



**REPORT ON THE CONDITION
OF POLISH BANKS IN 2013**

**POLISH FINANCIAL SUPERVISION AUTHORITY
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KEY INSIGHTS AND CONCLUSIONS¹

Despite a strong slowdown in the economic growth in Poland observed in H2 2012 and H1 2013, the banking sector remained stable in 2013.

Maintenance of a strong capital base, improvement of the main capital adequacy ratios

The capital base improved (own funds increased from PLN 129.0bn as at the end of 2012 to PLN 139.4bn as at the end of 2013, the solvency ratio increased from 14.7% to 15.8%, Tier 1 ratio increased from 13.1% to 14.2%). The capital position is sound – the solvency ratio and Tier 1 ratio of only a small number of banks is below, correspondingly, 12% and 9% (correspondingly 7.1% and 2.0% of the assets of the banking sector). In the context of improvement of the main capital adequacy measures, as observed in recent periods, it is to be noted that the improvement partly results from the changes in the capital requirement calculation methods, which were introduced in some large banks (a change of basic/standard methods to advanced ones), which ultimately leads to a reduction in the total capital requirement.

Despite the sound current situation, we recommend that the capital base be maintained or, in case of some banks, further consolidated in view of the risk accumulated in banks' balance sheets and difficult external conditions, which may trigger disturbances on the financial markets and deterioration of the financial standing of some bank client.

Implementing this goal will preserve stability and security, ensure further development of the sector and facilitate acquisition of funding from the market on favourable conditions. With this in mind, the PFSA issued recommendations to banks on the distribution of 2013 profits, and the PFSA Chairman upheld his recommendation concerning/related to the desired capital adequacy ratio level (not lower than 12%) and Tier 1 ratio (at least 9%).

Good current liquidity position

The liquidity position was good. The basic liquidity ratios remain stable and are still at a satisfactory level (the positive liquidity gap decreased only slightly from PLN 156.9bn as at the end of 2012 to PLN 156.0bn as at the end of 2013, whereas the liquidity coverage ratio from 1.55 to 1.50 remaining considerably above the required minimum of 1.00).

The decreasing growth rate of loans to non-financial sector, as observed in recent years, combined with also reduced, but higher deposits growth rate, led to a gradual reduction in the shortage of deposits, and to an improvement of the loan-to-deposit ratio. At the end of 2013, the shortage of deposits and the level of deposit-to-credit ratio reached its lowest level (103.1% or PLN 24.1bn) since the end of 2007. Consequently, the sector came nearer to a balance between the scale of lending generated and the level of accumulated deposits.

Despite the satisfactory current liquidity position, we recommend that further measures be taken to increase the stability of funding sources, and that strategies that are well-integrated into the external conditions be implemented.

¹ Note: All data presented in the "Report" are derived from the database as at 4 February 2014, and therefore they do not take into account any subsequent adjustments resulting from, among other things, audits of financial statements by statutory auditors.

The sector's net profit at the 2012 level, but weaker performance in the second half of the year

Despite the difficult external conditions, the banking sector's net profit for 2013 was at a level similar to 2012 (the profit amounted to PLN 15,426m, which was only by about PLN 41m or 0.3% less than in 2012). However, it should be noted that most banks reported deterioration of earnings (501 entities accounting for 51.6% of the sector's assets reported a decrease in earnings; 18 entities reported a loss of PLN 214m in total), which was caused by a strong reduction in earnings of co-operative banks (down by 21.8%). It should also be noted that despite the gradual upturn in the economy, earnings achieved in the second half of the year turned out to be weaker than earnings recorded in the first half of the year.

The main cause of the weakening of earnings was a significant reduction in net income from banking operations (down by PLN 3,277m or 5.6%) due to a reduction in net interest income (down by PLN 1,343m or 3.8%), in net fee and commission income (down by PLN 334m or 2.3%) and in net income from other banking operations (down by PLN 1,600m or 17.9%). The decrease in net interest income resulted from a strong reduction of NBP interest rates, which translated into a decline in WIBOR rates and a reduction in the yield of debt instruments. However, it should be noted that after a strong decline in interest income in the first half of the year, there was a strong increase in it in the second half (profit in the fourth quarter was close to the record level achieved in the third quarter of 2011), which means that some banks quickly adopted to new market conditions (mainly by a strong reduction in interest on deposits). The decrease in net fee and commission income resulted, to a considerable degree, from changes in the method of recognizing income from the sale of the so-called bancassurance products, which led to a reduction in earnings of some banks in this area. Net income from other banking operations declined due to a reduction in dividend income, net gain on financial assets and liabilities held for trading and net gain on financial assets and liabilities designated at fair value through profit or loss.

Banks counteracted the negative phenomena observed in income by reducing operating expenses (by PLN 227m or 0.8%). The increase in profit on other income and expenses (by PLN 531m) and in net income from other operations (by PLN 400m) also positively influenced the sector's performance and was strongly associated with the one-off events.

The stabilization or improvement of performance in some banks was mainly caused by a decrease (of PLN 2,026m or 20.1%) in the negative balance of impairment losses and provisions. This resulted from reduction in impairment losses on consumer loans and housing loans, from profit on IBNR (compared to loss in 2012) and reduction in the scale of provisions recognised, which was accompanied by an increase in impairment losses on other loans to households and receivables from businesses. A strong reduction in the level of impairment losses may be attributed to higher impairment losses in previous periods, as well as earlier tightening of lending policy and regulatory actions, which had a positive impact on reducing the risk and related costs in the current economic downturn. A strong reduction of interest rates also had a positive impact on the financial condition of borrowers, which translated into a significant reduction in servicing costs of PLN loans. However, it cannot be ruled out that in the face of a significant decrease in net income from banking operations, some banks made attempts to improve their financial performance through a more liberal risk pricing, and as a result lower impairment losses.

Deterioration of financial performance triggered deterioration of Key Performance Indicators (C/I ratio increased from 50.9 to 53.3, ROA ratio declined from 1.22 to 1.10, and ROE ratio dropped from 11.2 to 10.1).

Based on 2014 forecasts submitted to the PFSA by commercial banks, it can be concluded that in 2014, banks expect a slight improvement in performance. However, forecasting is difficult. On the one hand, the expected improvement in the economic situation, combined with record-low interest rates, will create favourable conditions for the improvement in borrowers' financial position and may lead to an increase in demand for loans and other banking services. On the other hand, despite a clear improvement in the economic situation,

recent forecasts indicate that the rate of growth in the coming years will be significantly lower than during the boom of the past decade. The situation on the labour market will be also less favourable. In addition, there is uncertainty as to developments in the external environment of the Polish economy. Consequently, this may result in deterioration of the financial position of some borrowers, as well as limiting their demand for credit and banking products. Additional pressure on banks' financial performance will be exerted by the introduction of a fee for the stabilization fund in BGF, as well as reduction of interchange fees.

Moderate increase in the activity of the banking sector, changes in the sector's structure

Adverse external conditions prevailing for the most part of 2013 and uncertainty as to the future economic growth combined with reduced willingness of households and enterprises to incur liabilities resulted in limited growth in the scale of banking sector operations (as measured by the balance-sheet total growth) (total assets of the banking sector went up by PLN 57.0bn or 4.2%, and adjusted for the impact of changes in the rates of currencies against PLN by PLN 56.1bn or 4.2%). This means that the increase in total assets was lower than in the years 2010-2012, when it exceeded PLN 80bn. This was significantly influenced not only by limited growth of the scale of the sector's operations, but also by withdrawal from the national bank of large government deposits at the end of the year.

Slowdown in the growth of the banking sector and the negative developments in the environment meant that most banks continued their efforts to increase efficiency, e.g. by optimising employment and the sales network. This process was reinforced by the finalisation of two large mergers at the end of 2012 and at the beginning of 2013, and by constant development of electronic banking. As a result, there was a slight decrease (of 800 persons) in the number of employees in the banking sector and reduction of the sales network (by about 115 units).

As a result of mergers, the banking sector's concentration level increased, which was particularly distinct for the market share of the 10 largest banks (the share of the 5 largest banks in the sector's assets increased from 45.0% to 46.1%, and the share of the 10 largest banks from 64.6% to 67.3%). Taking into account the mergers carried out in recent years (and those that will be finalized in the coming periods), as well as the experiences of other countries of similar size to Poland, including those associated with the costs of overcoming crises, it seems that the level of concentration of the Polish banking sector is similar to the optimal one from the point of view of maintaining adequate competition and long-term stability of the banking sector and the economy.

The share of banks controlled by domestic investors increased slightly in the sector's total assets (from 36.4% to 36.8%; a higher share was observed during the year, due to large deposits of the public sector with the national bank).

Low increase in loans due to the stagnation of loans to businesses and public sector

After a slowdown in the growth rate of lending, as observed at the end of 2012 and in early 2013, the second and third quarters of 2013 saw its revival, followed, however, by repeated deceleration in the fourth quarter. As a result, an increase in the loan portfolio in the whole 2013 was significantly lower than in the years 2009-2012 (the amount of total loans increased by PLN 37.5bn or 4.0%, whereas adjusted amount by PLN 36.7bn or 3.9% compared to PLN 50-90bn in the years 2009-2012). Loans to households and, on a much smaller scale, loans to the financial sector and businesses, were the main area of lending growth. The level of state budget sector loans practically did not change.

The growth rate of loans to non-financial sector decreased (an increase of PLN 28.3bn or 3.5%; an adjusted increase of PLN 27.8bn or 3.4%), which resulted from significant weakening of the growth dynamics of loans

to businesses (an increase of PLN 5.7bn or 2.1%; an adjusted increase of PLN 5.3bn or 2.0%). The dynamics, in some periods, showed signs of stagnation, while in the area of loans to households a slight increase in the growth rate was reported (an increase of PLN 22.3bn or 4.2%; an adjusted increase of PLN 22.1bn or 4.1%). The weakening of growth in loans to non-financial sector resulted from a series of factors, where the weakening of the economic growth and the experiences of recent years seem to be of key importance. This led to a reduction in some entities' demand for loans and to provision of more selective supply of loans by banks.

The growth in housing loans, which was recorded in the previous year (an increase of PLN 14.5bn or 4.5%; an adjusted increase of PLN 14.3bn or 4.5%) turned out to be the lowest one in recent years, which was particularly a consequence of a low increase in the first quarter. In subsequent quarters, there was an increase in the scale of lending. However, at this point it should be added that despite the limited growth in loans, the level of housing sales in the primary market turned out to be not only much higher than in 2012 (sales in major markets were 17.5% higher, and the sales by WSE listed real estate development companies were higher by more than 40%), but reached the record 2007 level.

The causes for the slowdown in housing loans' growth, which was observed over the past years, should be sought in the coincidence of a number of factors. In particular, deterioration of economic growth perspectives resulted in fears of some households about their future income position, which was not conducive to incurring long-term liabilities, but also resulted in the tightening of banks' lending policy. At the same time, a price adjustment in the real-estate market, as observed in recent years, resulted in suspension of a portion of the demand in anticipation of a better purchase price, and reduced credit needs in value terms. An unfavourable ratio of average housing prices to average wages of households was (and still is) a strong barrier due to which some of them cannot afford a housing loan, or the incurrence of such a loan involves excessive risk, leads to reduction in the current consumption of these households and reduces their ability to create savings. Changes in the governmental programme "Rodzina na swoim" ("Family on its own") (reducing the so-called limits and then closing the program at the end of 2012), tightening lending policy in some banks as well as regulatory changes were additional factors influencing the decline in the growth of lending. Finally, it must be noted that the demand for loans has been largely satisfied through extensive lending in previous years (in 2013, the number of active credit loans increased by 88,200 and amounted to 1,819,800 at the end of the year), as well as the gradual satisfaction of housing needs (thanks to the systematic development of the residential construction, the so-called statistical housing deficit decreased from 1.6m in 2002 to about 700,000 flats in 2013, and it should be eliminated in the coming years). In consequence, the demand is reduced to a certain extent and is stabilizing at lower levels than in the years of the loan boom.

On the other hand, an increase in lending that occurred in the second and subsequent quarters of the last year should be associated with a strong reduction in the NBP interest rates, stabilization of real estate prices, a gradual improvement in the economic situation and the revised Recommendation S (except for a number of facilitating solutions, it also introduced changes aimed at significant limitation in the risk to banks and customers, such as shortening the maximum credit period and the introduction of restrictions on the maximum LTV level and of a minimum own contribution requirement). This resulted in stimulation of demand and an increase in lending.

In the context of record-low interest rates, it should be noted that in addition to positive developments (such as an increase in the availability of loans, beneficial impact on the situation in the construction and real estate development sector), they may also cause negative effects, such as a rise in real estate prices (not substantiated in an increase in production costs, but only in an increase in the purchasing power of customers as a result of an increase in their credit standing due to a reduction in interest rates) and thus they may lead again to reduced actual availability of flats and houses for households (as measured by the level of their income) and to granting loans to persons with poor income situation, or granting loans that are too high compared to the actual financial situation of borrowers. Therefore, banks and customers should take into account the risk of rising interest rates, so that the mistakes related to the extensive granting of foreign currency loans at the top of the appreciation of the Polish zloty are not repeated.

In the generated lending structure, a positive trend of dominance of PLN-denominated loans was continued, which was accompanied by marginalisation of FX loans. Consequently, the share of FX loans was further reduced (from 55.4% to 50.2%). On the other hand, the excessively extended credit periods and a high share of loans with LTV > 80% in sales should be considered negative phenomena.

Particularly unfavourable practices occurring in the grant of certain loans include assuming, for the calculation of the creditworthiness, the cost of living at the subsistence level or lower, DTI not adjusted to borrowers' income situation and the underestimation of interest rate risk. These issues are the subject of constant observation and analysis made by the PFSA and of detailed review during the process of inspection and audit recommendations issued.

Following a reduction in the portfolio of consumer loans, as observed in 2011 and 2012, the portfolio stabilised in the second quarter of 2013 and then rose in subsequent quarters. As a result, in the whole 2013 the amount of consumer loans increased (by PLN 3.2bn or 2.6%; an adjusted increase was similar). The increase would have been higher if not for the transactions of sale of the bad loan portfolio or the transfer of bad loans to off-balance sheet records (for a total amount of PLN 5.6bn), which was also one of the two reasons for a decrease in consumer loans in 2011 and 2012. It should be noted, however, that the increase in lending, as recorded in the Q4 of the last year, resulted to a considerable degree not from the actual growth, but from a change in the classification of some loans in one of the large banks (i.e. a transfer of a portion of loans from the category of other loans to households to consumer loans).

The greatest increase occurred in the debt from other loans (an increase of about PLN 3.2bn), including overdrafts and other loans payable in a single payment. The increase was smaller in the case of installment loans (an increase of PLN 1.2bn). On the other hand, a further decrease in the debt on payment cards and car loans was observed (by PLN 0.4bn and PLN 0.8bn, respectively).

The causes of recovery in lending should be sought in the last year's revision of Recommendation T, which made the existing solutions more flexible and provided an option to use the so-called simplified rules for creditworthiness assessment, as a result of which some banks that due to previous regulations transferred their lending operations to other entities returned to the market. The factors that contributed to lending growth also included the revival of the economy, lower interest rates on loans and improved quality of loans, which translated into a certain increase in the demand for, and supply of, loans. In addition, some banks have modified their strategies to achieve a greater share of short-term loans to retail customers.

In 2013, banks granted 2.4m loans (or 33.7% of the total number of loans granted in 2013) for the total amount of PLN 8.5bn (i.e. 15.6% of the total amount of loans granted) under the simplified creditworthiness assessment rules. Despite a high share in the total number of loans granted and a significant share in their total amount, at the end of the last year they accounted for only 8.4% of total number of loans and only for 5.5% of their total amount. Their low share in the balance sheet resulted from relatively low amounts of these loans (average amount of a loan according to the simplified rules was about PLN 3,600 compared to 9,900 for other loans) and their short-term nature. A total of 23 entities decided to grant such loans, and three entities specializing in granting instalment and cash loans were of key importance on the market these loans (they granted almost 80% of loans under simplified creditworthiness assessment rules). It should be noted that some of the major participants of the consumer credit market have not decided to grant such loans at all or such loans are of marginal importance in their business.

Low growth in corporate loans was due to the weakening in the area of loans to SMEs (down by PLN 0.9bn or 0.5%), while loans to large companies showed relatively satisfactory growth (up by PLN 6.6bn or 6.1%). Low growth/stagnation in the area of corporate loans should be associated with a strong slowdown in the economic growth that occurred in the second half of 2012 and in the first half of 2013, which on the one hand, translated into a reduction of the financial needs of some enterprises, and on the other hand resulted in more selective supply of credit.

In subsequent periods, there is a chance of revival in lending, which results from gradual economic recovery, record-low interest rates and stabilized quality of the credit portfolio, which should translate into an increase

in demand for, and larger supply of, loans. Additionally, the launch of the government Portfolio De Minimis Guarantee Line Programme should stimulate lending in the area of loans for SMEs.

In the context of assessing corporate loans' dynamics, it should be remembered that own funds and liabilities to business partners play the key role in the financing of enterprises. Moreover, systematic development of the Polish economy leads to the development of alternative forms of corporate financing (issue of debt securities, issue of shares, leasing and factoring, etc.), which in 2013 increased in the scale exceeding the increase in debt from bank loans. In addition, due to links of some companies with international financial markets, foreign financing also plays a significant role. As a result, the scale of alternative forms of funding is comparable to, or even bigger than, the scale of funding provided by the banking sector.

In the context of low dynamics in lending, it should be noted that this phenomenon is visible in most EU countries and that the dynamics of lending in Poland is relatively satisfactory in comparison to other countries (at the end of 2013, annual growth rate in the euro area was 0.1% for loans to households, -3.0% for consumer loans, 0.7% for housing loans and -3.0% for corporate loans compared to 4.1%, 4.5%, 2.6% and 2.0% respectively in Poland).

Indirectly, this confirms that slowdown in lending is mainly caused by the long-term financial crisis and the associated change in the attitudes of some households, companies and banks.

The quality of loans remains stable, although deterioration is reported in some areas

Despite strong weakening in economic growth, as observed in the second half of 2012 and the first half of 2013, and despite a weak situation in the labour market, the quality of the loan portfolio remained stable. Throughout 2013, the level of non-performing loans reduced marginally (down by PLN 0.5bn or 0.7%). Their share in the portfolio also decreased (from 7.7% at the end of 2012 to 7.4% at the end 2013). This favourable image can be explained by several factors. First, the transactions of sale of the "bad loan" portfolio, which related mainly to consumer loans, had a significant influence. Secondly, reduction in NBP interest rates by the Monetary Policy Council led to a strong fall in WIBOR rates, and in consequence significantly reduced loan-servicing costs, which had a stabilizing effect or led to the improvement in the financial position of some borrowers. Thirdly, despite the economic slowdown, the financial position of the corporate sector remained good. Finally, the self-regulation process, which occurred in recent years, as well as activities of banking supervision, both at the level of the entire sector and individual banks, had a strong influence, which strengthened the credit risk management process. However, it cannot be ruled out that some banks made attempts to improve their performance through a more liberal credit risk pricing, which, however, is the subject of ongoing review by the PFSA (in 2014, the PFSA will review the quality of assets of 15 largest banks based on the AQR model carried out by ECB for the largest banks of the euro area), as well as review of assets by statutory auditors.

As far as individual portfolios are concerned, the following was reported: the improved quality in the area of consumer loans, stability in the area of corporate loans and deterioration in the portfolio of housing loans and other loans to households.

The improved quality of consumer loans (non-performing loans decreased by PLN 2.8bn or by 12.9% and their share in the portfolio of consumer loans from 17.2% to 14.6%; 30+ DPD loans decreased by PLN 2.4bn or by 10.2% and their share in the portfolio from 18.9% to 16.1%) resulted primarily from the sale of a portion of the bad loan portfolio or their transfer to off-balance sheet records (their total amount exceeded PLN 5bn). In addition, the loan quality improvement was supported by growth in lending.

The stabilization of the quality of corporate loans (non-performing loans decreased marginally by PLN 0.1bn, and their share in the portfolio decreased from 11.8% to 11.5%) can be explained by a favourable financial position of businesses (despite the weakening in the economic growth, the net profit of the corporate sector

increased by 12.2% to PLN 92.1bn), which was partly related to the reduction in interest rates resulting in a decrease in debt service costs.

Despite the deterioration in the quality of the housing loan portfolio (non-performing loans increased by PLN 1.5bn or 16.2%, and their share in the portfolio increased from 2.8% to 3.1%), there are signs of possible stabilization of their quality in future periods, which may be signified by a gradual deceleration and a decrease in 30+ DPD loans, as observed in Q4 (over the whole year, 30+ DPD loans increased by PLN 0.7bn or 6.5%, and their share in the portfolio from 3.3% to 3.4%). In addition, the environment of record-low interest rates has a positive impact on the quality of PLN loans, which significantly reduces debt servicing costs. On the other hand, it should be borne in mind that banks sold a portion of bad loan portfolio (worth PLN 0.3bn). In addition, banks' portfolios comprise a significant number of loans subject to restructuring or enjoying the so-called "loan-repayment holidays".

The quality of other loans to households has deteriorated (non-performing loans increased by PLN 0.9bn or by 9.8%, and their share in the portfolio increased from 10.5% to 10.9%), which resulted from the deterioration of credit quality for current operations of small businesses, and, to a lesser extent, from investment loans, and is related to a slowdown in the economic growth. But the second half of last year saw a deceleration in the growth of non-performing loans and a reduction in their share in the portfolio.

The quality of loans to the financial and the public sector remained high.

In the context of a high quality of housing loans compared to other portfolios, it should be borne in mind that this portfolio generates a number of potential risks for customers, banks and the economy. This results, in particular, from the dominant role of these loans in the balance sheet of the banking sector (at the end of the last year, they accounted for 41.4% of loans to the non-financial sector and 23.5% of the banking sector's total assets, but in some banks, this share was significantly higher), a high share of foreign currency loans generating a number of risks (it is expressed in, for example, class actions filed against banks) and a high LTV ratio of a large portion of the loan portfolio (over 500,000 loans with an LTV ratio > 80%, including more than 200,000 loans with an LTV ratio > 100%), which raises concerns about the situation of households that would be covered by the debt recovery processes (some of them, despite the sale of the property, would still have very high liabilities to repay), and may have an adverse impact on the position of banks with a large portfolio of loans with such parameters. Additional risk is related to loans granted as part of the "Rodzina na swoim" (Family on Its Own) programme (it results from the abrupt growth of instalments to be repaid after 8 years of subsidies, which will be "felt" by some families), limited liquidity in the real estate market (the effectiveness of realizing security and the impact of this process on the situation in the real estate market), unsatisfactory bases of data on the real estate market and on the financial position of borrowers, a strong variation in real estate prices (including within the same location), which impedes their fair valuation, or lack of a fully satisfactory funding sources.

Finally, one should bear in mind the social and legal issues related to the realisation of security. In this context, it should be stated that at the end of 2013, banks' portfolios covered 50,100 non-performing loans, which were secured by residential property (37,500 housing loans, 12,600 other loans that were secured by residential property), which means that about 100,000-150,000 people were affected by the problem of servicing loans secured by residential property (assuming that loans were contracted by a 2-3 person households).

In view of these potential risks, in June last year the PFSA revised Recommendation S. The full implementation of Recommendation S into the universal banking practice will increase the security of banks and their customers (borrowers and depositors), and will create favourable conditions for a stable, long-term development of the real estate market.

Increase in the most liquid assets

Limited growth in lending translated into an increase in the most liquid assets (by PLN 27.2bn or 7.1%) and an increase in their share in total assets (from 28.4% to 29.1%). The increase in liquid assets concerned mainly the portfolio of treasury bonds and NBP bills, and to a lesser extent funds deposited in other banks. On the other hand, there was a decrease in deposits with the NBP. Due to the liquid nature of those deposits, one should not attach too much significance to their changes.

Moderate increase in liabilities and equity, stable foreign financing

A limited growth in the scale of banks' activity was also reflected in a moderate increase in liabilities (an increase of PLN 49.6bn or 4.1%; an adjusted increase of PLN 49.1bn or 4.1%). The level of the sector's equity also increased moderately (by PLN 7.4bn or 5.0%).

The increase in deposits of the non-financial sector (up by about PLN 51.4bn or 7.1%; an adjusted one proved to be identical), which was higher than in 2012, but lower than in previous years, had the decisive impact on the increase in liabilities. This was due to a reduction in the growth of household deposits (an increase of PLN 32.2bn or 6.2%; adjusted one by PLN 32.4bn or 6.3%), due to, among other things, low growth in income of households. On the other hand, the growth rate of corporate deposits clearly accelerated (an increase of PLN 18.5bn or 9.7%; adjusted one by PLN 18.3bn or 9.6%), which resulted from the improvement of the financial situation of the business sector, accompanied by reduced propensity of businesses to invest and the low base effect (a decrease in these deposits in 2012).

In the context of the ability to increase the deposit base, the environment of low interest rates and the economic slowdown will present a challenge to banks. A reduction in the NBP interest rates translated into a strong reduction in interest rates on bank deposits (the average interest rate on new deposits of households fell from 4.2% in December 2012 to 2.6% in December last year, and of businesses from 4.0% to 2.3%), which leads to a reduced growth in deposits from interest on investments already made, negatively affects the propensity to save, and leads to searching for alternative forms of investments (including capital and real estate market). Pressure on the deposit base is also exerted by the economic slowdown, which reduces the ability to create savings by some households and some companies, but on the other hand, the same factor may induce them to increase the level of savings in banks in order to create a buffer against the deterioration of the financial position.

Despite periodic fluctuations, the deposits of, and loans to, the financial sector in the banking sector remained relatively stable in recent years (in 2013, they increased by PLN 5.5bn or by 2.2%, and adjusted one by PLN 5.3bn or 2.1%). However, the stabilization of these funds leads to a gradual reduction in their share in the structure of liabilities and, consequently, and in the balance-sheet total (at the end of 2013, they accounted for 20.6% of total liabilities and 18.3% of the balance-sheet total). From the perspective of the country of origin, the structure of these funds did not change significantly. The majority are still the funds that the banks received from non-residents, although in 2013 there was a further increase in national funds.

Other liabilities remained largely unchanged. Following a strong inflow of the government sector's deposits opened with the national bank, as observed over most of the previous year, those deposits were withdrawn at the end of the year, and the public sector's deposits decreased (by PLN 4.4bn). Issues of equities increased slightly (by PLN 1.1bn) and subordinated loans decreased (by PLN 1.0bn). However, it should be borne in mind that the scale of these measures is limited, and moreover they are highly concentrated, as a result of which their role in the financing of banks' operations remains limited.

Foreign funding remained stable (at the end of the last year it amounted to PLN 217.9bn compared to PLN 218.7bn at the end of 2012), although Q2 saw increased inflow of these funds, and Q4 a decrease in these

funds. More than a half of liabilities to non-residents are liabilities to group entities. In 2013, the level of these funds decreased slightly (from PLN 122.0bn at the end of 2012 to PLN 120.1bn at the end of 2013), although some entities reported a significant growth in these funds. Stabilization of non-resident funds in conjunction with an increase in other liabilities and total assets resulted in a reduction in the share of these funds in the liabilities structure (to 17.4%) and in total assets (to 15.2%), which means less dependence on foreign financing, and at the same time greater stability of the banking sector.

In the context of foreign funding, it should be noted that in recent years Poland, unlike other countries in the region, did not report an outflow of foreign capital as a result of the so-called “deleveraging” of foreign banks. The observed changes in Poland in terms of foreign funding are mainly caused by the modification of the strategy of some banks, which consist of a reduction in the degree of dependence on funds from parent financial groups and withdrawal of foreign currency housing loans from the offer, which leads to a gradual drop in the demand for foreign funds. Volatility of exchange rates also constitutes an important source of fluctuations in the level of foreign funding (around 70% of non-resident funds are foreign currency funds), similarly as volatility of the scale of financial market operations performed by certain entities that are funded from parent institutions’ resources. It should be also remembered that not all banks entering the Polish market were successful. As a consequence, they decide to cease operations and exit the market, but this phenomenon has nothing to do with “deleveraging”. These are rather ordinary business activities.

Improved balance-sheet currency structure

The supervisory activities taken in recent years, along with increased awareness of foreign exchange risk for banks and their customers, and the relative stabilization of the Polish zloty against major currencies, as observed in 2013, helped to improve the currency structure of the banking sector’s balance sheet, and thus to increase its stability. Foreign currency assets decreased slightly (by PLN 4.1bn or 1.2%), while foreign currency liabilities increased marginally (by PLN 0.7bn or 0.2%). In conjunction with an increase in PLN assets and liabilities, this resulted in a reduction in the share of both foreign currency assets and foreign currency liabilities in the balance sheet (to 23.4% and 19.2%, respectively). As a consequence, there was also a reduction of the negative currency gap (down to PLN 58.7bn) and its share in the balance-sheet total (down to 4.2%).

Long-term funding without major changes

In 2013, there were no significant changes in the maturity structure of the banking sector’s balance sheet (liabilities of over one year increased from PLN 193.2bn to PLN 196.0bn, but their share in total assets decreased from 14.4% to 14.0%), although a few banks managed to obtain a relatively significant long-term funding.

Largely mismatched maturities of assets and liabilities indicate that long-term lending is based on short-term deposits, whereby liquidity risk is higher. Hence, banks need to continue their efforts to obtain long-term stable funding sources. In this context, once again, attention should be paid to the usefulness and necessity of banks’ compliance with instructions and recommendations of the PFSA relating to, for example, an adequate amount of equity, the dividend policy and risk management, which will help to strengthen their financial standing and credibility in the market and thus facilitate them to obtain funding on favourable terms.

Increase in liabilities granted, decrease in derivative transactions

Limited growth in lending was reflected in a moderate increase of funding-related liabilities granted by banks (by PLN 17.6bn or 8.7%), as well as of guarantees granted (by PLN 4.4bn or 7.8%).

Strong reduction of the NBP interest rates translated into a significant increase in the scale of derivative instrument transactions relating to interest rates in the first half of the last year. However, the number of such operations decreased in the second half of the year due to the completion of the monetary policy easing

cycle and due to the stabilisation of investor expectations as to the level of interest rates in the coming periods. At the same time, the relative stabilization of the Polish zloty against the major currencies resulted in some reduction in the scale of transactions concluded on currency derivatives. In consequence, there was a reduction in the scale of transactions on derivative instruments in total (the nominal value of those transactions fell from PLN 1,976.0bn at the end of 2012 to PLN 1,858.7bn at the end of 2013 or by 5.9%).

Banks' operational risk reduced, but still at an elevated level

The recovery of the Polish economy, as observed in H2 2013, along with the improvement of the situation in the euro area countries and the United States resulted in a significant improvement in growth prospects of the Polish economy in the coming periods. In conjunction with a good financial situation of the banking sector and an improvement in banks' ability to absorb losses, this results in the reduction in banks' operational risk.

On the other hand, it should be noted that even if better forecasts of the economic growth are fulfilled, this means a lower growth rate than during the boom years of the past decade. At the same time, these projections are burdened with uncertainty, which results, among other things, from the difficulty to predict the recovery in the euro area, the effects of restriction of highly expansive monetary policy by FED (and, on the other hand, of an increased expansion of the policy pursued by the ECB) and a reduction in the rate of growth of key emerging economies. It is also difficult to predict the consequences of a possible escalation of the crisis in Ukraine, which may adversely affect trade and the sentiment of investors, businesses and households and, consequently, reduce their willingness to invest and consume. In the context of risk, the lawsuits filed by some borrowers with loans denominated in Swiss francs should be borne in mind, and banks should take account of this risk in their operations.

Accordingly, despite the decrease, the risk of banking operations remains high.

Macroeconomic Environment²

Steep slowdown in economic growth but improvement visible quarter by quarter

After a sharp slowdown in the growth of the Polish economy in H1 2013, H2 saw clear recovery. As a result, over the whole 2013, GDP growth amounted to 1.6% (in each quarter 0.5%, 0.8%, 1.9% and 2.7%, respectively). The low growth rate resulted from stagnation in domestic demand (0.0%) due to a reduction in the investment level (gross fixed capital formation decreased by 0.2%), and at the same time a low growth rate of consumption (total consumption increased by 1.2%, while individual consumption went up by only 0.8% and public consumption grew by 2.8%). In the second half of the year, consumption revived and a slight increase in investments was observed. As a consequence, the main economic category that supported economic growth was net exports.

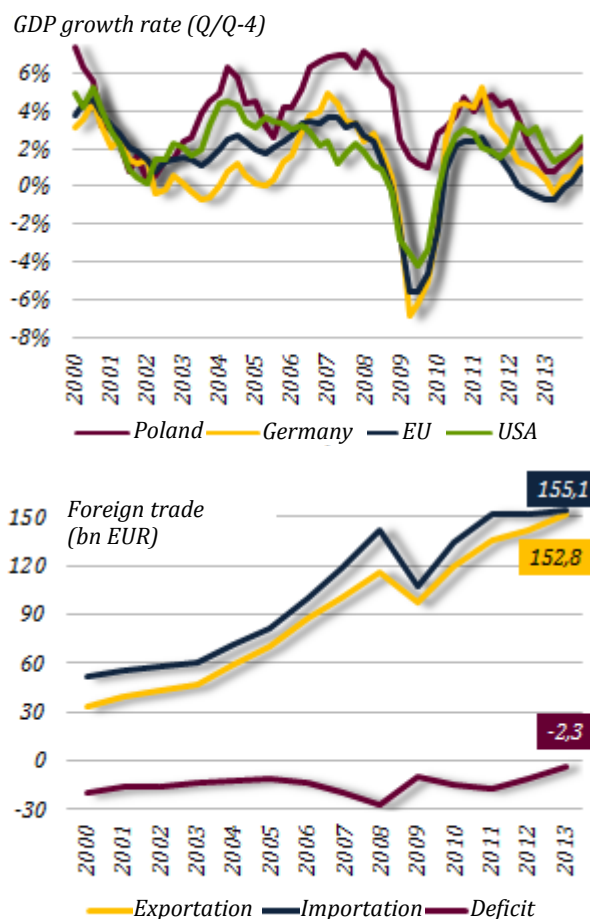
The main causes of the slowdown that occurred in H2 2012 and H1 2013 was the completion of some of the major infrastructure investments, the necessity to reduce the deficit of the public finance sector and the weak economic situation in the environment of the Polish economy. It adversely affected operations of some companies and their propensity to invest, as well as consumption of some households and their propensity to incur more expenses.

