panel;**
- **Equity Investment and Underwriting Panel.**

Credit Committee takes credit decisions in accordance with the applicable credit discretion levels.

Provisions Committee decides on the amount of impairment losses, both in individual and portfolio approach to credit exposures, as well as for other financial instruments and assets and the legal provisions. The Committee formulates the methodology, reviews and verifies the adequacy of the parameters used for the calculation of impairment on a portfolio and individual level for BZ WBK Group, excluding Santander Consumer Bank.

Information Management Committee is responsible for the quality and organisation of data related to risk management and other areas of the bank's operations.

Cyber Risk Committee, a forum for direct cooperation and communication among all organisational units involved in the processes related to cyber security, to ensure effective supervision of the cyber security strategy.

Operational Risk Management Committee (ORMCo) sets the strategic activities within the operational risk management in BZ WBK Group, including business continuity management, information security and fraud prevention.

Assets and Liabilities Committee (ALCO) supervises the activity on the banking book, manages liquidity interest rate risk in the banking book. It is responsible for the funding and balance sheet management, including for the pricing policy.

Capital Committee is responsible for capital management, in particular the ICAAP process.

Disclosures Committee verifies the Group's financial information in terms of its compliance with legal and regulatory requirements.

Deposit Working Group has a responsibility for ensuring a balanced growth of the savings and investment products portfolio.

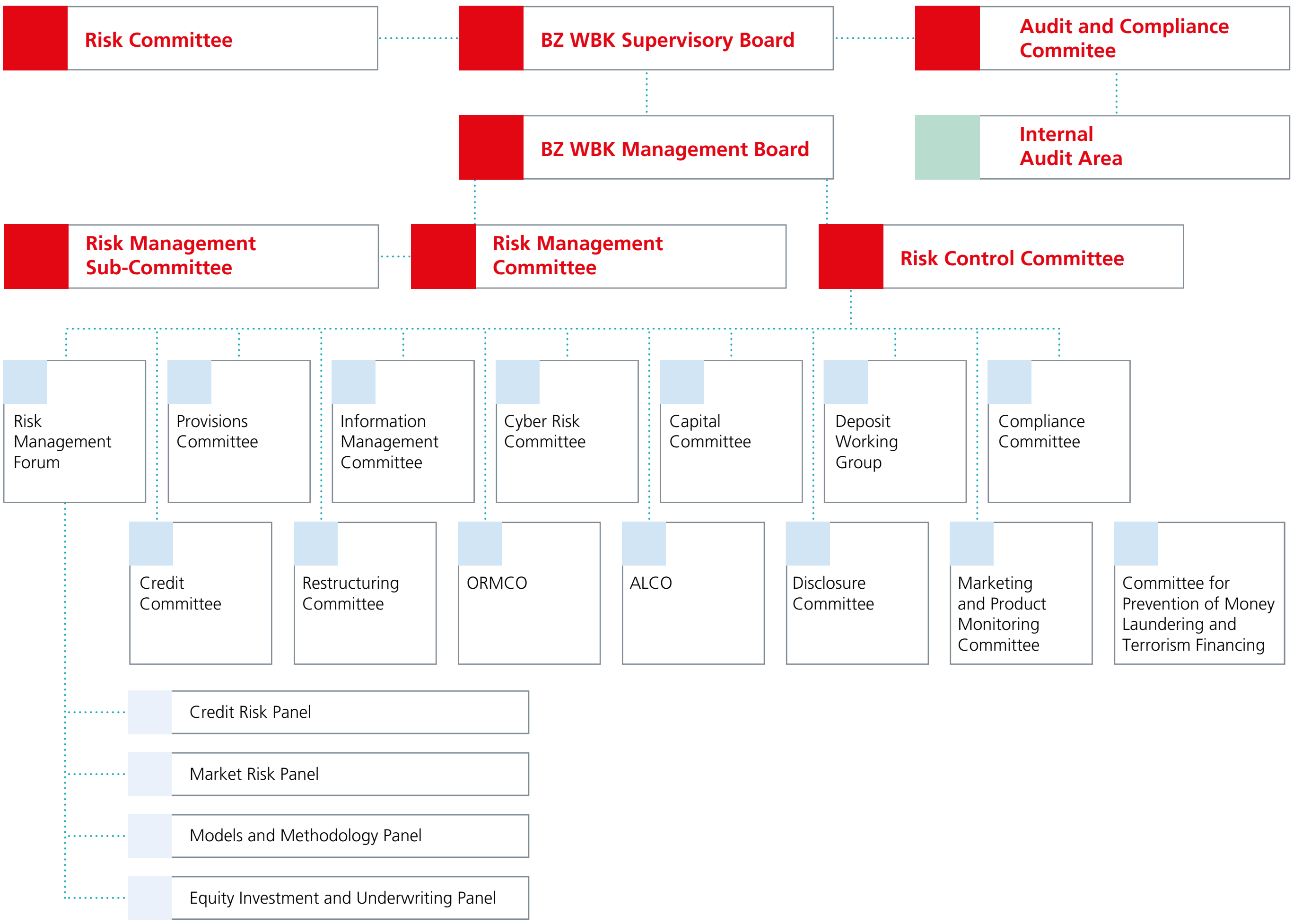
Product Marketing and Monitoring Committee approves new products and services to be implemented in the market, taking into account the reputation risk analysis.

Compliance Committee is responsible for setting standards with respect to the management of compliance risk and the codes of conducts adopted by the Group.

Anti-Money Laundering and Terrorism Financing Committee approves the Group's policy on prevention of money laundering and the financing of terrorism. It approves and monitors the bank's activities in this area.

Restructuring Committee takes decisions as to the relationship management strategy for borrowers in distress as well as the cancellation and sale of loan receivables under the lending discretions.

THE FIGURE BELOW PRESENTS THE CORPORATE GOVERNANCE STRUCTURE IN RELATION TO THE RISK GOVERNANCE PROCESS.



Risk management is consistent with the risk profile resulting from the agreed general risk appetite approved by the Risk Management Committee.

The risk appetite is expressed as quantitative limits and captured in the "Risk Appetite Statement" approved by the Management Board and the Supervisory Board. With global limits in place, watch limits are set and risk management policies are drafted.

BZ WBK Group is exposed to a variety of risks impacting the strategic goals. The Group continuously analyses the risks, identifies their sources, creates the relevant risk management mechanisms including among others the measurement, control, mitigation and reporting. The following risks are of key significance for BZ WBK Group:

- credit risk,
- concentration risk,
- market risk in the banking and trading book,
- liquidity risk,
- operational risk,
- compliance risk.

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

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

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

Credit risk

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

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

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

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

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

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

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

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

Risk Management Forum

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

Risk Management Division

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

Credit Policies

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

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

Credit Decision Making Process

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

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

Credit Grading

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

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

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

Credit Reviews

The Group performs regular reviews to determine the actual quality of the credit portfolio, confirm that adequate credit grading and provisioning processes are in place, verify compliance with the procedures and credit decisions and to objectively assess professionalism in credit management. The reviews are performed by the two specialised units: Credit Review Department and the Control & Quality Assessment Department, which are independent of the risk-taking units.

Collateral

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

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

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

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

Retail customers

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

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Business customers

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

Collateral management process

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

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

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

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

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

Financial effect of the collateral

The financial effect of the accepted collateral was calculated as a change in the credit loss allowance as a result of exclusion of the cash flow from collateral (non-performing exposures are assessed on an case-by-case basis). For other portfolios (mortgage, SME and corporate loans), this effect was calculated by adjusting the LGD parameter to the level observed for particular clients on unsecured products.

THE TABLE BELOW PRESENTS THE FINANCIAL EFFECT OF COLLATERALS OF BANK ZACHODNI WBK AS AT 31.12.2017:

Financial effect of collaterals	Gross Amount	Financial effect of collateral
Loans and advances to customers		
Housing loans	33 723 865	(175 822)
Business loans	49 011 673	(560 443)
Total balance sheet	**93 569 128**	**(736 265)**
Total off–balance sheet	**24 642 271**	**(8 634)**

Credit risk stress testing

Stress testing is one of the components of the credit risk management process aimed at assessing how the BZ WBK Group might be affected by specific changes in its environment, changes in financial and macroeconomic indicators or in the risk profile. The analysis also covers the potential credit quality changes in the wake of adverse developments. Moreover, the process provides management information about the adequacy of the agreed limits and internal capital allocation.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Calculation of Impairment

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

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

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

The tables below present BZ WBK Group's maximum exposure to credit risk, for presentation purposes grouped by classes, defined by provisions cover.

31.12.2017	Provision cover/ number of days	Loans and advances to customers			
		individuals	housing loans	business loans	Total
Individually impaired portfolio					
Gross amount		–	–	2 378 258	2 378 258
Impairment		–	–	(1 225 187)	(1 225 187)
Net amount		–	–	1 153 071	1 153 071
					–
Collectively impaired					–
Gross amount		1 819 031	998 123	1 312 162	4 129 316
Impairment		(1 327 612)	(659 864)	(894 931)	(2 882 407)
Net amount		491 419	338 259	417 231	1 246 909
					–
IBNR portfolio– non–past due					–
	up to 0.10%	1 459 972	29 515 446	31 767 897	62 743 315
	0.10% – 0.30%	2 626 977	1 325 621	11 194 309	15 146 907
	0.30% – 0.65%	5 405 252	2 968 339	2 211 931	10 585 522
	over 0.65%	7 873 202	926 174	4 878 661	13 678 037
					–
IBNR portfolio– past due					–
	1–30 days	1 066 555	1 206 932	953 539	3 227 026
	31–60 days	176 603	246 121	104 475	527 199
	61–90 days	96 748	106 335	38 985	242 068
	> 90 days	4 778	205	13 916	18 900
Gross amount–IBNR portfolio					106 168 974
Impairment					(738 536)
Net amount					105 430 438
					–
Gross amount –total		20 529 118	37 293 296	54 854 134	112 676 548
					(4 846 130)
Other receivables*					9 479
Total net amount					107 839 897

**other receivables are unrated, non-past due and unimpaired*

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

31.12.2016	Provision cover/ liczba dni przeterminowania	Loans and advances to customers			
		individuals	housing loans	business loans	Total
Individually impaired portfolio					
Gross amount		–	–	2 641 177	2 641 177
Impairment		–	–	(1 265 943)	(1 265 943)
Net amount		–	–	1 375 234	1 375 234
		–			–
Collectively impaired		–			–
Gross amount		1 823 020	1 006 226	1 631 203	4 460 449
Impairment		(1 503 362)	(639 969)	(778 524)	(2 921 855)
Net amount		319 658	366 257	852 679	1 538 594
		–			
IBNR portfolio– non–past due		–			
	do 0.10%	1 184 224	24 478 265	29 280 750	54 943 240
	0.10% – 0.30%	1 863 857	5 319 953	9 004 336	16 188 146
	0.30% – 0.65%	5 361 682	2 614 911	2 392 816	10 369 409
	powyżej 0.65%	7 488 185	1 869 021	3 677 435	13 034 641
IBNR portfolio– past due					
	1–30 dni	1 306 480	1 286 045	2 512 350	5 104 875
	31–60 dni	164 618	302 606	242 749	709 972
	61–90 dni	86 472	131 316	84 039	301 827
	> 90 dni	4 485	38	7 347	11 870
Gross amount–IBNR portfolio					100 663 980
IBNR					(691 083)
Net amount					99 972 897
Gross amount –total		19 283 024	37 008 380	51 474 202	107 765 606
					(4 878 881)
Other receivables*					181 813
Total net amount					**103 068 538**

**other receivables are unrated, non-past due and unimpaired*

Loans and advances to banks are assessed using ratings. The assessment method was set out in the Group's internal regulations. Each institutional client (exposure) is assigned a rating by one of the reputable rating agencies (Fitch, Moody's, S&P), in accordance with the CRR. Then, a relevant grade is allocated to the client. Grade 1 is equivalent to 20% risk weight.

Loans and advances to banks	31.12.2017	31.12.2016
Credit quality grade:		
1	518 202	410 952
2	1 401 747	2 736 116
3	160 710	322 262
4	3 709	26 677
5	1 241	601
6	–	–
none	50 865	16 670
Total	**2 136 474**	**3 513 278**

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Financial instruments from the available-for-sale and held-for-trading portfolio are assessed in accordance with the sovereign rating (treasury bonds, securities issued by the National Bank of Poland [NBP], Bank Gospodarstwa Krajowego [BGK], available-for-sale and held-for trading instruments). The sovereign rating is the same as the NBP/BGK rating. All have the same rating as Poland, according to Fitch it is A-. There are no overdue or impaired instruments in these categories.

'Other assets' include items without an assigned rating, the significant majority of them are non-past due and unimpaired.

Credit risk concentration

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

As at 31.12.2017, pursuant to art. 71 of the Banking Law Act, the maximum limits for the Group amounted to:

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

As at 31.12.2016, pursuant to art. 71 of the Banking Law Act, the maximum limits for the Group amounted to:

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

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

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

A list of the 20 largest borrowers (or groups of related borrowers) of Bank Zachodni WBK Group (performing loans) as at 31.12.2017 (including exposures of individual customers towards subsidiaries of BZ WBK).

Industry code (PKD)	Industry description	Total credit exposure	Balance sheet exposure incl. towards subsidiaries	Committed credit lines, guarantees, treasury limits and capital investments
61	TELECOMMUNICATION	1 739 072	1 654 095	84 977
47	RETAIL	1 007 000	749 928	257 072
07	MINING	988 025	187 406	800 619
61	TELECOMMUNICATION	952 545	691 708	260 837
35	POWER INDUSTRY	878 972	458 972	420 000
70	CONSULTING	831 420	648 989	182 431
06	MINING	825 213	214 052	611 161
35	POWER INDUSTRY	792 000	153 100	638 900
68	REAL ESTATE SERVICES	652 521	561 091	91 430
68	REAL ESTATE SERVICES	652 284	630 178	22 106
35	POWER INDUSTRY	619 853	329 853	290 000
41	CONSTRUCTION	616 378	537 965	78 413
19	REFINERY	568 390	0	568 390
41	CONSTRUCTION	541 219	1 233	539 986
20	CHEMICAL INDUSTRY	513 959	446 857	67 102
70	CONSULTING	454 351	277 400	176 951
47	RETAIL	400 000	187 896	212 104
35	POWER INDUSTRY	398 116	398 116	–
68	REAL ESTATE SERVICES	373 264	353 953	19 311
35	POWER INDUSTRY	361 922	300 436	61 486
Total gross exposure		**14 166 504**	**8 783 228**	**5 383 276**

A list of the 20 largest borrowers (or groups of related borrowers) of Bank Zachodni WBK Group (performing loans) as at 31.12.2016 (including exposures of individual customers towards subsidiaries of BZ WBK).

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Industry code (PKD)	Industry description	Total credit exposure	Balance sheet exposure incl. towards subsidiaries	Committed credit lines, guarantees, treasury limits and capital investments
61	TELECOMMUNICATION	1 857 349	1 612 419	244 930
06	MINING	1 180 593	15 047	1 165 546
07	MINING	1 173 796	228 506	945 290
47	RETAIL	1 074 502	670 571	403 931
35	POWER INDUSTRY	878 974	295 974	583 000
68	REAL ESTATE SERVICES	792 496	646 988	145 508
35	POWER INDUSTRY	791 261	253 597	537 664
19	REFINERY	681 806	–	681 806
41	CONSTRUCTION	657 954	591 470	66 484
35	POWER INDUSTRY	564 615	405 657	158 958
68	REAL ESTATE SERVICES	555 243	342 772	212 471
35	POWER INDUSTRY	545 830	329 830	216 000
20	CHEMICAL INDUSTRY	537 789	462 701	75 088
41	CONSTRUCTION	494 001	1	494 000
19	REFINERY	427 430	163 560	263 870
68	REAL ESTATE SERVICES	414 811	394 328	20 483
86	HEALTHCARE	398 521	327 066	71 455
68	REAL ESTATE SERVICES	392 753	392 753	–
61	TELECOMMUNICATION	387 002	2	387 000
70	CONSULTING	384 922	156 757	228 165
	Total gross exposure	**14 191 648**	**7 289 999**	**6 901 649**

Industry concentration

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

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

PKD GROUPS BY INDUSTRIES:

	Industry	Gross exposure	
		31.12.2017	31.12.2016
	Distribution	14 535 418	12 834 912
	Manufacturing	11 234 366	10 892 968
	Property	7 958 554	8 724 541
	Energy	3 602 532	2 868 057
	Transportation	3 472 978	3 055 197
	Agriculture	2 528 768	2 133 411
	Financial sector	1 449 395	966 677
	Construction	1 509 824	1 411 827
	Other industries	8 562 299	8 282 577
A	Total Business Loans	54 854 134	51 170 167
B	Retail (including mortgage loans)	57 822 414	56 595 439
A+B	BZ WBK Group portfolio	112 676 548	107 765 606
C	Other receivables (commercial bonds)	9 479	181 813
A+B+C	**Total BZ WBK Group**	**112 686 027**	**107 947 419**

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Forbearance Policy

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

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

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

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

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

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

			31.12.2017	31.12.2016
Loans and advances to customers– gross amount				
under forbearance measure:			**3 460 838**	**4 041 684**
corporate exposures			1 972 878	2 575 162
mortgage exposures			1 227 239	1 260 580
individual exposures			260 721	205 942
Allowance for impairment – forbearance clients			**(847 582)**	**(954 595)**
			–	–
	of which:	individually impaired	(413 613)	(503 469)
			–	–
Loans and advances to forbearance clients– net amount			**2 613 256**	**3 087 089**

ANALYSIS OF THE CREDIT QUALITY OF FINANCIAL ASSETS SUBJECT TO FORBEARANCE:

Loans and advances to customers under forebearance	Gross exposure		Collateral value		Allowance for impairment	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016	31.12.2017	31.12.2016
Loans and advances –impaired	**1 774 300**	**2 099 884**	**9 354 162**	**6 985 767**	**(793 791)**	**(875 886)**
Loans and advances –unimpaired	**1 686 538**	**1 941 800**	**3 079 351**	**5 378 460**	**(53 791)**	**(78 709)**
non–overdue	1 316 773	1 190 359	2 488 941	2 868 868	(32 470)	(43 336)
from 1 to 30 days overdue	254 422	609 743	421 737	2 260 936	(13 531)	(22 813)
from 31 to 60 days overdue	76 150	92 091	113 030	115 416	(3 916)	(6 242)
from 61 to 90 days overdue	39 193	49 607	55 643	133 240	(3 874)	(6 318)
Total gross amount	**3 460 838**	**4 041 684**	**12 433 513**	**12 364 227**	**(847 582)**	**(954 595)**

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Interest income on assets subject to forbearance was PLN 82,418k as at 31 December 2017 and PLN 108,775k as at 31 December 2016.