Improved growth perspectives, but considerable uncertainty

The apparent economic recovery, combined with the improvement of the situation in the euro area (in Q4 2013, the euro area recorded the first GDP growth y/y since 2011) and in the United States, translated into the raising of growth forecasts for the Polish economy (according to NBP projections as of March 2014, the GDP growth rate in the years 2014-2016 will amount to 3.6%, 3.7% and 3.5%, respectively). However, it should be noted that even if these forecasts are fulfilled, this means a weaker growth rate than during the boom years of the past decade. In addition, forecasts are subject to considerable uncertainty arising from the difficulty to predict developments in the euro area and in the U.S., reduction in the growth rate of key emerging economies, as well as the consequences of a possible escalation of the crisis in Ukraine, which are difficult to determine.

²For more information see: *Information on socio-economic situation of the country*, GUS; *Inflation Report*, NBP; *Convergence Programme*, MF; *Financial Stability Report*, NBP; *Gross Domestic Product. Preliminary estimate*, GUS; *Foreign trade turnover in total and by countries*, GUS; *Financial performance of non-financial enterprises*, GUS; *Communication of the Meeting of the Monetary Policy Council*, NBP; *Housing Construction*, GUS; *Report on housing prices and real estate and housing market*, NBP; *Monthly Bulletin*, ECB.

Fig. 1.
GDP, foreign trade



Source: OECD, GUS

Stable position of the business sector

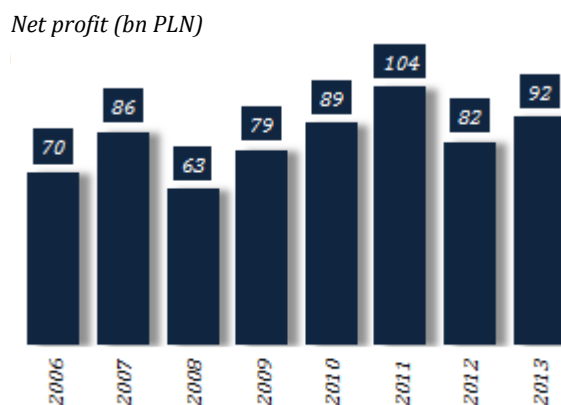
According to preliminary estimates of the Central Statistical Office, industrial production increased by 2.1%, construction and assembly production fell by 11.0%, while retail sales increased by 1.6%. Despite the slowdown in the economy, the financial performance of the business sector improved (net profit of the business sector increased by 12.2% to PLN 92.1bn; net profit was recorded by 79.6% of all businesses; current ratio improved and quick ratio decreased slightly).

Difficult situation on the labour market with signs of improvement

The labour market situation remained difficult, although it improved to some extent in Q4. According to preliminary estimates, in 2013 the number of employees in the national economy increased (by 0.6%), but the average employment in the business sector decreased (by 1.0%), although the end of the year saw a slight increase. For most of 2013, the unemployment rate was running at a level higher than in the previous year, but at the year-end, the rate returned to the end of 2012 level (the registered unemployment rate was 13.4%; 9.9% according to the Survey of Economic Activity of Population (BAEL), which was a lower level than at the end of 2012). Limited demand for labour resulted in a reduction in wage growth (average gross wages in the business sector in 2013 were by 2.9% higher than in 2012), but due to a strong reduction in inflation, the growth rate of real wages was relatively high (2.0% compared to a decrease by 0.2% in 2012).

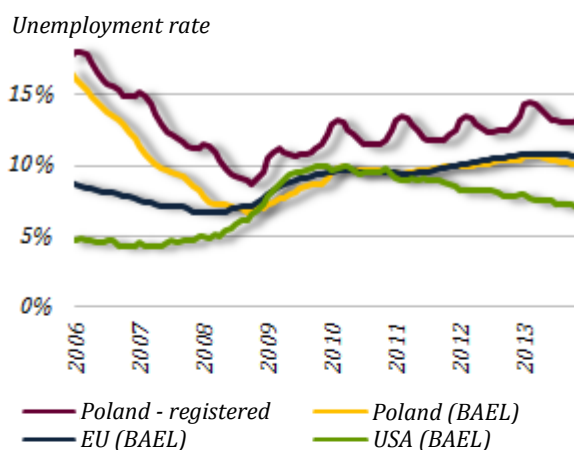
The growth rate of average retirement and other pensions payment was higher than of wages and salaries (in the non-agricultural social security system, their real growth was 4.4%, whereas for farmers - 5.1%).

Fig. 2. Financial performance of the business sector

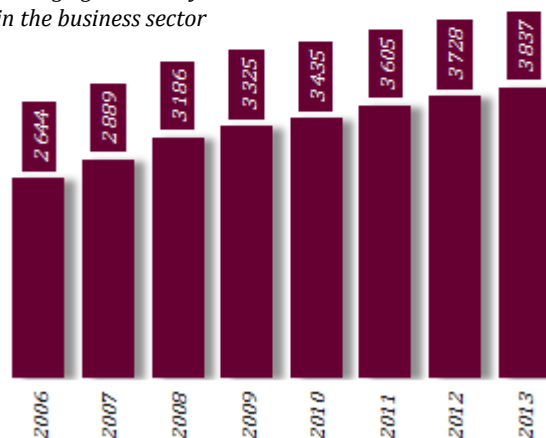


Source: GUS

Fig. 3. Situation on the labour market



Average gross salary in the business sector



Source: Eurostat, GUS

Strong easing of monetary policy

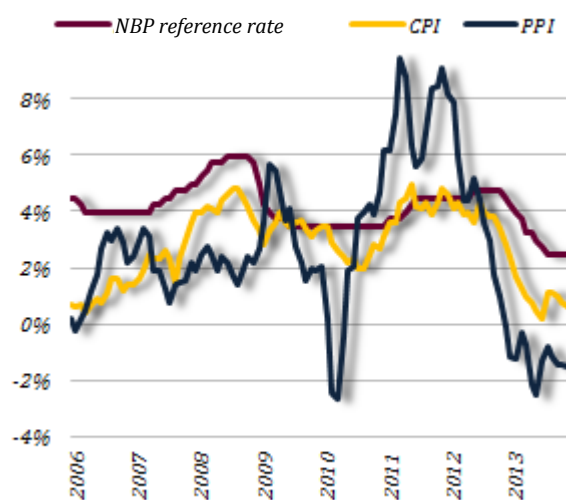
Strong economic slowdown, combined with low inflation, which was running well below the lower band of permissible deviations from the inflation target (in December 2013, the CPI was 0.7% and the PPI -1.0%), induced the MPC to continue the monetary policy easing cycle, which ended in July last year. As a result, there was a strong reduction in the NBP reference rate (from 4.25% in December 2012 to 2.50% in July 2013; over the entire cycle, it was reduced by 225 basis points). At the same time the MPC decided to keep interest rates unchanged until at least the end of the first half of 2014 (in March 2014, this period was extended to the end of Q3 2014)

Public finances remain relatively stable

Irrespective of the economic slowdown, public finances were relatively stable. However, the decline in economic activity associated with a strong reduction in inflation resulted in a decrease in tax proceeds and rapid realisation of the budget deficit planned for the whole year. Consequently, the budget act was revised and the deficit increased. The final execution of the budget was more favourable than assumed in the revised act (proceeds amounted to PLN 279.2bn and were 2.9% lower than in 2012, expenditure amounted to PLN 321.3bn and was 1.1% higher than in 2012, whereas the deficit amounted to PLN 42.2bn against PLN 30.4bn in 2012).

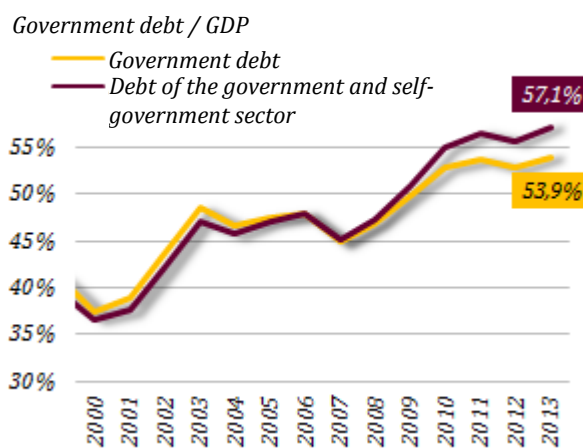
There was a further increase in the public debt (by 4.7% to PLN 880.2bn) and in the debt of the government and self-government sector (by 5.1% to PLN 932.5bn), as well as in their share in GDP. At the same time, as part of an effort to reduce the public sector deficit, changes were made in the pension system, as a result of which the ratio of public debt, and of the debt of the government and self-government sector to GDP will decrease (by about 7-8%), and will help to reduce the debt service cost.

Fig. 4. Inflation, NBP reference rate

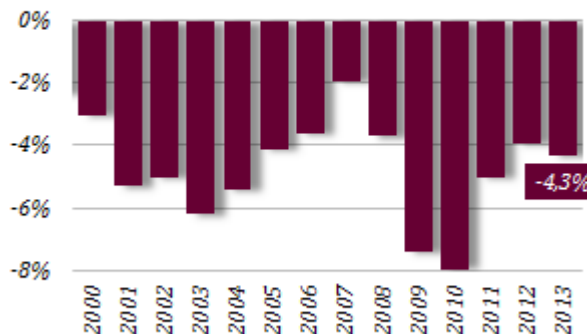


Source: NBP, GUS

Fig. 5. Public finances position



Relation of the deficit of the general government and self-government sector to GDP



Source: MF, GUS

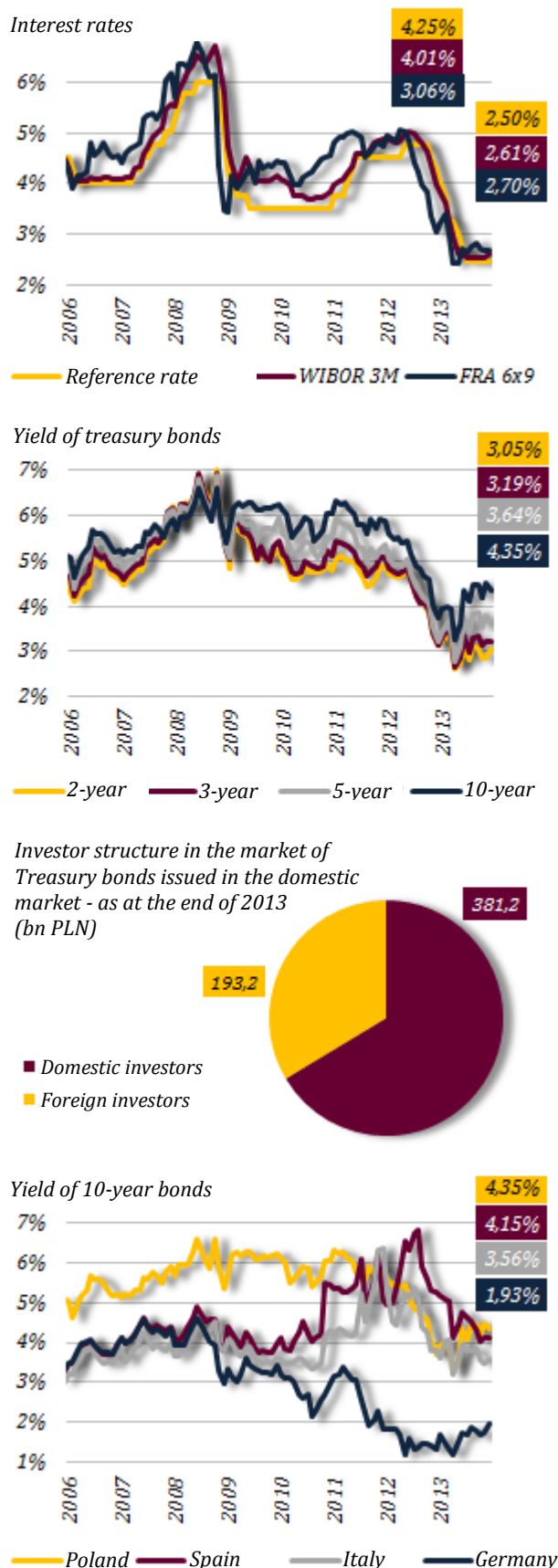
Situation in the financial markets relatively stable

The situation in the global financial markets was relatively stable. It was mainly shaped by data coming from the major economies (U.S., euro area, China, Japan) and actions of major central banks. The decisions of FED and the related investor expectations regarding the scale and method of limiting the quantitative easing programme (QE3) were of key importance and led to higher yields of treasury bonds, and also caused periodic falls in equity markets and the outflow of capital from emerging markets. The slowdown in the Chinese economy and issues related to political decisions in major economies (including the issue of raising the debt limits in the U.S. and elections in Germany), as well as regional conflicts were additional risk factors.

The situation on the domestic market can be considered relatively stable, although it was under a strong influence of the decisions of the Monetary Policy Council, planned changes in the pension system and sentiments on the global markets. Nonetheless, the following has to be noted:

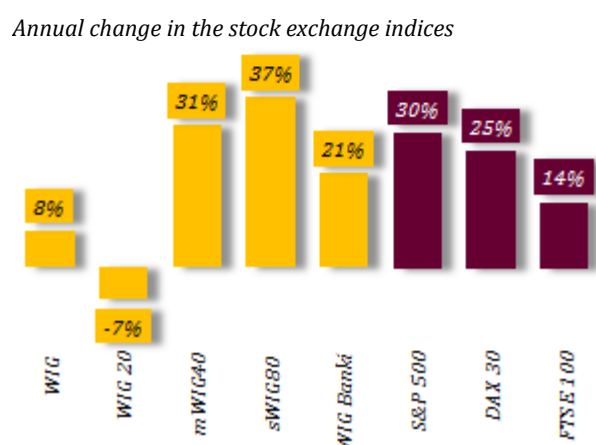
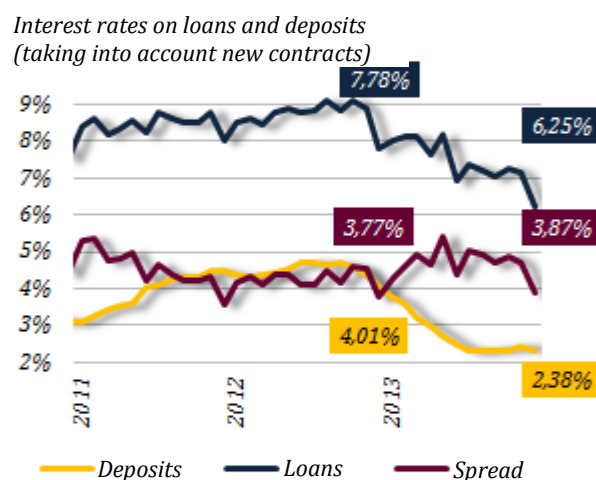
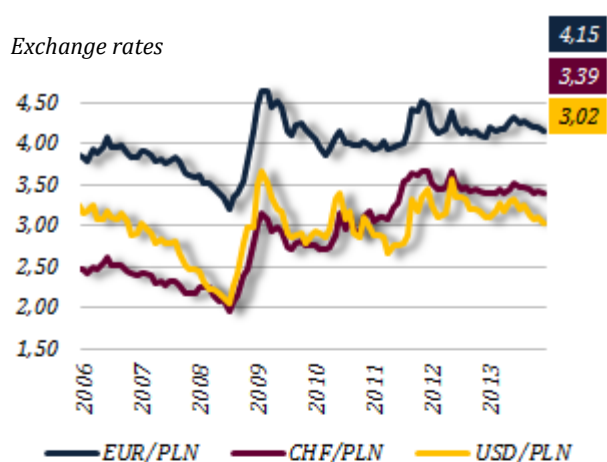
- interest rates on the interbanking market decreased considerably (the average WIBOR 3M rate decreased from 4.2% in December 2012 to 2.6% in December 2013); and market participants' expectations as to future interest rates fell and then stabilized (in December 2013, the average quotations FRA 6x9 stood at 2.7% and were similar to the current WIBOR 3M);
- a decrease in the yield of treasury bonds during the period from March to the first decade of May, in which they reached historically low levels (in the culminating point, the yield of 10-year treasury bonds fell to 3.1% and of 2-, 3- and 5-year bonds to 2.5-2.6%). In subsequent weeks, there was an increase in the yield, followed by its stabilization, as a result of which the average yield of Treasury securities at the shorter end of the curve was similar to that recorded in December 2013, and at the long end - higher (average yield of 2-, 3-, 5- and 10-year Treasury bonds on the secondary market in December 2013 was 3.0%, 3.2%, 3.7%, 4.4% compared to 3.2%, 3.3%, 3.3% and 3.9% in December 2012).

Fig. 6. Situation in the financial markets



In the first part of the year, the market of treasury bonds issued in the domestic market saw an increase in foreign investors' involvement, which in April and May reached its record level of over PLN 207bn. In the following months, the portfolio of bonds held by this investor group decreased (at the end of 2013, it amounted to PLN 193.2bn). In the context of a high share of foreign investors in the domestic debt market, it is clear that this is conducive to the development of the Polish economy, but on the other hand, it is associated with an increased risk due to the possibility of earlier withdrawal of some capital, which could adversely affect the yield of Treasury bonds and the exchange rate of the Polish zloty;

- despite periodical fluctuations, the rate of the Polish zloty against major currencies remained relatively stable (at the end of 2013, the average NBP exchange rate of 1 EUR, 1 CHF and 1 USD amounted to 4.1472; 3.3816 and 3.0120 compared to 4.0882, 3.3868, 3.0996 at the end of 2012);
- a strong reduction of interest rates on deposits and loans. Taking into account new contracts, interest rates on deposits in total decreased from 4.0% in December 2012 to 2.4% in December 2013 (of household deposits from 4.2% to 2.6% and of businesses from 4.0% to 2.3%). The interest rate on loans in total decreased from 7.8% to 6.3% (of consumer loans from 16.0% to 13.1% - the actual rate from 22.2% to 19.9%, of housing loans from 6.6% to 5.2% - the actual rate from 7.1% to 5.6%, and of corporate loans from 6.2% to 4.4%).
- the situation on the Warsaw Stock Exchange was shaped by record-low interest rates and the associated significant inflow of new funds to investment funds, changes in open-end pension funds, as well as the situation in the global markets (it was characterized by strong increases in the major indexes in mature markets, accompanied by poor performance of the major indexes in most emerging markets). Over the whole year, an increase was reported in the WIG, mWIG40, sWIG80 and WIG Banki indexes, and, on the other hand, a fall in the WIG 20 index. It is worth mentioning that the share of individual investors in the market turnover is further marginalised (in 2013, their share in trading in the main market fell to 15%, and their realized turnover amounted to PLN 66bn - for comparison, in 2007 their share was 30%, and their realized turnover amounted to PLN 135bn).



Source: Bloomberg, MF, NBP

Revival in the housing market, but low level of housing starts

Despite earlier fears, in 2013 the situation in the housing market turned out to be relatively favourable. Despite strong slowdown in the economic growth, the difficult situation on the labour market, limited credit growth and the lack of government support program for the purchase of a first home, there was a strong recovery in demand in the primary market, which resulted in a strong increase in sales and a decrease in the surplus of supply over demand. According to the REAS,³ the number of sales realised in 2013 in the primary market in the major markets was higher than in 2012 (by 17.5%) and reached the 2007 record level (very good sales numbers are confirmed by an increase of over 40% in the number of apartments sold by real estate development companies listed on the Warsaw Stock Exchange).

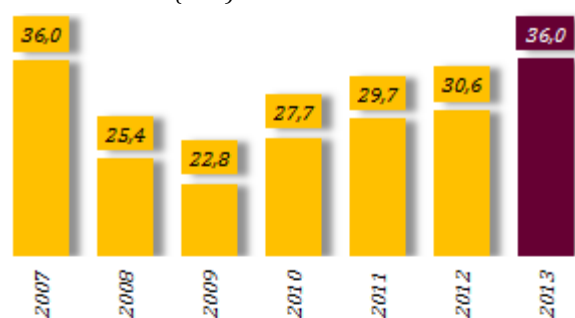
The sales numbers were so good thanks to the activation of deferred demand (waiting for the best moment of purchase), a decrease in interest rates to record-low levels, which led to strong growth in creditworthiness (much higher than the increase in wages and salaries) and to seeking forms of investment alternative to low-interest bank deposits. A revision of Recommendation S was also a stimulating factor - it activated customers who wanted to take out a loan with the highest LTV values and the longest lending periods.

Housing prices were in the phase of stabilization or growth. According to the NBP data, in Q4 2013, average transaction prices in the primary market for seven major markets were 6.9% higher than in Q4 2012 (partly due to the effect of the reduced statistical base, as a result of the completion of the "Rodzina na swoim ("Family on its own") programme, which was one of the causes of the decline in prices in Q4 2012), and in the secondary market they were lower by 3.1%.

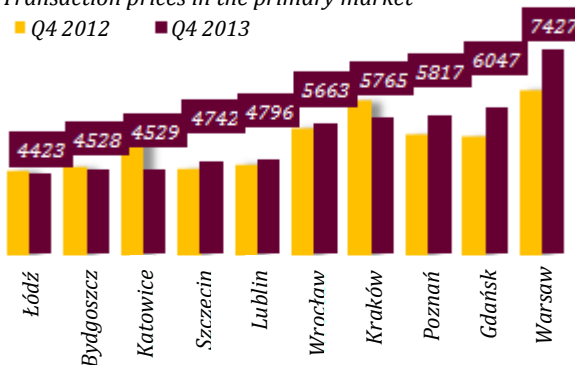
According to the data of the Central Statistical Office, the number of houses commissioned for use

Fig. 7. Situation in the housing market

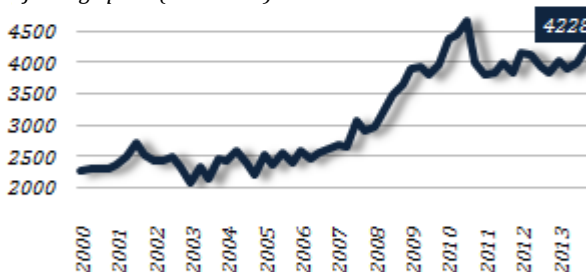
Sales of flats in the primary market in Warsaw, Krakow, Wrocław, Tricity, Poznan and Lodz ('000)



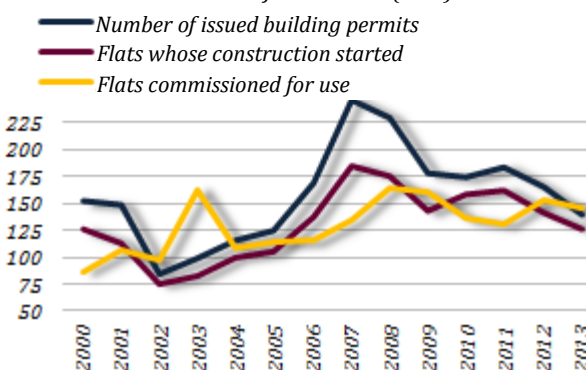
Transaction prices in the primary market



Average cost of construction of 1 sq.m. of living space (statewide)



Selected characteristics of the market ('000)



Source: REAS, NBP, GUS

³For more information see „Housing Market in Poland”, REAS. It should be noted that the REAS data include paid reservations, as a result of which apartments are not available to other buyers, which distorts the actual sales numbers, although it seems that in principle, this does not change the picture of the market.

in 2013 amounted to 146,100 (private house building - 81,100, co-operative house building - 3,500, for sale or rent - 57,500) and was by 4.4% lower than in 2012. In addition, at the end of 2013, approximately 694,000 housing units were under construction, i.e. by 2.6% less than at the end of 2012. At the same time, a decrease in housing starts was reported (of 10.2% to 127,400). and in the number of planning permissions (of 16.0% to 138,700).

The last two phenomena should be considered unfavourable (partly, they result from entry into force of the “real estate development law” in 2012). In particular, as a result of a low number of housing starts (the lowest since 2005) combined with record-high sales in the primary market, the situation in the market may change from the supply surplus phase to the demand surplus phase (according to REAS data, at the end of 2013, the sales offer of real estate development companies in major markets covered about 41,000 housing units). On the other hand, it should be noted that the distinct revival in demand as well as satisfactory/high profitability may induce real estate development companies to re-start shelved projects and to start new investments.

In this context, once again the advisability of adjustments in housing policy should be noted, which should lead to increased supply and competition in the market (including the issue of development plans and the availability of land for housing purposes, shortening and facilitation of the investment process while maintaining appropriate construction standards, support - upon meeting appropriate conditions - of operations of real estate development companies and co-operatives in the construction of infrastructure and access to finance), creating propensity for long-term savings for housing purposes and the development of the rental market.

Banks’ operational risk reduced to a certain degree, but still at an elevated level

The recovery of the Polish economy, as observed in H2 2013, along with the improvement of the situation in the euro area countries and the United States resulted in a significant improvement in growth prospects of the Polish economy in the coming periods. In conjunction with a good financial situation of the banking sector and an improvement in banks’ ability to absorb losses (thanks to the strengthening of the capital base in recent years), this results in the reduction in banks’ operational risk.

On the other hand, as mentioned earlier, it should be noted that even if better forecasts are fulfilled, this means a weaker growth rate than during the boom years of the past decade. At the same time, these projections are burdened with uncertainty, which results, among other things, from the difficulty to predict the recovery in the euro area, the effects of restriction of highly expansive monetary policy by FED or the results of a possible increased expansion of the policy pursued by the ECB, and a reduction in the rate of growth of key emerging economies.

It is also difficult to predict the consequences of a possible escalation of the crisis in Ukraine, which may adversely affect trade (this would undoubtedly have a significant influence on some businesses and households) as well as the sentiment of investors, businesses and households and, consequently, reduce their willingness to invest and consume.

In the context of risk, the lawsuits filed by some borrowers with loans denominated in Swiss francs should be borne in mind, and banks should take account of this risk in their operations.

Therefore, despite its lowering, the risk of the banking sector remains at an elevated level.

1. BANKING SECTOR'S STRUCTURE, THE ROLE OF BANKS IN THE ECONOMY

Long-term stability of the banking sector structure

Despite some changes, most major characteristics determining the banking sector's structure show long term stability.

Table 1. Selected ratios describing the sector's structure

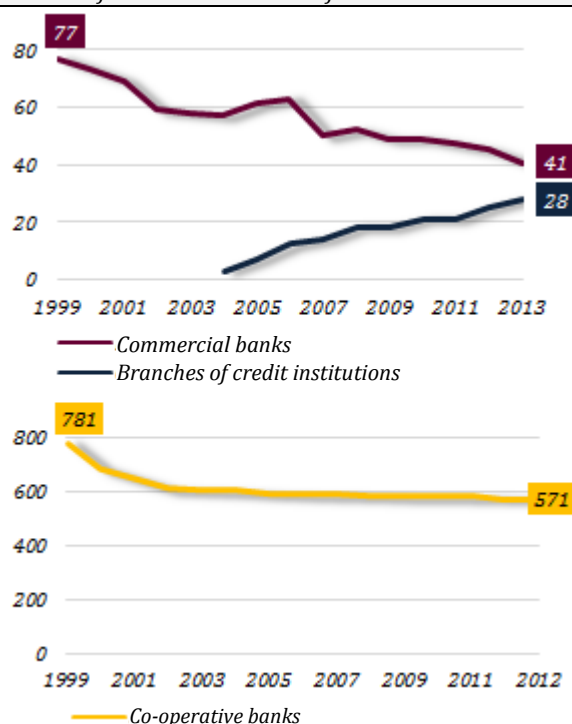
	2009	2010	2011	2012	2013
Number of entities dealing with banking operations	643	646	642	642	640
- commercial banks	49	49	47	45	41
- branches of credit institutions	18	21	21	25	28
- co-operative banks	576	576	574	572	571
Employment	175 249	176 916	176 658	175 094	174 331
Number of banking establishments⁴	13 910	14 207	13 921	15 412	15 297
Share in the sector's assets					
- banks controlled by domestic investors	31.9%	33.8%	35.0%	36.4%	36.8%
- banks controlled by foreign investors	68.1%	66.2%	65.0%	63.6%	63.2%
Share in the sector's assets					
- of the 5 largest banks	44.2%	43.9%	44.3%	45.0%	46.1%
- of the 10 largest banks	63.5%	63.0%	63.4%	64.6%	67.3%

The number of entities conducting banking activities remains stable.

In 2013, four commercial banks and two co-operative banks were covered by mergers, two commercial banks changed their legal form of operation, which involved their transformation in the branches of credit institutions, one of the branches of credit institutions discontinued operations and three new branches of credit institutions started operations. In consequence, the number of entities pursuing banking activities decreased from 642 at the end of 2012 to 640 at the end of 2013 (the number of commercial banks decreased to 41, the number of co-operative banks decreased to 571, and the number of branches of credit institutions increased to 28).

It is worth noting that except for one, all co-operative banks were associated in Bank Polskiej Spółdzielczości S.A. in Warsaw (365) or in SGB-Bank S.A. in Poznań (206).

Fig. 8.
Number of banks and branches of credit institutions



⁴ Data for the years 2012 and 2013 is not fully comparable with previous periods as it also includes the so-called partner establishments, which were not included in previous reports.

Reduction in employment and sales network

Slowdown in the growth of the banking sector and the negative developments in the environment meant that most banks continued their efforts to increase efficiency, e.g. by optimising employment and the sales network. This process was reinforced by the finalization of two major mergers at the turn of 2012 and 2013 (the acquisition of Polbank EFG by Raiffeisen Bank Poland and the acquisition of Kredyt Bank by Bank Zachodni WBK), and the constant development of electronic banking. As a result, there was a slight decrease (by 800 persons) in the number of employees in the banking sector and reduction of the sales network (by about 115 units). The situation was not, however, uniform for all banks. Some of them reported an increase in employment and the number of branches (e.g. in the co-operative sector). It is also worth noting that the reduction in the number of units took place mainly through the reduction in the number of large units (branches), accompanied by an increase in the number of smaller units.

Slight increase in the share of banks controlled by domestic investors

Share of banks controlled by domestic investors increased slightly in the sector's total assets (a higher share was observed during the year, due to large deposits of the public sector with the national bank).

As at the end of 2013, domestic investors controlled 10 commercial banks and all co-operative banks (the Treasury controlled 4 commercial banks); foreign investors controlled 31 commercial banks and all branches of credit institutions. Investors from 17 countries held the controlling interest, and investors from Italy, Germany, the Netherlands and Spain played the dominant role (the share of the latter increased considerably as a result of the finalization of the acquisition of Kredyt Bank).

Fig. 9. Employment and sales network

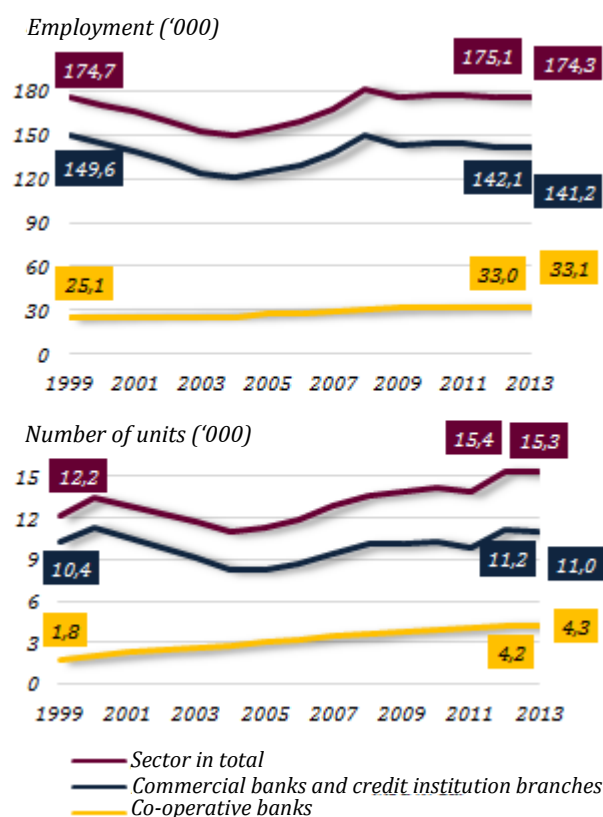
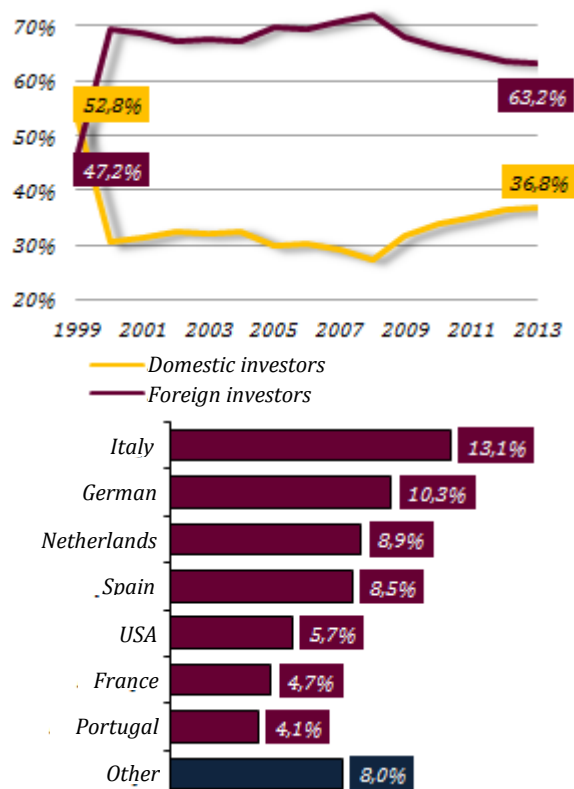


Fig. 10. Ownership structure (share in sector assets)



A distinct increase in concentration

As a result of mergers made at the turn of 2012 and 2013, an increase in the banking sector's concentration occurred, which was particularly distinct for the market share of the 10 largest banks (the share of the 5 largest banks in the sector's assets increased from 45.0% to 46.1%, and the share of the 10 largest banks from 64.6% to 67.3%). Taking into account the mergers carried out in recent years (and those that will be finalized in the coming periods), as well as the experiences of other countries of similar size to Poland, including those associated with the costs of overcoming crises, it seems that the level of concentration of the Polish banking sector (as measured by the market share of the 5 and 10 largest banks) is close to the optimal one from the point of view of maintaining adequate competition and long-term stability of the banking sector and the economy.

Fig. 11. Sector concentration

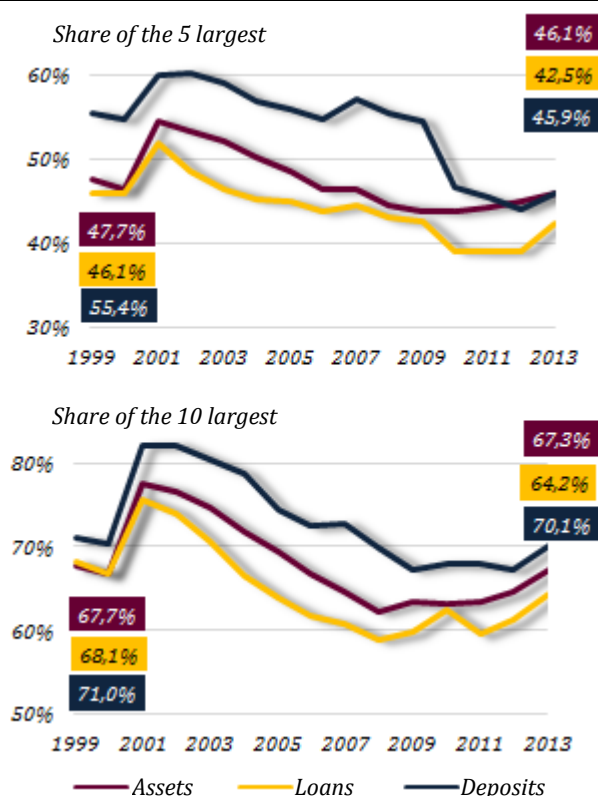


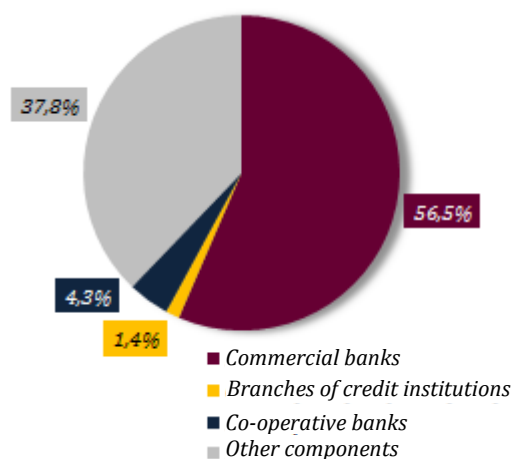
Table 2. Assets of the financial system in years 2012-2013 (without NBP)

	Amount (bn PLN)		Change in 2013		Structure	
	2012	2013	bn PLN	%	2012	2013
Financial sector in total, including:	2 093.5	2 261.9	168.4	8.0%	100.0%	100.0%
Commercial banks	1 236.2	1 278.6	42.4	3.4%	59.1%	56.5%
Branches of credit institutions	28.1	32.0	3.9	13.8%	1.3%	1.4%
Co-operative banks	85.8	96.5	10.7	12.5%	4.1%	4.3%
Banking sector in total	1 350.2	1 407.2	57.0	4.2%	64.5%	62.2%
Co-operative savings and loan unions	16.9	19.1	2.3	13.4%	0.8%	0.8%
Universal pension fund companies (assets of members)	269.6	299.3	29.7	11.0%	12.9%	13.2%
Insurance companies	162.7	167.6	4.9	3.0%	7.8%	7.4%
Assets of customers in brokerage houses	134.4	156.5	22.1	16.5%	6.4%	6.9%
Investment fund companies	159.8	212.2	52.4	32.8%	7.6%	9.4%

Banks' key role for stability of the financial system

At the end of 2013, assets of the financial system (without the NBP) amounted to nearly PLN 2.3bn, of which the banking sector accounted for over 60%. At the same time, the amount of the largest banks' assets was comparable or higher than the amount of assets of some other segments. It should be borne in mind that some entities from other segments of the financial market are controlled by banks. The above means that the stability of the banking sector is of key importance for the stability of the whole system.

Fig. 12. Financial system's structure at the end of 2013

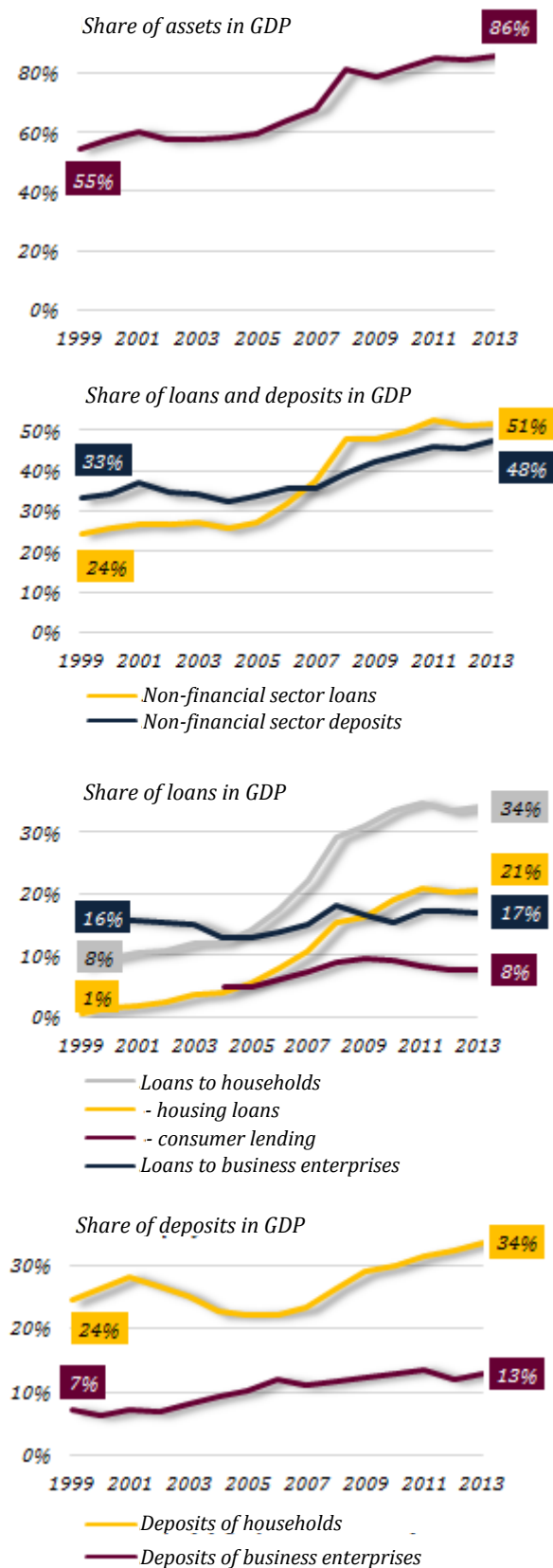


Growing importance of the banking sector in the economy

Banks' role in the economy grows systematically. This is confirmed by a growing share of the sector's assets in the GDP, as observed over the past dozen or so years (from 55% in 1999 up to 86% in 2013). Particularly noticeable in this regard is an increase in the share of household loans (from 8% to 34%), especially of housing loans (from 1% to 21%), and of household deposits (from 24% to 34%) and deposits of businesses (from 7% to 13%). On the other hand, a long-term stability of the share of loans to businesses can be observed (fluctuates around 15%).

In 2013, despite a moderate rate of growth of the banking sector's scale operations, as measured by an increase in assets, loans and deposits, it was still higher than the growth rate of nominal GDP. As a result, there was an increase in the share of total assets and their major components in GDP.

Fig. 13.
Role of the banking sector in the economy



2. CAPITAL POSITION

Maintaining a strong capital position of the banking sector

In 2013, the capital base was further strengthened and the main capital adequacy measures improved, although this was partly due to one-off events and the change in the methods of determining capital requirements in some banks.

Table 3. Capital adequacy

	Amount (bn PLN)				Change in 2013	
	2011	2012	09/13	2013	bn PLN	%
Own funds	110.7	129.0	139.3	139.4	10.4	8.0%
Total capital requirement	67.6	70.0	71.3	70.8	0.8	1.1%
- credit risk	59.7	60.8	62.3	61.8	0.9	1.6%
- operational risk	6.4	6.5	6.8	6.7	0.2	3.1%
- other risks	1.5	2.6	2.2	2.3	-0.4	-14.1%
Surplus/shortage of own funds	43.1	59.0	68.1	68.6	9.6	16.3%

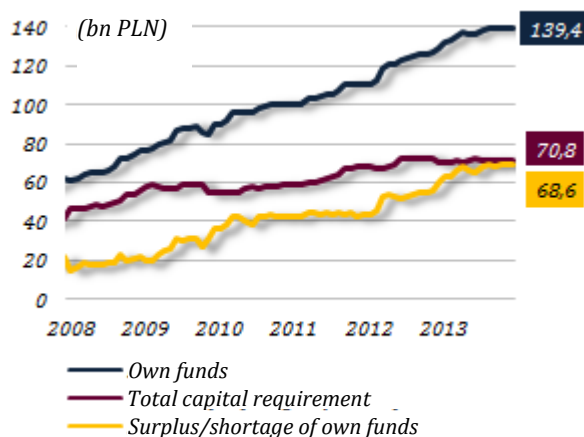
Increase in own funds, but a strong influence of a one-off event

The increase in own funds (by PLN 10.4bn or 8.0%) resulted from adding a portion of profits for 2012 (nearly 50% of profits in commercial banks were allocated for increasing own funds, whereas in co-operative banks, more than 90%) and from adding to funds a portion of audited profits earned during the previous year. One-off events had a significant impact on the increase in funds. Those events involved the sale of shares held in other banks, as a result of which the items decreasing their own funds were reduced and additional funds were received from the owner.

All banks satisfied the requirements of minimum own funds (with one exception).

As at the end 2013, all commercial banks satisfied the requirement of minimum own funds at the level of EUR 5m. As far as co-operative banks are concerned, one bank did not meet the minimum fund requirements of EUR 1m, although the deficit amount was relatively low (less than EUR 50,000).

Fig. 14.
Own funds and total capital requirement



Low increase in capital requirements, partly due to changes in calculation methods

The increase in the total capital requirement was low (of PLN 0.8bn or 1.1%). This resulted from a slight increase (of PLN 0.9bn or 1.6%) in the capital requirement for that risk, which was the main item of capital requirements, as well as a slight increase in the capital requirement for operational risk and a decrease in capital requirements for other risk categories.

A low increase in requirements was a consequence of the limited lending growth and changes in the methods of determining the capital requirements for individual types of risk, as made in some large banks. These changes consisted in the replacement of the basic/standard methods by advanced methods, which led to a reduction in the total capital in those banks.

Increase in the surplus of funds over the capital requirement

The considerable increase of funds and a limited increase in capital requirements resulted in further growth of the surplus of own funds over the total capital requirement (to PLN 68.6bn).

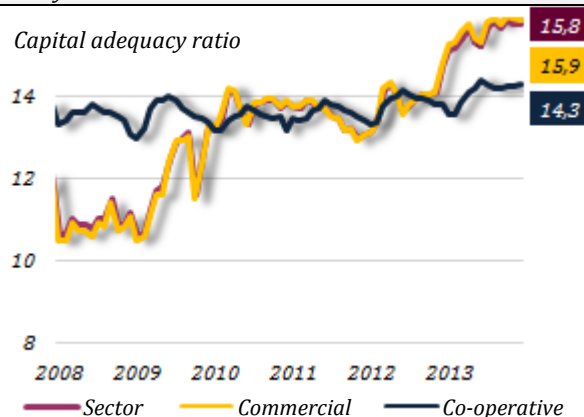
Table 4. Capital adequacy ratio and Tier 1 ratio

	Capital adequacy ratio (%)				Share in sector's assets (%)			
	2011	2012	09/13	2013	2011	2012	09/13	2013
Capital adequacy ratio (CAR)								
Sector	13.1	14.7	15.6	15.8				
Commercial banks	13.1	14.8	15.8	15.9				
Co-operative banks	13.4	13.8	14.2	14.3				
Bank distribution by capital adequacy ratio								
below 8%	-	-	-	-	-	-	-	-
8-10%	28	16	13	11	8.5%	0.6%	0.2%	0.2%
10-12%	120	97	80	73	35.8%	7.4%	6.3%	6.8%
12% and more	473	504	521	528	53.5%	89.9%	91.3%	90.7%
Tier 1 ratio								
Sector	11.7	13.1	14.2	14.2				
Commercial banks	11.6	13.1	14.2	14.3				
Co-operative banks	12.6	13.0	13.3	13.4				

Increase in the capital adequacy ratio and Tier 1 ratio

The observed changes in funds and capital requirements caused, in consequence, a considerable increase in the capital adequacy ratio (to 15.8) and in the Tier 1 ratio (to 14.2).

Fig. 15. Solvency ratio



Limited share of banks with CAR < 12% and Tier 1 < 9%

The sector's strong capital position is evidenced by a limited number of banks with a low capital adequacy ratio or Tier 1 ratio. At the end of 2013, the capital adequacy ratio was lower than 12% in only 3 commercial banks and 81 co-operative banks, but total share of those banks in the sector's assets amounted to only 7.1%. At the same time, the Tier 1 ratio was less than 9% in only 1 commercial bank and 15 co-operative banks, and the share of those banks in the sector's assets amounted to only 2.0%.

Maintaining a strong capital base recommended

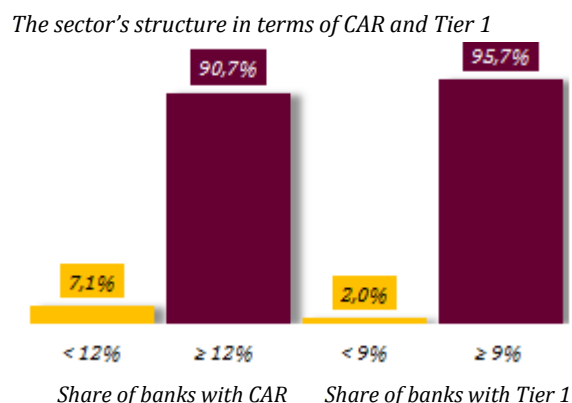
Although the current situation is good, it is recommended that a strong capital base be maintained and, for some banks, further consolidated.

It results from the level of risk already accumulated in banks' balance sheets, as well as external factors, which - despite the apparent economic recovery - may still cause negative pressure on the financial position of some customers. Banks must also reckon with the possibility of the occurrence of unexpected disturbances in the functioning of financial markets. A strong capital position is conducive not only to the maintenance of stability and security, but also makes it easier for banks to acquire alternative funding sources. Finally, banks should take into account that a high level of equity increases the possibilities for their development, and is also necessary to absorb the negative effects resulting from the materialisation of previously unexpected risks.

In view of the above, the PFSA issued, for banks (and other supervised institutions), recommendations regarding the allocation of 2013 profits. The banks that are not covered by a recovery plan and whose capital adequacy ratio exceeds 12% and Tier 1 ratio exceeds 9% (taking into account the projections of these ratios in the stress testing scenario), and whose overall supervisory review and assessment (BION) rating and equity level assessment is not worse than 2.5 will be able to pay a dividend in the amount of 100% of their profits.

In this context it is worth noting that the PFSA's active role in shaping the dividend policy of supervised entities, which was pursued in recent years, contributed to the significant strengthening of the capital base of the whole financial sector. Consequently, this is an important aspect that lowers the systemic risk, maintains confidence in the financial sector, creates favourable conditions to the acquisition of funds by financial institutions from the market at a reasonable cost, facilitates their further development and creates favourable conditions to the development of the whole economy. It also affects positively the external perception and evaluation of individual institutions, as well as the entire domestic financial system and the entire Polish economy.

Fig. 16.
The sector's structure in terms of CAR and Tier 1



In the context of the capital position it should be added that on 1 January 2014, new rules on capital adequacy set by the so-called CRR/CRD IV package⁵ came into force. The CRR came into force directly in all EU Member States, while the CRD IV requires transposition into Polish law.

According to the new rules, banks should calculate their own funds and capital requirements under the new rules and maintain capital ratios at the new appropriate levels. A key element of the new solutions is greater importance given to the most basic portion of equity, i.e. to high-quality common funds (inviolable and not burdened with liabilities).

According to the CRR/CRD IV package, capital adequacy ratios shall be determined on the basis of three categories of funds:

- the first one is Common Equity Tier 1 (CET 1) capital or the highest-quality capital, which will be the basis for determining the ratio of Common Equity Tier 1 (CET 1), the minimum level of which shall ultimately amount to no less than 4.5% of risk-weighted assets;
- the second one is Tier I capital composed of Common Equity Tier 1 capital (CET 1) and additional Tier I capital. This capital will be the basis for calculating Tier I capital ratio. Its target level, according to requirements, shall be not less than 6% of risk-weighted assets;
- the third one are own funds composed of the sum of Common Equity Tier 1 (CET 1) capital, additional Tier I capital and Tier II capital. They are the basis for calculating the total capital ratio. Its target level shall be not less than 8% of risk-weighted assets.

In addition, capital ratios may be increased by adding additional capital buffers (capital conservation buffer, countercyclical capital buffer, the buffer relating to systemically important banks and systemic risk buffer), which are designed to immunize banks and the banking sector against potential shocks and crisis situations.

However, it should be noted that until the final transposition of the provisions of the CRD, the PFSA Chairman upheld his recommendation (issued at the end of 2011) according to which all banks should have a capital adequacy ratio of not less than 12% and the Tier 1 capital ratio of not less than 9 %.

⁵ The CRD IV/CRR package includes:

- Regulation of the European Parliament and of the Council (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012;
- Directive of the European Parliament and of the Council 2013/36/EC 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.

3. LIQUIDITY POSITION

Good current liquidity position

The current liquidity position remains satisfactory.

Table 5. Selected capital adequacy ratios

	Amount (bn PLN)				Change in 2013	
	2011	2012	09/13	2013	bn PLN	%
Basic liquidity reserve	294.0	301.3	338.7	310.2	8.9	3.0%
Supplementary liquidity reserve	148.5	142.5	152.0	155.2	12.7	8.9%
Unstable foreign funds	302.3	286.9	330.0	309.4	22.6	7.9%
Liquidity coverage gap	140.3	156.9	160.7	156.0	-0.9	-0.6%
Liquidity coverage ratio	1.46	1.55	1.49	1.50	x	x
Stable foreign funds	889.0	913.8	952.2	961.5	47.7	5.2%
Non-financial sector loans	764.3	771.3	801.0	799.5	28.2	3.7%
Non-financial sector deposits	698.6	724.0	747.5	775.4	51.4	7.1%
Deposit surplus/shortage	65.7	47.3	53.5	24.1	-23.2	-49.0%
Loans/deposits ratio	109.4%	106.5%	107.2%	103.1%	x	x

The basic capital adequacy ratios

2013 saw an increase in the basic and supplementary liquidity reserve, which was accompanied by a similar increase of unstable external funds. As a result, short-term liquidity gap remained practically unchanged and the short-term liquidity ratio remained relatively stable and was well above the minimum required level.

Fig. 17.
Selected capital adequacy ratios

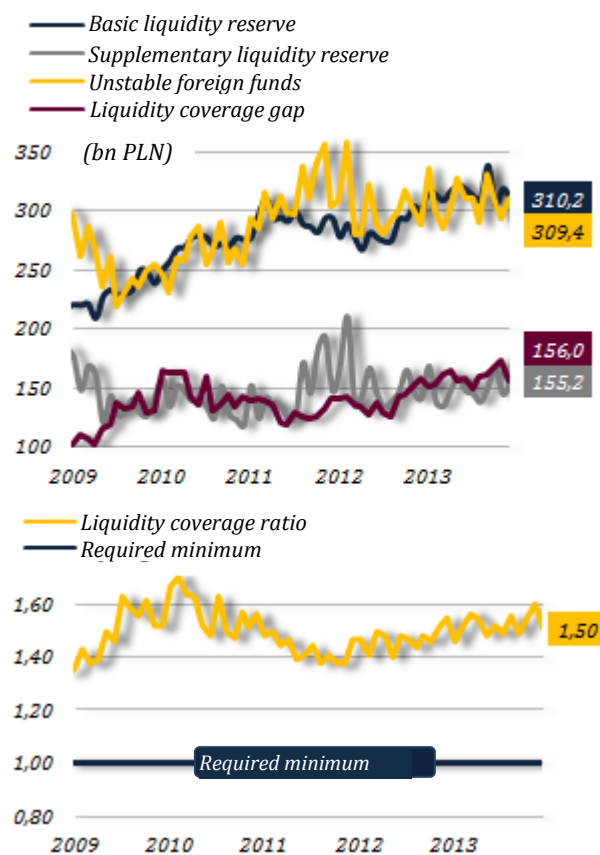


Table 6. Number of entities that did not comply with Resolution of the PFSA No 386/2008 at the end of the period

	Number of entities that did not comply with Resolution of the PFSA No 386/2008					Share in the sector's assets				
	2009	2010	2011	2012	2013	2009	2010	2011	2012	2013
January	11	5	3	2	1	2.7%	0.2%	0.0%	0.1%	0.0%
February	8	7	1	6	2	0.4%	0.7%	0.0%	0.3%	0.0%
March	10	7	1	1	1	4.7%	0.2%	0.0%	0.1%	0.0%
April	15	8	3	2	1	0.3%	0.7%	2.1%	0.2%	0.0%
May	12	5	1	4	2	0.7%	0.1%	2.1%	0.2%	0.0%
June	13	10	4	1	1	0.3%	0.2%	2.1%	0.0%	0.0%
July	8	6	3	2	1	0.2%	0.1%	2.1%	0.0%	0.0%
August	13	7	-	1	1	0.3%	0.2%	-	0.0%	0.0%
September	14	6	5	3	4	0.4%	0.2%	0.1%	0.0%	0.1%
October	15	4	5	2	1	0.4%	0.1%	0.0%	0.0%	0.0%
November	9	5	2	1	3	0.3%	0.1%	0.0%	0.0%	0.0%
December	11	4	2	5	2	0.3%	0.1%	0.1%	0.1%	0.0%

Satisfactory compliance with Resolution of the PFSA No

Compliance with the provisions of Resolution of the PFSA No 386/2008 remains satisfactory. The number of violations of the resolution remains insignificant and concerns entities of marginal importance taking into account the scale of the system.

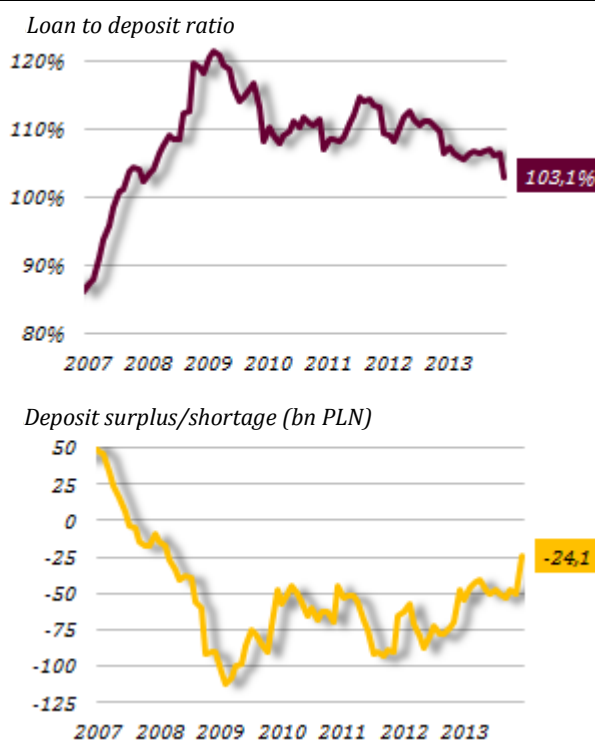
Significant improvement in the loan to deposit ratio

The decreasing growth rate of loans to non-financial sector, as observed in recent years, combined with also reduced, but higher rate of growth of deposits, led to a gradual reduction in the shortage of deposits, and to an improvement of the loan-to-deposit ratio. At the end of 2013, the shortage of deposits and the level of deposit-to-credit ratio reached its lowest level (103.1% or PLN 24.1bn) since the end of 2007. This was due to a low growth in lending in Q4 2013 and a high inflow of deposits (characteristic of Q4). Consequently, the sector came nearer to a balance between the scale of lending generated and the level of accumulated deposits.

Further measures to increase the stability of funding sources recommended

Despite the satisfactory current liquidity position, we recommend that further measures be taken to increase the stability of funding sources, and that strategies that are well-integrated into the external conditions be implemented.

Fig. 18. Non-financial sector loans to deposits ratio



4. FINANCIAL PERFORMANCE

The sector's financial performance at the 2012 level although deteriorated in most banks

Table 7. Selected elements of the banking sector's profit and loss account

	Amount (m PLN)			Change in 2013		Performance in the last four quarters			
	2011	2012	2013	(mPLN)	%	Q1 2013	Q2 2013	Q3 2013	Q4 2013
Net income from banking operations	57 305	58 773	55 496	-3 277	-5.6%	13 654	14 181	13 567	14 095
- net interest income	34 979	35 484	34 141	-1 343	-3.8%	8 189	8 115	8 608	9 230
- net fee and commission income	14 283	14 337	14 002	-334	-2.3%	3 479	3 477	3 532	3 515
- other items	8 042	8 953	7 353	-1 600	-17.9%	1 986	2 590	1 427	1 350
Operating expenses	26 684	27 785	27 558	-227	-0.8%	6 719	6 914	6 861	7 065
Depreciation and amortisation	2 576	2 590	2 646	55	2.1%	646	651	673	675
The balance of provisions and impairment losses (negative)	8 855	10 074	8 048	-2 026	-20.1%	1 753	1 950	1 886	2 461
NET PROFIT OR LOSS	15 539	15 467	15 426	-41	-0.3%	4 087	4 134	3 603	3 602
- commercial banks and credit institution branches	14 641	14 499	14 669	170	1.2%	3 864	3 961	3 407	3 437
- co-operative banks	898	967	757	-211	-21.8%	223	172	196	165

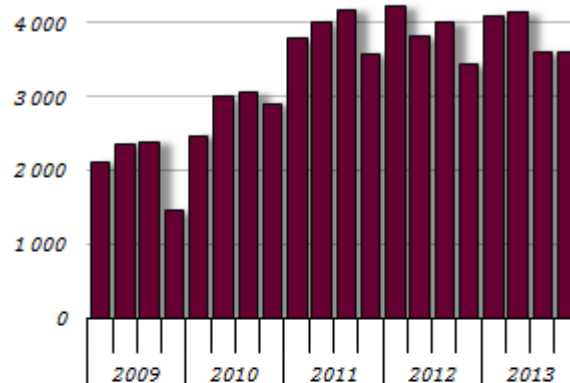
Despite the difficult external conditions, net income generated by the banking sector in 2013 turned out to be lower by only 0.3% (about PLN 41m) than in 2012. However, it should be noted that that in the second half of the last year performance were significantly weaker than banks' performance reported in the first half of last year (despite a gradual upturn in the economy).

501 entities accounting for 51.6% of the sector's assets reported a fall in earnings. In particular, a strong decrease in performance occurred in co-operative banks (-21.8%), of which 469 reported a fall in profit, and only 102 reported an increase in profit.

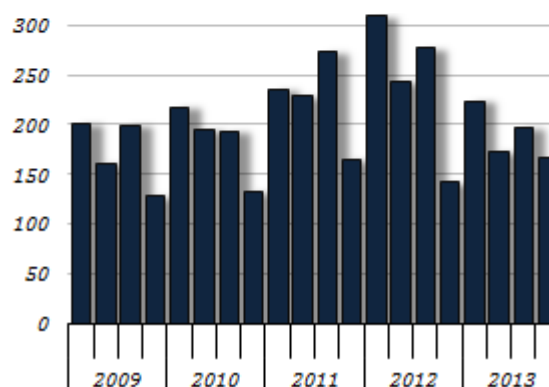
At the same time, 2 commercial banks, 8 co-operative banks and 8 branches of credit institutions reported a total loss of PLN 214m (their total share in the banking sector's assets amounted to 2.5%).

Fig. 19. Net profit or loss (quarterly)

Banking sector in total (m PLN)



of which co-operative banks (m PLN)



Decrease in net income from banking operations compensated for by a reduction in impairment losses and provisions and by the sale of some assets

Table 8. Factors that changed the net profit or loss of the banking sector in 2013

	Amount (m PLN)		Impact on change
	2012	2013	
1. Net income from banking operations	58 773	55 496	
- net interest income	35 484	34 141	-1 343
- net fee and commission income	14 337	14 002	-334
- net income from other banking operations	8 953	7 353	-1 600
2. Other operating income / expenses (balance) ⁶	876	1 407	531
3. Bank's operating expenses	27 785	27 558	227
4. Depreciation and amortisation	2 590	2 646	-55
5. The balance of impairment losses and provisions (negative)	10 074	8 048	2 026
6. Net income from operations (1+2-3-4-5)	19 200	18 651	
7. Profit or loss from extraordinary and non-operating activities	2	402	400
8. Profit or loss before tax from continuing operations (6 +7)	19 202	19 053	
9. Compulsory charges	3 720	3 629	91
10. Net profit on continuing operations (8-9)	15 482	15 424	
11. Net profit or loss on discontinued operations	-15	2	17
12. Net profit or loss (10 +11)	15 467	15 426	-41

In the structure of the sector's earnings, a significant drop in net income from banking operations (by PLN 3,277m) can be noticed, which was caused by decreases in all its components. On the other hand, the financial performance increase was caused mainly by a reduction in the negative balance of impairment losses and provisions (by PLN 2,026m), and a rise in other income and expenses (the impact of one-off events resulting from the sale of some assets) and a reduction of operating costs.

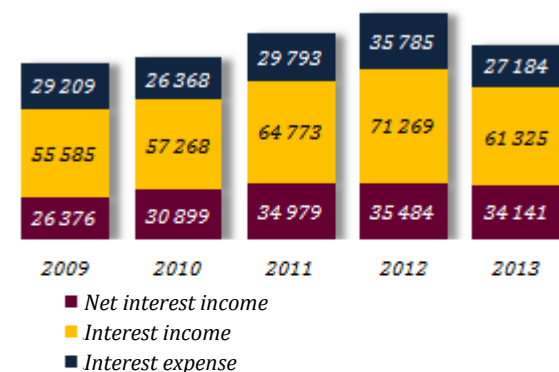
Decrease in net interest income, but strong improvement in the second half

Despite a strong decline in net interest income, as observed in H1 2013, in the whole year net interest income decreased only slightly (by PLN 1 343m or 3.8%), which was the result of its strong improvement in the second half of the year (net interest income in Q4 was close to the record level achieved in Q3 2011).

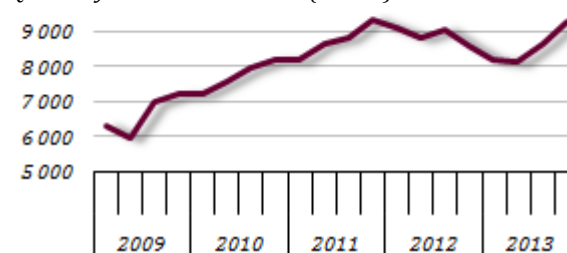
The decrease in net interest profit resulted from a strong reduction of NBP interest rates, which translated into a decline in WIBOR rates and a reduction in the yield of debt instruments. This resulted in a decrease in interest income on loans and debt instruments (-PLN 9,944m or -14.0%), which was not fully offset by a decrease in interest expense (-PLN 8,602m or -24.0%), which were strongly reduced only in Q3 and especially in Q4.