Loans and advances to customers under forbearance by geographical region (gross amount)	31.12.2017	31.12.2016
Dolnośląskie	357 370	344 929
Kujawsko–Pomorskie	67 175	70 613
Lubelskie	50 461	48 282
Lubuskie	61 876	62 642
Mazowieckie	1 376 072	1 937 784
Małopolskie	222 240	122 639
Opolskie	30 244	28 061
Podkarpackie	34 630	35 734
Podlaskie	38 677	34 491
Pomorskie	180 989	191 445
Warmińsko–Mazurskie	41 277	39 366
Wielkopolskie	187 622	188 845
Zachodniopomorskie	76 702	75 893
Śląskie	574 185	570 193
Świętokrzyskie	76 776	195 961
Łódzkie	84 542	94 806
Total	**3 460 838**	**4 041 684**

Loans and advances to customers under forbearance by industry (gross amount)	31.12.2017	31.12.2016
Construction	224 891	274 516
Distribution	82 793	74 408
Energy	398 913	399 368
Financial sector	557	341
Other industries	192 709	196 909
Property	799 621	1 360 369
Manufacturing	169 215	227 267
Agriculture	69 065	8 410
Transportation	35 114	33 574
Individuals	1 487 960	1 466 522
Total	**3 460 838**	**4 041 684**

	31.12.2017	31.12.2016
Net carrying amount at the beginning of the period	3 087 089	2 984 876
Allowance for impairment	107 013	409 088
Loans and advances derecognised during the period	(144 515)	(758 110)
Loans and advances recognised during the period	1 174 068	1 305 291
Other changes/repayments	(1 610 399)	(854 056)
Net carrying amount at the end of the period	**2 613 256**	**3 087 089**

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Mortgage loans – currency analysis

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

The table below presents the PLN equivalent of the mortgage loan-book value of Bank Zachodni WBK Group as at 31 December 2017 and 31 December 2016:

Gross mortgage loans by currency		31.12.2017	31.12.2016
CHF denominated mortgage loans, of which:		10 771 859	13 458 166
	Bank Zachodni WBK	8 425 648	10 507 854
	Santander Consumer Bank	2 346 211	2 950 312
Mortgage loans denominated in other currencies, of which:		26 521 437	23 550 214
	in PLN	24 560 622	21 287 359
Total		**37 293 296**	**37 008 380**

Risk profile of CHF-indexed/denominated loans

CHF gross mortgage loans as at 31.12.2017	Gross amount	Impairment losses	Coverage ratio
Performing loans	10 595 020	51 774	0.49%
Non–performing loans	176 839	77 549	43.85%
Total	**10 771 859**	**129 323**	

CHF gross mortgage loans as at 31.12.2016	Gross amount	Impairment losses	Coverage ratio
Performing loans	13 273 975	84 051	0.63%
Non–performing loans	184 191	87 338	47.42%
Total	**13 458 166**	**171 389**	

Market risk

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

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

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

General principles of market risk management

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

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

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

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

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

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

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

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

Assessment methods

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

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

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

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

Interest rate risk in the banking book

The interest rate risk in the banking book is the risk of adverse impact of interest rate changes on the Group's income and the value of its assets and liabilities. The main source of interest rate risk are transactions entered in the bank's branches and in the business and corporate centres, as well as the transactions made in the money market by the Financial Management Division. Additionally, interest rate risk can be generated by transactions concluded by other units, e.g. through acquisition of municipal/commercial bonds, or the bank's borrowings from the interbank market. However, all positions that generate a repricing risk are transferred for management to the Financial Management Division, responsible for shaping the balance sheet structure of the Bank by entering into transactions in the interbank markets so as to manage the overall interest rate risk profile according to the approved risk strategy and in compliance with the allocated risk limits.

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

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

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

The sensitivity measures for 2017 and 2016 are presented in the table below. It presents the results of scenarios, in which the impact of changes in interest rates on interest income and the economic value of capital would be negative.

	NII Sensitivity		MVE Sensitivity	
1 day holding period	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**
Maximum	238	218	377	250
Average	211	184	267	198
as at the end of the period	238	218	347	218
Limit	**310**	**280**	**380**	**340**

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

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Interest rate risk in the trading book

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

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

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

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

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

The table below shows risk measures at the end of 2017 and 2016 for 1-day position holding period.

Interest rate risk	VAR	
1 day holding period	**31.12.2017**	**31.12.2016**
Average	1 559	1 706
Maximum	4 777	3 681
Minimum	373	659
as at the end of the period	839	1 509
Limit	**6 266**	**7 523**

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

FX risk

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

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

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

The table below illustrates the risk measures at the end of December 2017 and 2016.

FX risk	VAR	
1 day holding period	**31.12.2017**	**31.12.2016**
Average	414	393
Maximum	1 725	3 096
Minimum	50	30
as at the end of the period	175	319
LIMIT	**2 611**	**3 134**

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

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

FX Balance Sheet

In 2017, the share of assets in foreign currencies in the bank's balance sheet decreased further compared to the level observed in previous periods. A slight decrease fall in amounts receivable in EUR and in amounts receivable in CHF were observed as a result of continued amortisation of mortgage loans. A decrease in amounts due from customers in EUR and a decrease in amounts due from customers in CHF were observed as a result of the continuing amortisation of the mortgage loan portfolio, as well as strengthening of the national currency. The above decrease, together with the increase in financing in the form of a subordinated loan, significantly reduced the gap between EUR assets and liabilities.

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

The tables below present the Group's key FX positions as at 31 December 2017 and in the comparable period.

31.12.2017	PLN	EUR	CHF	USD	Other	Total
ASSETS						
Cash and balances with central banks	3 678 110	316 343	16 408	74 683	60 678	4 146 222
Loans and advances to banks	372 076	1 293 529	2 738	312 260	155 871	2 136 474
Loans and advances to customers	80 699 235	15 591 398	10 769 691	644 332	135 241	107 839 897
Financial assets available for sale	27 163 287	803 777	–	448 748	–	28 415 812
Selected assets	111 912 708	18 005 047	10 788 837	1 480 023	351 790	142 538 405
LIABILITIES						
Deposits from banks	1 279 330	1 452 388	4 811	37 246	9 308	2 783 083
Deposits from customers	90 954 915	14 979 642	357 006	4 097 331	1 092 241	111 481 135
Subordinated liabilities	–	1 488 602	–	–	–	1 488 602
Selected liabilities	**92 234 245**	**17 920 632**	**361 817**	**4 134 577**	**1 101 549**	**115 752 820**

31.12.2016	PLN	EUR	CHF	USD	Other	Total
ASSETS						
Cash and balances with central banks	4 420 741	221 877	18 083	48 073	66 886	4 775 660
Loans and advances to banks	474 505	2 712 604	23 120	204 939	98 110	3 513 278
Loans and advances to customers	70 939 453	17 835 604	13 466 073	675 748	151 660	103 068 538
Financial assets available for sale	27 870 140	995 506	–	442 232	–	29 307 878
Selected assets	103 704 839	21 765 591	13 507 276	1 370 992	316 656	140 665 354
LIABILITIES						
Deposits from banks	1 306 701	1 223 688	–	29 928	964	2 561 281
Deposits from customers	95 131 257	13 251 280	302 495	2 941 889	895 536	112 522 457
Subordinated liabilities	–	440 457	–	–	–	440 457
Selected liabilities	**96 437 958**	**14 915 425**	**302 495**	**2 971 817**	**896 500**	**115 524 195**

Equity price risk

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

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

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

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

The table below presents the risk measures in 2017 and 2016:

Equity risk	VAR Brokerage Office	
1 day holding period	**31.12.2017**	**31.12.2016**
Average	304	301
Maximum	694	742
Minimum	46	50
as at end of the period	90	77
LIMIT	**3 621**	**4 346**

Liquidity risk

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

Liquidity Risk Management

The BZ WBK Group Liquidity Risk Policy is designed to:

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

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

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

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

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

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

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

Management Process

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

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

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

Risk Measurement and Reporting

The responsibility for assessment and reporting of the liquidity risk rests on the Risk Management Division, specifically the Financial Risk Department. The role of the Department is to draft liquidity management policies, carry out stress tests and to measure and report on risk.

Liquidity is measured by means of the modified liquidity gap, which is designed separately for the PLN and currency positions. The reported contract positions are subject to modifications based on: statistical analyses of the deposit and credit base behaviour, evaluation of the possibility to liquidate State Treasury securities by selling or pledging them in repo transactions or using liquidity supporting instruments in NBP, evaluation of transaction rolling in the interbank market.

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

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

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

Stress tests and the contingency plan

In order to establish a detailed risk profile, the Group conducts stress tests using the following six scenarios:

- Baseline scenario, which assumes non-renewability of wholesale funding;
- Idiosyncratic liquidity crisis scenarios (specific to the bank);
- Local systemic liquidity crisis scenario;
- Global systemic liquidity crisis scenario;
- Combined liquidity crisis scenario (idiosyncratic crisis and local systemic crisis);
- Deposit outflows in a one-month horizon.

For each of the above scenarios, BZ WBK Group estimates the minimum survival horizon. For selected scenarios, the bank sets survival horizon limits which are subsequently included in the liquidity risk appetite.

In addition, the Group performs stress tests for intraday liquidity as well as reverse stress tests.

BZ WBK Group has the Contingency Liquidity Plan in place to ensure that there are mechanisms available to take adequate and effective actions in response to unexpected external or internal liquidity problems. The Plan allows the bank to:

- identify threats to the bank's liquidity on the basis of a set of early warning ratios which are subject to ongoing monitoring;
- effectively manage liquidity / funding, using a set of possible remedial actions and the management structure adjusted to the stressed conditions;
- communicate with customers, key market counterparties, shareholders and regulators.

In 2017, as in previous years, BZ WBK Group focused on keeping its loan-to-deposit ratio at a comfortable level (which totalled 86% as at 31 December 2017) and controlling key short- and long-term liquidity measures.

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

The tables below present the economic liquidity gap analysis on the standalone basis (for Bank Zachodni WBK) as at 31.12.2017 and in the comparable period (nominal values).

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

31.12.2017	On demand	up to 1 month	from 1 to 3 months	from 3 to 6 months	from 6 to 12 months	from 1 to 2 years	from 2 to 5 years	above 5 years
Assets	16 285 962	5 487 477	2 737 369	7 877 137	6 474 997	11 747 539	29 354 839	52 897 949
Liabilities and equity	18 843 600	27 882 654	16 438 439	9 538 471	7 722 235	6 373 358	10 297 600	35 766 911
including:	–	–	–	–	–	–	–	–
– Sell–buy–back transactions	–	–	–	–	–	–	–	–
– Deposits from banks	746 740	2 101 959	410 361	73 443	15 400	–	–	–
– Deposits from customers	18 096 859	25 572 150	15 250 513	8 942 409	6 832 174	6 014 336	8 958 040	9 081 624
– Debt securities in issue	–	–	750 000	485 000	–	–	–	–
– Subordinated liabilities	–	–	–	–	–	–	–	1 489 428
Contractual liquidity mismatch/ gap	(2 557 638)	(22 395 177)	(13 701 070)	(1 661 334)	(1 247 239)	5 374 180	19 057 239	17 131 038
Cumulative liquidity gap	(2 557 638)	(24 952 815)	(38 653 886)	(40 315 219)	(41 562 458)	(36 188 277)	(17 131 038)	0
Net derivatives	–	(63 970)	13 782	(76 812)	(33 280)	12 856	(6 049)	(119 732)

31.12.2016	On demand	up to 1 month	from 1 to 3 months	from 3 to 6 months	from 6 to 12 months	from 1 to 2 years	from 2 to 5 years	above 5 years
Assets	21 977 376	6 015 915	1 818 154	2 780 366	5 651 079	16 734 537	26 288 169	50 152 393
Liabilities and equity	61 200 626	15 721 571	11 352 248	7 971 541	4 624 337	2 966 499	1 847 241	25 733 926
including:								
– Sell–buy–back transactions	–	–	–	–	–	–	–	–
– Deposits from banks	578 557	86 607	118 025	34 237	26 400	–	–	–
– Deposits from customers	60 622 069	15 634 964	10 945 920	7 394 630	3 979 739	1 260 040	70 033	–
– Debt securities in issue	–	–	285 000	–	475 000	485 000	–	530 880
– Subordinated liabilities	–	–	–	–	–	–	–	442 400
Contractual liquidity mismatch/ gap	(39 223 249)	(9 705 656)	(9 534 094)	(5 191 175)	1 026 742	13 768 038	24 440 928	24 418 467
Cumulative liquidity gap	(39 223 249)	(48 928 906)	(58 463 000)	(63 654 174)	(62 627 432)	(48 859 394)	(24 418 467)	–
Net derivatives	–	12 207	(145 252)	(11 535)	(51 183)	(173 801)	(187 448)	(1 018 843)

Operational Risk

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

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

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

BZ WBK Group has defined the "Operational Risk Management Strategy".

The Operational Risk Management Committee (ORMCo) established by the Management Board is responsible for setting operational risk management standards for BZ WBK Group. ORMCo is the main forum for discussions on operational risk. It sets out the strategic direction for operational risk management, determines and monitors objectives for managing operational risk, including business continuity, information security, outsourcing / insourcing and money laundering risk. Within the ORMCo Committee several bodies (Forums) were established to address specific aspects of operational risk e.g. Crime Prevention Forum and the Forum of Insurance. The effects of this work are reported to the Risk Control Committee.

In view of high and rising cyber risk worldwide new Cyber Risk Committee has been set up. It is a forum for direct cooperation and communication among all organisational units involved in the processes related to cyber security, to ensure effective supervision of the cyber security strategy.

BZ WBK Group uses the following tools:

- Identification and assessment of operational risk

The primary tool for identification and assessment of operational risk is self-assessment. In the self-assessment process, BZ WBK Group identifies the risks it may be exposed to when delivering its functions, assesses inherent and residual risks in terms of their likelihood and impact, and evaluates efficiency of the existing controls. In addition, action plans are devised to improve the efficiency of the existing and/or new controls.

The process of identification and assessment of operational risk is additionally supported by other tools dedicated to specific risk aspects such as: scenario analyses, business impact analyses, analysis of risk in new initiatives.

- Reporting on operational incidents

Each organisational unit is required to report operational incidents. For significant operational incidents there is the path for prompt notification to senior management. The Group runs a database of operational incidents identified across BZ WBK Group. The data are used to analyse the root cause and consequences of the incidents, capture lessons learned and take preventive and corrective measures.

The Group also makes inputs to the external database of operational events run by the Polish Banks Association and uses information about external events from a number of sources. The analysis of external events allows for benchmarking and lesson learning from events identified outside the Group.

- Analysis of risk indicators

The primary tool for monitoring of operational risk are risk indicators. BZ WBK Group monitors risk indicators, both financial and operational ones. Risk indicators provide early warning of emerging threats and operational losses and depict the risk level present in the Group. Monitoring is based both on financial and technological and operational meters.

- Defining actions lowering the risk

The process of managing activities limiting operational risk is aimed at eliminating or reducing operational risk. The basis for determining risk mitigation measures are the results of analyzes carried out in various operational risk tools (including operational events database, risk indicators, and risk self-assessment).

- Business continuity management (BCM)

Each organisational unit is required to develop and update its business continuity management plans to ensure that critical business processes remain uninterrupted following an unplanned disruption. BCM plans are tested on a regular basis to provide assurance to BZ WBK Group that critical business processes may be restored at the required service level and within the agreed timeframe. BZ WBK Group has backup locations in place where critical processes can be restored and continued should an incident occur.

- Information Security

Ensuring an appropriate level of information security and security of the BCM environment is a key aspect of the bank's operations.

At BZ WBK, there is an Information Security Management System that is certified in accordance with ISO / IEC 27001: 2013. Information security management includes supervision over information security matters in the BZ WBK Group's business environment and assessment of specific information security and information systems requirements.

- Insurance

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

- Regular reporting to the Risk Management Committee and Supervisory Board

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

The Group's Information Security Management System has a certificate of compliance with ISO 27001:2013 standard.

Compliance Risk

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

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

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

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

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

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

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

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

In July 2017, the bank's Management Board adopted an amended policy statement on compliance with legal and regulatory obligations, which was approved by the Supervisory Board. The policy provides the Compliance Area together with Anti-Money Laundering Department forms Compliance Unit operating within the Legal and Compliance Division, with the relevant mandate to support senior managers in effective management of the compliance risk. The Compliance Area escalates all issues to the Risk Management Committee and Audit and Compliance Committee of the Supervisory Board. Both Committees ensure compliance with regulatory obligations and approve internal control rules and the Policy framework as well as provide necessary resources for the Compliance Unit, so that the Compliance Unit can operate independently from business units and has relevant resources to perform its tasks.

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

- as part of monitoring of new products;
- as part of compliance monitoring;
- as part of the monitoring of proprietary transactions effected by employees;
- based on the information on regulators' activity;
- as part of the review of upcoming legislative initiatives;
- as part of the review of anti-money laundering initiatives;
- as part of the review of ethical issues;
- as part of the review of customers' complaints. The Compliance Unit's tasks are delivered through:
- independent identification, assessment and monitoring of compliance risk that the Group is exposed to (with the focus on new products and services, prevention of money laundering and terrorist financing, protection of confidential information, conflicts of interest or private account shares dealing by employees;
- prevention of using the financial system for money laundering and terrorist financing;
- providing advice and reporting to the Risk Management Committee, bank's Management Board and Audit and

Compliance Committee on the effectiveness of the processes established to ensure compliance with laws and regulations within its area of responsibility;

- publication of policies and procedures, providing the management and staff with guidance on compliance risk and adequate risk management policies and procedures;
- centralisation of contacts with market regulators (KNF, UOKiK, GIIF, GIODO);
- centralisation of the approval of new products;
- coordination and support for compliance processes regarding the model of sale of investment products and MiFID Directive;
- strengthening of the principles regarding ethical business conduct
- cooperation with compliance units within the Group and with central compliance unit in Santander Group.

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

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

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

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

5. Capital management

Introduction

It is the policy of the Bank Zachodni WBK Group to maintain the level of capital adequate to the type and scale of operations and the level of risk. The level of own funds required to ensure safe operations of BZ WBK Group and capital requirements estimated for the unexpected loss is determined in accordance with the CRD IV / CRR package. The package consists of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR) and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD IV), which became effective on 1 January 2014 by the decision of the European Parliament and the European Banking Authority (EBA). These requirements reflect the recommendations of the Polish Financial Supervision Authority (KNF) regarding the use of national options and a higher risk weight for exposures secured with mortgages on properties, including the exposures secured with a mortgage on a residential property, where the principal instalment or the interest instalment amount depends on fluctuations of exchange rates of currencies other than the currency of the debtor's income, which have a risk weight of 150%, and office property or other commercial properties located in Poland, which have a risk weight of 100%.

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

The Management Board delegated on-going capital management to Capital Committee. Capital Committee conducts regular assessment of capital adequacy of the bank and the Group, also under stress conditions, monitors the actual and required capital levels and initiates transactions affecting these levels (e.g. by recommending the value of dividends to be paid). The Credit Committee is the first body in the bank to define capital policy and rules for assessment of capital adequacy both for the bank and the Group. Any ultimate decisions regarding increase or decrease of capital are taken by relevant authorities of the bank and subsidiaries in accordance with the applicable law and the bank's Statutes.

Pursuant to the bank's information strategy, details about the level of own funds and capital requirements are presented in the annual report entitled "Information on capital adequacy of the bank and BZ WBK Group as at 31 December 2017".

In 2017, Bank Zachodni WBK Group met all regulatory requirements regarding capital management.

Capital Policy

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

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

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

- a Tier 1 capital ratio of 11.16%;
- a total capital ratio of 14.29%; and for the BZ WBK Group were as follows:
- a Tier 1 capital ratio of 11.08%;
- a total capital ratio of 14.19%;

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

Pursuant to the KNF's decisions of 15 December 2017 and 20 November 2017, Bank Zachodni WBK Group and Bank Zachodni WBK maintain own funds to cover an additional capital requirement for risk attached to foreign currency home mortgages for households. As at 31 December 2017, the buffer was set at 0.54 p.p. above the total capital ratio for Bank Zachodni WBK, and at 0.44 p.p. for Bank Zachodni WBK Group. The buffer includes at least 75% of Tier 1 capital (which corresponds to the capital requirement of 0.41 o.p. above Tier 1 capital ratio for Bank Zachodni WBK, and 0.33 p.p. for Bank Zachodni WBK Group) and at least 56% of the Common Equity Tier 1 capital (which corresponds to the capital requirement of 0.30 p.p. above the Common Equity Tier 1 capital for Bank Zachodni WBK, and 0.25 p.p. for Bank Zachodni WBK Group).