Fig. 20. Interest income, expenses and profit or loss

By year (m PLN)



Quarterly net interest income (m PLN)



⁶ The following were also taken into account: profit or loss on adjustments of fair value (hedge accounting) and profit or loss on derecognition of assets other than assets held for sale.

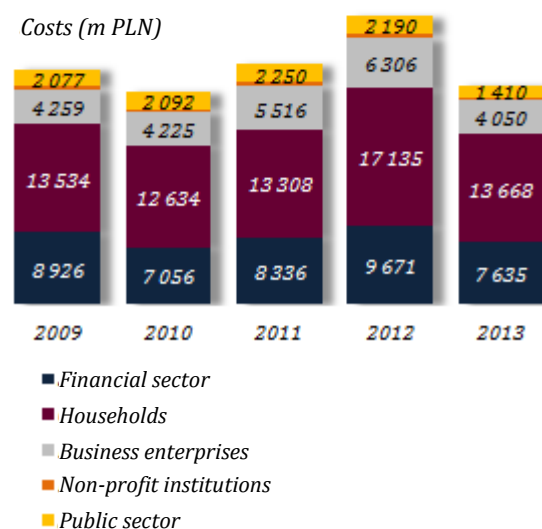
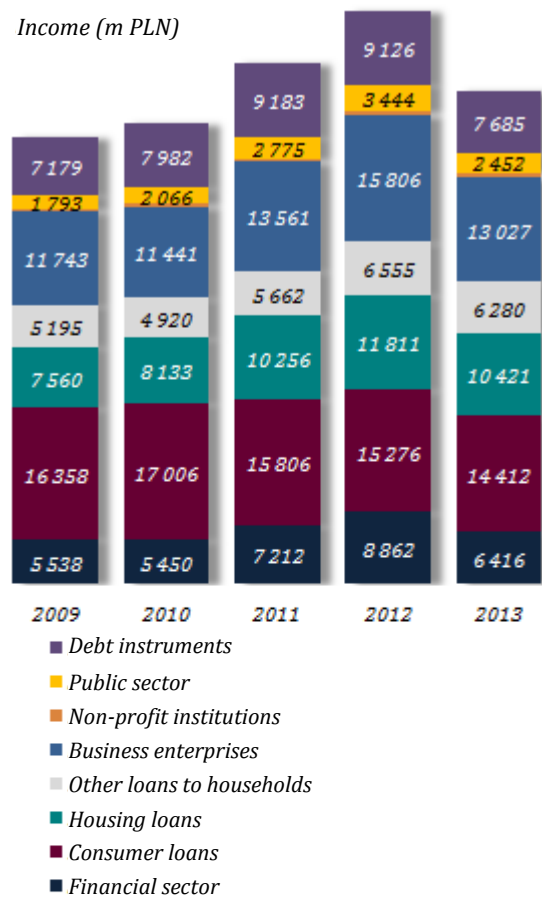
The decrease in interest income occurred in almost all items, but in terms of value, it mostly affected income on corporate loans (-PLN 2,779m or -17.6%) and receivables from the financial sector (-PLN 2,446m or -27.6%). Banks experienced, on a smaller scale, a reduction in income from debt instruments (by PLN 1 441m or 15.8%) and housing loans (PLN 1 390m or 11.8%), and also from loans to the public sector (by PLN 992m or 28.8%) and consumer loans (by PLN 863m or 5.7%). The relatively small reduction in income from consumer loans resulted from the improvement of the portfolio's quality and revival of lending in this area.

Interest income on receivables from non-profit institutions was an exception (an increase of PLN 243m or 62.3%), which should be associated with a significant increase in these receivables in recent periods.

The reduction in interest expense was related mainly to the interest paid on deposits from households (down by PLN 3,467m or 20.2%), and the reduction was progressing quarter by quarter (in Q4, interest expense accounted for only 60% of the expense paid in Q1). A significant decrease also occurred in interest on corporate deposits (of PLN 2,256m or 35.8%) and financial sector deposits (of PLN 2,036m or 21.1%).

The decrease in interest expenses paid to other customer groups was significantly lower, which resulted from a limited significance of these sources of funding.

Fig. 21.
Interest income and expenses structure (H1)



A limited decrease in net fee and commission income

Net fee and commission income fell slightly (by PLN 334m or 2.3%). This resulted, to a considerable degree, from changes in the method of recognizing income from the sale of the so-called bancassurance products related to credit products (in accordance with the PFSA's recommendation). In consequence, there was a reduction in earnings of some banks in this area. On the other hand, banks raised some fees and commissions, as a result of which net fee and commission income has not changed much in the sector as a whole.

Decrease in profit on other banking operations

Profit on other banking operations declined significantly (-PLN 1,600m or -17.9%) due to a decrease in profit realised on financial assets and liabilities held for trading and a decrease in profit on financial assets and liabilities measured at fair value with the measurement outcome recognized in the profit and loss account. Dividend income also decreased.

Increase in profit on other operating income and operating costs

An increase in profit on other income and expenses⁷ (of PLN 531m or 60.6%) had a positive impact on the banking sector's performance. This resulted, to a considerable degree, from a one-off event involving the sale of shares in an associate by a major bank.

In this context, it is worth noting that the sale of shares in a subsidiary, which was made by another big bank, generated a significant profit from non-operating activities (Table 8, item 7).

Fig. 22.
Net fee and commission income

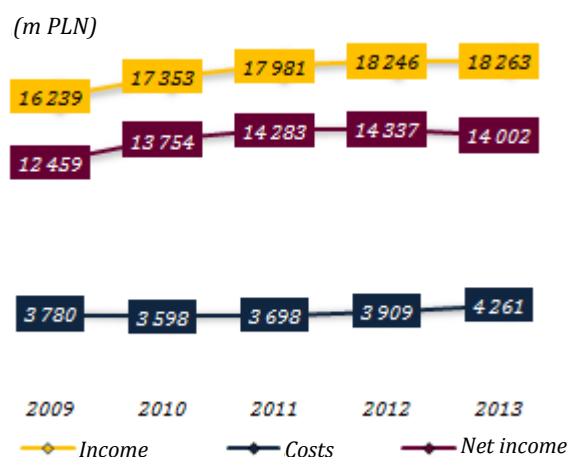


Fig. 23.
Profit from other banking operations

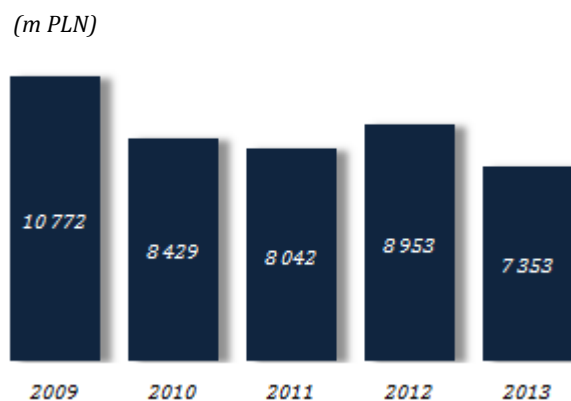
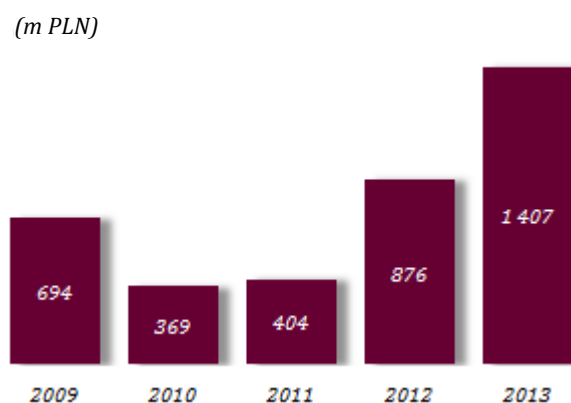


Fig. 24.
Other income and expenses



⁷ This item conventionally includes: profit or loss on operating income and expenses as well as profit or loss on derecognition of assets other than held for sale and profit or loss of adjustments of fair value in hedge accounting.

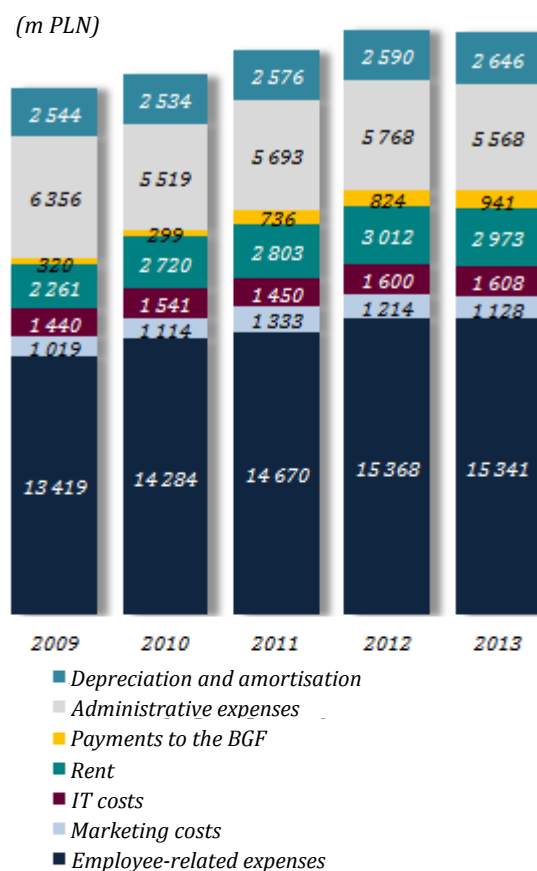
Reduction in operating expenses

Banks endeavoured to prevent the lowering of profit on banking operations by a tighter expense control. As a result, the costs of operation of the banking sector decreased slightly (by PLN 227m or 0.8%). This resulted from a reduction in general administrative expenses (down by PLN 201m or 1.6%), particularly marketing expenses (down by PLN 86m or 7.1%). Rental fees and other costs decreased to a lesser extent (by PLN 39m or 1.3% and by PLN 200m or 3.5%, respectively). On the other hand, fees for the Bank Guarantee Fund increased (by PLN 117m or 14.1%) and there was a slight increase in IT expenses (of PLN 8m or 0.5%). Employee costs also decreased marginally (by PLN 26m or 0.2%). This resulted from a reduction in costs related to share-based payments (by PLN 111m or 53.1%), a reduction in the total amount of salaries paid (by PLN 26m or 0.2%) and non-salary benefits (by PLN 33m or 7.2%). On the other hand, there was an increase in costs related to retirement pensions (of PLN 161m or 169.1%) as well as overheads and other staff-related costs.

Depreciation and amortization expenses remained relatively stable (an increase of PLN 55m or 2.1%).

Despite the observed reduction of costs, their share in the generated profit increased (from 50.9% in 2012 to 53.1% in 2013), which was due to a significant reduction in net income from banking operations.

Fig. 25. Operating expenses, depreciation and amortisation



Share of operating costs, amortisation and depreciation in net income from banking operations and in other operating income and expenses

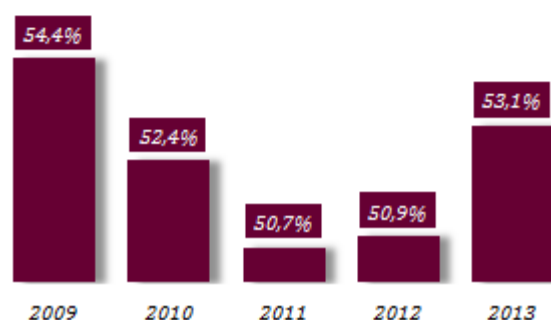


Table 9. Balance of impairment losses and provisions

	Amount (m PLN)			Change in 2013		Performance in the last four quarters			
	2011	2012	2013	(m PLN)	%	Q1 13	Q2 13	Q3 13	Q4 13
Balance of impairment losses and provisions, including:	-8 855	-10 074	-8 048	2 026	-20.1%	-1 753	-1 950	-1 886	-2 461
- commercial banks and credit instit. branches	-8 578	-9 717	-7 751	1 966	-20.2%	-1 701	-1 888	-1 807	-2 355
- co-operative banks	-277	-357	-298	60	-16.7%	-52	-62	-79	-105
1/ Impairment losses on financial assets	-7 611	-8 243	-7 569	674	-8.2%	-1 699	-1 763	-2 020	-2 087
Households	-6 360	-4 793	-4 038	755	-15.7%	-1 159	-826	-1 036	-1 017
- consumer loans	-3 707	-2 436	-1 585	851	-34.9%	-545	-427	-389	-225
- housing loans	-1 331	-1 198	-1 092	105	-8.8%	-242	-128	-385	-338
- other loans	-1 322	-1 159	-1 360	-201	17.4%	-373	-271	-262	-454
Business enterprises	-1 257	-3 433	-3 541	-108	3.1%	-527	-957	-1 003	-1 053
Other entities	6	-17	10	27	x	-12	20	20	-17
2/ Provisions ⁸	-670	-1 151	-485	666	-57.9%	-196	-41	55	-303
3/ Impairment losses on non-fin. assets	-95	-297	-23	274	-92.4%	9	-51	62	-44
4/ IBNR/General risk	-479	-384	28	412	x	132	-95	17	-27

Reduction of the negative balance of impairment losses and provisions

Despite significant weakening of the economic growth, as observed over a large part of last year, and despite the difficult situation on the labour market declined, there was a drop in the negative balance of write-downs and provisions (by PLN 2 026m or 20.1%; a reduction in the balance of write-downs was recorded in 388 entities, and its increase in 246 entities).

This resulted from a reduction in impairment losses on consumer loans (by PLN 851m), a reduction in provisions (by PLN 666m), and from profit on IBNR (compared to loss in 2012). The reduction in impairment losses on non-financial assets (by PLN 274m) and impairment losses on housing loans (by PLN 105m) also contributed to the reduction in the balance of write-downs, but to a lesser extent.

On the other hand, there was an increase in impairment losses on other receivables from households (by PLN 201m) and on receivables from corporate sector (by PLN 108m).

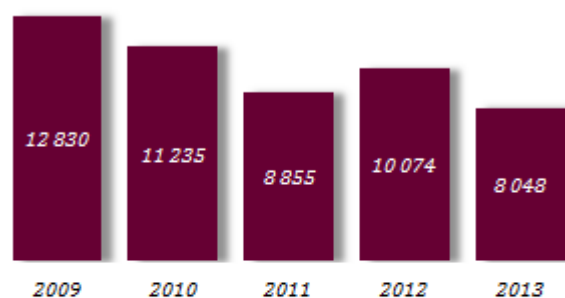
However, it should be noted that in Q4 2013 there was an increase in the negative balance, mainly due to the increase in provisions and an increase in impairment losses on other receivables from households.

The decrease in impairment losses may be explained by a higher level of impairment losses recognised by banks in prior periods (especially in

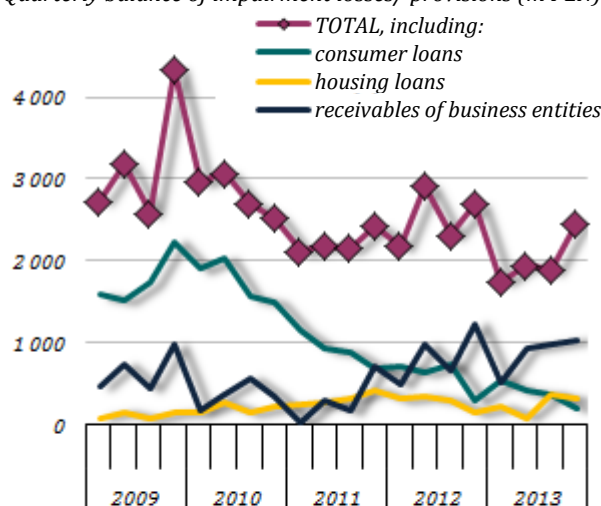
Fig. 26.

Balance of impairment losses and provisions

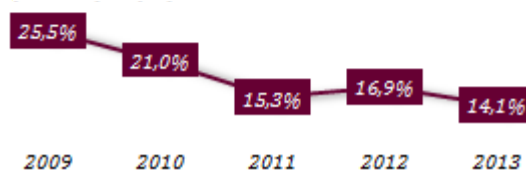
Balance of impairment losses and provisions (m PLN)



Quarterly balance of impairment losses/ provisions (m PLN)



Share in net income from banking operations and in other operating income and expenses



⁸ This category includes provisions related to restructuring, litigation, retirement pensions and employee benefits, off-balance sheet liabilities, other onerous contracts, etc.

the area of consumer lending), as well as by the earlier tightening of the lending policy and regulatory measures, which had a positive impact on reducing the cost of risk in the period of current downturn. A positive impact was also exerted by the reduction of interest rates, which caused a significant decrease in the cost of servicing PLN loans, and stabilised the financial position of borrowers. On the other hand, the reduction in the scale of provisions and the recognition of a positive IBNR result was, to a decisive extent, the consequence of changes in these positions in two large banks.

However, it cannot be ruled out that in the face of a significant decrease in profit on banking operations, some banks made attempts to improve their financial performance through a more liberal risk pricing and the resulting lower impairment losses.

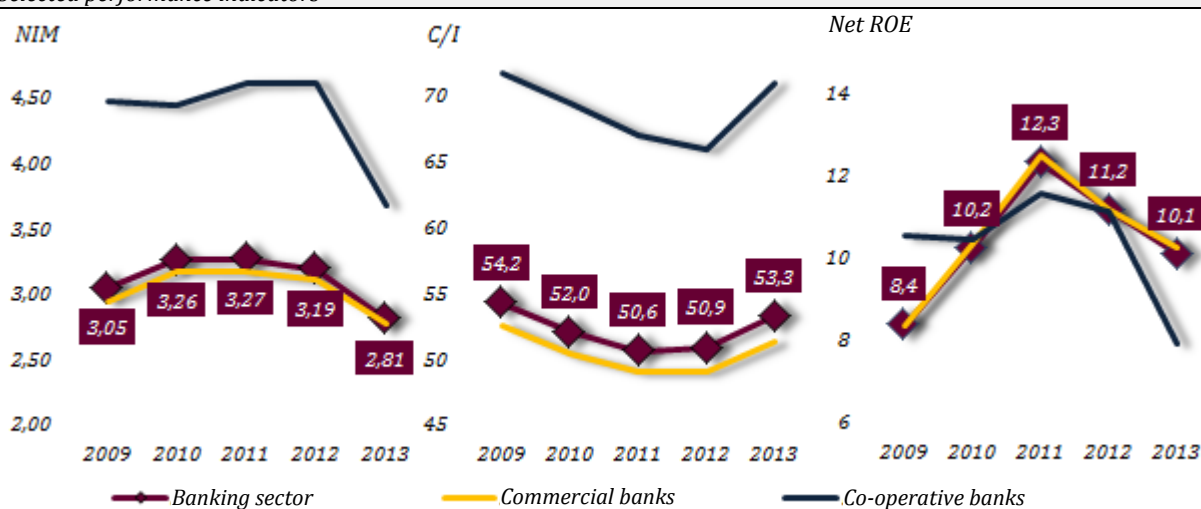
Significant reduction in impairment losses and provisions resulted in a reduction of their share in the profit generated by the sector (from 16.9% in 2012 to 14.1% in 2013) in spite of the fall in the profit.

Deterioration of the key performance indicators

Table 10. Selected performance indicators

	SECTOR			Commercial banks			Co-operative banks		
	2011	2012	2013	2011	2012	2013	2011	2012	2013
C/I (costs/income)	50.61	50.86	53.25	49.08	49.10	51.23	66.89	65.85	70.81
NIM (net interest income / average interest assets)	3.27	3.19	2.81	3.17	3.11	2.77	4.60	4.61	3.68
ROA (net income/average assets)	1.26	1.22	1.10	1.28	1.23	1.14	1.21	1.18	0.81
ROE (net income / average funds)	12.30	11.16	10.09	12.51	11.16	10.24	11.59	11.13	7.90
Share in (average) assets									
Profit or loss on banking operations	4.69	4.62	4.00	4.62	4.59	3.98	5.74	5.60	4.58
Bank's operating expenses	2.18	2.19	1.99	2.08	2.08	1.89	3.61	3.50	3.08
- employee-related	1.20	1.21	1.11	1.11	1.12	1.02	2.53	2.45	2.15
- administrative	0.98	0.98	0.88	0.97	0.96	0.87	1.08	1.06	0.93
Balance of impairment losses and provisions	0.66	0.73	0.61	0.68	0.78	0.64	0.31	0.40	0.33
Assets per employee (m PLN)									
Employee-related costs per employee ('000 PLN)	83.0	89.9	88.5	88.8	96.2	94.3	57.9	61.2	60.3
Gross profit per employee ('000 PLN)	112.8	114.5	111.2	131.0	133.4	131.5	35.5	38.1	29.4

Fig. 27. Selected performance indicators



Deterioration of financial performance triggered deterioration of Key Performance Indicators and in particular in the realised interest margin (from 3.19 in 2012 to 2.81 in 2013) and an increase in the cost

index (from 50.9 to 53.3), despite operating expenses reduction. In the case of ROE, an increase in equity (a positive development) was an additional factor having impact on the reduction in this ratio (from 11.2 to 10.1).

A noticeable development at the level of individual groups of banks is greater deterioration of performance indicators of co-operative banks, which is associated with a considerably greater role of interest income in their profit, as well as fewer opportunities to reduce operating costs (interest profit of co-operative banks was reduced by nearly 10%, whereas interest profit of commercial banks decreased by less than 4%).

Banks expect a slight improvement of performance in 2014

Based on 2014 forecasts of commercial banks, which were submitted to the PFSA, it can be stated that in the coming year, banks expect a slight improvement in performance (out of 39 banks surveyed, 26 expect an improvement in performance, whereas 13 banks expect deterioration - in the scale of the whole population surveyed, a net income increase of 1.1% is projected).

However, it is difficult to forecast the financial situation of the banking sector in subsequent periods.

On the one hand, the expected upturn in the Polish economy (as well as an upturn in the euro area), combined with record-low interest rates, will create favourable conditions for the improvement in borrowers' financial position and may lead to an increase in demand for loans and other banking services. At the same time the second half of the last year showed that some banks adopted well to the environment of low interest rates (by a strong reduction of interest rates on deposits), as evidenced by a very marked improvement in the banking sector's net interest income in Q3, and especially in Q4.

On the other hand, it should be borne in mind that despite a clear improvement in the economic situation, recent forecasts indicate that the rate of growth in the coming years will be significantly lower than during the boom of the past decade. The situation on the labour market will be also less favourable. In addition, there is uncertainty as to developments in the external environment of the Polish economy. Consequently, this may result in deterioration of the financial position of some borrowers, as well as limiting their demand for credit and banking products. Additional pressure on banks' financial performance will be exerted by the introduction of a fee for the stabilization fund in BGF, as well as reduction of interchange fees.

5. MAIN AREAS OF DEVELOPMENT

Limited increase of the banking sector's scale of operations

Adverse external conditions prevailing for the most part of the year and uncertainty as to the future economic growth combined with reduced willingness of households and enterprises to incur liabilities resulted in limited growth in the scale of banking sector operations (as measured by the balance-sheet total growth). In consequence, the balance-sheet total of the banking sector went up from PLN 1,350.2bn as at the end of 2012 to PLN 1,407.2bn as at the end of 2013, i.e. by PLN 57.0bn or 4.2% (after eliminating the impact of changes in the rates of currencies against PLN⁹ - by approximately PLN 56.1bn or 4.2%). This means that the increase in total assets was lower in the years 2010-2012, when it exceeded PLN 80bn. This was significantly influenced not only by limited growth in the scale of the sector's operations, but also by withdrawal of large government deposits from the state – owned bank at the end of the year, which translated into a quarterly fall in the assets of the whole sector.

Fig. 28.
Sector's balance-sheet total

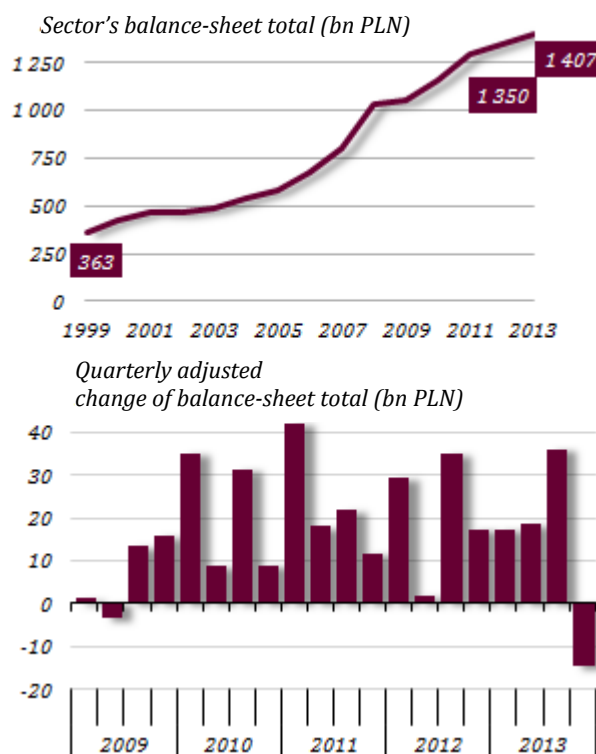
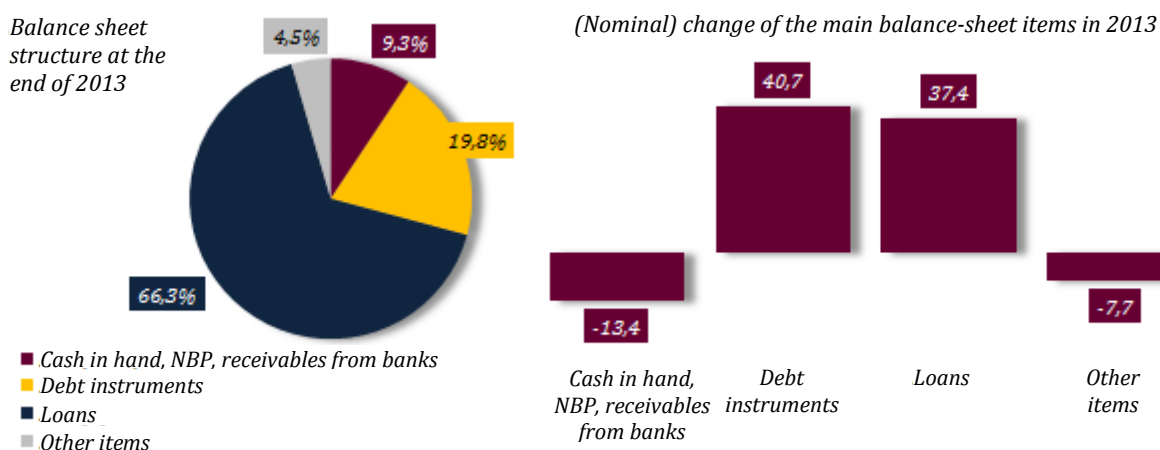


Fig. 29.
Structure and change of the main balance-sheet items in 2013



The increase in the balance-sheet total was expressed mainly in the growth of debt instrument portfolio and of loan portfolio.

⁹ To determine the growth rate of selected balance-sheet items, as adjusted for changes in exchange rates, their amount at the end of 2013 was adopted, except that the data presented should be treated as estimates due to the limitations of the reporting system.

Table 11. Loan portfolio

	Gross carrying amount (bn PLN)				Change in 2013			
	2011	2012	09/13	2013	nominal bn PLN	%	adjusted bn PLN	%
Total loans	911.3	935.2	973.9	972.7	37.5	4.0%	36.7	3.9%
1/ Financial sector	25.8	32.8	42.8	41.3	8.6	26.1%	8.5	25.9%
2/ Non-financial sector	800.7	810.4	841.0	838.7	28.3	3.5%	27.8	3.4%
- households	532.0	533.2	554.7	555.5	22.3	4.2%	22.1	4.1%
- business enterprises	264.5	272.2	281.2	278.0	5.7	2.1%	5.3	2.0%
- non-profit institutions	4.2	4.9	5.1	5.3	0.4	7.4%	0.4	7.4%
3/ Public sector	84.8	92.0	90.1	92.7	0.6	0.7%	0.4	0.4%
as per currency								
- PLN	604.5	659.1	693.6	697.5	38.4	5.8%	38.4	5.8%
- currencies	306.8	276.1	280.3	275.2	-0.8	-0.3%	-1.6	-0.6%

Low increase in lending

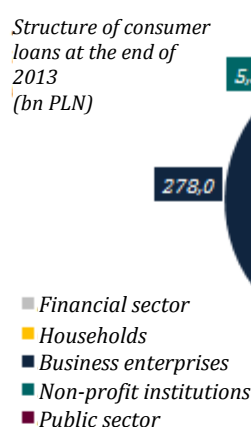
After a slowdown in the growth rate of lending, as observed at the end of 2012 and in early 2013, Q2 and Q3 2013 saw its revival. followed, however, by repeated deceleration in the fourth quarter. As a result, the growth of the loan portfolio in the whole 2013 amounted to PLN 37.5bn or 4.0% (adjusted: PLN 36.7bn or 3.9%) and was significantly lower than in the years 2009-2012 when ranged from PLN 50bn to PLN 90bn.

Loans to households and, on a much smaller scale, loans to the financial sector and businesses, were the main area of lending growth. The level of state budget sector loans practically did not change.

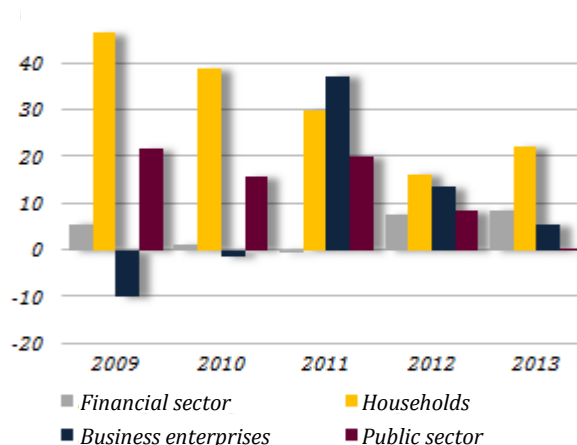
The weakening of growth rate in loans to non-financial sector, as observed in recent periods, resulted from a series of factors, where the weakening of the economic growth rate and the experiences of recent years seem to be of key importance. This led to a reduction in some entities' demand for loans and to provision of more selective supply of loans by banks. In addition, a good financial position of some enterprises allows them to finance development based on their own resources, or they use alternative sources of funding.

On the other hand, revival in lending can be expected in the event of further economic recovery and reduction in the impact of factors being sources of potential risks and uncertainties.

Fig. 30.
Total loans



Yearly adjusted change in lending (bn PLN)



Quarterly adjusted change in total loans (bn PLN)

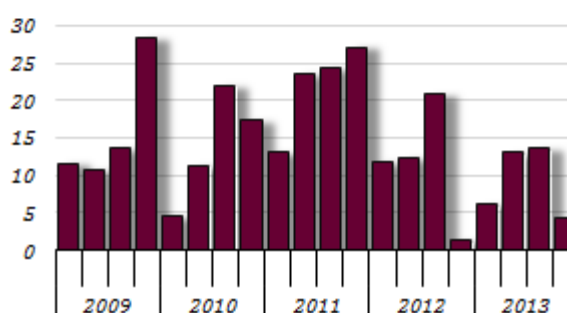


Table 12. Loans to households

	Gross carrying amount (bn PLN)				Change in 2013			
	2011	2012	09/13	2013	nominal bn PLN	%	adjusted bn PLN	%
Total	532.0	533.2	554.7	555.5	22.3	4.2%	22.1	4.1%
1/ Housing loans	319.0	321.8	335.3	336.3	14.5	4.5%	14.3	4.5%
- PLN	121.2	143.5	160.6	167.4	24.0	16.7%	24.0	16.7%
- currency	197.8	178.3	174.7	168.8	-9.5	-5.3%	-9.7	-5.4%
2/ Consumer lending	130.3	123.4	125.3	126.6	3.2	2.6%	3.2	2.6%
- credit cards	13.5	12.6	12.1	12.2	-0.4	-3.4%		
- car loans	6.8	5.7	5.0	4.8	-0.8	-14.4%		
- instalment loans ¹⁰	45.9	48.9	49.5	50.1	1.2	2.4%		
- other ¹¹	64.1	56.2	58.6	59.5	3.2	5.7%		
3/ Other	82.7	88.1	94.1	92.6	4.6	5.2%	4.6	5.2%
- operating	27.1	31.0	34.8	34.5	3.5	11.4%		
- investment loans	28.8	28.8	30.0	30.4	1.5	5.3%		
- real estate	8.8	9.6	10.2	10.1	0.6	6.0%		
- other receivables	18.0	18.7	19.2	17.6	-1.1	-5.7%		
as per currency								
- PLN	317.5	341.4	367.1	374.4	33.0	9.7%	33.0	9.7%
- currencies	214.5	191.9	187.6	181.1	-10.8	-5.6%	-10.9	-5.7%

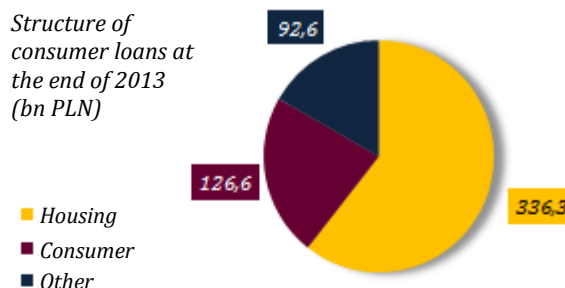
A slight acceleration of the growth of lending to households

After slowdown in the growth of loans to households (bearing the characteristics of stagnation), as observed at the end of 2012 and at the beginning of 2013, the subsequent quarters of 2013 saw recovery in lending (which was particularly distinct in Q3). As a result in the whole year the amount of these loans increased by PLN 22.3bn or 4.2% (an adjusted increase amounted to PLN 22.1bn or 4.1%). This means that the growth (adjusted) in lending was higher than recorded in 2012, although lower than in the years 2009-2011.