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

The Act of 5 August 2015 on macroprudential oversight of the financial system and crisis management in the financial sector transposes CRD IV into the Polish law with regard to, among other things, additional capital buffers to be maintained by banks. As of 1 January 2016, the minimum capital ratios for the banking sector in Poland will be increased by 1.25 p.p. due to introduction of a conservation buffer. In line with the CRR adaptation, this buffer should reach the level of 2.5 p.p. in 2019.

On 4 October 2016, KNF identified Bank Zachodni WBK as other systemically important institution and imposed an additional capital buffer of 0.5 p.p. Pursuant to the KNF decision of December 2017, Bank Zachodni WBK Group maintains capital buffer on the same level.

From 1 January 2018, Bank Zachodni WBK and the Group will have to comply with the systemic risk buffer of 300 p.p. and the conservation buffer of 1.875 p.p., which in turn will affect the minimum ratios for the bank, i.e.:

- a Tier 1 capital ratio of 11.79%;
- a total capital ratio of 13.92%.

For Bank Zachodni WBK Group, those ratios will be as follows:

- a Tier 1 capital ratio of 11.71%;
- a total capital ratio of 13.82%.

Regulatory Capital

The capital requirement for Bank Zachodni WBK Group is determined in accordance with Part 3 of CRR, which formed a legal basis as at 31 December 2017.

Bank Zachodni WBK uses the standardised approach to calculate the capital requirement for credit risk, market risk and operational risk. According to this approach, the total capital requirement for credit risk is calculated as the sum of risk-weighted exposures multiplied by 8%. The exposure value for these assets is equal to the balance sheet total, while the value of off-balance sheet liabilities corresponds to their balance sheet equivalent. Risk-weighted exposures are calculated by applying risk weights to all exposures in accordance with the CRR.

Calculation of the capital ratio for Bank Zachodni WBK Group as at 31.12.2017 and 31.12.2016

		31.12.2017	31.12.2016
I	**Total Capital requirement (Ia+Ib+Ic+Id), of which:**	**9 520 249**	**8 816 625**
Ia	– due to credit risk & counterparty credit risk	8 361 481	7 713 572
Ib	– due to market risk	107 752	93 321
Ic	– due to credit valuation ajdustment risk	42 400	42 739
Id	– due to operational risk	1 008 616	966 993
II	Total own funds*	22 314 566	19 179 697
III	Reductions	2 454 088	2 594 883
IV	**Own funds after reductions (II–III)**	**19 860 478**	**16 584 814**
V	**CAD [IV/(I*12.5)]**	**16.69%**	**15.05%**
VI	**Tier 1 ratio**	**15.28%**	**14.56%**

** On 30.09.2017, the bank included current year profit of PLN 519,865 k for the period between 1.01.2017 and 30.06.2017 in its own funds, with the permission of KNF.*

Internal Capital

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

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

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

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

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

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

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

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

Subordinated liabilities

In 2016, the bank amended the agreement under which subordinated registered bonds were issued on 5 August 2010 and taken up by the European Bank for Reconstruction and Development. The amendments included the extension of maturity until 5 August 2025, among other things. Pursuant to the KNF's decision of 18 May 2016, the foregoing subordinated bonds of EUR 100,000 k were allocated to the Tier II capital.

On 2 December 2016, the bank issued bonds worth EUR 120,000 k as part of its strategy aimed at increasing Tier 2 capital. On 24 February 2017, the bank was granted consent from the KNF to allocate the above bonds to Tier 2 capital.

Furthermore, on 22 May 2017, the bank issued additional subordinated bonds with a nominal value of EUR 137,100 k. Pursuant to the KNF decision of 19 October 2017, these instruments were allocated to Tier 2 capital.

Detailed information on subordinated liabilities is presented in Note 33.

6. Net interest income

Interest income	01.01.2017-31.12.2017	01.01.2016-31.12.2016
Loans and advances to enterprises	1 676 521	1 635 420
Loans and advances to individuals, of which:	3 602 440	3 221 059
Home mortgage loans	1 066 596	932 067
Debt securities incl.:	660 999	614 764
Investment portfolio available for sale	627 398	582 458
Trading portfolio	33 601	32 306
Leasing agreements	260 542	194 467
Loans and advances to banks	64 225	63 753
Public sector	6 376	6 929
Reverse repo transactions	27 342	8 957
Interest recorded on hedging IRS	230 862	315 571
Total	**6 529 307**	**6 060 920**

Interest expenses	01.01.2017-31.12.2017	01.01.2016-31.12.2016
Deposits from individuals	(558 060)	(632 301)
Deposits from enterprises	(342 180)	(382 886)
Repo transactions	(54 367)	(36 728)
Deposits from public sector	(54 061)	(48 081)
Deposits from banks	(46 645)	(38 660)
Subordinated liabilities and issue of securities	(197 097)	(151 892)
Total	**(1 252 410)**	**(1 290 548)**
Net interest income	**5 276 897**	**4 770 372**

As at 31.12.2017 net interest income includes interest on impaired loans of PLN 250,588 k (as at 31.12.2016 – PLN 268,084 k).

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

7. Net fee and commission income

Fee and commission income	01.01.2017–31.12.2017	01.01.2016–31.12.2016
eBusiness & payments	627 600	578 420
Current accounts and money transfer	338 306	338 374
Asset management fees	306 474	256 270
Foreign exchange commissions	346 056	320 003
Credit commissions	316 125	267 195
Insurance commissions	213 572	282 723
Brokerage activities	88 129	71 580
Credit cards	169 548	161 371
Off–balance sheet guarantee commissions	60 303	63 770
Finance lease commissions	16 228	15 041
Issue arrangement fees	14 502	15 104
Distribution fees	9 730	6 035
Other commissions	20 241	12 578
Total	**2 526 814**	**2 388 464**

Fee and commission expenses	01.01.2017-31.12.2017	01.01.2016-31.12.2016
eBusiness & payments	(225 707)	(201 454)
Distribution fees	(21 578)	(22 695)
Brokerage activities	(11 175)	(10 368)
Credit cards	(33 262)	(39 827)
Credit commissions paid	(98 335)	(58 018)
Insurance commissions	(17 523)	(37 919)
Finance lease commissions	(27 184)	(25 124)
Asset management fees and other costs	(6 607)	(6 107)
Other	(72 317)	(72 232)
Total	**(513 688)**	**(473 744)**
Net fee and commission income	**2 013 126**	**1 914 720**

The summary above includes the fee and commission income on credits, credit cards, off-balance sheet guarantees and finance leases of PLN 562,204 k (31.12.2016: PLN 507,377 k) and fee and commission expenses on credit cards, finance leases and paid to credit agents of PLN (158,781) k (31.12.2016: PLN (122,969) k) other than the fees taking into account while determining the effective interest rate, relating to financial assets and liabilities not carried at fair value through profit and loss.

8. Dividend income

Dividend income	01.01.2017–31.12.2017	01.01.2016–31.12.2016
Dividends from equity financial assets available for sale	76 270	96 051
Dividends income from equity financial assets at fair value through profit or loss	546	531
Total	**76 816**	**96 582**

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

9. Net trading income and revaluation

Net trading income and revaluation	01.01.2017–31.12.2017	01.01.2016–31.12.2016
Derivative instruments and interbank fx transactions	153 040	254 446
Other FX related income	43 673	20 204
Profit on equity instruments	4 265	(1 710)
Profit on debt instruments	(6 004)	7 880
Total	**194 974**	**280 820**

Net trading income and revaluation includes the change of the value of derivative instruments in the amount of PLN (10,287) k for 2017 and PLN (5,817) k for 2016.

The amounts include CVA and DVA adjustments which in 2017 and 2016 totaled PLN (11,572) k and PLN (2,748) k, respectively.

10. Gains (losses) from other financial securities

Gains (losses) from other financial securities	01.01.2017–31.12.2017	01.01.2016–31.12.2016
Profit on the sale of equity shares available for sale	26 464	317 828
Profit on the sale of debt securities available for sale	20 824	93 184
Charge due to impairment losses	(461)	(10 398)
Total profit (losses) on financial instruments	46 827	400 614
Change in the fair value of hedging instruments	23 760	57 112
Change in the fair value of underlying hedged positions	(23 085)	(54 952)
Total profit (losses) on hedging and hedged instruments	675	2 160
Total	**47 502**	**402 774**

On 21.06.2016, Visa Inc. announced the completion of its acquisition of Visa Europe Limited. As a result, BZ WBK Group received:

- Bank Zachodni WBK and Santander Consumer Bank (SCB) – EUR 49,974,289 and EUR 1,654,744 in cash, respectively
- Bank Zachodni WBK and SCB – 18,092 and 600 series C preference shares of Visa Inc., respectively.

Furthermore, the earn-out of EUR 1.12bn payable to all transaction participants was settled. The share of Bank Zachodni WBK in the above amount is 0.3839946336% and the share of SCB is 0.0127491571%. The earn-out payable to the Group may be adjusted within three years of the transaction date in the circumstances stipulated in the agreement.

In 2016, the total profit made by Bank Zachodni WBK and SCB on the above transaction was PLN 305,865 k and PLN 10,154 k, respectively and was recognised under "Gains from other financial securities" in the income statement.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

11. Other operating income

Other operating income	01.01.2017–31.12.2017	01.01.2016–31.12.2016
Income on sale of services	20 535	15 769
Reimbursements of BGF charges *	433	54 215
Release of provision for legal cases and other assets	43 297	14 830
Settlements of leasing agreements	3 266	4 470
Recovery of other receivables	5 641	6 919
Profit on sales or liquidation of fixed assets, intangible assets and assets for disposal	11 543	6 680
Received compensations, penalties and fines	1 039	1 296
Other income from legal cases	24 238	–
Other	40 595	36 585
Total	**150 587**	**140 764**

** Following the change in the calculation of contributions to the Bank Guarantee Fund as a result of the introduction of the Bank Guarantee Fund Act of 10 June 2016, the bank changed the method of settlement and also the presentation of the data which are now disclosed under fee and commission income.*

12. Impairment losses on loans and advances

Impairment losses on loans and advances	01.01.2017–31.12.2017	01.01.2016–31.12.2016
Collective and individual impairment charge	(668 164)	(828 170)
Incurred but not reported losses	(65 420)	(27 015)
Recoveries of loans previously written off	43 534	45 166
Off–balance sheet credit related facilities	(423)	25 429
Total	**(690 473)**	**(784 590)**

13. Employee costs

Employee costs	01.01.2017–31.12.2017	01.01.2016–31.12.2016
Salaries and bonuses	(1 293 085)	(1 246 336)
Obligatory salary related costs	(216 933)	(205 215)
Staff benefits costs	(39 705)	(37 736)
Professional training	(18 730)	(20 057)
Retirement fund, holiday provisions and other employee costs	5 836	(1 020)
Total	**(1 562 617)**	**(1 510 364)**

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

14. General and administrative expenses

General and administrative expenses	01.01.2017–31.12.2017	01.01.2016–31.12.2016
Maintenance and rentals of premises	(348 290)	(355 529)
Marketing and representation	(133 906)	(146 587)
IT systems costs	(213 047)	(197 510)
Bank Guarantee Fund, Polish Financial Supervision Authority and National Depository for Securities	(224 168)	(281 383)
Postal and telecommunication costs	(52 911)	(48 068)
Consulting fees	(65 574)	(60 398)
Cars, transport expenses, carriage of cash	(67 356)	(67 847)
Other external services	(104 616)	(94 130)
Stationery, cards, cheques etc.	(27 280)	(31 741)
Sundry taxes	(33 587)	(33 469)
Data transmission	(12 458)	(15 763)
KIR, SWIFT settlements	(28 480)	(26 242)
Security costs	(25 286)	(25 470)
Costs of repairs	(14 137)	(17 504)
Other	(25 719)	(23 224)
Total	**(1 376 815)**	**(1 424 865)**

15. Other operating expenses

Other operating expenses	01.01.2017–31.12.2017	01.01.2016–31.12.2016
Charge of provisions for legal cases and other assets	(59 540)	(112 058)
Impairment loss on property, plant, equipment and intangible assets	(8 397)	(12 306)
Costs of purchased services	(8 177)	(2 775)
Other membership fees	(992)	(896)
Paid compensations, penalties and fines	(3 091)	(2 312)
Donations paid	(4 876)	(4 338)
Other	(28 976)	(20 587)
Total	**(114 049)**	**(155 272)**

16. Corporate income tax

Corporate income tax	01.01.2017-31.12.2017	01.01.2016-31.12.2016
Current tax charge	(801 991)	(874 323)
Deferred tax	(14 885)	127 976
Adjustments from previous years	169	8 385
Total	**(816 707)**	**(737 962)**

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Corporate total tax charge information	01.01.2017-31.12.2017	01.01.2016-31.12.2016
Profit before tax	3 335 221	3 122 054
Tax rate	19%	19%
Tax calculated at the tax rate	(633 692)	(593 190)
Non–tax–deductible expenses	(20 954)	(34 690)
The fee to the Bank Guarantee Fund	(40 082)	(15 403)
Tax on financial institutions	(80 524)	(73 568)
Sale of receivables	(52 237)	(43 223)
Non–taxable income (dividends)	14 423	18 122
Non–tax deductible bad debt provisions	(10 970)	(8 023)
Adjustment of prior year tax	169	8 385
Tax effect of consolidation adjustments	5 045	6 834
Other	2 115	(3 206)
Total income tax expense	**(816 707)**	**(737 962)**

Deferred tax recognised directly in equity	31.12.2017	31.12.2016
Relating to equity securities available–for–sale	(130 950)	(122 523)
Relating to debt securities available–for–sale	(57 957)	35 033
Relating to cash flow hedging activity	20 508	25 251
Relating to valuation of defined benefit plans	(125)	(1 913)
Total	**(168 524)**	**(64 152)**

17. Earnings per share

Earnings per share	01.01.2017–31.12.2017	01.01.2016–31.12.2016
Profit for the period attributable to ordinary shares	2 213 054	2 166 847
Weighted average number of ordinary shares	99 275 197	99 234 534
Earnings per share (PLN)	**22.29**	**21.84**
Profit for the period attributable to ordinary shares	2 213 054	2 166 847
Weighted average number of ordinary shares	99 275 197	99 234 534
Weighted average number of potential ordinary shares	187 456	155 947
Diluted earnings per share (PLN)	**22.25**	**21.80**

The weighted average number of potential ordinary shares takes into account the number of share options granted under the incentive scheme described in Note 52.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

18. Cash and balances with central banks

Cash and balances with central banks	31.12.2017	31.12.2016
Cash	2 270 698	2 134 971
Current accounts in central banks	1 857 824	2 538 686
Term deposits	17 700	102 003
Total	**4 146 222**	**4 775 660**

Bank Zachodni WBK and Santander Consumer Bank hold an obligatory reserve in a current account in the National Bank of Poland. The figure is calculated at a fixed percentage of the monthly average balance of the customers' deposits, which was 3.5% as at 31.12.2017 and 31.12.2016.

In accordance with the applicable regulations, the amount of the calculated provision is reduced by the equivalent of EUR 500 k.

19. Loans and advances to banks

Loans and advances to banks	31.12.2017	31.12.2016
Loans and advances	850 541	795 140
Current accounts	1 285 933	2 718 138
Total	**2 136 474**	**3 513 278**

Fair value of loans and advances to banks is presented in Note 43.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

20. Financial assets and liabilities held for trading

Financial assets and liabilities held for trading	31.12.2017		31.12.2016	
	Assets	Liabilities	Assets	Liabilities
Trading derivatives	**1 226 551**	**1 237 704**	**1 859 361**	**1 728 931**
Interest rate operations	**307 344**	**275 046**	**970 357**	**898 100**
Forward	–	68	6	20
Options	13 211	13 226	17 744	17 743
IRS	291 615	260 187	945 715	873 241
FRA	2 518	1 565	6 892	7 096
Transactions on equity instruments	**6 053**	**6 053**	**12 032**	**12 032**
Options	6 053	6 053	12 032	12 032
FX operations	**913 154**	**956 605**	**876 972**	**818 799**
CIRS	282 186	253 890	210 135	245 130
Forward	41 175	160 814	69 838	61 693
FX Swap	493 265	444 919	429 814	352 967
Spot	1 360	1 832	1 561	2 041
Options	95 168	95 150	156 718	156 718
Other	–	–	8 906	250
Debt and equity securities	**2 189 557**	**–**	**1 321 624**	**–**
Debt securities	**2 174 096**	**–**	**1 312 589**	**–**
Government securities:	2 170 048	–	612 233	–
– bonds	2 170 048	–	612 233	–
Central bank securities:	–	–	699 883	–
– bills	–	–	699 883	–
Commercial securities:	4 048	–	473	–
– bonds	4 048	–	473	–
Equity securities:	**15 461**	**–**	**9 035**	**–**
– listed	15 461	–	9 035	–
Short sale	**–**	**–**	**–**	**80 129**
Total financial assets/liabilities	**3 416 108**	**1 237 704**	**3 180 985**	**1 809 060**

Financial assets and liabilities held for trading – trading derivatives include the change in the value of counterparty risk in the amount of PLN 190 k as at 31.12.2017 and PLN 9,525 k as at 31.12.2016.

Interest income from debt instruments and other fixed rate instruments is disclosed under “Interest income”.

Profit and loss from fair value changes of financial assets and liabilities held for trading are disclosed under net trading income and revaluation in the consolidated income statement.

All financial assets measured at fair value through profit and loss are assigned to this category due to the trading character of the transactions. At 31.12.2017 and in comparable period there were no cases of instruments designated to financial assets measured at fair value through profit and loss at initial recognition.

Offsetting financial assets and financial liabilities

In accordance with IFRS 7, the information below refers only to financial assets and financial liabilities arising from forward and derivative transactions effected under master agreements such as ISDA Master Agreement or other master agreements providing for the possibility to terminate and settle the transaction with a counterparty in the event of default on the basis of a net amount of mutual receivables and payables.

The Group has no right to set off financial assets and liabilities in the financial statements. The table below presents fair value amounts of derivative instruments (both held for trading and designated as hedging instruments under hedge accounting) and cash collateral covered by mandate agreements providing for the right of set-off under specific circumstances. The maximum amounts of compensations other than those resulting from collaterals based on framework contracts have been presented separately.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Offsetting financial assets and financial liabilities	31.12.2017		31.12.2016	
	Financial assets	Financial liabilities	Financial assets	Financial liabilities
Fair value measurements of derivative instruments	1 226 551	1 237 704	1 916 422	3 690 509
Value of collateral accepted/provided	(373 184)	(268 306)	(232 591)	(2 131 485)
Assets and liabilities subject to set–offs under a mandate agreement	853 367	969 398	1 683 831	1 559 024
Maximum amount of potential set–off	(387 764)	(387 763)	(924 984)	(924 984)
Assets and liabilities subject to set–offs under a mandate agreement, taking into account the maximum amount of potential set–off	**465 603**	**581 635**	**758 847**	**634 040**

The table below presents nominal values of derivative instruments.

	Nominal values of derivative instruments	31.12.2017	31.12.2016
1.	Term derivatives (hedging)	25 301 383	32 810 487
a)	Single–currency interest rate swap	2 404 709	2 881 319
b)	Macro cash flow hedge –purchased (IRS)	1 575 000	2 242 000
c)	Macro cash flow hedge –purchased (CIRS)	10 430 903	12 714 713
d)	Macro cash flow hedge –sold (CIRS)	10 542 739	14 402 131
e)	FX Swap cash flow hedge –purchased (FX)	176 806	284 172
f)	FX Swap cash flow hedge–sold (FX)	171 226	286 152
2.	Term derivatives (trading)	282 611 381	289 441 541
a)	Interest rate operations	168 569 058	170 149 579
	Single–currency interest rate swap	156 870 056	146 126 096
	FRA – purchased amounts	3 260 000	16 680 000
	Options	8 370 402	7 314 133
	Forward– purchased amounts	–	27 090
	Forward– sold amounts	68 600	2 260
b)	FX operations	114 042 323	119 291 962
	FX swap – purchased amounts	29 815 344	30 143 163
	FX swap – sold amounts	29 745 471	30 025 420
	Forward– purchased amounts	8 226 882	5 580 260
	Forward– sold amounts	8 393 420	5 620 242
	Cross–currency interest rate swap – purchased amounts	10 743 244	12 916 870
	Cross–currency interest rate swap – sold amounts	10 720 212	12 961 985
	FX options –purchased CALL	4 036 440	5 398 974
	FX options –purchased PUT	4 162 435	5 623 037
	FX options –sold CALL	4 036 440	5 398 974
	FX options –sold PUT	4 162 435	5 623 037
3.	Currency transactions– spot	2 894 072	1 540 212
	Spot–purchased	1 446 853	769 621
	Spot–sold	1 447 219	770 591
4.	Transactions on equity financial instruments	817 734	1 335 679
	Derivatives contract – purchased	401 987	664 431
	Derivatives contract – sold	415 747	671 248
	Total	**311 624 570**	**325 127 919**

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In the case of single-currency transactions (IRS, FRA, non-FX options) only purchased amounts are presented.

21. Hedging derivatives

Hedging derivatives	31.12.2017		31.12.2016	
	Assets	Liabilities	Assets	Liabilities
Derivatives hedging fair value	2 283	115 496	3 232	140 338
Derivatives hedging cash flow	215 778	463 302	64 413	1 883 006
Total hedging derivatives	**218 061**	**578 798**	**67 645**	**2 023 344**

Hedging derivatives – derivatives hedging cash flow include value adjustments day first profit or loss for start forward CIRS transactions in the amount of PLN (9,613) k as at 31.12.2017 and (10 665) k as at 31.12.2016.

For the valuation of hedging transactions, Group uses a valuation model classified to the Level II of fair value, in which data used for valuation are based on observable market parameters (directly or indirectly). Group treats differences that arise in the initial valuation it as the Day 1 profit or loss and amortises it in time and indicates the valuation effect in the profit and loss account. Amortisation of adjustment to the valuation of day 1 is recognized in Net trading income and revaluation.

22. Loans and advances to customers

Loans and advances to customers	31.12.2017	31.12.2016
Loans and advances to enterprises	47 776 973	45 179 803
Loans and advances to individuals, of which:	57 822 414	56 291 404
Home mortgage loans	37 293 296	37 008 380
Finance lease receivables	6 848 960	6 098 499
Loans and advances to public sector	228 201	195 900
Other	9 479	181 813
Gross receivables	**112 686 027**	**107 947 419**
Allowance for impairment	(4 846 130)	(4 878 881)
Total	**107 839 897**	**103 068 538**

As at 31.12.2017 the fair value adjustment due to hedged risk on individual loans was PLN 3,555 k.

Finance lease receivables are presented in Note 46. Fair value of loans and advances to customers is presented in Note 43.

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Movements on impairment losses on loans and advances to customers	31.12.2017	31.12.2016
Individual and collective impairment		
As at the beginning of the period	(4 187 798)	(4 471 467)
Individual and collective impairment acquired in a business combination	–	(11 548)
Charge/write back of current period	(668 164)	(828 170)
Write off/Sale of receivables	735 191	1 110 443
Transfer	(16 960)	26 631
F/X differences	30 137	(13 687)
Balance at the end of the period	(4 107 594)	(4 187 798)
IBNR		
As at the beginning of the period	(691 083)	(659 596)
IBNR acquired in a business combination	–	(1 947)
Charge/write back of current period	(65 420)	(27 015)
Sale of receivables	3 429	3 182
Transfer	940	558
F/X differences	13 598	(6 265)
Balance at the end of the period	(738 536)	(691 083)
Allowance for impairment	**(4 846 130)**	**(4 878 881)**

In September 2015, SCB securitized the instalment loan portfolio. The transaction was a traditional, revolving transaction and consisted in transferring the right to securitized receivables to SC Poland Consumer Sp. z o.o. 15-1 (SPV2), with its registered seat in Poland.

On the basis of the securitized assets, the aforesaid company issued bonds with a total value of PLN 1,051,125 k secured in the form of a registered pledge on the assets of SPV2. The bonds bear an interest rate comprising 1M WIBOR and margin. As a result of the securitization, SCB obtained financing in return for the right to future cash flows from the securitized credit portfolio. The latest redemption date is 19 August 2025, but in SCB estimation, the aforesaid bonds should be redeemed within two years from the transaction date.

In August 2016 SCB performed a transaction of securitization of cash loans portfolio. The concluded transaction is a traditional and revolving securitization including transfer of ownership rights to securitized receivables for the benefit of the special purpose vehicle, SC Poland Consumer 16-1 Sp. z o.o. (SPV3) with its registered seat in Poland.

This Company issued, on the basis of securitized assets, bonds of the total value of PLN 1,225,000 k, secured with a registered pledge on the property of SPV3. The bonds bear an interest rate comprising 1M WIBOR and margin. As a result of the securitization

SCB obtained funding of its activity in exchange for giving rights to future flows arising from the securitized loans portfolio. The maximum period for redemption of the bonds is 16 September 2026 but SCB estimated that it shall take place within 3 years from the transaction date.

In the light of provisions of the IAS 39, the contractual terms and conditions of the securitization transaction do not require SCB to derecognize the securitized assets from its financial statements.

Consequently, at 31 December 2017, SCB recognizes securitized assets under Loans and advances granted to clients in the net amount of PLN 2,136,690 k. The fair value of net securitized assets measured as of 31 December 2017 amounted respectively to PLN 2,145,065 k.

In May 2016 SCB finalized the transaction of securitization of car loans and instalment loans portfolios concluded in 2014. The transaction included transfer of ownership rights to securitized receivables for the benefit of the special purpose vehicle, SC Poland Auto 2014-1 Limited (SPV1) with its registered seat in Ireland. The transaction was finalized after redemption of all issued bonds and included exercising of the procedure specified in the agreement, so called redemption option. In the frame of realization of the procedure of datio in payment, SCB took over from the SPV the rights to remaining unpaid receivables which allowed total settlement of the transaction. The value of the net securitization portfolio as of the redemption moment was PLN 391,684 k.

The profit earned by all SPVs is zero because SPV absorbs all revenues and expenses which are offset against the revenues and expenses of SCB. In this model SPV allocated all payments received from SCB to particular types of payments, including other settlements with SCB, according to a specified priority, in the sequence as agreed in the agreement.

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23. Financial assets available for sale

Financial assets available for sale	31.12.2017	31.12.2016
Debt securities	**27 494 933**	**28 423 828**
Government securities:	24 025 353	23 429 089
– bonds	24 025 353	23 429 089
Central bank securities:	1 379 839	2 849 694
– bills	1 379 839	2 849 694
Other securities:	2 089 741	2 145 045
– bonds	2 089 741	2 145 045
Equity securities	**920 879**	**884 050**
– listed	19 329	34 473
– unlisted	901 550	849 577
Total	**28 415 812**	**29 307 878**

As at 31.12.2017 fixed interest rate debt securities measured at fair value amounted to PLN 17,640,329 k, variable interest rate securities amounted to PLN 9,854,604 k.

As at 31.12.2016 fixed interest rate debt securities measured at fair value amount to PLN 19,649,445 k, variable interest rate securities amount to PLN 8,774,383 k.

As at 31.12.2017 fair value adjustment resulting from fair value hedge on available for sale debt securities totaled PLN 107,005 k (as at 31.12.2016 PLN 132,512 k).

Unlisted equity investments classified as available-for-sale for which no active market exists are recognized at cost and tested for impairment or their fair value is assessed based on valuation models. The Group performs the review of the fair value of its unlisted available-for-sale financial instruments at each balance sheet date.

The fair value of "Financial assets available for sale" is presented in Note 43.

Movements on financial assets available for sale	Debt securities	Financial instruments representing equity rights	Total
As at 1 January 2017	28 423 828	884 050	29 307 878
Additions	60 756 329	2 536	60 758 865
Disposals (sale and maturity)	(62 053 423)	(9 193)	(62 062 616)
Fair value adjustment	463 913	43 947	507 860
Movements on interest accrued	19 756	–	19 756
Allowances for impairment	–	(461)	(461)
F/X differences	(115 470)	–	(115 470)
As at 31 December 2017	**27 494 933**	**920 879**	**28 415 812**

Movements on financial assets available for sale	Debt securities	Financial instruments representing equity rights	Total
As at 1 January 2016	23 463 634	1 158 444	24 622 078
Additions	49 889 981	80 284	49 970 265
Disposals (sale and maturity)	(44 608 851)	(17 749)	(44 626 600)
Fair value adjustment	(453 803)	(326 531)	(780 334)
Movements on interest accrued	80 715	–	80 715
Allowances for impairment	–	(10 398)	(10 398)
F/X differences	52 152	–	52 152
As at 31 December 2016	**28 423 828**	**884 050**	**29 307 878**

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24. Investments in associates

Balance sheet value of associates	31.12.2017	31.12.2016
Polfund – Fundusz Poręczeń Kredytowych S.A.	43 570	43 216
BZ WBK – Aviva Towarzystwo Ubezpieczeń Ogólnych S.A.and BZ WBK – Aviva Towarzystwo Ubezpieczeń na Życie S.A.	845 802	828 275
Total	**889 372**	**871 491**

Movements on investments in associates	01.01.2017-31.12.2017	01.01.2016-31.12.2016
As at the beginning of the period	871 491	831 142
Share of profits	58 264	55 439
Dividends	(44 861)	(10 827)
Other	4 478	(4 263)
Balance at the end of the period	889 372	871 491

Fair value of "Investments in associates" is presented in Note 43.

The table below presents information regarding the Group's share in capital of associate:

Name of associate	Country of incorporation and place of business	The Group's share in capital / voting power		Valuation method	Scope of business
		2017	2016		
BZ WBK – Aviva Towarzystwo Ubezpieczeń na Życie S.A.	Poland	49.00	49.00	Equity method	life insurance
BZ WBK – Aviva Towarzystwo Ubezpieczeń Ogólnych S.A.	Poland	49.00	49.00	Equity method	property and personal insurance

The table below presents condensed financial information regarding associates which have a significant contribution to the Group:

	BZ WBK – Aviva Towarzystwo Ubezpieczeń na Życie S.A.		BZ WBK – Aviva Towarzystwo Ubezpieczeń Ogólnych S.A.	
	2017 *	2 016	2017 *	2 016
Loans and advances to banks	67 377	44 635	69 888	30 857
Financial assets held for trading	12 079	19 457	1 256	1 230
Financial assets available for sale	318 393	260 392	373 978	348 360
Deferred tax assets	705	646	981	908
Net life insurance assets where the deposit (investment) risk is incurred by the insuring party	387 534	545 539	–	–
Other settlements	22 523	24 512	56 494	42 057
Prepayments	163 842	127 946	–	12 875
Other items	818	1 205	859	1 173
Total assets	**973 271**	**1 024 332**	**503 456**	**437 460**
Technical insurance provisions	733 747	851 318	164 235	172 589
Reinsurers' share in provisions	(7 444)	(7 322)	(143 055)	(113 294)
Estimated recourses and recoveries (negative value)	–	–	(1 003)	(602)
Other liabilities	136 678	85 565	157 253	105 488
Prepayments and accruals	6 641	2 458	94 618	69 198
Special funds	35	26	33	33
Total liabilities	**869 657**	**932 045**	**272 081**	**233 412**
Income	180 571	201 104	156 972	154 987
Profit (loss) for the period	45 011	37 849	73 173	72 372
Dividends paid to BZ WBK	**19 142**	**10 827**	**25 719**	**–**

** Data are based on estimates of companies.*

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2016 data are based on audit financial report of companies BZ WBK – Aviva Towarzystwo Ubezpieczeń na Życie S.A. and BZ WBK – Aviva Towarzystwo Ubezpieczeń Ogólnych S.A.

Data published in Annual Report 2016 were based on estimates of companies. Difference between estimates and real data are irrelevant.

25. Intangible assets

Intangible assets Year 2017	Licences, patents etc.	Other	Expenditure on intangible assets	Total
Gross value – beginning of the period	1 387 288	429 893	195 384	2 012 565
Additions from:				
– purchases	–	–	174 088	174 088
– intangible assets taken for use	145 582	13 338	–	158 920
– transfers	13	–	–	13
– merger	2 890	–	–	2 890
Disposals from:				
– liquidation	(44 085)	(2 091)	(669)	(46 845)
– intangible assets taken for use	–	–	(158 920)	(158 920)
– transfers	(2)	–	(11 362)	(11 364)
– merger	(2 890)	–	–	(2 890)
Gross value – end of the period	1 488 796	441 140	198 521	2 128 457
Accumulated depreciation – beginning of the period	(1 174 777)	(351 026)	–	(1 525 803)
Additions/disposals from:				
– current year amortization	(136 738)	(30 798)	–	(167 537)
– liquidation, sale	44 085	2 090	–	46 175
– transfers	–	9 034	–	9 034
Write down/Reversal of impairment write down	–	–	–	–
Accumulated depreciation– end of the period	(1 267 430)	(370 700)	–	(1 638 131)
Balance sheet value				
Purchase value	1 488 796	441 140	198 521	2 128 457
Accumulated depreciation	(1 267 430)	(370 700)	–	(1 638 130)
As at 31 December 2017	**221 366**	**70 440**	**198 521**	**490 327**

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Intangible assets Year 2016	Licences, patents etc.	Other	Expenditure on intangible assets	Total
Gross value – beginning of the period	1 307 659	429 027	170 653	1 907 339
Intangible assets acquired in a business combination	745	–	–	745
Additions from:				
– purchases	–	–	159 181	159 181
– intangible assets taken for use	132 505	7 503	–	140 008
– transfers	335	3	6 173	6 511
Disposals from:				
– liquidation	(53 956)	(6 640)	(107)	(60 703)
– intangible assets taken for use	–	–	(140 009)	(140 009)
– transfers	–	–	(507)	(507)
Gross value – end of the period	1 387 288	429 893	195 384	2 012 565
Accumulated depreciation – beginning of the period	(1 122 378)	(319 274)	–	(1 441 652)
Accumulated depreciation acquired in a business combinations	(676)	–	–	(676)
Additions/disposals from:				
– current year amortization	(113 416)	(30 491)	–	(143 907)
– liquidation, sale	53 441	6 535	–	59 976
– transfers	8 145	(8 145)	–	–
Write down/Reversal of impairment write down	107	349	–	456
Accumulated depreciation – end of the period	(1 174 777)	(351 026)	–	(1 525 803)
Balance sheet value				
Purchase value	1 387 288	429 893	195 384	2 012 565
Accumulated depreciation	(1 174 777)	(351 026)	–	(1 525 803)
As at 31 December 2016	**212 511**	**78 867**	**195 384**	**486 762**

26. Goodwill

As at 31 December 2017 the goodwill covered the following items:

- PLN 1,688,516 k – goodwill arising from the merger of Bank Zachodni WBK and Kredyt Bank on 4 January 2013,
- PLN 23,540 k – goodwill arising from the fact that Bank Zachodni WBK holds 60% shares of Santander Consumer Bank, which, in turn, has 50% stake in PSA Finance Polska. Bank Zachodni WBK discloses non-controlling interests representing 70% of share capital and voting power at the General Meetings of PSA Finance Polska and, indirectly, PSA Consumer Finance Polska (for more information, see Note 50).

In the corresponding period, at 31 December 2016 the goodwill was PLN 1,688,516 k.

In accordance with IFRS 3 the goodwill was calculated as the surplus of the cost of acquisition over the fair value of assets and liabilities acquired.

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Test for impairment of goodwill arising from the merger between Bank Zachodni WBK and Kredyt Bank

In 2017 and in the corresponding period, the Group conducted tests for impairment of goodwill arising from the merger with Kredyt Bank on 4 January 2013. The carrying amount as at 31 December 2017 was PLN 1,688,516 k (the same as at 31 December 2016).

Recoverable amount based on value in use

The recoverable amount of cash-generating units is the higher of fair value less costs of disposal and value in use. Value in use which is higher than the fair value less costs of disposal is measured on the basis of a discounted cash flow model relevant for banks and other financial institutions. The future expected cash flows generated by business segments of Bank Zachodni WBK are in line with the 3-year financial projections of the Group's management for 2018-2020.

Taking into account the stability of Bank Zachodni WBK Group and sustainable financial performance, and comparing the value in use with the carrying amount of the cash-generating unit, no impairment was identified.

Key assumptions for measuring value in use

For the purposes of goodwill impairment testing the bank applies the following allocation of goodwill to historical business segments. The allocation results from the initial recognition as at acquisition date:

	Retail Banking	Business and Corporate Banking	Global Banking and Markets	ALM and Centre	Total
Goodwill	**781 308**	**480 946**	**299 552**	**126 710**	**1 688 516**

Under the adopted valuation model, the assumptions used to determine the value in use for the individual segments are the same.

Financial projection

The financial projection for 2018-2020 was prepared taking into account strategic and operational plans for 2018-2020 and available macroeconomic and market forecasts. According to the macroeconomic forecasts for 2018-2020 underlying the goodwill impairment test, the average GDP growth is projected at 2.5%. Interest rates are expected to continue at the low level at least until the end of 2018 and grow thereafter. The financial projection assumes the continued expansion of products and services, with a special focus on an increase in the main product lines and on services to retail and SME customers who use financing and savings products and transactional banking services.

Discount rate

Depending on the time horizon, the discount rate in the dividend discount model is 8.5% – 9.0%. The discount rate equal to the rate of return was calculated on the basis of the Capital Assets Pricing Model, taking into account: risk-free rate, beta coefficient for BZ WBK published on the Bloomberg site and market risk premium. The risk-free rate for the next three years ranges from 3.8% to 4.16% and is based on the yield of treasury securities commensurate with the discount period. Cash flows beyond the 3-year financial projection are discounted using predicted yield of 10-year treasury securities, after the third year of detailed projection at 4.27%. As at the end of 2017, market risk premium was estimated at 5.5%.

Growth rate in the period beyond the financial projections

The extrapolation of cash flows exceeding the 3-year period of financial projections (residual value) was based on an annual growth rate of 2.5%, i.e. the projected long-term GDP growth rate.

Minimum solvency ratio imposed by the regulator

An increase in the required capital amount results in a decrease in the amount of capital available for distribution as part of the test. On 1 January 2018, the following legal provisions take effect: higher capital requirements for 50% profit distribution, additional capital requirements for risk attached to mortgage loans (0.54 p.p.), additional conservation buffer of 1.25 p.p., buffer of other systemically important institution of 0.5 p.p. (determined individually by the KNF) and systemic risk buffer of 3.0 p.p., increased by 1.5 p.p. In addition, banks are required to adjust dividend yield depending on the share of FX home loans in the credit portfolio. All the above factors have a negative impact on the capital available for distribution and, consequently, on the results of the goodwill impairment test.