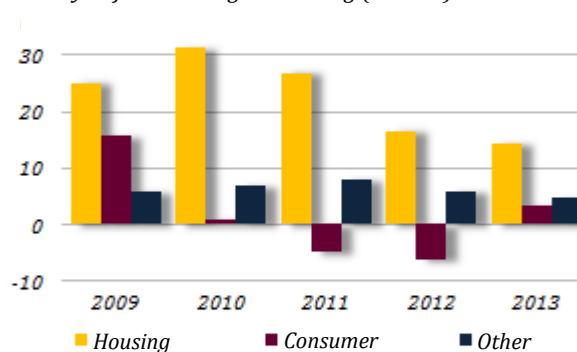
Lending increased in all areas, and it is worth noting that consumer loans increased for the first time in two years.

The main causes for limited growth in lending should be sought in unfavourable external conditions, which, despite gradual improvement, still exert negative pressure on the attitudes of consumers and small businesses. Combined with experiences of recent years, this leads to a very selective demand for loans and more selective supply of loans.

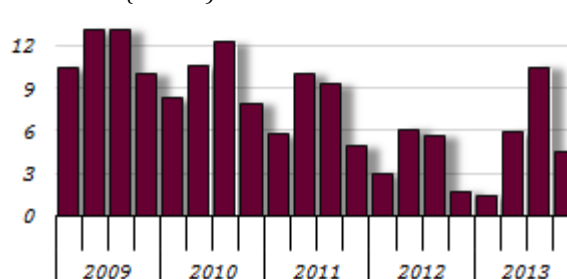
Fig. 31.
Loans to households



Yearly adjusted change in lending (bn PLN)



Quarterly adjusted change in loans to households (bn PLN)



¹⁰ This category also includes cash loans repaid on instalment basis.

¹¹ This category also includes overdrafts and cash loans repaid on a one-off basis.

Limited growth in housing loans with signs of recovery in lending

After a strong reduction in the growth in housing loans in Q1 2013, the growth accelerated in subsequent quarters. As a result, in the whole 2013, the amount of the portfolio of these loans increased by PLN 14.5bn or 4.5% (after eliminating the impact of changes in exchange rates - by PLN 14.3bn or also by 4.5%), although this increase was lower than the increases in previous years.

According to figures from AMRON-SARFiN, in 2013 banks granted 176,900 loans for the total amount of PLN 36.5bn (compared to 196,600 loans granted in 2012 for the total amount of PLN 39.1bn), and the number of active loan agreements increased by 88,200 to 1,819,800.¹²

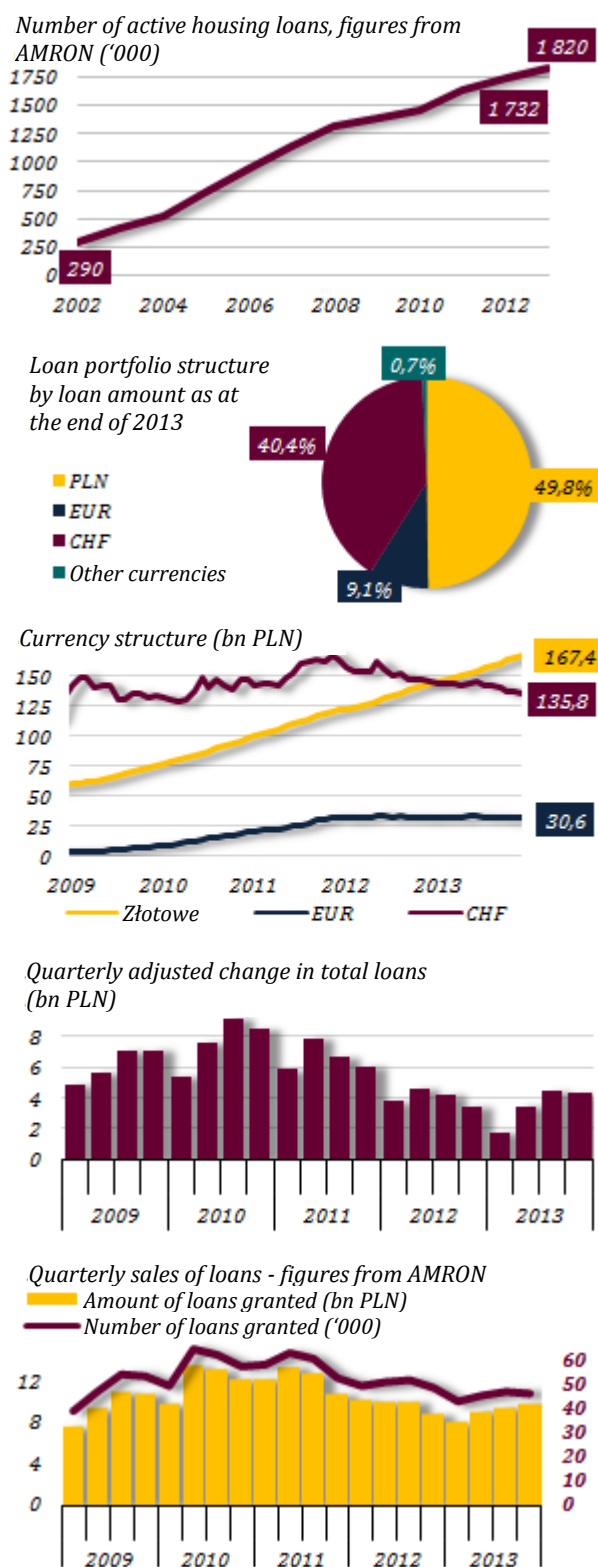
The positive trend of dominance of PLN-denominated loans in the structure of new loans, and at the same time marginalisation of sales of FX loans, which accounted for 1% of all new loans, was continued. Consequently, the share of foreign currency loans decreased to 50.2% (from 55.4% at the end of the last year).

Excessively liberal rules for granting some loans (for example, assuming too low subsistence expenses for calculating creditworthiness), over-extended crediting periods and a high share of loans with LTV > 80% in sales are considered adverse phenomena.

Additional information about the loan portfolio structure and lending in 2013 are included in the Annex.

As already pointed out in previous reports, the causes for slowdown in the growth rate of housing loans, as observed over the past years, should be sought in the coincidence of a number of factors. In particular, experiences from the global crises and deterioration of economic development perspectives resulted in fears of households about their future income position, which was not conducive to incurring long-term liabilities, but also resulted in

Fig. 32.
Housing loans to households



¹²See "National report on housing loans and real estate transaction prices", AMRON-SARFiN. When interpreting the AMRON-SARFiN data, it should be borne in mind that this data also includes customers who change the funding bank, which leads to overestimation of the lending scale and may lead to erroneous conclusions when it comes to significant changes in the number and value of such operations between the periods under comparison.

the tightening of banks' lending policy. At the same time, the price adjustment observed in the real-estate market resulted in suspension of a portion of the demand in anticipation of a better purchase price, and reduced credit needs in value terms. An unfavourable ratio of average housing prices to average wages of households was (and still is) a strong barrier due to which some households with average (or lower than average) income cannot afford a housing loan, or the incurrence of such a loan involves excessive risk, leads to a reduction in the current consumption of these households and reduces their ability to create savings. Additional factors that reduced the growth rate of lending included changes to the "Rodzina na swoim" ("Family on its own") programme (the lowering of the so-called limits and the closing of the programme by the end of 2012 - both changes were positive), tightened lending policy of some banks and regulatory changes (for example, the 50%/65% limit for DTI ratio, as introduced by Recommendation T of 2010, and a 25-year period for calculating creditworthiness, as introduced by Recommendation S of 2011). It must be noted that the demand for loans has been largely satisfied through extensive lending in previous years. The gradual satisfaction of housing needs results in the gradual reduction in demand, which stabilizes at lower levels than in the loan-boom years. In the latter context, it is worth noting that in the period between the last two national censuses (2002 and 2011) the number of housing units increased by about 1m (from 12.5m in 2002 to 13.5m in 2011, while occupied units increased from 11.8m to 12.5m), which, combined with a limited increase in the number of households (from 13.3m to 13.6m) resulted in a reduction in the so-called statistical housing deficit from 1.6m to 1.0m. Taking into account the number of housing units built and occupied after the last census (about 300,000) it can be estimated that at the end of 2013 the housing deficit decreased to about 700,000 housing units and in the coming years it should be eliminated (this does not mean, however, that the situation in the housing market is fully satisfactory).

On the other hand, the recovery in lending, as observed in H2 2013, should be attributed to the concurrence of several factors. Firstly, a strong reduction in the NBP interest rates by the Monetary Policy Council caused a reduction in interest rates on loans to record-low levels, and strong growth in creditworthiness. At the same time, a parallel decrease in interest rates on deposits resulted in the search for alternative forms of investment, also in the real estate market. The recovery in lending was supported by the price stabilisation in the real estate market and signals of a gradual economic upturn. Finally, some influence was also exercised by the last year's revision of Recommendation S, which except for a range of facilitations (removal of the DTI regulatory limit thanks to the revision of Recommendation T, extension to 30 years of the period taken into account for the calculation of creditworthiness, as long as certain conditions are met, encouraging banks to grant loans to people with unstable income) also introduced changes designed to substantially reduce the risk borne by customers and banks (making the loan currency conditional on the income currency, setting the maximum lending period at 35 years, determining the maximum LTV and the minimum own contribution for new loans). This resulted in the activation of demand and consequently very strong sales numbers in the real estate development sector and an increase in lending.

In the context of record-low interest rates, it should be noted that in addition to positive developments (such as an increase in the availability of loans, beneficial impact on the situation in the construction and real estate development sector), they may also cause negative effects, such as a rise in real estate prices (not substantiated in an increase in production costs, but only in an increase in the purchasing power of customers as a result of an increase in their credit standing due to a reduction in interest rates) and thus they may lead again to reduced actual availability of flats and houses for households (as measured by the level of their income) and to granting loans to persons with poor income situation, or granting loans that are too high compared to the actual financial situation of borrowers. Therefore, banks and customers should take into account the risk of rising interest rates, so that the mistakes related to the extensive granting of foreign currency loans at the top of the appreciation of the Polish zloty are not repeated.

Increase in the level of consumer loan portfolio

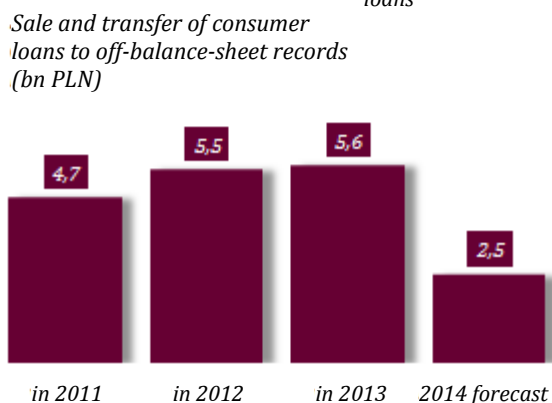
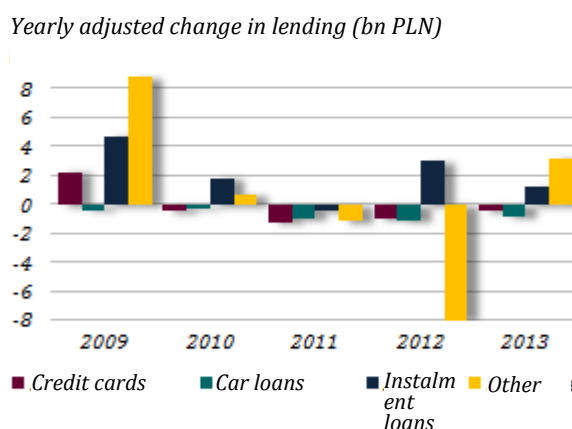
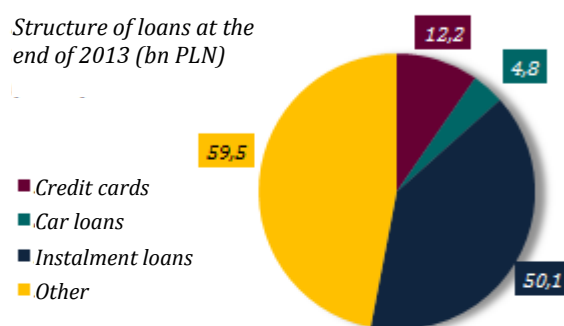
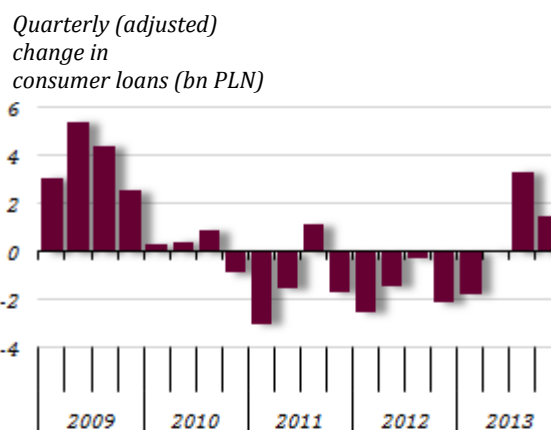
Following a reduction in the portfolio value of consumer loans, as observed in 2011 and 2012, the portfolio stabilised in the second quarter of 2013 and then rose in subsequent quarters. As a result, in the whole 2013 the amount of consumer loans increased by PLN 3.2bn or 2.6%. The greatest increase occurred in the debt from other loans (an increase of about PLN 3.2bn), including overdrafts and other loans payable in a single payment. The increase was smaller in the case of instalment loans (an increase of PLN 1.2bn)¹³. On the other hand, a further decrease in the debt on payment cards and car loans was observed (by PLN 0.4bn and PLN 0.8bn, respectively).

The 2013 increase in the number of loans would have been higher if not for the large transactions of sale of the bad loan portfolio or the transfer of bad loans to off-balance sheet records (for a total amount of PLN 5.6bn). It is worth noting that this process was also one of the two reasons for a decrease in consumer loans in 2011 and 2012, while the actual level of lending in this area generated by the banking sector was stable (the second cause was the transfer, by some banks, of the sale of instalment loans to other companies operating under the parent group, to circumvent regulatory actions).

On the other hand, it should be added that most of the growth recorded in Q4 2013 did not result from the actual increase in lending, but from the change in the classification of some loans in one of the large banks, which consisted in their transfer from the category of other loans to households to the category of consumer loans.

The development of lending showed significant differences at the level of individual banks - 321 banks recorded an increase in this portfolio (of PLN 9.8bn), and 294 banks recorded a decrease (of PLN 6.6bn).

Fig. 33. Consumer lending



¹³ Some caution should be exercised when interpreting the data, due to differences that can occur between banks in the loan classification.

The causes of recovery in lending should be sought in the last year's revision of Recommendation T, which made the existing solutions more flexible and softened the approach to risk management in some areas. In particular, the regulatory DTI limit was abolished and the possibility to use simplified creditworthiness assessment rules was introduced (these are loans with low amounts and short maturities, which means that their share in the number of loans granted is very high, but in the amount of loans - much higher; at the end of 2013, they amounted to PLN 6.7bn in the balance sheet). These changes stimulated activity in the areas where activity could have been reduced as a result of previous regulations. A notable effect of these measures some banks that due to previous regulations transferred their lending operations to other entities operating within the parent group returned to the market.

The factors that contributed to the increase in the scale of lending also included the revival of the economy, lower interest rates on loans and improved quality of loans, which translated into a certain increase in the demand for, and supply of, loans. In addition, some banks have modified their strategies to achieve a greater share of short-term loans to retail customers.

Stable growth in the area of other household loans

Similarly as in previous years, other loans to households (mainly operating and investment loans to small businesses) were characterized by stable growth (the decrease in the portfolio value, as observed in Q4 2013, resulted from the above-mentioned change in the classification of some loans in one of the large banks, which consisted in their transfer to the category of consumer loans). As a result in the whole year the amount of these loans increased by PLN 4.6bn or 5.2% (an adjusted increase was the same).

Fig. 34. Loans granted under simplified rules

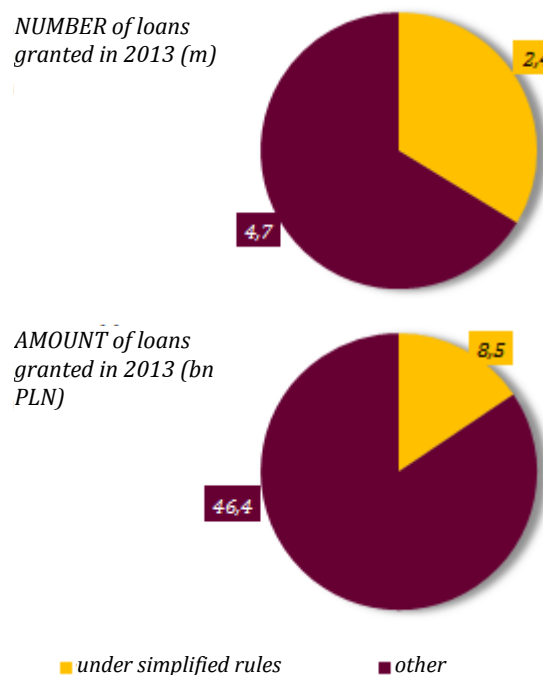
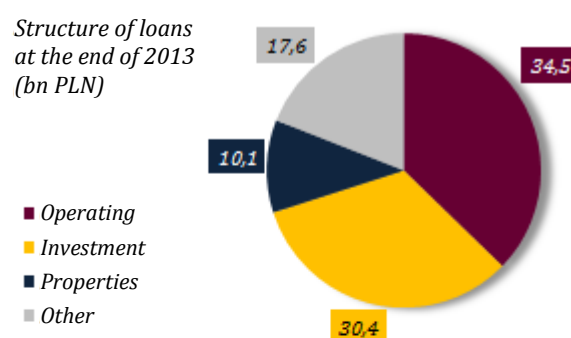


Fig. 35. Other loans to households



Quarterly adjusted change in total loans (bn PLN)

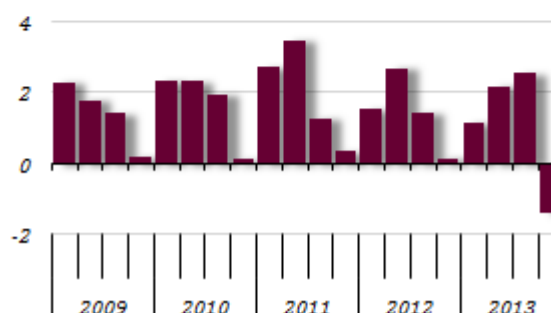


Table 13. Corporate lending

	Gross carrying amount (bn PLN)				Change in 2013				
	2011	2012	09/13	2013	nominal bn PLN	%	adjusted bn PLN	%	
Total	264.5	272.2	281.2	278.0	5.7	2.1%	5.3	2.0%	
1/ SME	159.0	164.8	166.4	163.9	-0.9	-0.5%	-1.1	-0.7%	
- operating	57.5	62.3	62.1	59.0	-3.3	-5.3%			
- investment loans	47.5	47.2	50.0	50.5	3.3	7.0%			
- real estate	39.9	42.0	41.0	40.8	-1.2	-2.8%			
- other receivables	14.2	13.3	13.3	13.6	0.3	1.9%			
2/ Large companies	105.5	107.4	114.8	114.0	6.6	6.1%	6.5	6.0%	
- operating	47.9	47.1	52.5	50.3	3.2	6.8%			
- investment loans	36.5	34.4	36.6	36.5	2.0	5.9%			
- real estate	8.4	9.2	9.2	8.8	-0.4	-4.4%			
- other receivables	12.7	16.7	16.5	18.5	1.8	10.8%			
as per currency									
- PLN	192.9	208.8	210.8	207.9	-0.9	-0.4%	-0.9	-0.4%	
- currencies	71.6	63.5	70.4	70.1	6.6	10.4%	6.2	9.7%	

Low increase in corporate lending

Significant weakening in economic growth, as observed in the second half of 2012 and in the first months of 2013, translated into a low dynamics of the increase in loans to the corporate sector. The second quarter of 2013 saw a slight recovery in lending, but in the third quarter, the scale of the growth in loans decreased again, and in the fourth quarter their amount was reduced. As a consequence, in the whole last year, the amount of loans to the corporate sector increased by only PLN 5.7bn or 2.1% (the adjusted increase amounted to about PLN 5.3bn or about 2.0%). It should be noted that the increase in debt occurred mainly in the area of loans to large enterprises, while debt in the SME sector showed a trend of stagnation (marginal decrease).

In subsequent periods, there is a chance of revival in lending, which results from gradual economic recovery, record-low interest rates and stabilized quality of the credit portfolio, which should translate into an increase in demand for, and larger supply of, loans. Additionally, the launch of the government De Minimis Portfolio Guarantee Line programme should stimulate lending in the area of operating loans to SMEs, and following the inclusion of investment and developmental loans, also in the latter area.

Fig. 36. Corporate lending

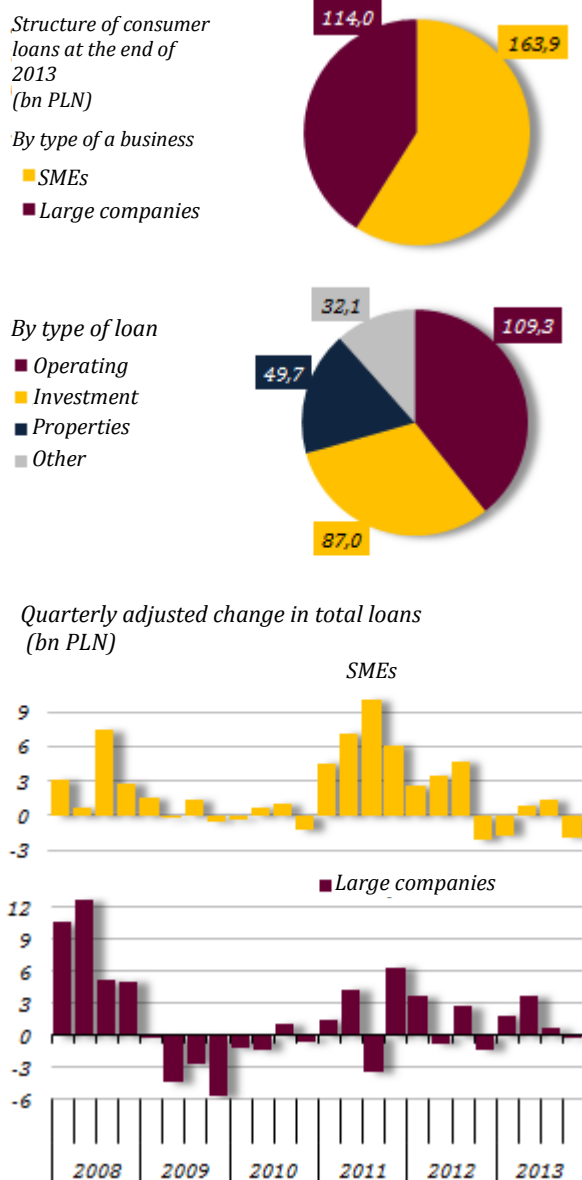


Table 14. Industry structure of large exposures¹⁴

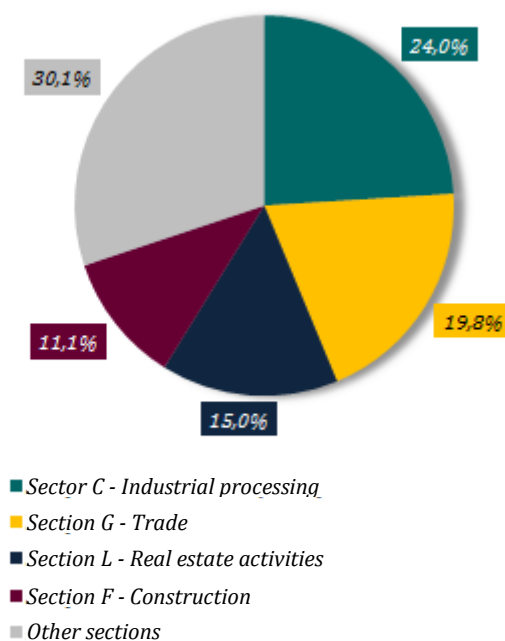
	Amount (bn PLN)				Structure
	2011	2012	09/13	2013	2013
Sector C - Industrial processing	67.3	65.8	68.6	68.6	24.0%
- food	15.3	15.9	16.3	16.3	5.7%
- chemicals and pharmaceuticals	9.1	9.6	11.2	11.3	4.0%
- metallurgy	9.6	9.8	10.2	10.1	3.5%
- timber and paper	7.3	7.2	6.8	6.5	2.3%
- machines	6.0	5.8	6.3	6.2	2.2%
- other production, repair of machines	3.9	4.0	4.7	4.6	1.6%
- refineries and coking industry	8.1	5.6	3.8	4.5	1.6%
- cement, plaster and glass production	3.6	3.7	4.0	3.8	1.3%
- manufacture of transport equipment	2.7	2.6	3.6	3.6	1.3%
- textile manufacturing	1.6	1.5	1.7	1.6	0.6%
Section G - Trade	49.6	51.1	57.7	56.5	19.8%
Section L - Real estate activities	42.4	42.2	43.2	43.0	15.0%
Section F - Construction	31.5	32.9	33.6	31.7	11.1%
Section D - Energy industry	5.6	7.3	11.0	11.3	3.9%
Section A - Agriculture, forestry and fishing	6.1	7.2	10.2	11.0	3.8%
Section M - Professional activities	8.1	9.5	10.8	10.8	3.8%
Section J - Information and communication	5.9	5.9	10.9	10.1	3.5%
Section H - Transportation	5.3	5.6	9.6	9.8	3.4%
Section I - Accommodation and food service activities	7.6	8.0	8.6	8.8	3.1%
Section N - Administrative activities	8.1	8.7	7.3	7.5	2.6%
Section B - Mining and quarrying	2.1	3.6	4.6	5.4	1.9%
Section Q - Health care	3.9	4.3	4.6	4.6	1.6%
Section E - Water supply, sewerage and waste	2.0	2.2	2.8	2.9	1.0%
Section R - Culture, entertainment and recreation	1.0	1.1	1.4	1.5	0.5%
Section P - Education	0.9	1.1	1.2	1.2	0.4%
Section S - Other service activities	0.8	0.9	1.0	1.0	0.4%
TOTAL	248.4	257.5	287.0	285.9	100.0%

Dominance of loans to industry, trade, for real estate servicing and to construction

In sectorial terms, the loans extended to industrial processing companies, trading companies, property market servicing companies and construction companies prevailed; they accounted for 70% of all (balance-sheet) commitment of banks.

Fig. 37. Structure of large exposures

As at the end of 2013



¹⁴ Note: Due to the changes in the reporting system, data for 09/2013 and 2013 is not fully comparable with previous periods.

Table 15. Selected forms of corporate financing¹⁵

	Amount (bn PLN)				
	2009	2010	2011	2012	2013
Credit facilities and loans of the Polish banking sector	222,1	219,7	264,5	272,2	278,0
Domestic loans	18,3	23,5	37,5	38,1	no data
Foreign bank credit facilities	49,1	43,1	46,9	38,8	no data
Foreign loans	55,4	41,0	71,6	85,2	no data
Corporate bonds over 365 days	12,2	17,6	24,2	31,4	37,8
Leases - total assets funded by leasing companies	23,0	27,3	31,1	31,2	35,3
Factoring - the value of purchased receivables	51,4	64,2	79,4	113,1	131,0
Private equity / venture capital	0,6	0,5	2,0	1,9	no data
The value of the issue of shares in public companies (excluding banks)	14,6	5,6	8,2	5,6	4,8
Accounts payable	277,8	305,2	343,2	329,8	no data
Equity	1 025,2	1 099,0	1 170,2	1 236,4	no data

Source: PFSA, NBP, GUS, FITCH, ZPL, PZF, PSIK

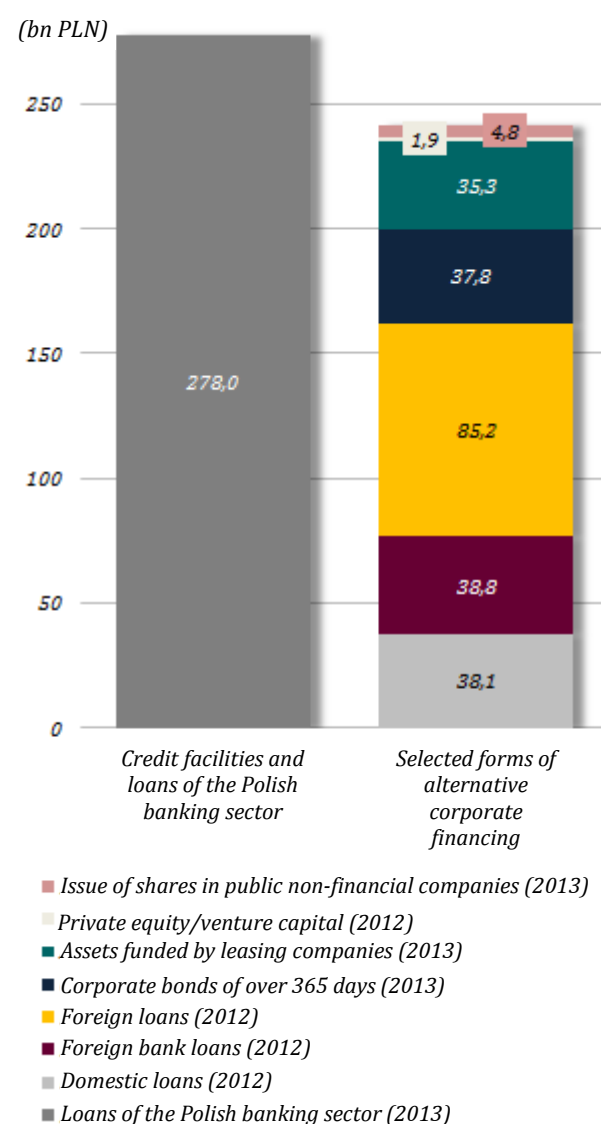
Systematic development of alternative forms of corporate financing

In the context of a limited growth dynamics of lending to the corporate sector in recent years (as well as stable share of loans to businesses in the GDP in the long term), it should be noted that the systematic development of the economy and of the financial market also leads to the development of alternative forms of corporate financing, such as the issue of debt securities, the issue of shares, leasing and factoring. At the same time, due to the openness of the Polish economy and corporate links with international financial markets (including through foreign parent entities), foreign financing plays an important role for some companies. As a result, the scale of alternative forms of funding is comparable to the funding obtained from the domestic banking sector (if all groups and all forms of funding were taken into account, it would be even higher). However, it should be noted that some of these areas are indirectly financed by banks, for example, through financing operations of leasing and factoring companies (some of them are subsidiaries of banks), or through the purchase of corporate debt securities.

It should be also borne in mind that own funds play a key role in corporate financing, and liabilities to trading partners are also of significant importance.

Fig. 38.

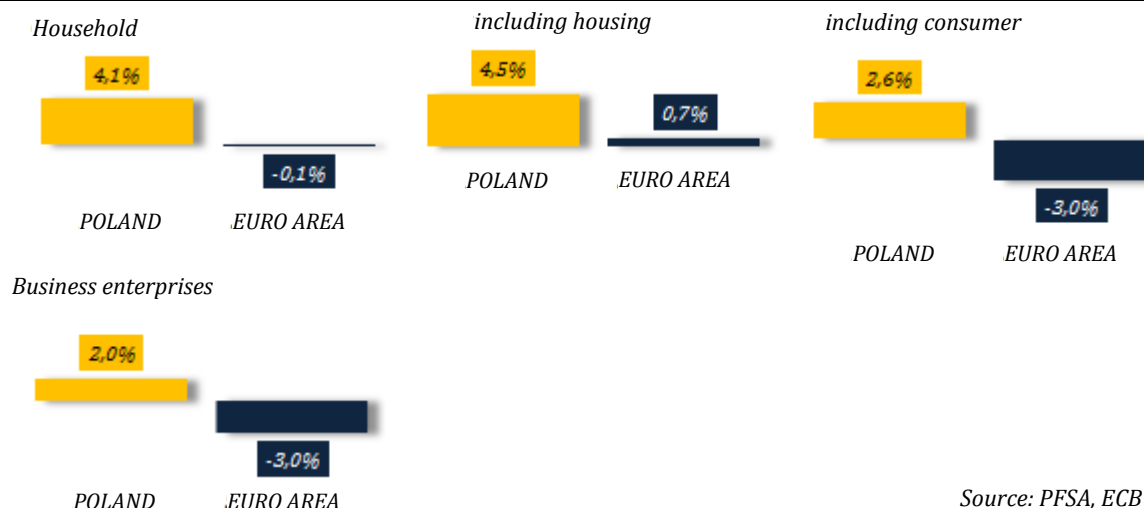
Selected forms of corporate financing



¹⁵ The presented data do not cover the whole market, but only a part thereof included in the data of the PFSA, GUS, NBP, FITCH, ZPL and PZF (for more information see "Financial Performance of Enterprises", GUS; "The Financial System in Poland", NBP; "Summary of Q4 2013 and of 2013 on the Non-Treasury Securities Market", FITCH; "The Financial Situation of the Corporate Sector", NBP; "The Private Equity / Venture Capital Market in Poland in 2012", PSIK; "Catalyst Report - Summary and Development Prospects", Grant Thornton).