As a consequence, the minimum solvency ratio imposed by the KNF as a criterion for max 50% profit distribution is 14.79%.

Whereas higher capital requirements ensure stability and safety of Bank Zachodni WBK as they increase the capital base, they reduce the amount of dividends attributable to the shareholders, which in turn affects the value in use of the cash-generating unit.

Test for impairment of goodwill arising from the purchase of shares of PSA Finance Polska

The bank did not conduct the test for impairment of goodwill arising from the acquisition of shares of PSA Finance Polska and, indirectly, PSA Consumer Finance Polska by Santander Consumer Bank. Goodwill calculated as an excess of the value of non- controlling interests (70%) and the payment made over the carrying amount of the identified net assets is not significant.

As at 31 December 2017, no goodwill impairment was identified.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

27. Property, plant and equipment

Property, plant & equipment Year 2017	Land and buildings	Equipment	Transportation means	Other fixed assets	Capital expenditures	Total
Gross value – beginning of the period	**960 363**	**699 615**	**145 207**	**278 394**	**152 659**	**2 236 238**
Additions from:						
– purchases	–	–	–	–	240 121	240 121
– leasing	–	–	9 062	–	–	9 062
– fixed assets taken for use	27 253	136 875	45 940	15 842	–	225 910
– transfers	–	146	2 436	10	2 280	4 872
– merger	28	381	–	53	–	462
Disposals from:						
– sale, liquidation, donation	(44 330)	(30 308)	(31 572)	(30 919)	(225)	(137 354)
– fixed assets taken for use	–	–	–	–	(225 910)	(225 910)
– transfers	–	–	(15 537)	(62)	(86)	(15 685)
– merger	(28)	(381)	–	(53)	–	(462)
Gross value – end of the period	**943 286**	**806 328**	**155 536**	**263 265**	**168 839**	**2 337 254**
Accumulated depreciation – beginning of the period	**(621 431)**	**(468 323)**	**(32 154)**	**(236 032)**	**–**	**(1 357 940)**
Additions/disposals from:						
– current year amortization	(36 634)	(77 772)	(22 934)	(14 056)	–	(151 396)
– sale, liquidation, donation	35 380	29 812	9 048	30 008	–	104 248
– transfers	17	32	6 568	239	–	6 856
Write down/Reversal of impairment write down	(8 304)	–	(1)	–	–	(8 305)
Accumulated depreciation– end of the period	**(630 972)**	**(516 251)**	**(39 473)**	**(219 841)**	**–**	**(1 406 537)**
Balance sheet value						
Purchase value	943 286	806 328	155 536	263 265	168 839	2 337 254
Accumulated depreciation	(630 972)	(516 251)	(39 473)	(219 841)	–	(1 406 537)
As at 31 December 2017	**312 314**	**290 077**	**116 063**	**43 424**	**168 839**	**930 717**

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Property, plant & equipment Year 2016	Land and buildings	Equipment	Transportation means	Other fixed assets	Capital expenditures	Total
Gross value – beginning of the period	**985 451**	**625 042**	**120 374**	**310 922**	**132 927**	**2 174 716**
Property, plant and equipment acquired in a business combination	**429**	**1 740**	**1 722**	**997**	**–**	**4 888**
Additions from:						
– purchases	–	–	–	–	194 802	194 802
– leasing	–	–	30 680	–	–	30 680
– fixed assets taken for use	26 243	101 509	30 435	11 541	–	169 728
– transfers	58	18 728	4 390	676	922	24 774
Disposals from:						
– sale, liquidation, donation	(51 314)	(46 520)	(13 041)	(27 014)	–	(137 889)
– fixed assets taken for use	–	–	–	–	(169 727)	(169 727)
– transfers	(504)	(884)	(29 353)	(18 728)	(6 265)	(55 734)
Gross value – end of the period	**960 363**	**699 615**	**145 207**	**278 394**	**152 659**	**2 236 238**
Accumulated depreciation – beginning of the period	**(613 329)**	**(433 400)**	**(34 664)**	**(262 830)**	**–**	**(1 344 223)**
Accumulated depreciation acquired in a business combinations	**(180)**	**(1 605)**	**(101)**	**(975)**	**–**	**(2 861)**
Additions/disposals from:						
– current year amortization	(35 062)	(64 752)	(20 508)	(12 991)	–	(133 313)
– sale, liquidation, donation	39 433	46 508	6 878	25 517	–	118 336
– transfers	27	(15 074)	16 241	15 061	–	16 255
Write down/Reversal of impairment write down	(12 320)	–	–	186	–	(12 134)
Accumulated depreciation– end of the period	**(621 431)**	**(468 323)**	**(32 154)**	**(236 032)**	**–**	**(1 357 940)**
Balance sheet value						
Purchase value	960 363	699 615	145 207	278 394	152 659	2 236 238
Accumulated depreciation	(621 431)	(468 323)	(32 154)	(236 032)	–	(1 357 940)
As at 31 December 2016	**338 932**	**231 292**	**113 053**	**42 362**	**152 659**	**878 298**

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28. Net deferred tax assets

Deferred tax assets	31.12.2017	Changes to equity*	Changes to financial result	Changes in temporary differences	31.12.2016
Provisions for impairment of loans and advances	666 968	–	16 536	16 536	650 432
Valuation of derivative financial instruments	364 432	–	(353 780)	(353 780)	718 212
Cash flow hedges valuation	20 509	(4 743)	–	(4 743)	25 252
Other provisions	163 492	–	17 352	17 352	146 140
Deferred income	509 045	–	66 633	66 633	442 412
Differences between carrying and tax value of lease	373 662	–	76 007	76 007	297 655
Unrealised interest expenses on loans, deposits and securities	126 619	–	35 007	35 007	91 612
Other negative temporary differences	25 242	–	12 223	12 223	13 019
Total deferred tax assets	**2 249 969**	**(4 743)**	**(130 022)**	**(134 765)**	**2 384 734**

Deferred tax liabilities	31.12.2017	Changes to equity*	Changes to financial result	Changes in temporary differences	31.12.2016
Revaluation of financial instruments available for sale	(188 908)	(101 417)	–	(101 417)	(87 491)
Provisions for retirement allowances	(126)	1 788	–	1 788	(1 914)
Valuation of derivative financial instruments	(261 617)	–	105 928	105 928	(367 545)
Unrealised interest income on loans, securities and interbank deposits	(179 373)	–	31 125	31 125	(210 498)
Prepayments regarding amortization of applied investment relief	(1 751)	–	125	125	(1 876)
Difference between balance sheet and taxable value of non–financial assets	8 466	–	3 340	3 340	5 126
Unrealised FX translation differences from b/s valuation of receivables and liabilities	(8 773)	–	509	509	(9 282)
Valuation of shares / interests in subsidiaries	(146 966)	–	816	816	(147 782)
Other positive temporary differences	(56 694)	–	(27 544)	(27 544)	(29 150)
Total deferred tax liabilities	**(835 742)**	**(99 629)**	**114 299**	**14 670**	**(850 412)**
Net deferred tax assets	**1 414 227**	**(104 372)**	**(15 723)**	**(120 095)**	**1 534 322**

** The changes carried in equity do not reflect the deferred tax effect in relation to the item recognised in non-controlling interests.*

As at 31.12.2017, the calculation of deferred tax assets did not include purchased receivables in the gross amount of PLN 5,114 k and provisions for loans that did not become tax expense in the amount of gross PLN 65,960 k.

Deferred tax assets	31.12.2016	Changes to equity*	Changes to financial result	Changes in temporary differences	31.12.2015
Provisions for impairment of loans and advances	650 432	–	41 699	41 699	608 733
Valuation of derivative financial instruments	718 212	–	(49 632)	(49 632)	767 844
Cash flow hedges valuation	25 252	(20 637)	–	(20 637)	45 889
Other provisions	146 140	–	3 215	3 215	142 925
Deferred income	442 412	–	35 685	35 685	406 727
Differences between carrying and tax value of lease	297 655	–	106 734	106 734	190 921
Unrealised interest expenses on loans, deposits and securities	91 612	–	1 715	1 715	89 897
Other negative temporary differences	13 019	–	(2 388)	(2 388)	15 407
Total deferred tax assets	**2 384 734**	**(20 637)**	**137 028**	**116 391**	**2 268 343**

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Deferred tax liabilities	31.12.2016	Changes to equity*	Changes to financial result	Changes in temporary differences	31.12.2015
Revaluation of financial instruments available for sale	(87 491)	140 283	–	140 283	(227 774)
Provisions for retirement allowances	(1 914)	(1 304)	–	(1 304)	(610)
Valuation of derivative financial instruments	(367 545)	–	56 063	56 063	(423 608)
Unrealised interest income on loans, securities and interbank deposits	(210 498)	–	(27 838)	(27 838)	(182 660)
Prepayments regarding amortization of applied investment relief	(1 876)	–	327	327	(2 203)
Difference between balance sheet and taxable value of non–financial assets	5 126	–	2 951	2 951	2 175
Unrealised FX translation differences from b/s valuation of receivables and liabilities	(9 282)	–	(790)	(790)	(8 492)
Valuation of shares / interests in subsidiaries	(147 782)	–	4 882	4 882	(152 664)
Other positive temporary differences	(29 150)	–	(8 451)	(8 451)	(20 699)
Total deferred tax liabilities	**(850 412)**	**138 979**	**27 144**	**166 123**	**(1 016 535)**
Net deferred tax assets	**1 534 322**	**118 342**	**164 172**	**282 514**	**1 251 808**

** The changes carried in equity do not reflect the deferred tax effect in relation to the item recognised in non-controlling interests.*

As at 31.12.2016, the calculation of deferred tax assets did not include purchased receivables in the amount of gross PLN 8,500 k and provisions for loans that did not become tax expenses in the gross amount of PLN 52,896 k.

Movements on net deferred tax	31.12.2017	31.12.2016
As at the beginning of the period	1 534 322	1 251 808
Changes on net deferred tax in a business combination	–	35 387
Changes recognised in income statement	(14 885)	127 976
Changes recognised in other comprehensive income	(104 372)	118 342
Transfer	(838)	809
Balance at the end of the period	**1 414 227**	**1 534 322**

Temporary differences recognised in equity comprise deferred tax on available for sale securities, cash flow hedges and provisions for retirement allowances.

Temporary differences recognised in the income statement comprise deferred tax on the valuation of other financial assets, allowance for impairment of loans and receivables and assets in the course of business.

The impact of IFRS 9 implementation on the deferred tax effect is presented in Note 2.2.

29. Assets classified as held for sale

Assets classified as held for sale	31.12.2017	31.12.2016
Land and buildings	8	608
Other fixed assets	95	21
Total	**103**	**629**

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30. Other assets

Other assets	31.12.2017	31.12.2016
Interbank settlements	142 701	106 829
Sundry debtors	756 662	443 476
Prepayments	128 892	125 164
Repossessed assets	103	24 567
Settlements of stock exchange transactions	31 711	21 385
Other	4 999	4 293
Total	**1 065 068**	**725 714**
of which financial assets*	931 074	571 690

** Financial assets include all items of Other assets, with the exception of Prepayments, Repossessed assets and Other.*

31. Deposits from banks

Deposits from banks	31.12.2017	31.12.2016
Term deposits	64 023	98 531
Loans from other banks	1 994 759	1 945 101
Current accounts	724 301	517 649
Total	**2 783 083**	**2 561 281**

As at 31.12.2017, the fair value adjustment for hedged deposit totaled PLN nil (as at 31.12.2016 – PLN nil). The fair value of "Deposits from banks" is presented in Note 43.

Movements in loans received from banks	31.12.2017	31.12.2016
As at the beginning of the period	1 945 101	574 693
Increase (due to:)	985 114	1 911 927
– drawing of loans	953 810	1 849 792
– interest on loans	31 304	21 348
– FX differences and other	–	40 787
Decrease (due to):	(935 456)	(541 519)
– repayment of loans	(841 644)	(522 731)
– interest repayment	(31 700)	(18 788)
– FX differences and other	(62 112)	–
As at the end of the period	**1 994 759**	**1 945 101**

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32. Deposits from customers

Deposits from customers	31.12.2017	31.12.2016
Deposits from individuals	**64 987 719**	**63 547 942**
Term deposits	21 911 544	23 711 846
Current accounts	42 948 226	39 650 731
Other	127 949	185 365
Deposits from enterprises	**42 170 092**	**45 709 065**
Term deposits	17 486 056	22 608 733
Current accounts	20 481 778	18 464 132
Loans	3 552 388	4 075 897
Other	649 870	560 303
Deposits from public sector	**4 323 324**	**3 265 450**
Term deposits	2 085 917	1 504 136
Current accounts	2 233 410	1 747 709
Other	3 997	13 605
Total	**111 481 135**	**112 522 457**

As at 31.12.2017 deposits held as collateral totaled PLN 271,147 k (as at 31.12.2016 – PLN 289,695 k). The fair value of "Deposits from customers" is presented in Note 43.

Movements in loans received from other financial institutions	31.12.2017	31.12.2016
As at the beginning of the period	**4 075 897**	**3 002 047**
Increase (due to:)	**483 022**	**1 572 132**
– drawing of loans	466 860	1 425 007
– interest on loans	16 162	14 165
– FX differences and other	–	132 960
Decrease (due to):	**(1 006 531)**	**(498 282)**
– repayment of loans	(726 764)	(486 245)
– interest repayment	(16 513)	(12 037)
– FX differences and other	(263 254)	–
As at the end of the period	**3 552 388**	**4 075 897**

33. Subordinated liabilities

Subordinated liabilities	Redemption date	Currency	Nominal value
Tranche 1	05.08.2025	EUR	100 000
Tranche 2	03.12.2026	EUR	120 000
Tranche 3	22.05.2027	EUR	137 100

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Movements in subordinated liabilities	31.12.2017	31.12.2016
As at the beginning of the period	440 457	526 634
Increase (due to):	1 133 436	31 671
– interest on subordinated loan	33 564	18 919
– FX differences	–	12 752
– reclassification *	1 099 872	–
Decrease (due to):	(85 291)	(117 848)
– subordinated loans repayment	–	(100 000)
– interest repayment	(27 528)	(17 848)
– FX differences	(57 763)	–
Subordinated liabilities – as at the end of the period	1 488 602	440 457
Short–term	11 257	1 604
Long–term (over 1 year)	1 477 345	438 853

** Bonds issued by Bank Zachodni WBK and qualified with the consent of KNF to subordinated liabilities.*

Other details concerning these liabilities are disclosed in Note 5.

34. Debt securities in issue

Issuance of debt securities in 2017 (non–matured securities)	Nominal value	Currency	Redemption date
Series F bank securities	750 000	PLN	19.02.2018
Series A	700 000	PLN	18.04.2018
SCB00038	300 000	PLN	09.08.2021
SCB00039	252 100	PLN	09.10.2020
SCB00040	261 400	PLN	07.10.2022
SCB00041	60 000	PLN	07.10.2022

Issuance of debt securities in 2016 (non–matured securities)	Nominal value	Currency	Redemption date
Series D	185 000	PLN	26.02.2017
Series C bank securities	100 000	PLN	17.02.2017
Series E	120 000	EUR	03.12.2026
SCB00031	40 000	PLN	23.02.2018
SCB00032	20 000	PLN	26.08.2019
SCB00037	40 000	PLN	02.12.2019
SCB00033	50 000	PLN	26.02.2020
SCB00034	140 000	PLN	05.05.2020
SCB00035	82 000	PLN	29.05.2020
SCB00036	100 000	PLN	10.08.2020
Securitized bonds float sale	1 225 000	PLN	16.09.2026

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Movements in debt securities in issue	31.12.2017	31.12.2016
As at the beginning of the period	**5 529 187**	**4 320 891**
Increase (due to:)	**3 745 653**	**2 894 670**
– debt securities in issue	3 562 288	2 762 880
– interest on debt securities in issue	167 135	131 790
– FX differences	16 230	–
Decrease (due to):	**(3 379 026)**	**(1 686 374)**
– debt securities redemption	(2 095 000)	(1 554 700)
– reclassification*	(1 099 872)	–
– FX differences	(21 786)	–
– interest repayment	(162 368)	(131 674)
As at the end of the period	**5 895 814**	**5 529 187**

** Bonds issued by Bank Zachodni WBK and qualified with the consent of KNF to subordinated liabilities.*

35. Provisions

Provisions	31.12.2017	31.12.2016
Provisions for off–balance sheet credit facilities	50 652	50 746
Provisions for legal claims	99 463	74 396
Provisions for restructuring *	3 019	4 986
Total	**153 134**	**130 128**

** Provisions for restructuring acquired as a result of the acquisition of control over Santander Consumer Bank on July 1, 2014 in the amount of PLN 15,547 k (as at 31.12.2017 in the amount of PLN 3,019 k) referred to:*
– restructuring of employment in the bank PLN 3,323 k (as at 31.12.2017 in the amount of PLN 955 k),
– liquidation of branches PLN 12,224 k. (as at 31.12.2017 in the amount of PLN 2,064 k).

The restructuring is related to the business reorganisation plan for Santander Consumer Finance (SCF) in Poland which was adopted by the Group in 2010. The plan was adopted after SCF Group had taken control over AIG Bank Polska S.A. and in the wake of subsequent restructuring actions carried out in the years 2013-2014 (amongst others, restructuring of the business transferred from Santander Consumer Finanse Sp z o.o.). Provision has also been associated with the implementation of the Operational Excellence Programme in 2015.

Change in provisions 31.12.2017	Provisions for legal claims	Provisions for off balance sheet credit facilities	Provisions for restructuring	Total
As at the beginning of the period	**74 396**	**50 746**	**4 986**	**130 128**
Provision charge	63 742	77 447	4 754	145 943
Utilization	(12 142)	(517)	–	(12 659)
Write back	(26 533)	(77 024)	(6 721)	(110 278)
Other changes	–	–	–	–
Balance at the end of the period	**99 463**	**50 652**	**3 019**	**153 134**
Short–term	99 463	43 693	3 019	146 175
Long–term	–	6 959	–	6 959

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Change in provisions 31.12.2016	Provisions for legal claims	Provisions for off balance sheet credit facilities	Provisions for restructuring	Total
As at the beginning of the period	**48 582**	**75 340**	**8 648**	**132 570**
Provision charge	93 280	93 586	377	187 243
Utilization	(66 157)	835	–	(65 322)
Write back	(1 309)	(119 015)	(4 000)	(124 324)
Other changes	–	–	(39)	(39)
Balance at the end of the period	**74 396**	**50 746**	**4 986**	**130 128**
Short–term	74 396	41 752	4 986	121 134
Long–term	–	8 994	–	8 994

36. Other liabilities

Other liabilities	31.12.2017	31.12.2016
Settlements of stock exchange transactions	25 851	25 314
Interbank settlements	952 192	585 606
Employee provisions	407 722	375 959
Other provisions	3 300	3 300
Sundry creditors	511 537	512 010
Other deferred and suspended income	249 880	250 059
Public and legal settlements	84 971	86 298
Accrued liabilities	532 117	436 249
Finance lease related settlements	99 306	72 901
Other	1 898	866
Total	**2 868 774**	**2 348 562**
of which financial liabilities *	2 532 025	2 011 339

** Financial liabilities include all items of 'Other liabilities' with the exception of Public and legal settlements, Other deferred and suspended income and Other.*

Change in provisions 31.12.2017	Employee provisions		Other provisions	Total
		of which: Provisions for retirement allowances		
As at the beginning of the period	**375 959**	**60 397**	**3 300**	**379 259**
Provision charge	330 771	14 270	–	330 771
Utilization	(232 256)	–	–	(232 256)
Write back	(66 675)	(1 941)	–	(66 675)
Other changes	(77)	–	–	(77)
Balance at the end of the period	**407 722**	**72 726**	**3 300**	**411 022**
Short–term	334 996	–	3 300	338 296
Long–term	72 726	72 726	–	72 726

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Change in provisions 31.12.2016	Employee provisions	of which: Provisions for retirement allowances	Other provisions	Total
As at the begining of the period	**380 724**	**63 209**	**3 306**	**384 030**
Provision acquired in a business combination	**747**	**46**	**–**	**747**
Provision charge	327 004	1 046	–	327 004
Utilization	(269 233)	–	(6)	(269 239)
Write back	(63 543)	(319)	–	(63 543)
Other changes	260	(3 585)	–	260
Balance at the end of the period	**375 959**	**60 397**	**3 300**	**379 259**
Short–term	315 562	–	3 300	318 862
Long–term	60 397	60 397	–	60 397

Employee related provisions and accruals consists of items outlined in Note 51.

37. Share capital

31.12.2017

Series/ issue	Type of share	Type of preferences	Limitation of rights to shares	Number of shares	Nominal value of series/issue in PLN k
A	bearer	none	none	5 120 000	51 200
B	bearer	none	none	724 073	7 241
C	bearer	none	none	22 155 927	221 559
D	bearer	none	none	1 470 589	14 706
E	bearer	none	none	980 393	9 804
F	bearer	none	none	2 500 000	25 000
G	bearer	none	none	40 009 302	400 093
H	bearer	none	none	115 729	1 157
I	bearer	none	none	1 561 618	15 616
J	bearer	none	none	18 907 458	189 075
K	bearer	none	none	305 543	3 055
L	bearer	none	none	5 383 902	53 839
M	bearer	none	none	98 947	990
				99 333 481	**993 335**

The nominal value of one share is PLN 10. All shares in issue are fully paid.

The shareholder having minimum 5% of the total number of votes at the BZ WBK General Meeting of Shareholders was Banco Santander with a controlling stake of 69.34% stake.

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31.12.2016

Series/ issue	Type of share	Type of preferences	Limitation of rights to shares	Number of shares	Nominal value of series/issue in PLN k
A	bearer	none	none	5 120 000	51 200
B	bearer	none	none	724 073	7 241
C	bearer	none	none	22 155 927	221 559
D	bearer	none	none	1 470 589	14 706
E	bearer	none	none	980 393	9 804
F	bearer	none	none	2 500 000	25 000
G	bearer	none	none	40 009 302	400 093
H	bearer	none	none	115 729	1 157
I	bearer	none	none	1 561 618	15 616
J	bearer	none	none	18 907 458	189 075
K	bearer	none	none	305 543	3 055
L	bearer	none	none	5 383 902	53 839
				99 234 534	**992 345**

The nominal value of one share is PLN 10. All shares in issue are fully paid.

The shareholders having minimum 5% of the total number of votes at the BZ WBK General Meeting of Shareholders were Banco Santander with a controlling stake of 69.41% stake and Nationale-Nederlanden OFE with a share of 5.15%.

38. Other reserve capital

Other reserve capital	31.12.2017	31.12.2016
General banking risk fund	649 810	649 810
Share premium	7 035 424	7 035 424
Other reserves of which:	9 234 895	8 106 321
Reserve capital	8 953 176	7 879 974
Supplementary capital	937 954	890 172
Adjustment to equity from acquisition/loss of controlling interest in subsidiaries	(656 234)	(663 825)
Total	**16 920 129**	**15 791 555**

Share (issue) premium is created from surplus over the nominal value of shares sold less costs of share issuance and constitutes the bank's supplementary capital.

Reserve capital as at 31.12.2017 includes share scheme charge of PLN 118,423 k and reserve capital as at 31.12.2016 includes share scheme charge of PLN 120,750 k.

Other movements of other reserve capital are presented in "movements on consolidated equity" for 2017 and 2016.

Statutory reserve (supplementary) capital is created from profit allocations in line with the prevailing banking legislation and the bank's Statute. The capital is not subject to split and is earmarked for covering balance sheet losses. Allocations from profit for the current year to reserve capital should amount to at least 8% of profit after tax and are made until supplementary capital equals at least one third of the bank's share capital. The amount of allocations is adopted by the General Meeting of Shareholders.

Reserve capital is created from profit allocations in the amount adopted by the General Meeting of Shareholders. The decision on reserve capital use is taken by the General Meeting of Shareholders.

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39. Revaluation reserve

Revaluation reserve 31.12.2017	Total gross amount	Deferred tax adjustment	Total net amount
Opening balance, of which:	340 856	(64 763)	276 093
Debt and equity securities	465 234	(88 396)	376 838
Valuation related to cash flow hedge	(134 282)	25 514	(108 768)
Actuarial gains/losses on retirement allowances	9 904	(1 881)	8 023
Change in valuation of debt and equity securities available for sale	549 139	(104 336)	444 802
Decrease in revaluation reserve related to sale of investments	(23 503)	4 465	(19 037)
Change of cash flow hedges valuations	24 931	(4 737)	20 193
Change of actuarial gains/losses on retirement allowances	(9 365)	1 779	(7 586)
Closing balance, of which:	882 058	(167 592)	714 466
Debt and equity securities	990 870	(188 267)	802 603
Valuation related to cash flow hedge	(109 351)	20 777	(88 574)
Actuarial gains/losses on retirement allowances	539	(102)	437

Revaluation reserve 31.12.2016	Total gross amount	Deferred tax adjustment	Total net amount
Opening balance, of which:	959 153	(182 239)	776 914
Debt and equity securities	1 197 303	(227 489)	969 814
Valuation related to cash flow hedge	(241 359)	45 859	(195 500)
Actuarial gains/losses on retirement allowances	3 209	(609)	2 600
Change in valuation of debt and equity securities available for sale	(459 368)	87 280	(372 088)
Decrease in revaluation reserve related to sale of investments	(272 701)	51 813	(220 888)
Change of cash flow hedges valuations	131 726	(25 028)	106 698
Decrease in revaluation reserve related to sale of cash flow hedges	(24 649)	4 683	(19 966)
Change of actuarial gains/losses on retirement allowances	6 695	(1 272)	5 423
Closing balance, of which:	340 856	(64 763)	276 093
Debt and equity securities	465 234	(88 396)	376 838
Valuation related to cash flow hedge	(134 282)	25 514	(108 768)
Actuarial gains/losses on retirement allowances	9 904	(1 881)	8 023

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40. Non – controlling interests

Name of the subsidiary	Country of incorporation and place of business	Percentage share of non–controlling interests in share capital / voting rights		Net profit for the period attributable tonon–controlling interests		Accumulated non–controlling interests	
		31.12.2017	31.12.2016	31.12.2017	31.12.2016	31.12.2017	31.12.2016
BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A.	Poland	50.00	50.00	33 252	24 634	42 507	46 802
BZ WBK Asset Management S.A.	Poland	0,00	0,00	–	1 763	–	–
Santander Consumer Bank S.A.	Poland	40.00	40.00	272 208	190 848	1 393 902	1 190 847
Total				**305 460**	**217 245**	**1 436 409**	**1 237 649**

The table below presents condensed financial information regarding subsidiaries which have a significant contribution to the Group:

	BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A.		BZ WBK Asset Management S.A.		Santander Consumer Bank S.A.	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016	31.12.2017	31.12.2016
Loans and advances to banks	79 045	86 904	–	–	130 022	111 871
Loans and advances to customers	–	–	–	–	13 891 179	13 370 604
Investments in subsidiaries	–	–	–	–	154 775	157 552
Financial assets available for sale	–	–	–	–	2 608 443	2 959 214
Net deferred tax assets	2 234	1 573	–	–	468 338	425 644
Other items	36 352	29 457	–	–	394 257	357 384
Total assets	**117 631**	**117 934**	**–**	**–**	**17 647 014**	**17 382 269**
Deposits from banks	–	–	–	–	152 739	73 339
Deposits from customers	–	–	–	–	10 846 837	10 889 396
Sell–buy–back transactions	–	–	–	–	1 171 179	1 632 613
Debt securities in issue	–	–	–	–	1 676 559	1 466 769
Other items	32 617	24 331	–	–	609 633	615 118
Total liabilities	**32 617**	**24 331**	**–**	**–**	**14 456 947**	**14 677 235**
Income	314 031	258 932	–	8 648	1 944 552	1 735 893
Profit (loss) for the period	66 503	49 267	–	3 525	649 136	451 408
Dividends paid to non–controlling interests	37 546	29 847	–	22 344	73 416	173 834

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41. Hedge accounting

Band Zachodni WBK Group uses hedging strategies within hedge accounting in line with the risk management principles set out in note 4 to the consolidated financial statements.

Fair value hedges

Bank Zachodni WBK Group uses fair value hedge accounting in relation to the following classes of financial instruments:

- Debt securities with a fixed interest rate in PLN and denominated in EUR;
- Loans with a fixed interest rate granted by the Bank in PLN;
- Loans with a fixed interest rate taken out by BZ WBK Leasing.

To hedge the fair value, Bank Zachodni WBK uses Interest Rate Swaps and Overnight Indexed Swaps, for which the Bank pays a fixed interest rate and receives a variable interest rate. The hedged risk is the change in the fair value of an instrument or a portfolio resulting from changes in market interest rates. The transactions do not hedge against fair value changes relating to credit risk.

Hedging items are measured at fair value. Hedged items are measured at amortised cost taking into account fair value adjustments on account of the risk being hedged.

The tables below contain details about individual groups of hedge transactions as at 31.12.2017 and 31.12.2016:

31.12.2017	Bonds	Loans
Nominal value of hedging position	1 979 709	425 000
Measurement to fair value of hedging instrument	(104 434)	3 763
Fair value adjustment of hedged instrument due to hedged risk asset/(liability)	107 005	(3 817)
Hedged risk	Interest rate risk	Interest rate risk
Period over which the instruments have an impact on the bank's results	up to 2025	up to 2021

31.12.2016	Bonds	Loans
Nominal value of hedging position	1 982 240	300 000
Measurement to fair value of hedging instrument	(128 789)	4 358
Fair value adjustment of hedged instrument due to hedged risk asset/(liability)	132 512	(4 409)
Hedged risk	Interest rate risk	Interest rate risk
Period over which the instruments have an impact on the bank's results	up to 2025	up to 2021

Since January 2016, Bank Zachodni WBK has used portfolio-based hedge accounting for the fair value of interest rate risk with respect to the portfolio of fixed interest rate loans in PLN. The fair value hedges are Interest Rate Swaps for which the bank pays a fixed rate and receives a variable rate. The purpose of the hedge is to eliminate the risk of changes in the fair value of the fixed interest rate loans resulting from movements in market interest rates. Credit margin is excluded from the hedging relationship.

In December 2015, Bank Zachodni WBK stopped applying fair value macro hedge accounting for a hedge of interest rate risk on fixed interest rate cash loans in PLN (6 relationships in total). By the time the bank stopped using the hedge accounting, the accumulated fair value adjustment for the hedged position recognized in the balance sheet was PLN 7,148 k. This amount is amortized against the profit & loss account according to the terms originally agreed for individual hedging relationships. PLN 1,199 k was recognised in the income statement for 2017 and PLN 262 k will be reflected in the income statement by the end of 2018.

As at 31.12.2017, BZ WBK Leasing had three derivative instrument – IRS (Interest Rate Swap), designated to hedge accounting of cashflows, which hedges the company against the risk of credit margin and the risk of credit interest rate. The nominal value of the transaction is PLN 905,172 k.

Transactions were made to hedge the interest rate risk and the credit margin risk arising from three loans raised with international financial institutions – with fixe interest rates. These loans finance lease agreements based on 1M EURIBOR – hence the need to match the moment of revaluation of liabilities and the moment of revaluation of assets.

There was 1 such transaction of PLN 599,079 k in BZ WBK Leasing's financial statements as at 2016 year-end. The fair value (including the accrued interest) totals PLN (365) k as at the balance sheet day.

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Details of the hedging transaction of BZ WBK Leasing S.A. as at 31.12.2017 and 31.12.2016 are presented in tables below:

31.12.2017	BZ WBK Leasing S.A.
Nominal value of hedging position	905 172
Measurement to fair value of hedging instrument	(3 422)
Fair value adjustment of hedged instrument due to hedged risk asset/(liability)	3 422
Hedged risk	Interest rate risk
Period over which the instruments have an impact on the BZ WBK Leasing results	up to 2022

31.12.2016	BZ WBK Leasing S.A.
Nominal value of hedging position	599 079
Measurement to fair value of hedging instrument	(392)
Fair value adjustment of hedged instrument due to hedged risk asset/(liability)	392
Hedged risk	Interest rate risk
Period over which the instruments have an impact on the BZ WBK Leasing results	up to 2022

Cash flow hedging

Bank Zachodni WBK Group uses hedge accounting for its future cash flows with respect to commercial and mortgage credit portfolios based on a variable interest rate, denominated in PLN or in EUR, USD and CHF with maximum maturity of 36 years.

The Group's hedging strategies are designed to protect the Group's exposures against the risk of changes in the value of future cash flows resulting from adverse interest rate movements or – in the case of credit portfolios denominated in foreign currency – from currency fluctuations.

Hedging relationships are created using Interest Rate Swaps, FX Swaps and Cross-Currency Interest Rate Swaps. The bank uses the hypothetical derivative approach whereby the hedged credit portfolio is reflected by a derivative transaction with specific characteristics.

Hedged items are measured at amortised cost, while hedging items are measured at fair value. Subject to fulfilment of the criteria for effectiveness of hedging relationships, changes in the fair value of hedging instruments are recognised in equity.

As of 31 December 2017, the nominal value of the hedging item was PLN 12,117,739 k (31 December 2016 – PLN 16,644,130 k). Measurement to fair value of the hedging instrument was PLN (109,351) k (31 December 2016 – PLN (134,281) k); the same amount, less deferred tax, is recognised in comprehensive income and accumulated in the bank's equity under revaluation reserve and are presented in note 39. Hedging instruments have been concluded for a period of time until 2028.

The non-effective portion of measurement of the cash flow hedge was PLN (10,703) k as of 31.12.2017 and PLN 11,170 k as of 31.12.2016. It was taken to the 'Net trading income and revaluation' line of the profit and loss account.

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42. Sell-buy-back and buy-sell-back transactions

The Group raises funds by selling financial instruments under agreements to repurchase these instruments at future dates at a predetermined price.

Repo and sell-buy back transactions may cover securities from the Group's balance sheet portfolio.

	31.12.2017 Balance sheet value	31.12.2016 Balance sheet value
Liabilities valued at amortised cost (contains sell–buy–back)	2 650 846	1 632 613
Fair value of securities held as collateral for sell–buy–back/repo transactions	2 990 774	1 827 329

Sell–buy–back transactions	31.12.2017	31.12.2016
Sell–buy–back transactions from banks	986 398	1 632 613
Sell–buy–back transactions from customers	1 664 448	–
Total	**2 650 846**	**1 632 613**

The foregoing items are not removed from the balance sheet, because the Group retains all rewards (i.e. interest income on pledged securities) and risks (interest rate risk and the issuer's credit risk) attaching to these assets.

All of the above-mentioned risks and costs related to the holding of the underlying debt securities in the sell-buy-back transactions remain with the Group, as well as power to dispose them.

The Group also effects reverse repo and buy-sell-back transactions at the same price increased by the pre-determined amount of interest.

Financial instruments covered by reverse repo and buy-sell-back transactions are not recognised in the balance sheet, because the Group does not retain any rewards or risks attaching to these assets.

These instruments represent a security cover accepted by the Group which may sell or pledge these assets.

Financial instruments held as security for (reverse repo) repurchase agreements may be sold or repledged under standard agreements, under the obligation to return these to the counterparty on maturity of the transaction.

43. Fair value

The fair value is an amount for which an asset could be exchanged or a liability settled in an arm's length transaction between market participants at the measurement date.

Below is a summary of the book values and fair values of the individual groups of assets and liabilities.

Assets	31.12.2017		31.12.2016	
	Book Value	Fair Value	Book Value	Fair Value
Cash and balances with central banks	4 146 222	4 146 222	4 775 660	4 775 660
Loans and advances to banks	2 136 474	2 136 474	3 513 278	3 513 278
Financial assets held for trading	3 416 108	3 416 108	3 180 985	3 180 985
Hedging derivatives	218 061	218 061	67 645	67 645
Loans and advances to customers	107 839 897	108 488 102	103 068 538	102 882 533
Financial assets available for sale	28 415 812	28 415 812	29 307 878	29 307 878
Investments in associates	889 372	889 372	871 491	871 491
Liabilities				
Deposits from banks	2 783 083	2 783 083	2 561 281	2 561 281
Hedging derivatives	578 798	578 798	2 023 344	2 023 344
Financial liabilities held for trading	1 237 704	1 237 704	1 809 060	1 809 060
Subordinated liabilities	1 488 602	1 500 989	440 457	564 402
Deposits from customers	111 481 135	111 496 805	112 522 457	112 548 047

Below is a summary of the key methods and assumptions used in the estimation of fair values of the financial instruments shown in the table above.

Financial assets and liabilities not carried at fair value in the statement of financial position

The Group has financial instruments which in accordance with the IFRS are not carried at fair value in the consolidated financial statements. The fair value of such instruments is measured using the following methods and assumptions.

Apart from assets that are not measured at fair value, all the other fair values fulfil conditions for classification to Level II of fair value.

Loans and advances to banks: The fair value of deposits is measured using discounted cash flows at the current money market interest rates for receivables of similar credit risk, maturity and currency. In the case of demand deposits without a fixed maturity date or with maturity up to 6 months, it is assumed that their fair value is not significantly different than their book value. The process of fair value estimation for these instruments is not affected by the long-term nature of the business with depositors.

Loans and advances to customers: Carried at net value after impairment charges. Fair value is calculated as the discounted value of the expected future cash flows in respect of principal and interest payments. It is assumed that loans and advances will be repaid at their contractual maturity date. The estimated fair value of the loans and advances reflects changes in the credit risk from the moment of sanction (margins) and changes in interest rates.

Financial assets not carried at fair value: The Group does not use fair valuation for equity securities of unlisted companies for which the fair value cannot be reliably established. In the statement of financial position, equity instruments are presented at cost less impairment. Debt instruments are measured at amortised cost.

Deposits from banks and deposits from customers: Fair value of the deposits with maturity exceeding 6 months was estimated based on the cash flows discounted by the current market rates for the deposits with similar maturity dates. In the case of demand deposits without a fixed maturity date or with maturity up to 6 months, it is assumed that their fair value is not significantly different than their book value. The process of fair value estimation for these instruments is not affected by the long-term nature of the business with depositors.

Debt securities in issue and subordinated liabilities: The Group has made an assumption that fair value of those securities is based on discounted cash flows methods incorporating adequate interest rates.

Financial assets and liabilities carried at fair value in the statement of financial position

As at 31.12.2017 and in the comparable periods the Group made the following classification of its financial instruments measured at fair value in the statement of financial position:

Level I (active market quotations): debt, equity and derivative financial instruments which at the balance sheet date were measured using the prices quoted in the active market. The Group allocates to this level fixed-rate State Treasury bonds, treasury bills, shares of listed companies and WIG 20 futures.

Level II (the measurement methods based on market-derived parameters): This level includes derivative instruments. Derivative instruments are measured using discounted cash flow models based on the discount curve derived from the inter-bank market.