Low/negative growth rate of lending in the majority of EU member states

Fig. 39. The annual growth rate in lending to the non-financial sector (as at the end of 2013)



Source: PFSA, ECB

In the context of low growth in lending to the non-financial sector, it should be noted that this occurs not only in Poland but in most EU countries, whereas compared to other countries, the growth in lending in Poland may be considered relatively satisfactory. Indirectly, this confirms that the weakened growth in lending is mainly caused by the long-term financial crisis and the associated change in the attitudes of some households, companies and banks.

Stagnation in lending to the public sector

The limited growth of investments financed with public funds, together with increased budgetary discipline, translated into a clear slowdown in the growth of loans to the public sector. In 2013, the amount of loans to the public sector increased by only PLN 0.6bn or 0.7% (the debt of government institutions increased by PLN 2.3bn, and the debt of social insurance funds and local government institutions decreased by PLN 0.8bn each).

Fig. 40. Loans to the public sector

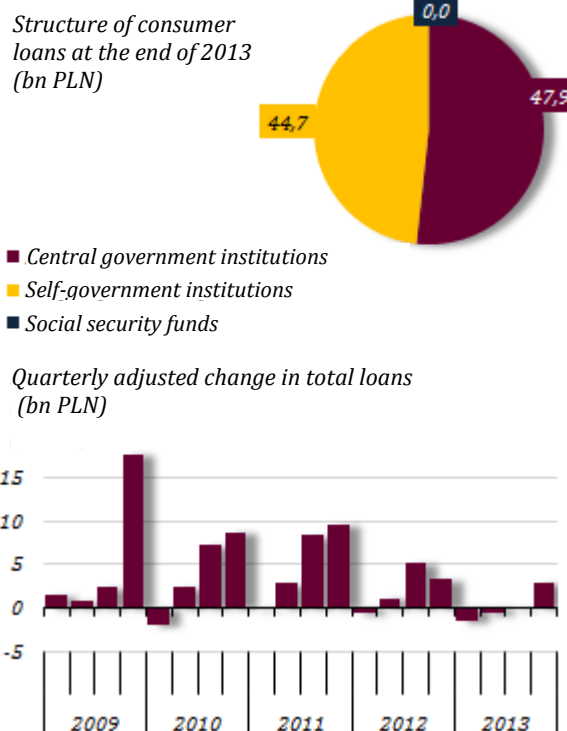


Table 16. Selected liquid assets

	Amount (bn PLN)				Change in 2013	
	2011	2012	09/13	2013	bn PLN	%
Total	355,4	382,9	433,0	410,2	27,2	7.1%
1/ Cash in hand, cash with central banks	40,3	71,4	57,5	55,0	-16,4	-23.0%
- cash in hand	13,4	14,9	13,1	15,3	0,4	3.0%
- cash with central banks	26,9	56,5	44,4	39,7	-16,9	-29.9%
2/ Receivables from banks	71,8	73,6	92,5	76,6	3,0	4.1%
- resident	41,3	42,8	60,4	50,5	7,7	18.0%
- non-resident	30,5	30,8	32,2	26,1	-4,7	-15.2%
3/ Debt and equity instruments	243,3	238,0	282,9	278,6	40,7	17.1%
- central banks	93,3	98,4	114,8	114,5	16,1	16.3%
- treasury instruments	130,8	120,5	148,8	142,4	21,8	18.1%
- debt instruments of other issuers	16,3	16,1	16,2	18,2	2,1	13.1%
- equity instruments	2,9	2,9	3,1	3,6	0,7	22.3%

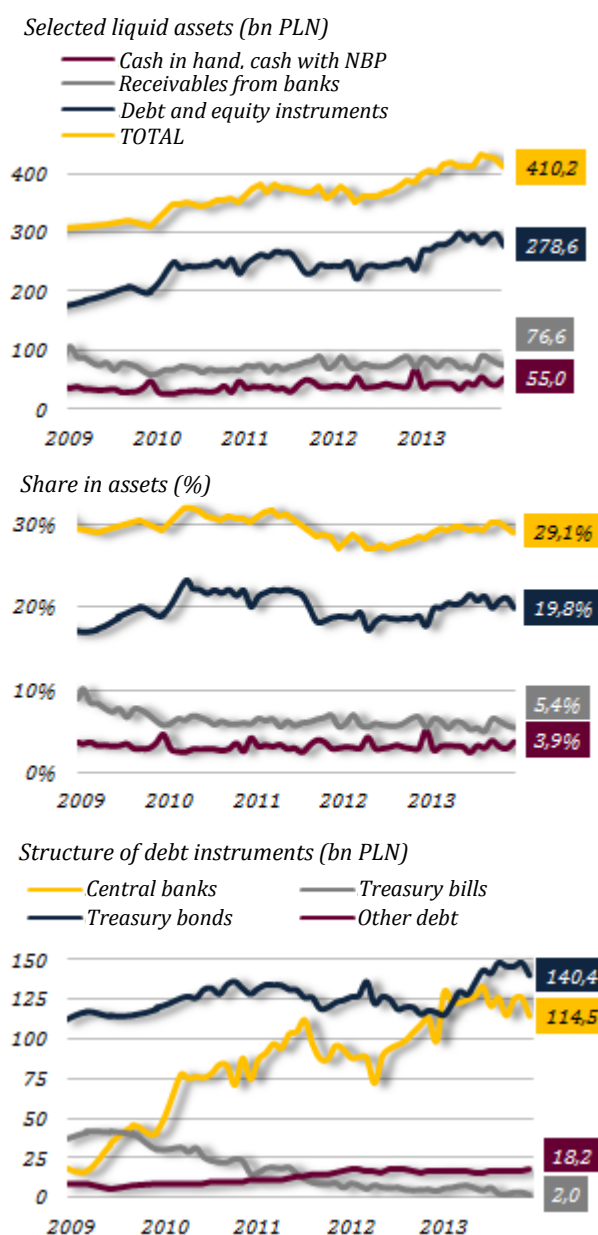
Increasing investments in the most liquid assets

Due to the limited development of lending, most banks increased their investments in the most liquid assets¹⁶. As a result, these assets increased in 2013 by PLN 27.2bn or by 7.1%. The share of these funds in the balance-sheet total also went up (from 28.4% at the end of 2012 to 29.1% at the end of 2013).

The increase in liquid assets concerned mainly the portfolio of treasury bonds and NBP bills, and to a lesser extent funds deposited in other banks. On the other hand, there was a decrease in deposits in the National Bank of Poland (due to the liquid nature of those deposits, one should not attach too much significance to their changes).

In the context of liquid assets, it should be borne in mind that the changes in the level and structure of these funds in a large state-owned bank may have a strong influence on the changes in the level and structure of these funds as observed across the entire sector (this explains a significant decrease in liquid assets which occurred in the fourth quarter last year).

Fig. 41.
Liquid assets



¹⁶ Defined herein as the total of funds accumulated as cash in hand, cash with central banks, receivables from banks and portfolio of debt and equity instruments.

**Increase in extended liabilities,
decrease in derivative
transactions**

A limited growth in lending, as observed in 2013, was reflected in a moderate increase in funding-related liabilities extended by banks (an increase of PLN 17.6bn or 8.7%). Liabilities to non-financial sector entities accounted for most liabilities (79.3%) and resulted from credit lines granted (PLN 159.1 bn). Their increase was relatively high (of 10.0%), which may be a signal of acceleration in lending growth in subsequent periods.

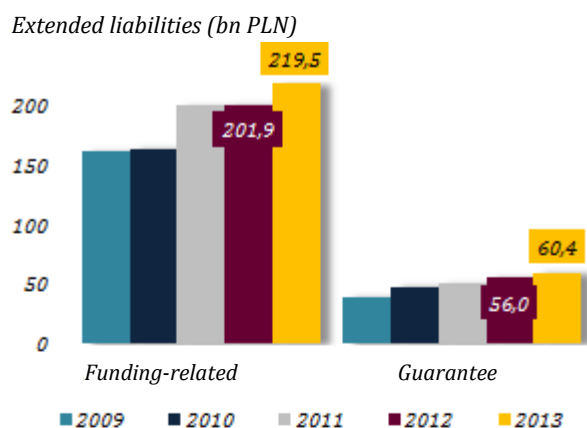
The value of guarantees granted by banks also increased (by PLN 4.4bn or 7.8%).

Strong reduction of the NBP interest rates translated into a significant increase in the scale of FRA transactions in the first half of 2013. However, the number of such operations decreased in the second half of the year due to the completion of the monetary policy easing cycle and due to the stabilisation of investor expectations as to the level of interest rates in the coming periods. In consequence, the number of interest-rate-related derivative transactions was lower at the end of 2013 than at the end of 2012 (the nominal value of those transactions fell from PLN 1,602.4bn at the end of 2012 to PLN 1,507.5bn at the end of 2013 or by 5.9%, mainly due to the reduction in the scale of FRA transactions, which was accompanied by an increase in OIS and other IRS transactions).

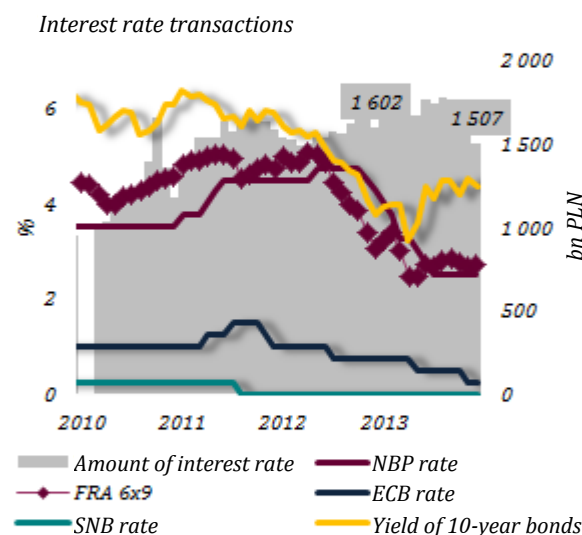
At the same time, the relative stabilization of the Polish zloty against major currencies, as observed in 2013, resulted in a certain decrease in the scale of transactions on currency derivative instruments (the nominal value of these transactions decreased from PLN 373.6bn at the end of 2012 to PLN 351.2bn at the end of 2013 or by 6.0%, mainly due to the reduction in FX swap transactions).

In consequence, there was a reduction in the scale of transactions on derivative instruments in total (the nominal value of those transactions fell from PLN 1,976.0bn at the end of 2012 to PLN 1,858.7bn at the end of 2013 or by 5.9%).

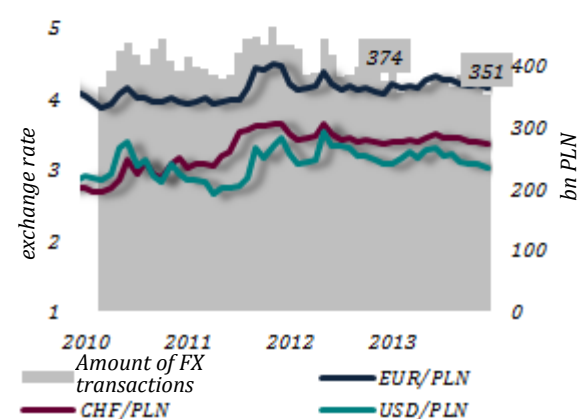
Fig. 42.
Off balance-sheet operations



Derivative transactions (nominal value)



FX transactions



6. FUNDING SOURCES

Moderate increase in liabilities and equity

A limited growth in the scale of banks' operations was reflected in a moderate increase in liabilities, which in nominal terms went up by PLN 49.6bn or 4.1% (or after adjustment for exchange rate changes - by approximately PLN 49.1bn or 4.1%). A growth in the non-financial sector's deposits exerted the decisive impact on the increase in liabilities (during the year, deposits of the public sector played a major role).

The level of the sector's equity also increased moderately.

Fig. 43.
The liability structure of the banking sector at the end of 2013

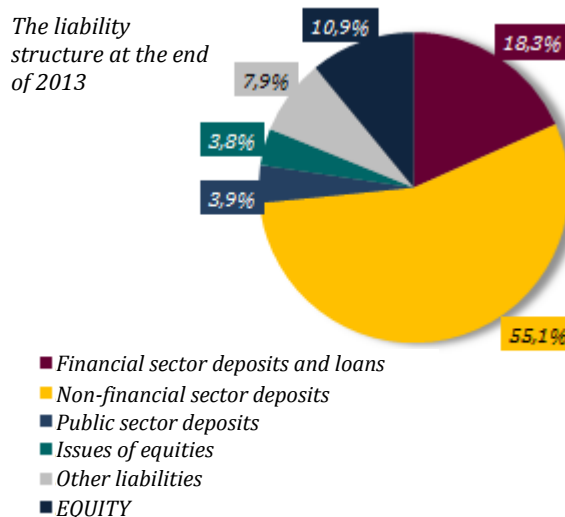
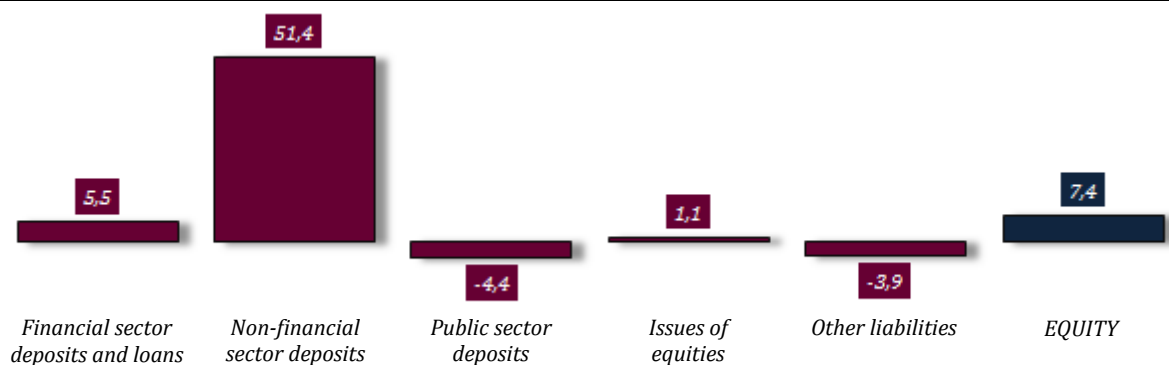


Table 17. Funding sources

	Amount (bn PLN)				Change in 2013			
	2011	2012	09/13	2013	nominal bn PLN	%	adjusted bn PLN	%
Liabilities	1 165.7	1 203.7	1 278.8	1 253.3	49.6	4.1%	49.1	4.1%
1/ Deposits and loans of the financial sector	266.6	252.1	266.6	257.6	5.5	2.2%	5.3	2.1%
2/ Deposits of the non-financial sector:	698.6	724.0	747.5	775.4	51.4	7.1%	51.4	7.1%
- households	477.4	516.0	535.2	548.2	32.2	6.2%	32.4	6.3%
- business enterprises	206.0	191.3	194.2	209.7	18.5	9.7%	18.3	9.6%
- non-profit institutions	15.3	16.7	18.2	17.5	0.7	4.4%	0.7	4.4%
3/ Deposits of the public sector	49.0	59.8	89.0	55.4	-4.4	-7.4%	-4.6	-7.6%
4/ Issue of equities	42.8	52.7	52.5	53.8	1.1	2.2%		
5/ Subordinated liabilities	10.1	8.0	7.3	7.0	-1.0	-12.5%		
6/ Other	98.6	107.0	115.9	104.1	-2.9	-2.7%		
as per currency								
- PLN	880.7	933.6	989.5	982.5	49.0	5.2%	49.0	5.2%
- currency	285.0	270.1	289.3	270.8	0.7	0.2%	0.2	0.1%
per country								
- resident	923.0	985.0	1 048.1	1 035.4	50.4	5.1%	50.0	5.1%
- non-resident	242.7	218.7	230.7	217.9	-0.8	-0.4%	-0.9	-0.4%
Including: funds from the parent group	x	122.0	126.8	120.1	-1.9	-1.5%		
Equity	128.9	146.5	150.2	153.9	7.4	5.0%		

Fig. 44.
Change (nominal) in funding sources in 2013



Moderate increase in deposits of the non-financial sector

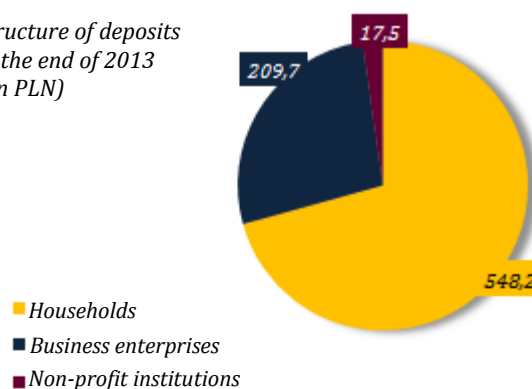
In 2013, there was a moderate increase in the non-financial sector deposits, which amounted to PLN 51.4bn or 7.1% (similarly an adjusted increase of about PLN 51.4bn or 7.1%). It was higher than in 2012, but lower than in previous years. The increase in deposits resulted from both an increase in deposits of households (up by PLN 32.2m or 6.2%) and of businesses (up by PLN 18.5m or 9.7%). However, it should be noted that while the growth rate of corporate deposits accelerated (in part, this was due to the low base effect resulting from a reduction in those deposits in 2012, and in part due to the improvement of the financial situation of the corporate sector and reduced propensity to invest), the growth rate of household deposits was further reduced, which was a consequence of a low growth rate of household income. It should be noted that over 25% of the increase in deposits of households was achieved by co-operative banks.

In the context of the ability to increase the deposit base, the environment of low interest rates and the economic slowdown presented a challenge to banks (despite a distinct revival in H2 2013). On the one hand, a strong reduction in interest rates on bank deposits (the average interest rate on new household deposits declined from 4.2% in December 2012 to 2.6% in December last year, and on new corporate deposits from 4.0% to 2.3%) reduces the increase in deposits from interest on the existing deposits, and on the other hand, it has a negative effect on the propensity to save and leads to the search for alternative forms of investment (including capital market and real estate market investments).

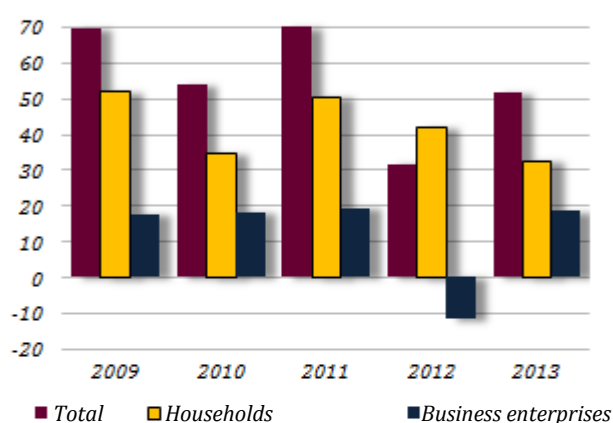
Pressure on the deposit base is also exerted by the economic slowdown, which reduces the ability to create savings by some households and some companies, but on the other hand, the same factor may induce them to increase the level of savings in banks in order to create a buffer against the deterioration of the financial position.

Fig. 45.
Deposits of the non-financial sector

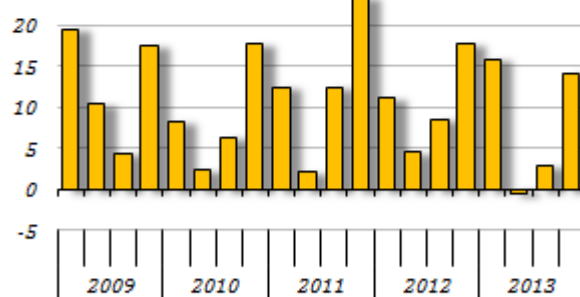
Structure of deposits at the end of 2013 (bn PLN)



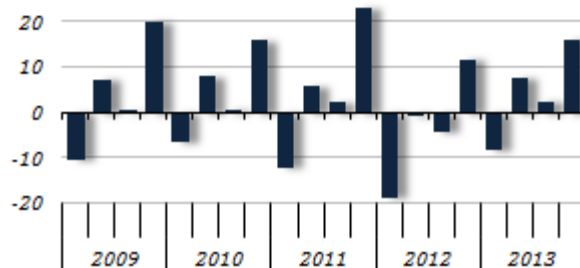
Yearly adjusted change (bn PLN)



Quarterly adjusted change Households



Business enterprises



Deposits and loans of the financial sector remain relatively stable

Despite periodic fluctuations, the deposits of, and loans to, the financial sector in the banking sector remained relatively stable in recent years (in 2013, they increased in nominal terms by PLN 5.5bn or by 2.2%, and following adjustment for changes in exchange rates - by about PLN 5.3bn or 2.1%). However, the relative stabilization of these funds leads to a gradual reduction in their share in the structure of liabilities and, consequently, and in the balance-sheet total (at the end of 2013, they accounted for 20.6% of total liabilities and 18.3% of the balance-sheet total).

From the perspective of the country of origin, the structure of these funds did not change significantly. The majority are still the funds that the banks received from non-residents, although in 2013 there was a further increase in national funds.

Deposits of the public sector show strong periodic fluctuations

After a strong but periodic inflow of the government sector's deposits opened with the national bank, as observed over most of the previous year, at the end of the year, these deposits were terminated, and the deposits of the public sector decreased compared to the end of 2012.

Fig. 46. Deposits and loans of the financial sector

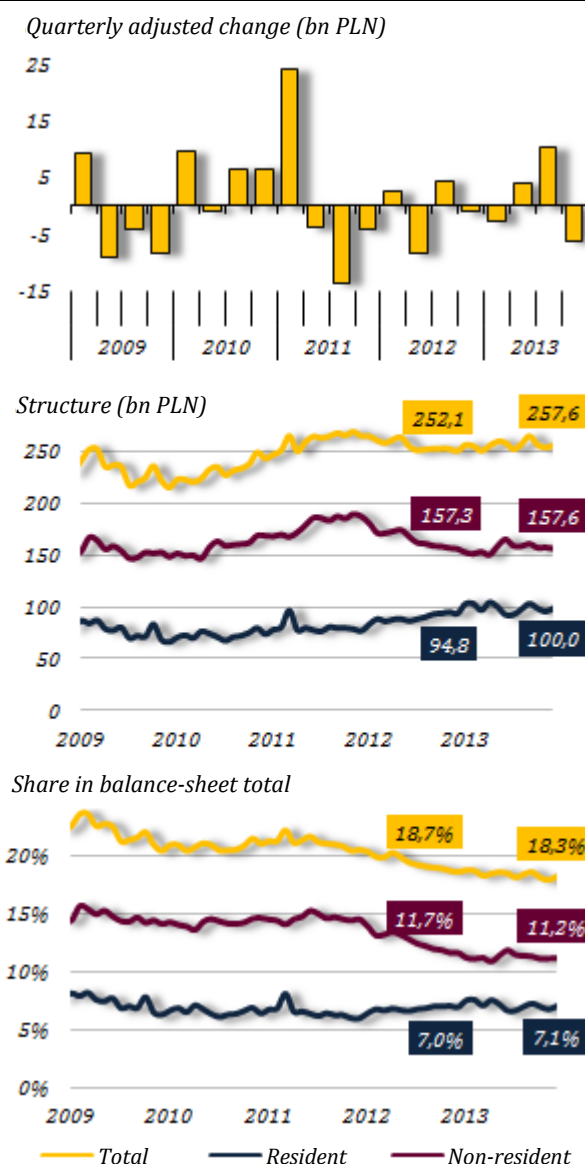
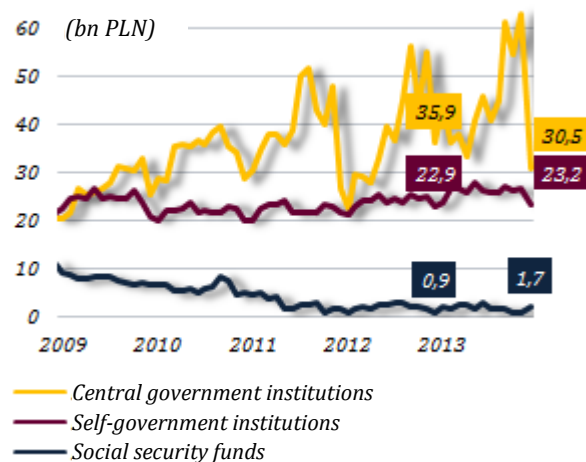


Fig. 47. Deposits of the public sector



Other liabilities without major changes

In 2013, the level of issues of equities did not change significantly (an increase of PLN 1.1bn or 2.2%). At the level of individual banks, an increase in these funds in several banks may be noticed (including in two banks, an increase of nearly PLN 1.0bn), which was accompanied by a decrease in these funds in several other entities. Growing importance of this funding source is a positive phenomenon, in particular considering the long- and medium-term nature of most funds acquired through this channel (the maturity of more than 70% of all funds is above 1 year, whereas the maturity of more than 20% of them is above 5 years). However, it should be borne in mind that the role of this funding source remains insignificant, and moreover, it is characterized by a very strong concentration (one state-owned bank accounts for most of it).

The importance of subordinated loans was further diminished (a decrease of PLN 1.0bn), which resulted from the repayment of a portion of these loans.

Moderate increase in equity

2013 saw an increase in equity of the banking sector (from PLN 146.5bn to PLN 153.9bn or of PLN 7.4bn or 5.0%), mainly as a result of retaining a large portion of the profits generated by banks in 2012. The increase in equity would have been higher if not for the reduction in the revaluation reserve (by PLN 2.4bn) due to a reduction in the valuation of financial assets available for sale.

In the context of dividends paid out on the 2012 profit, it should be stated that all commercial banks complied with the recommendation of the Polish Financial Supervision Authority (after complying with certain criteria, the maximum level of dividends should not exceed 75% of the profit). The exception was one bank, which despite its failure to comply with one of the criteria, paid dividends, but subsequently raised equity by an amount equal to the dividend paid through the issue of shares.

Fig. 48. Issues of equities and subordinated loans

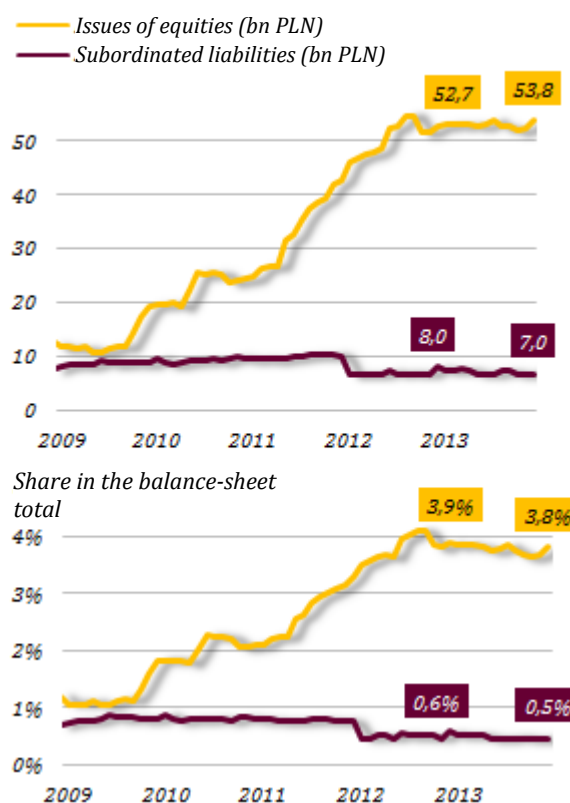
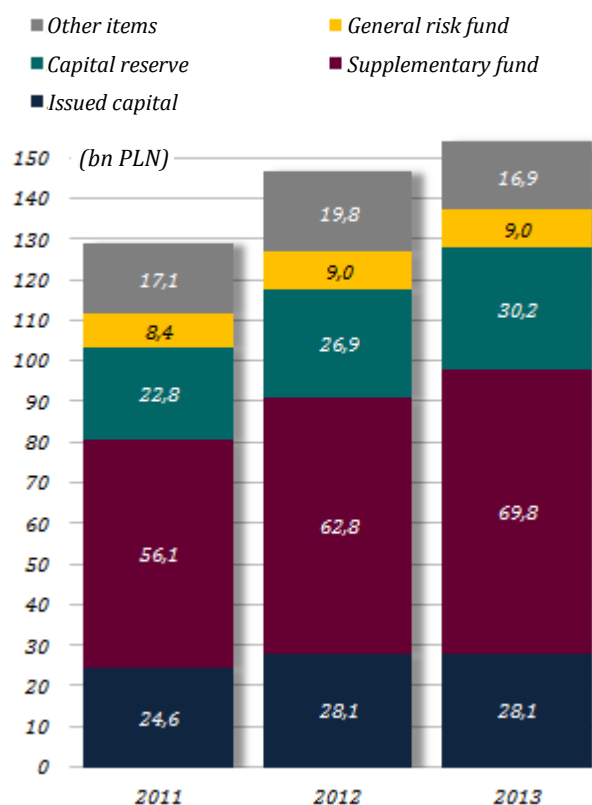


Fig. 49. Equity structure



Stable foreign funding

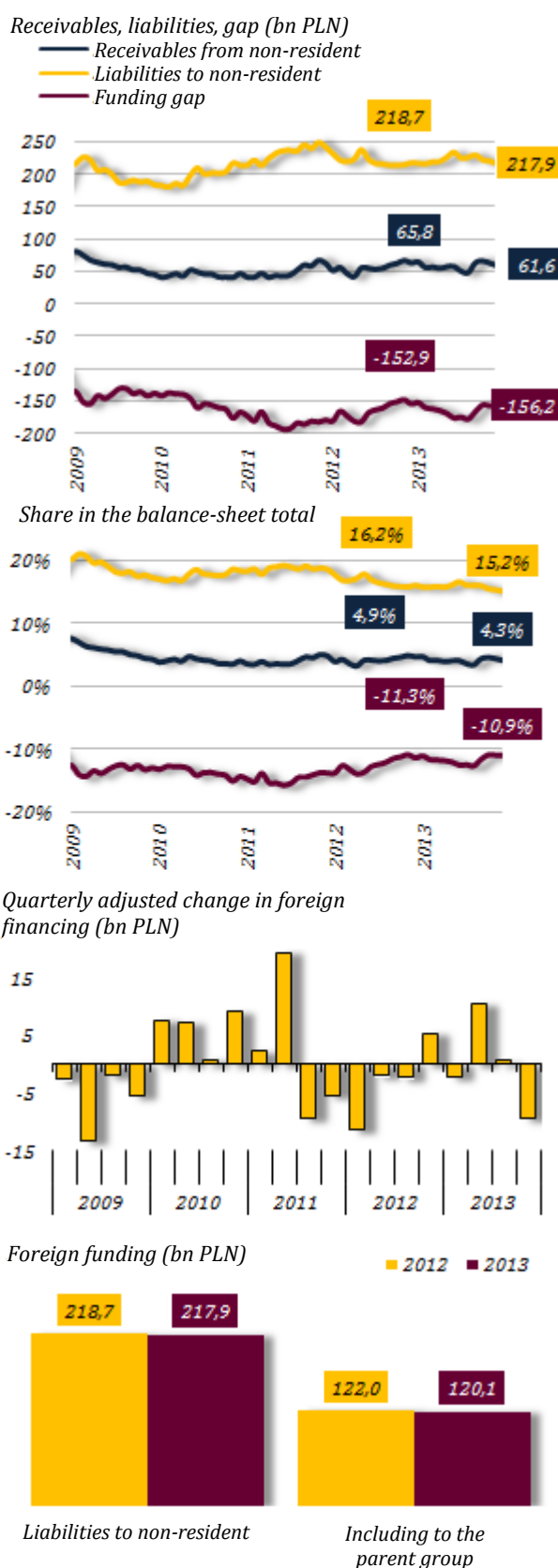
In 2013, a marginal decrease in foreign funding was recorded (by PLN 0.8bn), although Q2 saw increased inflow of these funds, and Q4 a decrease in these funds. However, it should be noted that some of these observations resulted from a change in these funds in entities that perform major operations in the financial market and that use for that purpose funds raised from parent entities, which in the case of accumulation of this phenomenon can cause significant fluctuations in funds in the scale of the entire sector.

More than half of liabilities to a non-resident originated from parent group entities. In 2013, the level of these funds decreased slightly (from PLN 122.0bn at the end of 2012 to PLN 120.1bn at the end of 2013), although the picture of the situation was not uniform - some entities reported a decrease, whereas others a significant growth in these funds.

Stabilization of non-resident funds in conjunction with an increase in other liabilities and total assets resulted in a reduction in the share of these funds in the liabilities structure (to 17.4%) and in total assets (to 15.2%), which means less dependence on foreign financing, and at the same time greater stability of the banking sector.

Stabilisation of banks' foreign liabilities was accompanied by a decrease in banks' amounts due from non-residents (of PLN 4.2bn). This resulted in a slight increase in the negative foreign funding gap (to PLN -156.2bn), and the gap's share in total assets decreased (-10.9%).