Level III (measurement methods using material non-market parameters): This level includes equity securities that are not quoted in the active market, measured using the expert valuation model; investment certificates measured at the balance sheet date at the price announced by the mutual fund and debt securities.

The objective of using valuation techniques is to determine the fair value, i.e., prices, which were obtained by the sale of an asset in in an arm's length transaction between market participants carried out under current market conditions at the measurement date.

The valuation of major capital investments classified to Level III:

a) AVIVA Towarzystwo Ubezpieczeń na Życie SA (AVIVA TUŻ),

b) AVIVA Powszechne Towarzystwo Emerytalne SA (AVIVA PTE),

c) AVIVA Towarzystwo Ubezpieczeń Ogólnych SA (AVIVA TUO).

is made semi-annually by specialized units of the bank using income methods based on discounted cash flows, where the most important variables of the model are the level of forecasted dividends and the risk free rate. During the reporting period revaluation of above equity investments has been made in the total amount of 33.8 million PLN and recognized in the revaluation reserve.

As at 31.12.2017 and in the comparable periods the Group classified its financial instruments to the following fair value levels:

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31.12.2017	Level I	Level II	Level III	Total
Financial assets				
Financial assets held for trading	2 189 110	1 226 551	447	3 416 108
Hedging derivatives	–	218 061	–	218 061
Financial assets available for sale – debt securities	27 462 401	–	32 532	27 494 933
Financial assets available for sale– equity securities	19 328	–	901 551	920 879
Total	**29 670 839**	**1 444 612**	**934 530**	**32 049 981**
Financial liabilities				
Financial liabilities held for trading	–	1 237 704	–	1 237 704
Hedging derivatives	–	578 798	–	578 798
Total	**–**	**1 816 502**	**–**	**1 816 502**

31.12.2016	Level I	Level II	Level III	Total
Financial assets				
Financial assets held for trading	282 769	2 897 965	251	3 180 985
Hedging derivatives	–	67 645	–	67 645
Financial assets available for sale – debt securities	16 025 497	12 360 090	38 240	28 423 827
Financial assets available for sale– equity securities	34 473	–	849 578	884 051
Total	**16 342 739**	**15 325 700**	**888 069**	**32 556 508**
Financial liabilities				
Financial liabilities held for trading	80 129	1 728 931	–	1 809 060
Hedging derivatives	–	2 023 344	–	2 023 344
Total	**80 129**	**3 752 275**	**–**	**3 832 404**

The tables below show reconciliation of changes in the balance of financial instruments whose fair value is established by means of the valuation methods using material non-market parameters.

Level III		Financial assets		Financial liabilities
31.12.2017	Financial assets held for trading	Financial assets available for sale – debt securities	Financial assets available for sale equity securities	Financial liabilities held for trading
Beginning of the period	**251**	**38 240**	**849 578**	**–**
Profits or losses	–	–	–	–
recognised in income statement (unrealised)	(29)	–	–	–
recognised in equity	–	–	68 337	–
Purchase	1 057	–	2 036	–
Sale	(832)	–	(18 400)	–
Transfer between levels	–	(5 708)	–	–
At the period end	**447**	**32 532**	**901 551**	**–**

Level III		Financial assets		Financial liabilities
31.12.2016	Financial assets held for trading	Financial assets available for sale – debt securities	Financial assets available for sale equity securities	Financial liabilities held for trading
Beginning of the period	**1 839**	**–**	**1 115 212**	**–**
Profits or losses	81	–	3 920	–
recognised in income statement (unrealised)	81	–	63 651	–
recognised in equity	–	–	(59 731)	–
Purchase	340	–	9 900	–
Sale	(2 009)	–	(279 454)	–
Transfer between levels	–	38 240	–	–
At the period end	**251**	**38 240**	**849 578**	**–**

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

44. Contingent liabilities

Significant court proceedings

As at 31.12.2017 no proceedings were instituted by court or by state administration agencies with relation to any claims made by or against the bank or its subsidiaries amounting to a minimum of 10% of the Group's equity.

The value of all litigations amounts to PLN 1,080,768 k, which is ca 4.63% of the Group's equity. This amount includes PLN 717,617k claimed by the Group, PLN 359,362 k in claims against the Group and PLN 3,789 k of the Group's receivables due to bankruptcy or arrangement cases.

On 20.10.2017, Bank Zachodni WBK received a notice of a class action instituted by the borrowers who had loans indexed to the CHF, originated by the former Kredyt Bank. The total value of the claim, estimated as at the reporting date, is PLN 32.3 m. However, this amount is very likely to be changed as new borrowers join the class action.

As at 31.12.2017 the amount of significant court proceedings which had been completed amounted to PLN 532,519 k.

As at 31.12.2017, the value of provisions for legal claims was PLN 99,463 k. In 10 cases against the bank, where the claim value was high, a provision of PLN 40,983 k was raised.

The bank raises provisions for legal risk where an internal risk assessment for a particular case indicates a possible outflow of cash. Provisions for cases disputed in court are presented in Note 35.

As at 31.12.2016 no proceedings were instituted by court or by state administration agencies with relation to any claims made by or against the bank or its subsidiaries amounting to a minimum of 10% of the Group's equity.

The value of all litigation amounts to PLN 780,750 k, which is ca 3.71% of the Group's equity. This amount includes PLN 518,256 k claimed by the Group, PLN 221,634 k in claims against the Group and PLN 40,860 k of the Group's receivables due to bankruptcy or arrangement cases. In 2016, there was a significant year-on-year increase in the amount claimed by the Group (from PLN 256,443 k to PLN 518,256 k) which results from the abrogation of the laws pertaining to the banking writs of execution and the need to refer to the court any unpaid receivables of the bank under ordinary proceedings or proceedings by writ of payment.

As at 31.12.2016 the amount of significant court proceedings which had been completed amounted to PLN 451,697 k.

As at 31.12.2016, the value of provisions for legal claims was PLN 74,396 k, including for significant cases against the Bank was PLN 37,639 k. In 8 cases against the bank, where the claim value was high, a provision of PLN 34,778 k was raised.

Off-balance sheet liabilities

The break-down of contingent liabilities and off-balance transactions into categories is presented below. The values of guarantees and letters of credit as set out in the table below represent the maximum possible loss that would be disclosed as at the balance sheet day if the customers did not meet any of their obligations towards third parties.

Contingent liabilities – sanctioned	31.12.2017	31.12.2016
Liabilities sanctioned		
– financial	24 642 271	23 243 064
– credit lines	20 279 546	19 134 360
– credit cards debits	3 730 667	3 419 031
– import letters of credit	624 207	655 624
– term deposits with future commencement term	7 851	34 049
– guarantees	4 885 661	4 182 758
Allowance for off-balance sheet liabilities	(50 652)	(50 746)
Total	**29 477 280**	**27 375 076**

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

45. Assets and liabilities pledged as collateral

Assets securing funds to cover the BGF are debt securities.

In order to calculate the contribution to the deposit protection fund, Bank Zachodni WBK and Santander Consumer Bank applied 0.55% (i.e. the same rate as in 2016) of funds deposited in all accounts with the bank, being the basis for calculating the obligatory reserve.

As at 31.12. 2017, assets allocated to that end totalled PLN 605,429 k compared with PLN 597,789 k a year before.

In 2017, deposits opened with financial institutions to secure the value of transactions totalled PLN 772,961 k (PLN 2,190,757k as at 31.12. 2016).

In 2017, the Group accepted PLN 500,105 k worth of deposits securing transactions (vs. PLN 232,670 k in 2016). Other assets pledged and liabilities accepted as collateral are disclosed in Notes 32 and 42.

46. Finance and operating leases

Finance leases

Lease agreements where the Group acts as a lessor

Bank Zachodni WBK Group operates on the leasing market through leasing companies which specialise in funding vehicles, machines and equipment for businesses and personal customers and property.

The item "Loans and advances to customers" contains the following amounts relating to the finance lease obligations:

Finance leases gross receivables – maturity	31.12.2017	31.12.2016
less than 1 year	2 724 540	2 340 974
between 1 and 5 years	4 452 169	4 041 964
over 5 years	115 819	128 190
Total	**7 292 528**	**6 511 128**

Present value of minimum lease payments – maturity	31.12.2017	31.12.2016
less than 1 year	2 751 560	2 257 106
between 1 and 5 years	4 011 195	3 749 807
over 5 years	86 205	91 586
Total	**6 848 960**	**6 098 499**

Reconciliation between the gross investment and the present value of minimum lease payments	31.12.2017	31.12.2016
Finance lease gross receivables	7 292 528	6 511 128
Unearned finance income	(443 568)	(412 629)
Impairment of finance lease receivables	(84 140)	(76 416)
Present value of minimum lease payments, net	**6 764 820**	**6 022 083**

Lease agreements where the Group acts as a lessee

The BZ WBK Group companies also avail of lease arrangements as lessees, however as the leases are between related entities they were eliminated from the consolidated statement of financial position and profit and loss account.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Operating leases

Lease agreements where the Group acts as a lessee

The BZ WBK leases offices in compliance with operational leasing agreements. As a standard, agreements are concluded for 5-10 years. A small part of the offices is subleased outside the Group. In 2017 and 2016 rentals totalled PLN 234,684 k and PLN 236,412 k, respectively. These payments are presented in the profit and loss account under "operating expenses".

The majority of lease agreements signed by SCB were concluded for a definite period of time ranging from three to five years. As regards the premises for mobile units, the lease agreements were entered for an indefinite period subject to one up to three months' notice.

PSA Finance Polska Sp. z o.o., acting together with its subsidiary PSA Consumer Finance Polska Sp. z o.o., leases mainly office space under the agreement renegotiated in 2016 and valid until 2021. The PSA Finance Polska sp. z o.o. and PSA Consumer Finance Polska sp. z o.o. Companies lease from Banque PSA Finance SA printers/scanners for a standard period of 4 years, laptops for 3 years and dekstop workstations for 4 years.

The table below shows the total obligations under irrevocable operating lease agreements concluded by the Group (including the value of perpetual usufruct of land).

Payments – maturity	31.12.2017	31.12.2016
less than 1 year	208 032	235 737
between 1 and 5 years	474 185	494 489
over 5 years	384 471	467 632
Total	**1 066 688**	**1 197 858**

Lease agreements where the Group acts as a lessor

The table below shows future minimum lease fees due to irrecoverable operating lease.

Future minimum lease fees due to irrecoverable operating lease	31.12.2017	31.12.2016
less than 1 year	9 301	8 534
between 1 and 5 years	9 160	6 802
over 5 years	–	–
Total	**18 461**	**15 336**

47. Consolidated statement of cash flows – additional information

The table below specifies components of cash balances of BZ WBK Group.

Cash and cash equivalents	31.12.2017	31.12.2016
Cash and balances with central banks	4 146 222	4 775 660
Receivables from interbank deposits*	2 136 307	3 513 206
Debt securities held for trading*	–	699 883
Debt securities available for sale*	1 379 839	2 849 694
Cash acquired	–	356
Total	**7 662 368**	**11 838 799**
The impact of changes in currency exchange rates during the financial year on cash and cash equivalents	(89 445)	84 951

** financial assets with initial maturity below three months.*

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Bank Zachodni WBK and Santander Consumer Bank have restricted cash in the form of a mandatory reserve held on an account with the central bank.

In the periods presented in the financial statements Bank Zachodni WBK Group has received and made interest payments in the following amounts:

Interest received and interests paid	01.01.2017–31.12.2017	01.01.2016–31.12.2016
Interest received, including:	**6 542 339**	**6 214 338**
– operating activities	5 875 868	5 595 969
– investing activities	666 471	618 369
Interest paid, including:	**(1 231 416)**	**(1 267 431)**
– operating activities	(993 307)	(1 087 084)
– financing activities	(238 109)	(180 347)

48. Related parties

The tables below present intercompany transactions. They are effected between associates and parent entity. Most of the transactions are banking transactions made as part of ordinary business activities and mainly include loans, deposits, guarantees and leases. Intercompany transactions effected by the bank and its subsidiaries have been eliminated during the consolidation process. In the case of internal Group transactions, a documentation is prepared in accordance with requirements of tax regulations for transfer pricing.

Transactions with associates	31.12.2017	31.12.2016
Assets	**93**	**70**
Other assets	93	70
Liabilities	**120 382**	**78 706**
Deposits from customers	90 102	78 414
Sell–buy–back transactions	30 044	–
Other liabilities	236	292
INCOME	**14 223**	**18 393**
Fee and commission income	14 223	18 393
Expenses	**6 654**	**10 924**
Interest expenses	1 806	1 313
Fee and commission expenses	3 020	3 230
Operating expenses incl.:	1 828	6 381
General and administrative expenses	1 828	6 381

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Transactions with Santander Group	with the parent company		with other entities	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016
Assets	**598 411**	**981 961**	**9 854**	**3 674**
Loans and advances to banks, incl:	308 691	594 042	9 831	274
loans and advances	95 993	353 911	–	–
current accounts	212 698	240 131	9 831	274
Financial assets held for trading	282 036	387 727	–	3 371
Hedging derivatives	7 469	–	–	–
Other assets	215	192	23	29
LIABILITIES	**403 807**	**633 941**	**86 720**	**262 160**
Deposits from banks incl.:	62 996	271 312	23 539	174 617
current accounts	62 996	271 312	23 539	3 683
Loans from other banks	–	–	–	170 934
Hedging derivatives	–	54 503	–	–
Financial liabilities held for trading	322 933	308 126	–	7 365
Deposits from customers	–	–	52 577	71 079
Other liabilities	17 878	–	10 604	9 099
Income	**14 914**	**16 747**	**411**	**294**
Interest income	11 321	14 268	95	28
Fee and commission income	3 593	2 096	299	239
Other operating income	–	–	17	27
Net trading income and revaluation	–	383	–	–
Expenses	**84 818**	**1 721**	**76 712**	**28 899**
Interest expenses	1 050	446	2 298	2 211
Fee and commission expenses	1 171	1 106	205	281
Net trading income and revaluation	64 720	–	57 672	2 420
Operating expenses incl.:	17 877	169	16 537	23 987
Bank's staff, operating expenses and management costs	17 877	–	16 529	23 987
Other operating expenses	–	169	8	–
Contingent liabilities	**–**	**10 706**	**–**	**–**
Sanctioned:	–	10 706	–	–
– financial	–	10 706	–	–
Derivatives' nominal values	**51 859 866**	**57 761 351**	**–**	**634 312**
Cross–currency interest rate swap – purchased amounts	3 478 300	5 645 125	–	–
Cross–currency interest rate swap – sold amounts	3 414 864	5 424 101	–	–
Single–currency interest rate swap	18 298 033	16 517 900	–	633 412
Options	8 001 216	7 285 846	–	–
FX swap – purchased amounts	4 719 697	5 363 317	–	–
FX swap – sold amounts	4 762 299	5 344 715	–	–
FX options – purchased CALL	2 010 291	2 643 269	–	–
FX options – purchased PUT	1 950 686	2 798 804	–	–
FX options – sold CALL	2 026 149	2 755 705	–	–
FX options – sold PUT	2 211 749	2 824 233	–	–
Spot – purchased	162 894	162 456	–	–
Spot– sold	163 182	162 876	–	–
Forward – purchased amounts	138 027	101 365	–	–
Forward – sold amounts	135 771	74 665	–	900
Capital derivatives contract – purchased	386 708	656 974	–	–

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

Transactions with Members of Management and Supervisory Boards

Remuneration of Bank Zachodni WBK Management Board Members, Supervisory Board Members and key management BZ WBK Group's.

Loans and advances made by the Banks to the key management personnel

As at 31.12.2017 and 31.12.2016 members of the Management Board were bound by the non-compete agreements which will remain in force after they step down from their function. If a Member of the Management Board is removed from their function or not appointed for another term, he/she is entitled to a once-off severance pay. The severance pay does not apply if the person accepts another function in the Bank.

Loans and advances have been sanctioned on regular terms and conditions.

Remuneration of Management Board Members and Key Management	Management Board Members		Key Management	
	2017	2016	2017	2016
Renumeration	12 774	10 162	40 903	40 600
Additional benefits (e.g among others, life insurance cover without pension option, medical cover, accommodation, travel expenses and school fees)	1 136	894	1 062	1 061
Awards paid in 2017 and 2016 *	8 186	6 910	16 587	12 669
Equivalent paid for unused annual leave	125	199	130	155
Additional compensation for termination of the contract and the non–competition clause	–	1 092	–	–
Loans and advances made by the bank to the Members of the Management Board/Key Executives	11 054	7 158	22 693	25 697
Deposits from the Management Board executives	17 328	13 312	13 106	14 199
Provisions for unused holidays	797	567	2 651	2 902
Number of conditional rights to shares	34 670	17 671	41 194	31 415

** included part of the award for 2016, 2015, 2014, 2013 and 2012 which was conditional and deferred in time*

The category of key executives includes the persons covered by the principles laid down in the "Policy on variable components of remuneration paid to the individuals holding managerial positions at Bank Zachodni WBK", and in the case of subsidiaries – by the principles laid down in their respective internal regulations.

BZ WBK Group applies the Policy on variable components of remuneration for individuals holding managerial positions in BZ WBK Group. The Policy has been approved by the bank's Management Board and Supervisory Board and is reviewed annually or each time significant organisational changes are made.

Persons holding managerial positions are paid variable remuneration once a year following the end of the settlement period and release of the bank's results. Variable remuneration is awarded in accordance with applicable bonus regulations and paid in cash and phantom stock. The latter shall represent min. 50% of the total amount of variable remuneration. Payment of min. 40% of variable remuneration referred to above is conditional and deferred for the period of three years (13.3% per annum). Variable remuneration is paid in arrears in equal annual instalments depending on individual performance in the period subject to assessment and the value of the phantom stock.

In 2017, the total remuneration paid to the Supervisory Board Members of Bank Zachodni WBK totalled PLN 1,556 k (PLN 1,712 k in 2016). Mr John Power received remuneration for the supervision over acquisition of a carved-out business of Deutsche Bank Poland by BZ WBK in the amount of PLN 84.0 k. Mr John Power received remuneration of PLN 28.7 k from subsidiaries for his membership in their Supervisory Boards (PLN 35 k in 2016).

49. Acquisitions and disposals of investments in subsidiaries and associates

Agreement on the acquisition of a carved-out business of Deutsche Bank Polska by Bank Zachodni WBK

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

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

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

Before the demerger, Bank Zachodni WBK will buy DBPL's shares from DB AG, representing 10% of votes at the DBPL's General Meeting of Shareholders. Next, the bank and DBPL will file requests for the registration of the demerger with relevant registry courts.

The demerger will be effected on the following terms:

- DBPL will be a demerged company and BZ WBK will be an acquiring company;
- The share capital of DBPL will be decreased by at least an equivalent of the total nominal value of the shares purchased by Bank Zachodni WBK. On the date of the registration of such capital decrease, all the shares purchased by the bank will cease to exist and DB AG will become the sole shareholder of DBPL;
- In exchange for the transfer of the carved-out business to Bank Zachodni WBK, DB AG will receive a stated number of BZ WBK shares (demerger shares) on the demerger date, calculated based on the agreed formula which will be used to determine a share exchange ratio in the demerger plan. The demerger will be effective as of the date of registration of the bank's capital increase by way of the issuance of demerger shares;
- On the demerger date, the carved-out business will be transferred to the bank and the business which is not subject to the transaction will remain in DBPL. DBPL's assets and liabilities will be allocated between the carved-out business and the retained business based on the terms specified in the transaction agreement and the demerger plan;

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

The consideration for the transaction will be paid in:

- cash, through the payment of a price for the purchased shares (20% of the preliminary purchase price);
- newly issued shares of the bank representing approx. 2.7% of the bank's share capital (80% of the preliminary purchase price).