Fig. 50.
Foreign funding



In Poland, the phenomenon of “deleveraging” of foreign banks does not exist.

In the context of foreign funding, it should be noted that in recent years Poland, unlike other countries in the region, did not report an outflow of foreign capital as a result of the so-called “deleveraging” of foreign banks¹⁷.

Changes in Poland in terms of foreign funding have a different background and are mainly caused by the modification of the strategy of some banks. They consist in an endeavour to reduce the degree of dependence on resources from parent financial groups, and withdrawal of FX housing loans from the offer, which leads to a gradual drop in the demand for foreign funds. Volatility of exchange rates also constitutes an important source of fluctuations in the level of foreign funding (around 70% of non-resident funds are foreign currency funds), similarly as volatility, as mentioned earlier, of the scale of financial market operations performed by certain entities that are funded from parent institutions’ resources.

It should be also remembered that not all banks entering the Polish market were as successful as they anticipated. As a consequence, some of them decided to cease operations and exit the Polish market, but this phenomenon has nothing to do with “deleveraging”. These are rather ordinary business activities.

In summary, we can conclude that the level of foreign financing remains stable and some reduction in the role of this source of funding, as observed in recent years, is primarily due to changes in business strategy in some banks. At the same time, this creates favourable conditions for increased stability of the Polish banking sector (this view is shared by the NBP¹⁸).

¹⁷ For more information see “Report on the situation of banks in 2012”, PFSA.

¹⁸See “Financial System Stability Report”, NBP, December 2013, op. cit. page 15: “The results of shock simulations covering funding risk indicate that further gradual reduction of some domestic banks’ dependence on the funding sourced from foreign parent companies would be beneficial for the stability of the domestic financial system.”

7. CURRENCY AND MATURITY STRUCTURE OF THE BALANCE SHEET

In the balance sheet structure, one may observe some phenomena giving rise to a variety of risks and potentially being a threat. High share of FX assets and excessive dependence of lending on short-term deposits are particularly unfavourable. Some of these phenomena arise from the function that banks play in the economy, but the majority is derived from excessively expansionary business strategies that were implemented by some banks in earlier years.

Table 18. Currency structure of the balance sheet in the banking sector

	Amount (bn PLN)				Change in 2013	
	2011	2012	09/13	2013	bn PLN	%
Assets						
- PLN	931.4	1 016.7	1 084.4	1 077.8	61.0	6.0%
- currency	363.2	333.5	344.6	329.4	-4.1	-1.2%
Liabilities						
- PLN	1 009.6	1 080.1	1 139.7	1 136.4	56.3	5.2%
- currency	285.0	270.1	289.3	270.8	0.7	0.2%
Currency mismatch						
- in bn PLN	-78.1	-63.4	-55.3	-58.7		
- % of total assets	-6.0%	-4.7%	-3.9%	-4.2%		

Improved currency structure

The supervisory activities successfully taken in recent years, along with increased awareness of foreign exchange risk for banks and their customers, and the relative stabilization of the Polish zloty against major currencies, as observed in 2013, helped to improve the currency structure of the banking sector's balance sheet, and thus to increase its stability. Foreign currency assets decreased slightly (by PLN 4.1bn or 1.2%), while foreign currency liabilities increased marginally (by PLN 0.7bn or 0.2%). In conjunction with an increase in PLN assets and liabilities, this resulted in a reduction in the share of both foreign currency assets and foreign currency liabilities in the balance sheet (to 23.4% and 19.2%, respectively). As a consequence, there was also a reduction in the negative currency gap (down to PLN -58.7bn) and its share in the balance-sheet total (down to -4.2%). One should bear in mind that the share of currency assets and liabilities and of the negative currency gap shows large differences at the level of individual banks. The highest share of foreign currency assets (30-60%) and the highest negative currency gaps (of up to -30%) occur in the banks which, in recent years, strongly developed FX housing loans, without adequate funding sources. But the changes made in the past two years in their lending policies lead to a gradual improvement in the structure of their balance sheets.

Fig. 51. Foreign currency assets and liabilities

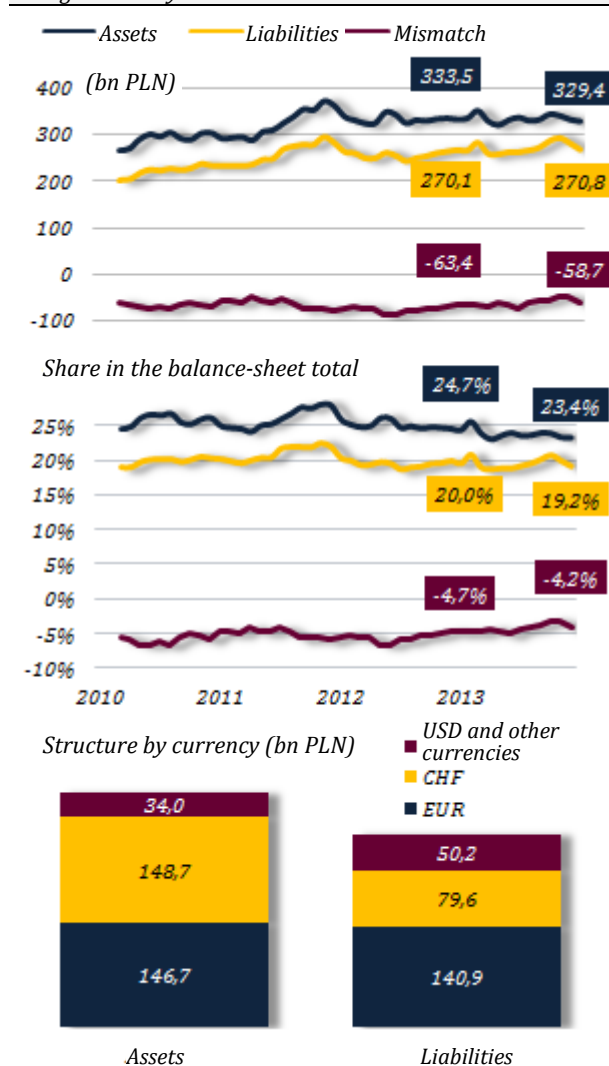


Table 19. Maturity structure of the balance sheet¹⁹

	Amount (bn PLN)				Change in 2013	
	2011	2012	09/13	2013	bn PLN	%
Assets	1 328.1	1 380.1	1 461.5	1 440.8	60.6	4.4%
up to a year	410.1	397.4	438.3	417.6	20.2	5.1%
1-2 years	105.7	108.9	121.4	123.2	14.3	13.1%
2-5 years	221.7	221.9	254.3	268.0	46.1	20.8%
more than 5 years	443.8	448.6	449.9	447.2	-1.4	-0.3%
without maturity	146.8	203.3	197.5	184.8	-18.5	-9.1%
Liabilities	1 289.9	1 343.7	1 422.5	1 402.5	58.8	4.4%
up to a year	965.4	978.7	1 048.8	1 029.5	50.7	5.2%
1-2 years	35.5	55.1	58.3	55.7	0.6	1.2%
2-5 years	64.2	57.6	68.2	76.1	18.5	32.1%
more than 5 years	69.0	80.5	73.2	64.2	-16.2	-20.2%
without maturity	155.8	171.8	174.0	177.0	5.2	3.0%

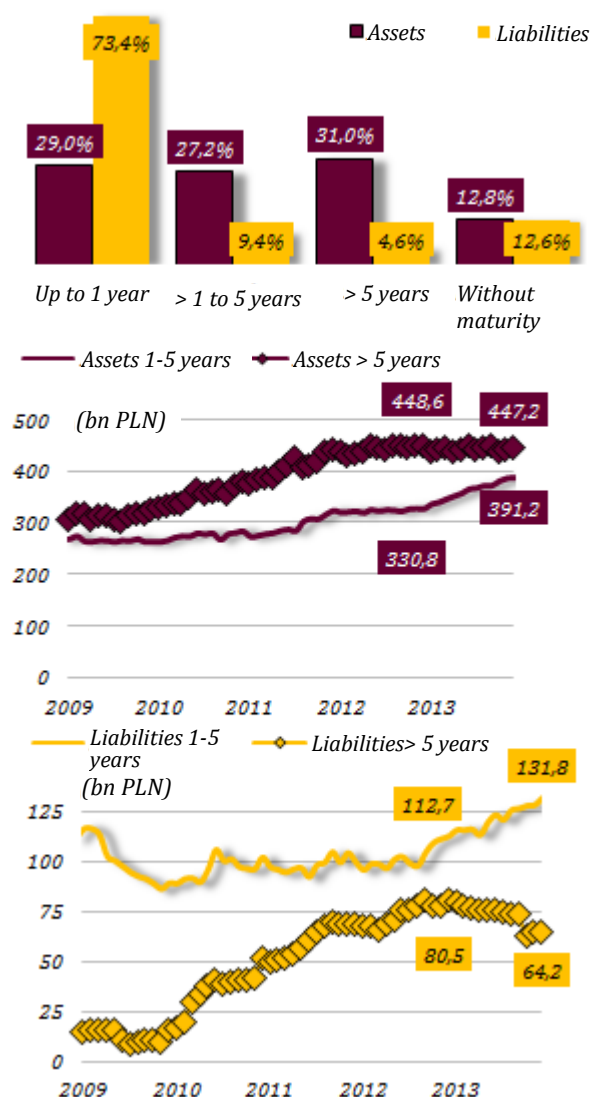
Long-term funding without major changes

In 2013, no significant changes in the maturity structure of the balance sheet of the banking sector were noticed. A few banks managed to gain significant long-term financing, but on the other hand, this was accompanied by a reduction of such financing in other banks. As a result, the level of long-term financing in the sector as a whole has not changed considerably - admittedly, liabilities maturing in the period of over one year did increase (from PLN 193.2bn at the end of 2012 to PLN 196.0bn at the end of 2013), but their share in the balance-sheet total decreased (from 14.4% to 14.0%).

It should be added that the marginal increase in long-term financing was possible thanks to an increase in liabilities to non-financial sector (especially in one large bank, which may be a temporary phenomenon), which, on the other hand, was accompanied by a decrease in long-term liabilities to the financial sector.

Largely mismatched maturities of assets and liabilities indicate that long-term lending is based on short-term deposits, whereby liquidity risk is higher. Therefore, it is necessary for banks to continue their efforts to obtain long-term stable funding sources.

Fig. 52.
Balance-sheet maturity structure



¹⁹As far as the maturity structure is concerned, the FINREP reporting system is based on the data in nominal values, and includes an item "without specified maturity", which causes certain distortions and inconsistencies (e.g. between total assets and liabilities). However, these restrictions do not affect the essence of phenomena and conclusions presented.

In the context of the possibility to obtain long-term funding, once again, attention should be paid to the usefulness and necessity of banks' compliance with instructions and recommendations of the PFSA relating to, for example, an adequate amount of equity, the dividend policy and risk management, which will help to strengthen their financial standing and credibility in the market and thus facilitate them to obtain funding on favourable terms.

8. LENDING PORTFOLIO QUALITY

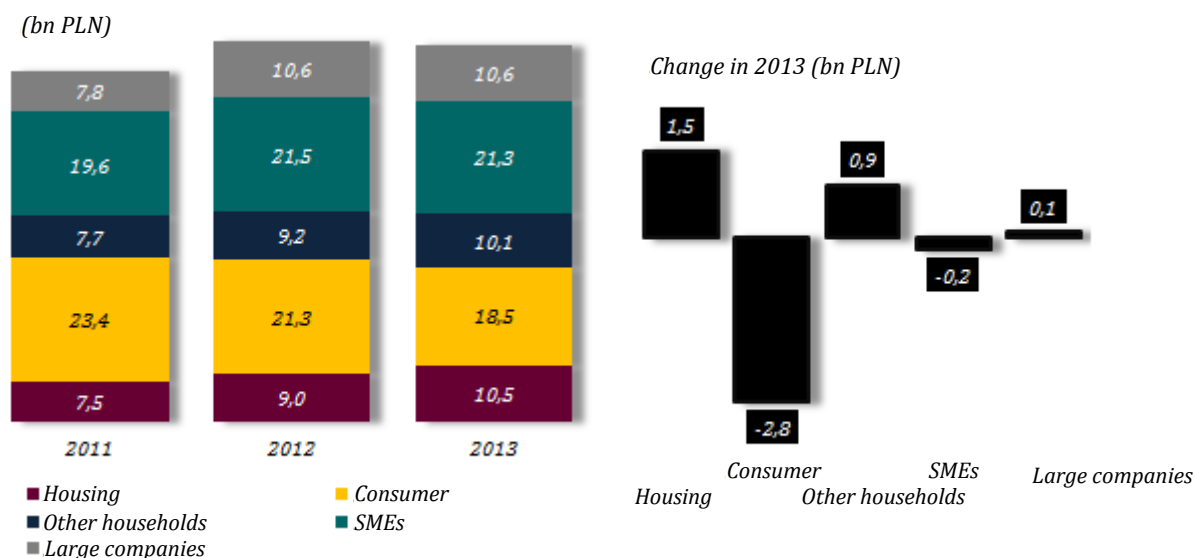
The quality of the lending portfolio remains stable, although deterioration is visible in some areas

Table 20. Loan portfolio quality

	Non-performing loans (bn PLN)				Change in 2013		Share (%)			
	2011	2012	09/13	2013	bn PLN	%	2011	2012	09/13	2013
Non-performing loans	66.4	72.2	72.3	71.7	-0.5	-0.7%	7.3%	7.7%	7.4%	7.4%
Financial sector	0.1	0.1	0.2	0.2	0.1	79.0%	0.5%	0.3%	0.5%	0.5%
Non-financial sector	66.0	71.7	71.8	71.2	-0.5	-0.7%	8.2%	8.9%	8.5%	8.5%
Public sector	0.3	0.4	0.3	0.3	-0.1	-22.6%	0.3%	0.4%	0.4%	0.3%
Households	38.6	39.6	39.3	39.2	-0.4	-1.0%	7.2%	7.4%	7.1%	7.0%
Consumer	23.4	21.3	19.4	18.5	-2.8	-12.9%	18.0%	17.2%	15.5%	14.6%
Housing	7.5	9.0	9.9	10.5	1.5	16.2%	2.3%	2.8%	2.9%	3.1%
Other	7.7	9.2	10.0	10.1	0.9	9.8%	9.3%	10.5%	10.6%	10.9%
Business enterprises	27.4	32.1	32.4	32.0	-0.1	-0.4%	10.4%	11.8%	11.5%	11.5%
SMEs	19.6	21.5	22.0	21.3	-0.2	-0.9%	12.3%	13.1%	13.2%	13.0%
Large companies	7.8	10.6	10.4	10.6	0.1	0.7%	7.4%	9.8%	9.1%	9.3%
Past due loans										
Consumer										
up to 30 days	9.3	9.4	8.7	8.5	-0.9	-9.6%	7.0%	7.5%	6.7%	6.4%
> 30 days	26.1	23.7	22.4	21.3	-2.4	-10.2%	19.7%	18.9%	17.0%	16.1%
Housing										
up to 30 days	11.4	13.3	13.9	12.8	-0.5	-3.9%	3.6%	4.1%	4.1%	3.8%
> 30 days	9.1	10.7	11.7	11.4	0.7	6.5%	2.8%	3.3%	3.5%	3.4%

Fig. 53.

Non-performing loans to the non-financial sector



Despite strong weakening in economic growth, as observed in the second half of 2012 and the first half of 2013, and despite a weak situation in the labour market, the quality of the loan portfolio remained stable. Throughout 2013, the level of impaired/non-performing loans reduced marginally (by PLN 0.5bn). Their share in the portfolio also decreased (from 7.7% at the end of 2012 to 7.4% at the end 2013). As far as individual portfolios are concerned, the following was reported: the improved quality in the area of consumer loans, stability in the area of corporate loans and deterioration in the portfolio of housing loans and other loans to households.

Deteriorated quality of housing loans with signs of stabilization

In 2013, the quality of housing loans deteriorated. This was reflected in an increase in the number of non-performing loans (by PLN 1.5bn or 16.2%) and in their share in the portfolio (from 2.8% to 3.1%). Also, loans repay ability deteriorated, which manifested itself in growth in 30+ DPD loans (by PLN 0.7bn or 6.5%) and their share in the portfolio (from 3.3% to 3.4%).

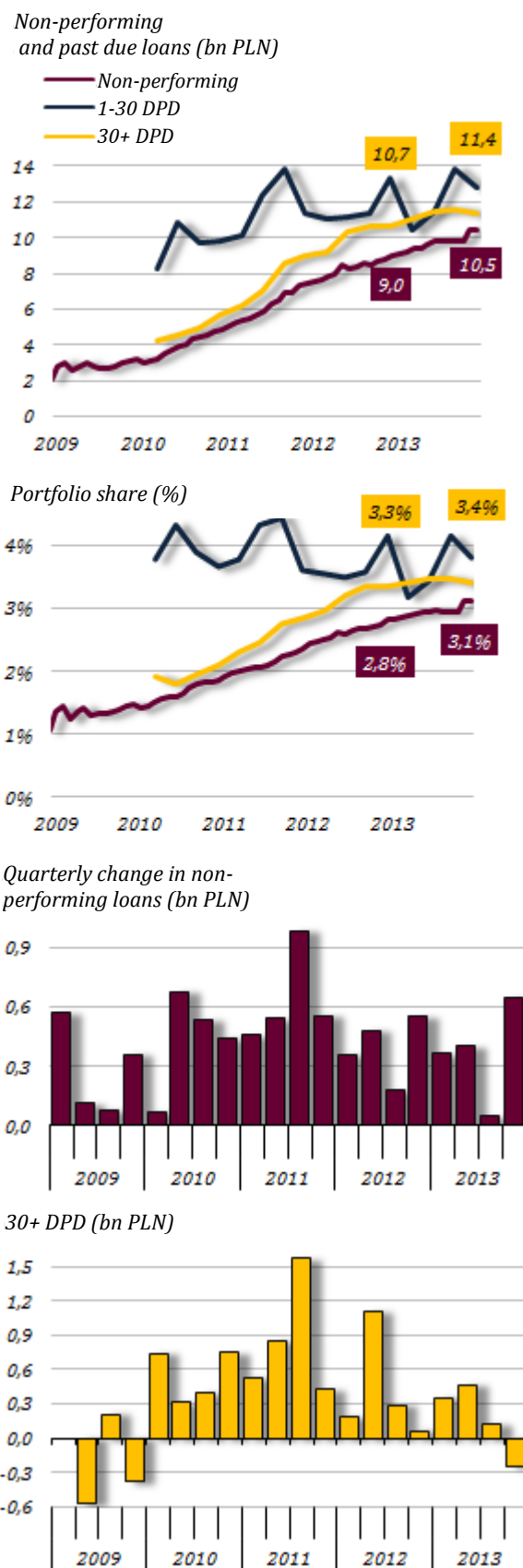
Despite the observed worsening, there are signs of possible stabilization of the quality of housing loans in future periods, as indicated by a gradual deceleration and decrease in 30+ DPD loans, as observed in the fourth quarter. In addition, the environment of record-low interest rates has a positive impact on the quality of PLN loans, which significantly reduces debt servicing costs and has a positive impact on borrowers' financial position. On the other hand, it should be borne in mind that banks derecognised a portion of "bad" loan portfolio (worth PLN 0.3bn), mainly due to their sales. In addition, banks' portfolios comprise a significant number of loans subject to restructuring or enjoying the so-called "loan-repayment holidays" (see the Annex).

Housing loan portfolio generates a number of risks for banks, customers and the economy

While the quality of housing loans remains high compared to other types of loans, this portfolio generates a number of potential risks for customers, banks and the economy, as the banking supervision has already repeatedly pointed out. In particular, one should take into account (for more information, see annex):

- the dominant role of housing loans in the banking sector's balance sheet (at the end of 2013, they accounted for 41.4% of loans to non-financial sector, and for 23.5% of the banking sector's total assets, and in some banks, their share was significantly higher);

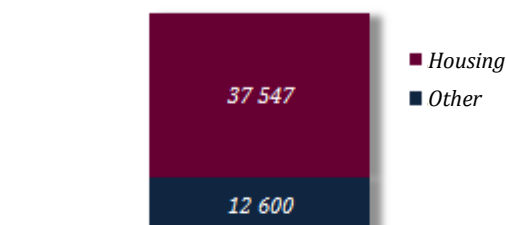
Fig. 54.
Quality of housing loans



- a brief record (loans in the years 2007 to 2013 represent 85% of the total portfolio value);
- a high share of currency loans in the portfolios of some banks, which generate a number of different types of risk for customers, banks and the economy, in particular due to the lack of security of households against currency risk; This risk is expressed, for example, in class actions filed against banks, and the banks that hold large portfolios of these loans must take them into account in their activities;
- too high LTV ratio of a large part of the loan portfolio (over 500,000 of loans with LTV > 80%, including over 200,000 loans with LTV > 100%), which raises concerns as to the position of households covered by the debt enforcement procedures (a portion of them would still have very large debts even if their real properties are sold) and may have a negative impact on the position of banks with a large portfolio of loans with such parameters;
- applying excessively liberal rules in awarding certain loans, for example: assuming too low costs of living (at subsistence level or lower), failure to adjust DTI to borrowers' income position, unduly extended periods of repayment, lack of an adequate buffer for the risk of rising interest rates;
- social and legal issues related to the realisation of security - assuming that loans were incurred by a 2-3 person households, we can conclude that at the end of 2013, about 100,000-150,000 people were affected by the problem of servicing the debt on loans secured on residential property;
- limited liquidity in the real estate market, which raises concerns about the effectiveness of realisation of security by banks and the impact of this process on the situation on the real estate market;
- risk inherent to loans granted as part of the "Rodzina na swoim" (Family on Its Own) programme, resulting from the abrupt growth of instalments to be repaid after 8 years of subsidies, which will be "felt" by some families with low income;
- unsatisfactory databases on the real property market and financial position of borrowers;

Fig. 55.
Selected housing loan problems

Number of non-performing loans secured on a residential real property



Taking into account borrowers' families, about 100,000-150,000 people are affected by the loan servicing problem

In some markets, "bad" loan portfolio can be a significant source of potential supply

LTV structure of the lending portfolio (bn PLN)



Over 200,000 loans with LTV > 100%
Over 300,000 loans with LTV 80-100%

Too liberal rules of granting some loans:

- Too low cost of living
- DTI not adjusted to borrowers' situation
- Over-extended crediting periods
- Lack of proper buffer for the risk of rising interest rates

- strong diversity of real estate prices, including within the same location (or even the same building), which hinders their fair valuation;
- lack of fully satisfactory long-term sources of funding.

For long-term mortgage loans, assuming the cost of living at or below the minimum subsistence level for the purpose of assessing creditworthiness does not leave households any possibility to incur bigger expenses and to create savings and does not leave an adequate margin for possible worsening of their income situation.

Minimum subsistence figure of IPiSS (Institute of Labour and Social Studies)

	Households of the employed					Pensioners'	
	1-person	2-person	3-person	4-person	5-person	1-person	2-person
Study - 2013							
<i>Nation-wide</i>							
Food	262	524	734	1 004	1 274	251	501
Flat	388	564	769	975	1 181	388	564
- exploitation	334	496	690	874	1 058	334	496
- fittings	54	68	79	100	123	54	68
Education	14	29	88	202	331	0	0
Culture and recreation	121	150	188	236	283	105	145
Clothing and footwear	50	100	147	196	244	40	79
Health care	41	78	101	126	151	82	160
Personal hygiene	30	57	70	97	124	25	48
Transportation and communication	81	149	374	386	398	99	165
Other expenditure	79	116	148	161	159	79	116
Total	1 065	1 766	2 620	3 383	4 146	1 069	1 779
- per 1 person	1 065	883	873	846	829	1 069	890
Study - 2012							
<i>Nation-wide</i>	1 027	1 698	2 654	3 379	4 104	1 043	1 720
- per 1 person	1 027	849	885	676	684	1 043	860
<i>Towns > PLN 500,000</i>	1 060	1 757	2 765	3 536	4 308	1 080	1 060
- per 1 person	1 060	879	922	707	718	1 080	530

The definition of the subsistence level according to the Institute of Labour and Social Studies:

"The minimum subsistence figure is a social category that measures the cost of living of households, taking into account the basic domestic and consumer needs. When forming the minimum subsistence basket, experts were not guided by the intention to create the poverty threshold. The intention was rather to determine the household expenses threshold measuring a minimum decent standard of living. Therefore, the minimum subsistence pattern is a model of meeting the needs at a level that is generally low but still sufficient to reproduce a person's vital forces at every stage of their biological development, to have and raise children and to maintain ties with society".

Given the detrimental effects observed in the portfolio of mortgage loans, as well as national and international experiences in recent years, in June last year the PFSA revised Recommendation S. The solutions adopted, together with other actions of the PFSA, should lead to the correction of the previous housing loan development model, increase security of banks and their customers (borrowers and depositors), and indirectly foster a long-term development of the real estate market.

At the same time, the banking supervision carries out systematic surveys aimed at identifying and eliminating areas of potential risk (which may materialize in the future) and unfavourable practices and conduct of banks, as well as of their customers, in the area of housing loans.

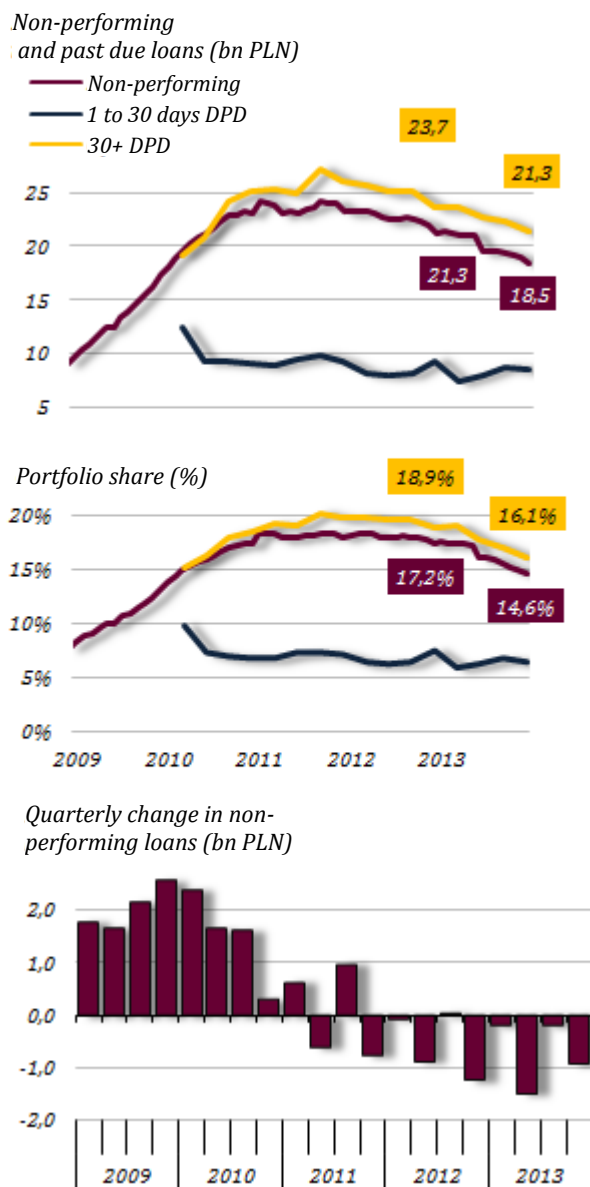
Improved quality of consumer loans due to the sale of a portion of the bad loan portfolio

In 2013, a significant improvement in the quality of consumer loan portfolio was recorded, as evidenced by a decrease in non-performing loans (of PLN 2.8bn or 12.9%) and a reduction in their share in the portfolio (from 17.2% to 14.6%). Loans repayability also improved, which manifested itself in a decrease in 30+ DPD loans (by PLN 2.4bn or 10.2%) and their share in the portfolio (from 18.9% to 16.1%).

The positive observations resulted mainly from the sale of a portion of the bad loan portfolio or the transfer of bad loans to off-balance sheet records (their total amount exceeded PLN 5bn). In addition, the loan quality improvement was supported by growth in lending, which led to a decrease in the share of non-performing and past due loans. In addition, the stabilisation and improvement of the loan quality is supported by the process of self-regulation of banks, which occurred in recent years, as well as regulatory and supervisory activities which strengthened the risk management process at the level of the entire sector and individual banks.

There are significant differences in the quality of the portfolio between banks (on the one hand, there is a group of banks focused on the consumer finance segment, in which the share of non-performing loans is 20-30%, and on the other hand, there are universal banks with a large portfolio of these loans, where in general, such share does not exceed 10%).

Fig. 56.
Quality of consumer loans



Deteriorated quality of other loans to households

The quality of other loans to households deteriorated, which is reflected in the increase in the volume of non-performing loans (by PLN 0.9bn or 9.8%) and in their share in the portfolio (from 10.5% to 10.9%). The above was the consequence of deteriorated quality of working loans granted to small entrepreneurs (an increase of PLN 0.6 bn in non-performing loans) and, to a lesser extent, of investment loans (of PLN 0.2 bn), and is related to a slowdown in the economic growth and the resulting deterioration of the financial position of some of these entities. However, the second half of last year saw signs of stabilisation expressed in a deceleration in the growth of non-performing loans and a reduction in their share in the portfolio.

Stabilisation of the quality of corporate loans

2013 saw stabilization in the quality of the portfolio of loans to the corporate sector. There was a marginal decrease in the amount of non-performing loans (a decrease of PLN 0.1bn), as well as in their share in the portfolio (a decrease from 13.1% to 13.0%).

A stable situation as far as the quality of corporate loans is concerned can be explained by the favourable financial situation of enterprises, which remained stable despite a strong decline in economic growth in H2 2012 and H1 2013. This was partly associated with a strong reduction in interest rates resulting in the reduction of debt servicing costs.