Once the transaction agreement is executed, the preliminary purchase price will be adjusted to reflect changes in relevant assets and liabilities that have taken place between the transaction agreement date and the demerger date.

The transaction is subject to regulatory approvals, including consents from the Polish Financial Supervision Authority (KNF) and the President of the Office of Competition and Consumer Protection (UOKiK), as well as resolutions of the General Meetings of Shareholders of BZ WBK and DBPL, signing of the demerger plan and fulfilment of certain operational conditions. The transaction is expected to close in Q4 2018. The migration of IT systems is planned to be completed immediately after closing.

Conclusion of the agreement will not lead to a take-over of control or significant influence over Deutsche Bank Polska S.A., nor will it give rise to any obligations that would need to be disclosed.

Contribution in kind of BZ WBK F24 S.A. (formerly BZ WBK Nieruchomości S.A.) shares to BZ WBK Finanse sp. z o.o

On 24.11.2017, BZ WBK S.A. made contribution in kind of BZ WBK F24 S.A. (formerly BZ WBK Nieruchomości S.A.) shares to BZ WBK Finanse sp. z o.o. to cover the acquisition of BZ WBK Finanse sp. z o.o. shares by BZ WBK S.A. In the second half of 2017, BZ WBK F24 S.A. changed its business model. The main profile of the business activity focused around financing of consumer car purchase – the company was registered by the Polish Financial Supervision Authority (KNF) as a lending institution.

The changed ownership structure will allow to limit the cost of business management and it is consistent with the strategy of extending the business activity of BZ WBK Group whereby BZ WBK F24 S.A. will offer financial products addressed to personal customers (consumers) on the market of so-called "light vehicles".

On 12.01.2018, in the Nation Court Register was registered increase of share capital BZWBK Finanse sp. z o.o to PLN 1,630 k. Share capital was fully paid.

Liquidation of AKB Marketing Services sp. z o.o.

On 28.03.2017, AKB Marketing Services sp. z o.o. , a subsidiary of Santander Consumer Bank S.A., was liquidated.

The subsidiary's assets and liabilities were finally accounted for. Profit on liquidation of PLN 3,757 k was presented in the consolidated income statement under 'Net gains/(losses) on subordinated entities'.

AKB Marketing Services sp. z o.o. in liquidation carried out ancillary business operations in respect of banking services. On 20.11.2017, the company AKB Marketing Services sp. z o.o. was deleted from the National Court Register.

Merger of BZWBK Leasing S.A. and BZWBK Lease S.A.

On 28.02.2017, BZ WBK Leasing S.A. and BZ WBK Lease S.A. merged.

The companies merged by way of absorption of BZ WBK Lease S.A. (the absorbed entity) by BZ WBK Leasing S.A. (the absorbing entity). All the assets of BZ WBK Lease S.A. were transferred to BZ WBK Leasing S.A. In connection with the merger, BZ WBK Lease

S.A. ceased to exist legally, while BZ WBK Leasing S.A., being the absorbing entity, assumed, under the law, all the rights and obligations of the absorbed entity. As a result, BZ WBK Leasing S.A. continues business operations which previously were carried out by BZ WBK Lease S.A. and assumed, under the law, all the rights and obligations of absorbed BZ WBK Lease S.A.

Registration of SC Poland Consumer 16-1 sp. z o.o.

On 17.05.2016, a subsidiary of Santander Consumer Bank trading as SC Poland Consumer 16-1 sp. z o.o. was registered. This is a special-purpose vehicle formed for the purpose of securitisation of a part of the credit portfolio, its shareholder being a polish legal person that is not associated with the Group. As the control criteria set out in IFRS 10.7 are met, the company is considered as an entity controlled by Santander Consumer Bank.

A merger of BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A. and BZ WBK Asset Management S.A. was completed, as a result of which BZ WBK TFI has acquired AM.

On 31.03.2016, a merger of BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A. (BZ WBK TFI) and BZ WBK Asset Management S.A. (BZ WBK AM) was completed, as a result of which BZ WBK TFI has acquired AM.

The merger was executed by way of transfer of all assets of AM (the acquired company) to BZ WBK TFI (the acquiring company) in return for shares which BZ WBK TFI has allotted to the shareholders of the acquired company. The merger of the companies took effect on the date of entry of the merger into the register of businesses. Upon recording of the merger, AM has been deleted from the register of businesses. As of the merger date BZ WBK TFI has taken over all rights and obligations of its legal predecessor, i.e. AM. Business combinations under common control have no material impact on the financial statements.

Metrohouse Franchise S.A. shares sale transaction

On 22.01.2016, BZ WBK Inwestycje Sp. z o.o. sold all its shares of Metrohouse Franchise S.A. and ceased to be a shareholder of Metrohouse Franchise S.A.

50. Controlling stake at the companies PSA Finance Polska sp. z o.o. and indirectly, PSA Consumer Finance Polska sp. z o.o.

Description the transaction

On 30.09.2016, Santander Consumer Bank (SCB), a subsidiary of Bank Zachodni WBK, and Banque PSA Finance entered into an agreement establishing strategic cooperation with regard to financing in Poland the vehicles manufactured by PSA Peugeot Citroen (PSA), financing the working capital requirements of the Polish PSA network and joint distribution of financial and banking products to the Polish customers of PSA.

Under the above agreement, as of 1 October 2016, Santander Consumer Bank took over control over PSA Finance Polska sp. z o.o. (PSA Finance Polska) and indirectly over PSA Consumer Finance Polska sp. z o.o. (PSA Consumer Finance Polska).

The change of control took place as a result of purchase (for a final price of PLN 58,849,775 paid in cash) of 50% shares in PSA Finance Polska and indirectly in PSA Consumer Finance Polska, representing 50% of total votes at the companies' General Meeting. The fair value of the price paid is 50% of the companies' fair value determined on the basis of the reference carrying amount.

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Difference in the amount of PLN 2 503 k the amount presented above between the initial purchase price in the amount PLN 61 353 k and the price paid for the shares results from the final settlement of the transaction.

Santander Consumer Bank recognises PSA Finance Polska and PSA Consumer Finance Polska as subsidiaries due to the fact that it has control over their key areas which influence the companies' financial results (notably the risk and funding areas). As a result, Santander Consumer Bank is a shareholder which is exposed to a higher risk and can derive greater benefits due to the consequences of the decisions relating to the financial activities of the two companies.

Due to the fact that Bank Zachodni WBK has a 60% stake in Santander Consumer Bank, which in turn has a 50% stake in PSA Finance Polska, the bank has disclosed non-controlling interests of 70% in the share capital and the number of votes at the General Meeting of PSA Finance Polska and, indirectly, PSA Consumer Finance Polska.

Cancellation of shares in PSA Finance Polska

On 5 April 2017, an agreement was signed whereby Santander Consumer Bank sold 10% of its shares in PSA Finance Polska to the latter company for the purpose of their cancellation, which took place on the basis of a resolution of the General Meeting of Shareholders of PSA Finance Polska. The resolution provided for reduction of the company's share capital by PLN 30,000 k and a voluntary cancellation of the company's shares PLN 12,266 k.

The initial purchase price and the price paid for the shares were adjusted by the value of the above cancellation.

The Management Board of PSA Finance Polska acquired own shares, with the intention of their cancellation, from both shareholders in equal proportions, as a result of which the company's ownership structure remained the same.

Assets and liabilities recognised at the merger date

In the financial year ended 31 December 2017 a final settlement was made of the acquisition of control over PSA Finance Polska and PSA Consumer Finance Polska.

The table below presents the fair value of assets and liabilities acquired by Santander Consumer Bank.

as at 31.12.2017	PSA Finance sp. z o.o.	PSA Consumer Finance sp. z o.o.
ASSETS		
Cash and balances with central bank	1	5
Loans and advances to banks	317	33
Loans and advances to customers	735 482	141
Intangible assets	66	3
Property, plant and equipment	2 027	–
Net deferred tax assets	35 386	1
Other assets	11 828	13
Total assets	**785 107**	**196**
LIABILITIES		
Deposits from banks	(476 864)	–
Deposits from customers	(96 731)	–
Current income tax liabilities	(6 060)	–
Other liabilities	(87 948)	–
Total liabilities	**(667 603)**	**–**
Fair value of identifiable net assets	**117 504**	**196**

No intangible fixed assets or contingent liabilities that would meet the criteria of being recognised as balance sheet assets were identified in the assets and liabilities acquired.

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Non-controlling interests

As a result of the take-over of control by Bank Zachodni WBK, non-controlling interests were recognised, representing indirect 70% of the share capital and the number of votes at the General Meeting of PSA Finance Polska and indirectly PSA Consumer Finance Polska. They result from the recognition of non-controlling shares both at the level of the acquired companies, and at the level of the shareholders of Santander Consumer Bank.

The carrying amount of the shares was PLN 82,390 k using the proportional share in the identified net assets method.

The goodwill arising on acquisition represents the excess of the value of non-controlling shares (70%) and the payment made over the book value of the identified net assets, determined as at the date of final settlement of the purchase price.

Goodwill calculation

Data presented in the consolidated financial statements for 2017 are different than in the financial statements for 2016 due to the final settlement of the transaction.

as at	31.12.2017
Goodwill	
Total consideration	58 850
Non–controlling interests	82 390
Less: fair value of identifiable net assets	(117 700)
Total	**23 540**

The goodwill arising as at the merger date results from the possibility of achieving additional benefits from the expected synergies and an increase in revenues and market share. These benefits were not recognised separately from the goodwill as they did not meet the criteria for recognition as intangible assets.

The goodwill arising on acquisition was not treated as tax deductible.

51. Employee benefits

Staff benefits include the following categories:

- Short-term benefits (remuneration, social security contributions, paid leaves, profit distributions and bonuses and non-cash benefits). Value of short-term employee benefits are undiscounted,
- Post-employment benefits (retirement benefits and similar payments, life insurance or medical care provided after the term of employment).

Within these categories, the companies of the BZ WBK Group create the following types of provisions:

Provisions for unused holidays

Liabilities related to unused holidays are stated in the expected amount (based on current salaries) without discounting.

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Provisions for employee bonuses

Liabilities related to bonuses are stated in the amount of the probable payment without discounting.

Provisions for retirement allowances

Based on internal regulations in respect to remuneration, the employees of the bank are entitled to defined benefits other than remuneration:
a) retirement benefits,
b) retirement pension.

The present value of such obligations is measured by an independent actuary using the projected unit credit method.

The amount of the retirement benefits and death-in-service benefits is dependent on length of service and amount of remuneration. The expected present value of the benefits is calculated, taking into account the financial discount rate and the probability of an individual get to the retirement age or die while working respectively. The financial discount rate is determined by reference to up-to-date market yields of government bonds. The probability of an individual get to the retirement age or die while working is determined using the multiple decrement model, taking into consideration the following risks: possibility of dismissal from service, risk of total disability to work and risk of death.

These defined benefit plans expose the Group to actuarial risk, such as:

- interest rate risk – the decrease in market yields on government bonds would increase the defined benefit plans obligations,
- remuneration risk – the increase in remuneration of the Bank's employees would increase the defined benefit plans obligations,
- mobility risk – changes in the staff rotation ratio,
- longevity risk – the increase in life expectancy of the bank's employees would increase the defined benefit plans obligations.
- The principal actuarial assumptions as at 31 December 2017 are as follows:
- the discount rate at the level of 3.3% (3.6% as at 31 December 2016),
- the future salary growth rate at the level of 2.0% (2,0% as at 31 December 2016),
- the probable number of leaving employees calculated on the basis of historical data concerning personnel rotation in the Group,
- the mortality adopted in accordance with Life Expectancy Tables for men and women, published by the Central Statistical Office, adequately adjusted on the basis of historical data of the bank.

Reconciliation of the present value of defined benefit plan obligations

The following table presents a reconciliation from the opening balances to closing balances for the present value of defined benefit plans obligations.

	31.12.2017	31.12.2016
As at the beginning of the period	60 397	63 209
Provision acquired in a business combination	–	747
Current service cost	308	1 073
Interest expense	2 611	2 228
Actuarial (gains) and losses	9 410	(6 860)
Balance at the end of the period	**72 726**	**60 397**

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Sensivity analysis

The following table presents how the impact on the defined benefit obligations would have increased (decreased) as a result of a change in the respective actuarial assumptions by one percent as at 31 December 2017.

Defined benefit plan obligations	1 percent increase	1 percent decrease
Discount rate	9.00%	-9.78%
Future salary growth rate	-9.91%	7.04%

The following table presents how the impact on the defined benefits obligations would have increased (decreased) as a result of a change in the respective actuarial assumptions by one percent as at 31 December 2016.

Defined benefit plan obligations	1 percent increase	1 percent decrease
Discount rate	10.86%	-11.94%
Future salary growth rate	-12.10%	9.51%

Other staff-related provisions

These are provisions for the National Fund of Rehabilitation of the Disabled, redundancies, overtime and staff training. These liabilities are stated at the amounts of expected payment without discounting.

The balances of the respective provisions are shown in the table below:

Provisions	31.12.2017	31.12.2016
Provisions for unused holidays	58 392	63 948
Provisions for employee bonuses	257 986	237 745
Provisions for retirement allowances	72 726	60 397
Other staff–related provisions	18 618	13 869
Total	**407 722**	**375 959**

Detailed information about movements on staff-related provisions is available in additional Note 36.

52. Share based incentive scheme

The fifth edition of the BZWBK incentive scheme vested as at 30.06.2017. The vesting level is 63% for participants having significant impact on the Group's risk profile and at the level of 67% for participants not having significant impact on the Group's risk profile. Its realization through issuance of new shares and their allocation to individual accounts of entitled individuals was processed in Q3 2017.

On 17.05.2017, Annual General Meeting of the Shareholders of Bank Zachodni WBK S.A. approved three-year Incentive Scheme no. VI which participants are employees of the Bank Zachodni WBK Group (including Members of the Management Board), however not more than 250 individuals. On 26.06.2017 the Supervisory Board approved the list of entitled individuals ("grant date").

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

In every single year annual award not exceeding one third on total award will be considered. Shares will vest on a linear pattern between 25% and 100% contingent on profit after tax (PAT) growth and on RORWA ratio growth. The range of the scale requires PAT growth between "lower level" set to 80% of assumed level of realization in 2017 and "upper level" of nominal growth at 17,8% in first year and between "lower level" set to 80% of assumed level of realization in 2018 and 2019 and "upper level" of nominal growth at 13,4% in second and third year of duration of scheme. The range of the scale requires RORWA ratio growth between "lower level" set to 80% of assumed level of realization in 2017 and "upper level" of nominal growth at 2,24% in first year, between "lower level" set to 80% of assumed level of realization in 2018 and "upper level" of nominal growth at 2,37% in second year and between "lower level" set to 80% of assumed level of realization in 2019 and "upper level" of nominal growth at 2,5% in third year of duration of scheme.

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Additionally the qualitative factors will be taken into account – participants are entitled to annual award depending on the level of an external customer satisfaction and engagement survey results (an internal customer). The level of customer satisfaction will be met when in the peer group Bank will be on second place in first and second year and on the first place in third year of duration of the scheme. The engagement survey results will not be lower than 50% in first year, 60% in second year and 70% in third year of duration of scheme.

Additionally, after 3 years cumulative award will be considered. Shares will vest on a linear pattern between 25% and 100% contingent on PAT compound annual growth rate in 3 years' time between 11,7% and 15% and on average value of RORWA ratio in 3 years' time between 1,9% and 2,38%. If the number of shares resulting from cumulative assessment is higher than the sum of annual awards vested to date, additional shares will be allocated to individuals up to the amount resulting from the cumulative assessment.

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

Share based payments granted in 2017:

	2017
Number of share based payments	131 262
Share price (PLN)	350.00
Excercise price	10
Vesting period	3 years
Expected volatility of share prices	30.07%
Award life	3 years
Discounted risk free rate	2.12%
Fair value per award	323.36 zł
Dividend yield	1.71%

The following table summarizes the share based payments activity:

	12 months of 2017 based payments	12 months of 2016 based payments
Outstanding at 1 January	157 254	168 784
Granted	131 912	–
Exercised	(100 233)	–
Forfeited	(3 958)	(11 530)
Expired	(55 176)	–
Outstanding at 31 December	129 799	157 254
Exercisable at 31 December	**–**	**–**

The expired rights presented in the table for 12 months of 2017 represent the lower level of the vested rights for the Incentive Scheme V.

For the share based payments outstanding as at 31.12.2017 and 31.12.2016 the average remaining contractual life is approximately 2.5 years and 0.5 year respectively.

The expenses of sixth edition of equity settled share-based payments scheme recognized in profit and loss account for 12 months of 2017 amounts to PLN 7,173 k.

The table below presents information about the number of conditional rights to shares vested in BZ WBK Management Board members under the 5th Incentive Scheme and the 6th Incentive Scheme launched in 2017.

of Bank Zachodni WBK Group for 2017 (In thousands of PLN)

No. of awards	2017	2016
Outstanding at 1 January	17 671	17 918
Granted	35 687	1 253
Expired	(6 053)	–
Exercised	(10 541)	–
Resignation from the function	(2 094)	(1 500)
As at 31 December	**34 670**	**17 671**

The table below presents information about the number of conditional rights to shares vested in Group BZ WBK Key Management.

No. of awards	2017	2016
Outstanding at 1 January	31 415	30 350
Granted	44 134	1 065
Expired	(9 484)	–
Exercised	(19 616)	–
Resignation from the function	(5 255)	–
As at 31 December	**41 194**	**31 415**

53. Dividend per share

As of the date of publication of this report, the Management Board of Bank Zachodni WBK SA has not finalised its analysis in respect of recommendation on dividend payout for 2017.

On 17.05.2017 Annual General Meeting of Bank Zachodni WBK adopted a resolution on dividend payment.

It was decided to allocate PLN 535,866 k from the bank's undivided net profit for 2014 and 2015 to dividend for shareholders. Dividend per share was PLN 5.40.

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54. Events which occurred subsequently to the end of the period

Issuance of own bonds by Bank Zachodni WBK

The Management Board of Bank Zachodni WBK S.A. informed that on 7.02.2018, it adopted a resolution approving the issuance by the Bank of subordinated bonds with a total nominal value not higher than PLN 1,000,000 k, to be qualified as Tier II instruments of the Bank subject to the consent from the Polish Financial Supervision Authority.

The Bonds will be offered solely on the territory of Poland. The Bonds may be issued in one or several series. The Bank plans to carry out the issuance by 30.06.2018. Details of the issuance will be communicated at a later date.

Signatures of Members of the Management Board

Date	Name	Function	Signature
12.02.2018	Michał Gajewski	President	
12.02.2018	Andrzej Burliga	Vice-President	
12.02.2018	Michael McCarthy	Vice-President	
12.02.2018	Juan de Porras Aguirre	Vice-President	
12.02.2018	Mirosław Skiba	Vice-President	
12.02.2018	Feliks Szyszkowiak	Vice-President	
12.02.2018	Artur Chodacki	Member	
12.02.2018	Carlos Polaino Izquierdo	Member	
12.02.2018	Marcin Prell	Member	
12.02.2018	Arkadiusz Przybył	Member	
12.02.2018	Maciej Reluga	Member	
12.02.2018	Dorota Strojkowska	Member	

Signature of person who is responsible for maintaining the book of account

Date	Name	Function	Signature
12.02.2018	Wojciech Skalski	Financial Accounting Area Director	