Fig. 57. Quality of other loans to households

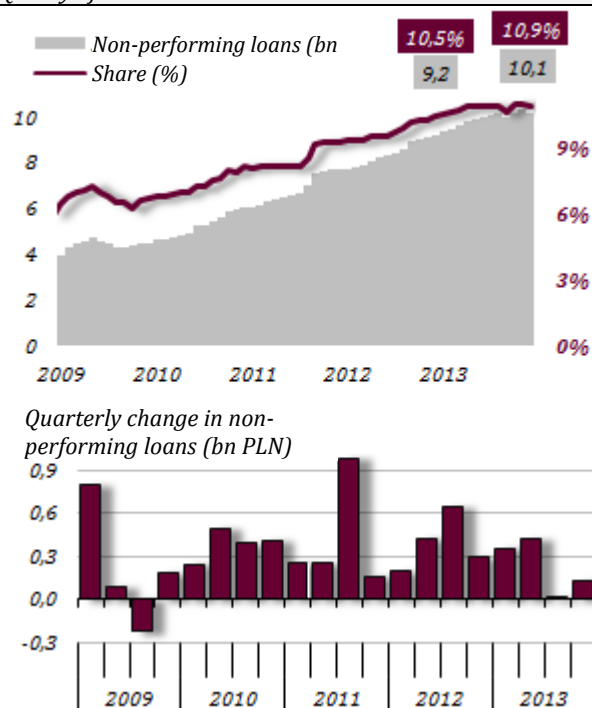


Fig. 58. Quality of corporate loans

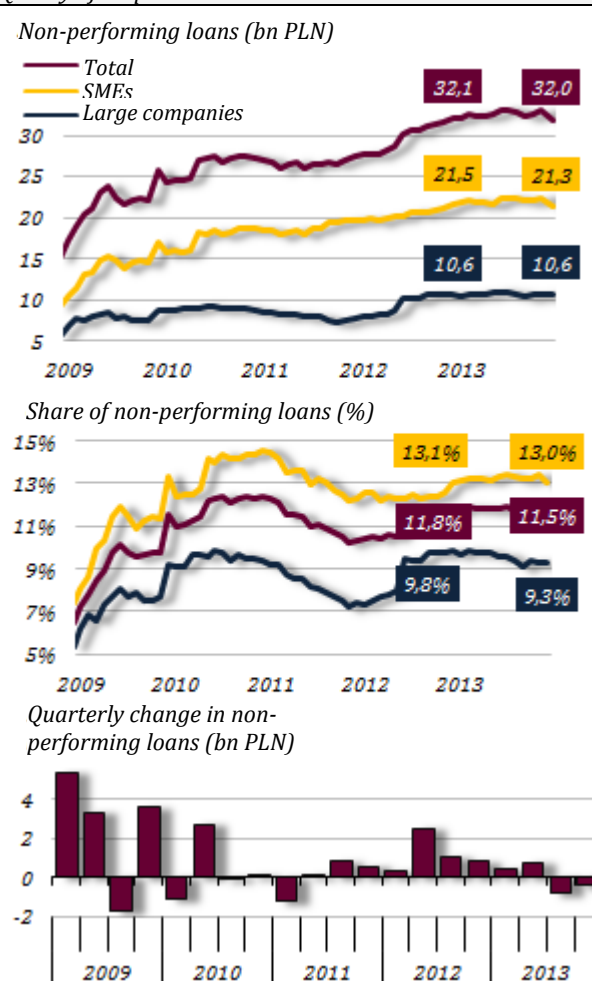
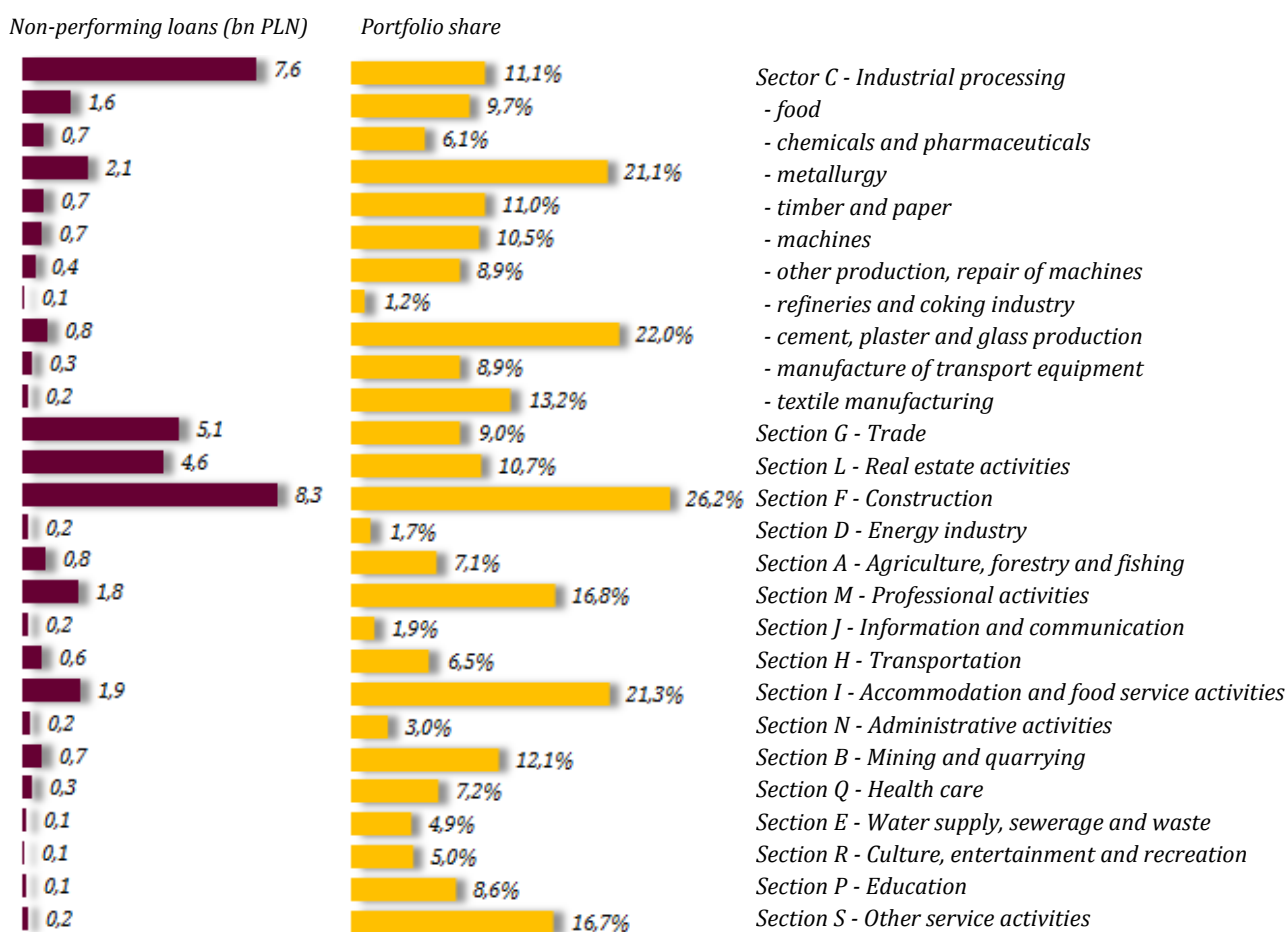


Fig. 59.
Quality of large exposures to corporate sector



From a sector perspective, the lowest quality was displayed by the portfolio of loans to the building sector (at the end of 2013, the share of non-performing loans amounted to 26.2%) and to companies operating in the following sectors: manufacture of cement, plaster and glass, hotels and catering and metallurgy (where this share exceeded 20%).

In summary, the relatively favourable situational picture of the loan portfolio quality in 2013 (despite the sharp weakening of the economy in the second half of 2012 and in the first half of 2013, as well as the deterioration in the labour market) can be explained by several factors. First, the transactions of sale of the “bad loan” portfolio, which related mainly to consumer loans, had a significant influence. Secondly, reduction in NBP interest rates by the Monetary Policy Council led to a strong fall in WIBOR rates, and in consequence significantly reduced loan servicing costs, which had a stabilizing effect or led to the improvement in the financial position of some borrowers. Thirdly, despite the economic slowdown, the financial position of the corporate sector remained relatively good. Finally, the self-regulation process, which occurred in recent years, as well as activities of banking supervision, both at the level of the entire sector and individual banks, had a strong influence, which strengthened the credit risk management process. At the same time, the substantial strengthening of capital base in recent years (arising largely from the activities of the banking supervision) offers banks greater opportunities in the debt restructuring process. However, it cannot be ruled out that some banks made attempts to improve their performance through a more liberal credit risk pricing, which, however, is the subject of ongoing review by the banking supervision, as well as review of assets by

statutory auditors. As far as the review of the credit portfolio quality is concerned, it needs to be mentioned that in connection with the Recommendations on asset quality reviews, as issued by the European Banking Authority (EBA), and Asset Quality Review (AQR) carried out by the ECB, concerning the largest banks in the euro area, in 2014, the PFSA will perform a similar review of the 15 largest banks in Poland, which account for over 70% of sector assets.

Table 21. Impaired/non-performing receivables covered by impairment losses

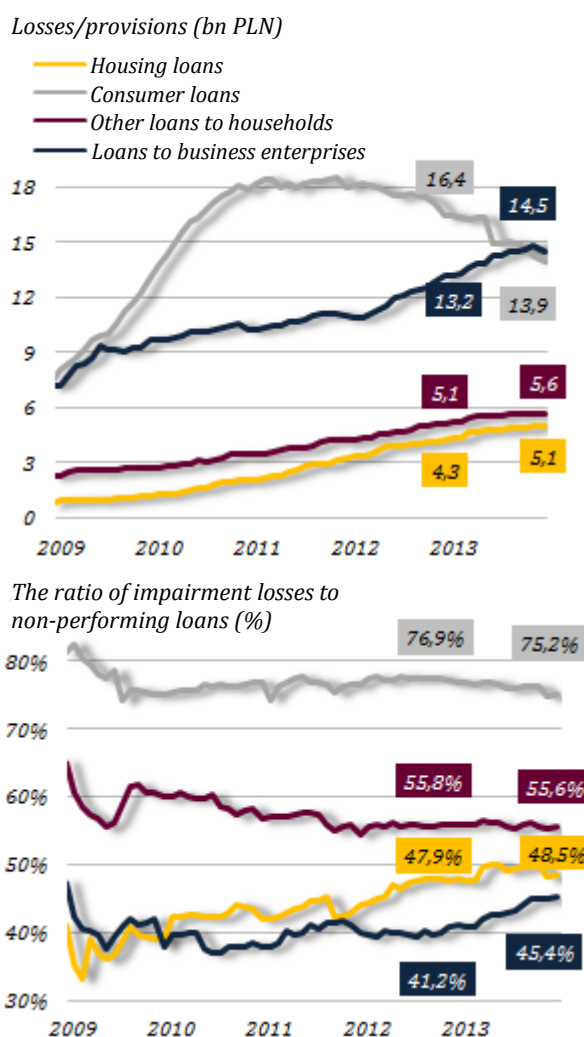
	Level of impairment losses (bn PLN)			Change in 2013		The coverage ratio of loans threatened with impairment losses (%)		
	2011	2012	2013	bn PLN	%	2011	2012	2013
Non-financial sector in total	36.4	39.1	39.2	0.1	0.3%	55.2%	54.5%	55.0%
Households	25.4	25.8	24.7	-1.2	-4.6%	66.0%	65.4%	63.0%
Housing	3.3	4.3	5.1	0.8	17.7%	44.1%	47.9%	48.5%
Consumer	18.0	16.4	13.9	-2.4	-14.9%	76.7%	76.9%	75.2%
Other	4.2	5.1	5.6	0.5	9.5%	54.5%	55.8%	55.6%
Business enterprises	11.0	13.2	14.5	1.3	9.7%	40.1%	41.2%	45.4%
SMEs	6.9	8.0	8.7	0.7	8.3%	35.1%	37.1%	40.5%
Large companies	4.1	5.2	5.9	0.6	11.8%	52.6%	49.6%	55.1%

Relatively stable level of impairment losses and of coverage of non-performing receivables

In the context of the quality of the loan portfolio, attention should be also paid to the issue of impairment losses recognised by banks due to the associated risks. In 2013, impairment losses on receivables from non-financial sector practically did not change (a marginal increase of PLN 0.1bn or 0.3%). This resulted from the above-mentioned sale transactions of a portion of “bad” consumer loans, which led to a significant reduction in impairment losses on these loans. For other receivables, there was an increase in impairment losses. The biggest increase was reported for housing loans.

The impairment losses to distressed receivables ratio remains relatively stable (at the end of 2013 it amounted to 55.0% compared to 54.5% at the end of 2012). 2013 saw a marked increase in the ratio of impairment losses to distressed receivables from the corporate sector (an increase of 45.4%) and a slight increase in the ratio of impairment losses to distressed receivables from housing loans (an increase of 48.5%). On the other hand, there was a decrease in the ratio of impairment losses to non-performing consumer loans (a decrease of 75.2%) and other loans to households (a decrease of 55.6%).

Fig. 60. Impairment losses on loans to non-financial sector



Quality of loans determined by economic developments

From the perspective of the loan portfolio quality, macroeconomic development in the future will be of key importance. The economic upturn observed in the second half of last year should create favourable conditions for the loan portfolio quality. At the same time, strong monetary easing by the Monetary Policy Council significantly reduced loan servicing costs and has a stabilizing effect or leads to improvement of the financial position of some borrowers. On the other hand, it should be noted that even the fulfilment of clearly improved growth forecasts for the coming years will mean that the key categories will be nevertheless weaker than in the boom years of the past decade, which could exert negative pressure on the financial position of some borrowers, and thus on the loan portfolio quality and the performance of banks.

In the long period, a favourable effect on the loan portfolio quality will be exerted by PFSA recommendations, which were revised in recent periods and whose implementation into the universal banking practice should significantly strengthen the credit risk management process, as well as enhance the security of borrowers.

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ANNEX

**SELECTED RESULTS OF THE ANALYSIS
OF THE PORTFOLIO OF HOUSING LOANS TO HOUSEHOLDS
AS AT THE END OF 2013**

The material was prepared based on a survey of banks with a dominant position in the market of housing loans for households. The study reflects data as at the end of 2013 and covers 28 entities holding 97.7% of the total value of these loans²⁰.

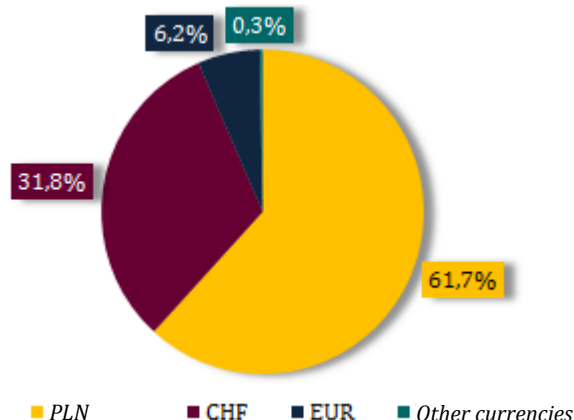
1. Selected characteristics of the structure and quality of the real estate loan portfolio

As at the end of 2013, banks' portfolios comprised 1.8m housing loans granted to households. In addition, banks' portfolios included 0.2m loans granted for other purposes but secured on residential property (see below).

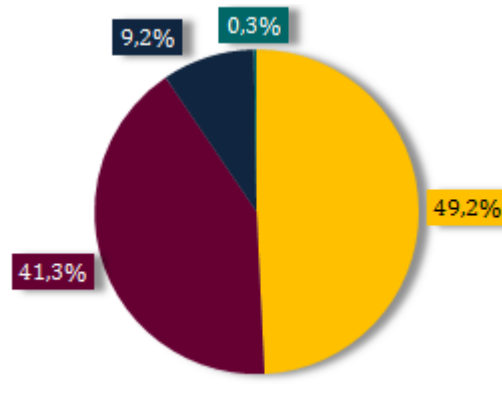
Loan portfolio structure by loan currency

	TOTAL	PLN	Currency	CHF	EUR	Other currencies
Number of loans	1 771 191	1 093 626	677 565	562 487	109 463	5 615
Amount of loans (m PLN)	328 768	161 877	166 891	135 684	30 271	936
Average loan amount ('000 PLN)	185.6	148.0	246.3	241.2	276.5	166.6

Share in the NUMBER of loans



Share in the AMOUNT of loans



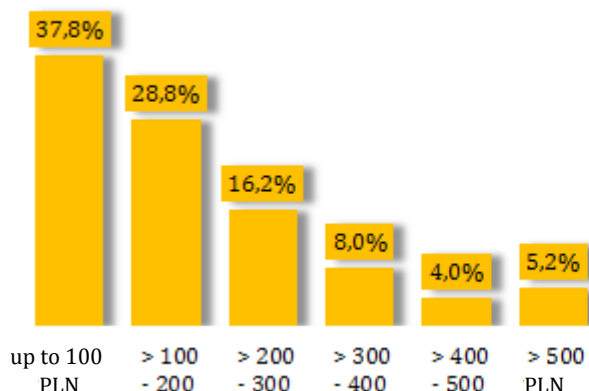
Most of the loans were granted in the Polish zloty, but in value terms, the shares of PLN and foreign currency loans were similar. The high share of foreign currency loans resulted from strong growth in 2007 and 2008 of loans granted, denominated in or indexed to the Swiss franc and the subsequent weakening of the Polish zloty against that currency. However, it should be noted that in 2013 there was a reduction in the number and amount of foreign currency loans (the number of loans decreased by 22,100 (including CHF loans by 18,000), and their amount decreased by PLN 10.1bn (including CHF loans by PLN 8.0bn) due to the gradual repayment and conversion of some non-performing loans.

²⁰While interpreting the results, one must take into account that some data provided by banks were expert estimates. In addition, not all banks provided complete data, or the data provided was not fully internally consistent and it was not possible to entirely eliminate the such inconsistency (this explains discrepancies as to the number and amount of loans in total, as presented in some tables or between the tables). Despite these reservations, the results of the analysis is a good estimation of the actual picture of housing loans.

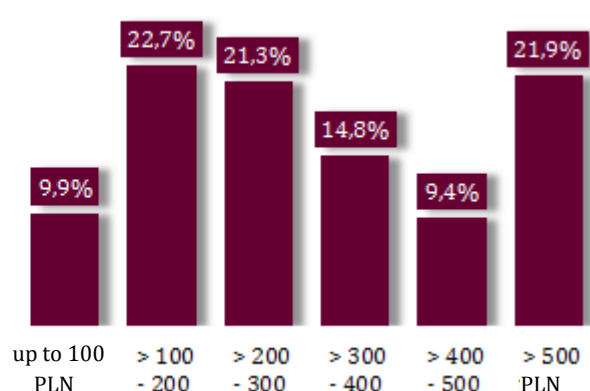
Loan portfolio structure by loan amount

	Number of loans			Amount of loans (m PLN)		
	TOTAL	PLN	Currency	TOTAL	PLN	Currency
TOTAL	1 771 191	1 093 626	677 565	328 768	161 877	166 891
up to PLN 100,000	669 502	481 853	187 649	32 430	22 936	9 494
> 100 - 200	510 461	340 396	170 065	74 525	49 513	25 012
> 200 - 300	287 055	163 263	123 792	70 157	39 805	30 353
> 300 - 400	141 793	60 998	80 795	48 654	20 855	27 799
> 400 - 500	70 165	23 130	47 035	31 057	10 209	20 848
> PLN 500,000	92 215	23 986	68 229	71 945	18 560	53 386

Share in the NUMBER of loans



Share in the AMOUNT of loans

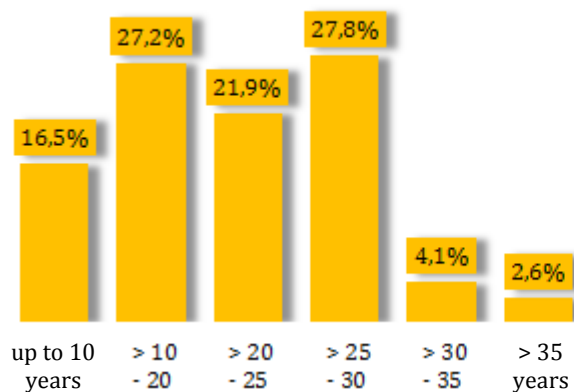


As far as the amount of a single loan is concerned, loans with amounts up to 200,000 prevail. What draws attention in the total amount of loans is relatively high share of loans with amounts over PLN 500,000 (it was also influenced by an increase in debt on account of foreign currency loans due to the weakening of the PLN).

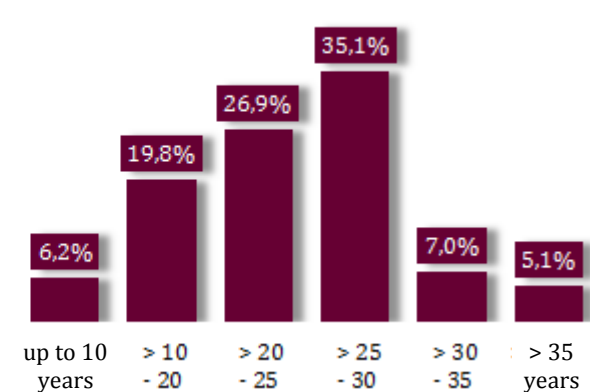
Loan portfolio structure by loan maturity

	Number of loans			Amount of loans (m PLN)		
	TOTAL	PLN	Currency	TOTAL	PLN	Currency
TOTAL	1 771 191	1 093 626	677 565	328 768	161 877	166 891
up to 10 years	291 903	216 097	75 806	20 282	13 755	6 527
> 10 - 20	481 100	309 718	171 382	65 086	36 807	28 278
> 20 - 25	388 024	178 568	209 456	88 484	29 332	59 152
> 25 - 30	492 838	338 539	154 299	115 341	69 034	46 306
> 30 - 35	72 635	31 028	41 607	22 891	7 534	15 357
> 35 years	45 690	19 676	26 014	16 685	5 414	11 272

Share in the NUMBER of loans



Share in the AMOUNT of loans

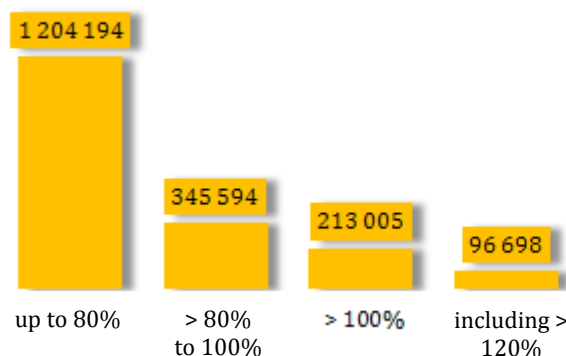


As far as loan maturity is concerned, loans with maturities of up to 25 years are dominant, but in terms of the total amount of loans, nearly half of them are loans with maturities over 25 years, which means banks' long exposure to credit risk.

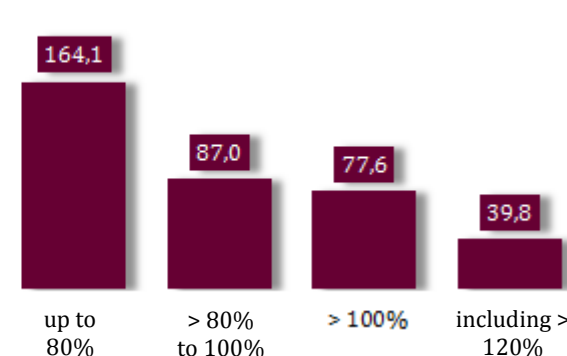
Loan portfolio structure by the current LTV ratio

	Number of loans				Amount of loans (m PLN)			
	TOTAL	PLN	Currency	CHF	TOTAL	PLN	Currency	CHF
TOTAL	1 762 793	1 085 278	677 515	562 441	328 694	161 803	166 891	135 684
up to 80%	1 204 194	777 750	426 444	359 082	164 126	92 739	71 387	58 451
> 80% - 100%	345 594	248 743	96 851	67 811	86 989	53 461	33 529	22 716
> 100%	213 005	58 785	154 220	135 548	77 578	15 603	61 975	54 517
including								
up to 50%	768 117	507 171	260 946	223 221	70 294	41 584	28 710	24 896
> 50% - 80%	436 077	270 579	165 498	135 861	93 832	51 155	42 677	33 555
> 80% - 90%	149 643	97 648	51 995	37 717	38 037	20 881	17 156	12 031
> 90% - 100%	195 951	151 095	44 856	30 094	48 952	32 579	16 373	10 685
> 100% - 110%	80 506	42 757	37 749	25 155	24 956	10 827	14 130	9 241
> 110% - 120%	35 801	8 609	27 192	23 119	12 785	2 325	10 460	8 755
> 120% - 130%	23 906	1 743	22 163	21 147	9 201	517	8 684	8 258
> 130% - 140%	19 649	825	18 824	18 460	7 883	266	7 617	7 457
> 140% - 150%	16 619	581	16 038	15 891	6 960	217	6 743	6 663
> 150% - 200%	31 917	1 845	30 072	29 767	14 022	797	13 225	13 072
> 200%	4 607	2 425	2 182	2 009	1 772	655	1 117	1 071

LTV structure of the loan portfolio
NUMBER of loans

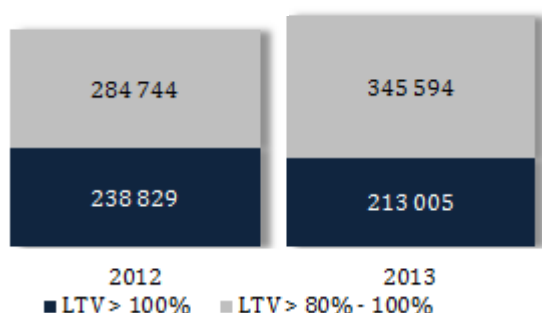


AMOUNT of loans (bn PLN)

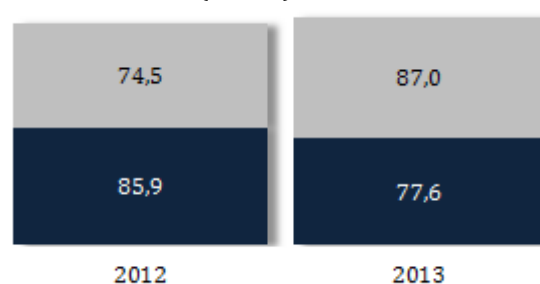


At the end of 2013, banks' portfolios comprised 213,000 housing loans (12.1% of the total number of loans) worth PLN 77.6bn (23.6% of the total amount of loans) whose current LTV ratio was higher than 100%, i.e. for which the current amount of liabilities exceeded the value of the property on which the loan was secured. In addition, banks had 345,600 loans (19.6% of the total number) amounting to PLN 87.0bn (26.5% of the total amount) with LTV > 80%. This means that 31.7% of loans representing 50.1% of their total amount was characterized by a high LTV ratio²¹.

NUMBER of loans



AMOUNT of loans (bn PLN)



In comparison to the survey as at the end of 2012, there was a reduction in the number and amount of loans with LTV > 100%, but at the same time there was an increase in the number and amount of loans with LTV >

²¹It should be noted that the data on the number of loans with high LTV ratios are slightly distorted by loans with relatively low amounts, which were granted for environmental investments (e.g. solar installations, where the loan is secured on the installation). However, this is irrelevant from the point of view of the amount of loans with high LTV ratios.

80%. A significant share of loans with high LTV ratios resulted from excessive risk taken by some customers and excessively liberal credit policy of some banks. Additionally, the fall in prices in the real estate market, which was observed in the years 2009-2012 and the strong weakening of the Polish zloty against the Swiss franc, which resulted from the global crisis, translated into an increase in the LTV ratio of loans extended at the peak of the boom in the real estate market.

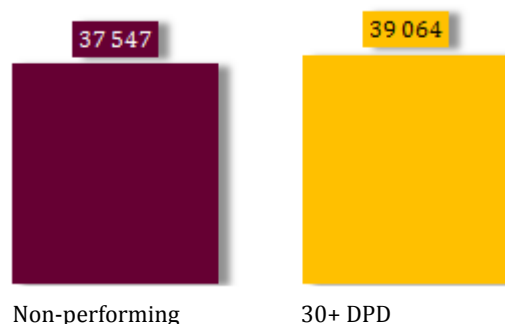
High LTV ratios of a portion of the loan portfolio raise concerns about the financial position of households not being able to repay such loans (including the inability to repay all liabilities to the bank by selling the property), and they may adversely affect the situation of the banks with a significant portfolio of such loans (in the event of a significant deterioration in their repay ability). An improper attitude of some customers and banks are the underlying cause of the provisions on the maximum LTV ratio for new loans and the minimum own contribution, which were added to the revised Recommendation S.

Non-performing and past due loans

	Number of loans			Amount of loans (m PLN)		
	2011	2012	2013	2011	2012	2013
Non-performing	29 512	34 052	37 547	7 262	8 935	10 317
30+ DPD	33 395	38 164	39 064	8 948	10 553	11 147
31-90 days	11 466	11 730	11 767	3 497	3 346	3 363
91-180 days	4 477	4 383	3 566	1 243	1 175	990
> 180 days	17 452	22 051	23 731	4 207	6 032	6 793

As at the end of 2013, banks' portfolios comprised 37,500 non-performing loans (2.1% of the total number of loans) and 39,100 of 30+ DPD loans (2.2% of the total number of loans). A limited increase in the number of 30+ DPD loans should be seen as beneficial, which may indicate a gradual stabilization of the loan portfolio quality.

NUMBER of loans

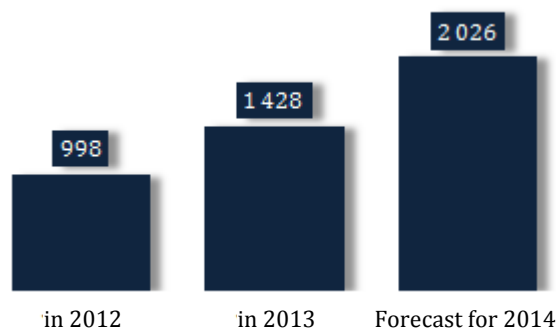


Sale and transfer of housing loans to off-balance-sheet records

	Number of loans			Amount of loans (m PLN)		
	Sale	Transfer to off balance-sheet records	Total	Sale	Transfer to off balance-sheet records	Total
In 2012	998	215	1 213	74	23	97
In 2013	1 428	299	1 727	300	41	341
Forecast for 2014	2 026	447	2 473	323	60	383

A modest increase in non-performing and past due loans in 2013 was partly due to the sale or transfer of some loans to off-balance sheet records, as it occurred in several banks. According to expectations, the scale of this phenomenon will gradually increase.

NUMBER of sold loans

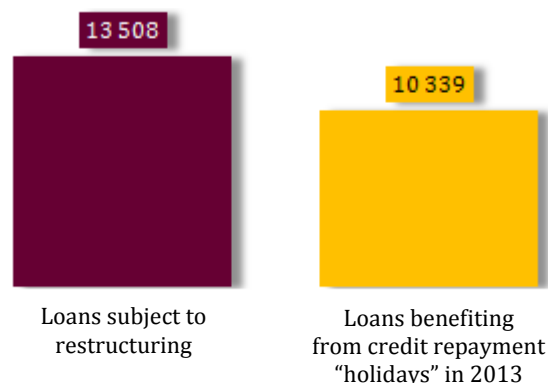


Loans covered by the restructuring process and benefiting from credit repayment "holidays"

	Number of loans			Amount of loans (m PLN)		
	Total	"Normal"	"Non-performing"	Total	"Normal"	"Non-performing"
Loans subject to restructuring	13 508	5 229	8 279	3 652	1 463	2 189
- reduction of liabilities	295	22	273	41	2	39
- extension of the repayment period	2 036	453	1 583	676	155	521
- suspension of repayment instalments	4 061	2 533	1 528	1 325	843	482
- other forms	7 116	2 221	4 895	1 610	462	1 148
Loan repayment "holidays" in 2013	10 339	10 237	102	2 937	2 911	26

In the context of the risk associated with housing loans, it should be kept in mind that there is a significant number and amount of loans covered by the restructuring process but shown as "normal" loans, as well as a large number of customers who in 2013 used the so-called loan repayment "holidays". It is true that for customers using the loan-repayment "holidays" most banks indicate no relationship between the use by customers of this form of the periodic reduction of the financial burden, and the future quality of these loans, but one of the banks with a key position in the market observed the relationship and concluded that *"borrowers applying for suspension of repayment have no financial surplus and are characterized by a higher probability of default"*.

NUMBER of loans

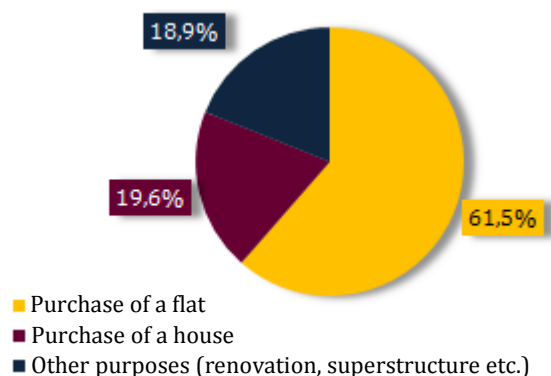


Structure and quality of loan portfolio by loan purpose

	Number of loans			Amount of loans (m PLN)				
	Total	Non-performing	30+ DPD	Total	Non-performing	Share	30+ DPD	Share
Total	1 771 191	37 547	39 064	328 768	10 317	3.1%	11 147	3.4%
1/ Purchase of a flat	1 083 315	19 947	20 978	202 050	5 434	2.7%	5 842	2.9%
- Warsaw	137 620	1 770	1 994	44 616	873	2.0%	999	2.2%
- Kraków	40 618	529	600	9 695	231	2.4%	259	2.7%
- Wrocław	44 545	607	708	10 620	217	2.0%	253	2.4%
- Poznań	33 540	531	583	7 300	178	2.4%	183	2.5%
- Łódź	24 611	444	515	4 038	128	3.2%	153	3.8%
- Katowice agglomeration	63 674	1 175	1 236	8 795	296	3.4%	317	3.6%
- Tricity (Gdańsk, Gdynia, Sopot)	47 821	1 004	1 109	11 050	334	3.0%	357	3.2%
- other	690 887	13 887	14 234	105 937	3 177	3.0%	3 322	3.1%
2/ Purchase of a house/building plot	298 641	7 262	8 009	64 418	2 466	3.8%	2 772	4.3%
3/ Other purposes (e.g. repair, etc.)	389 235	10 338	10 077	62 300	2 417	3.9%	2 533	4.1%
Additional information - "Family on its own" loans	159 008	676	712	26 307	114	0.4%	120	0.5%

From the point of view of the purpose for which a loan was granted, loans for the purchase of a flat are dominant, with a relatively large role of the Warsaw market.

Share in the AMOUNT of loans



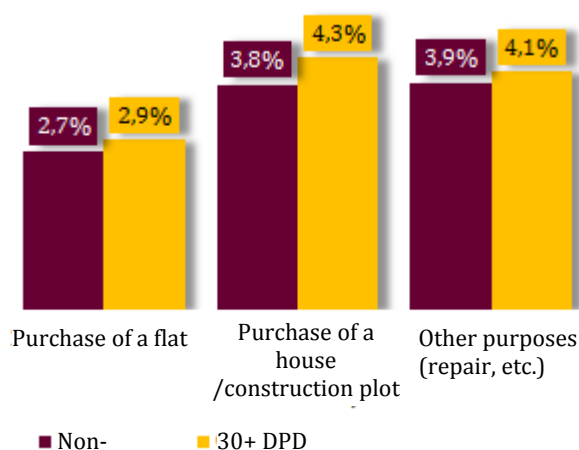
Taking into account the purpose of a loan, the highest quality is exhibited by loans granted for the purchase of a flat, while the quality of loans granted for the purchase of a house, a building plot or other purposes is lower.

It is worth noting that despite the large state aid in the repayment of loans granted under the “Family on its own” Programme and the record-low interest rates, 2013 saw an increase in non-performing and 30+ DPD loans in this group.

In the context of housing loans-related risk, the limited volume and liquidity of trading in the real property market must be taken into account.

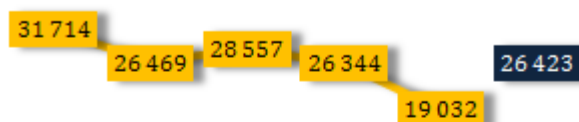
If a comparison is made between the number and amount of non-performing or 30+ DPD loans and the number and amount of transactions concluded over a year in local real estate markets, it turns out that these loans are a source of potential risk to the stability of these markets (for example in Warsaw they could account for 10% of annual turnover²², but this share may increase as a result of the gradual “maturing” of the portfolio). If banks (or other entities that acquired debt) decided to realise their claims by selling apartments in a short period of time, a negative pressure on market prices should be expected (prices in such transactions differ significantly from the market averages). This would also have a negative impact on sales realized by the real estate development companies (and their propensity to invest) and the participants in the secondary market.

Therefore, it is in the best interest of all market participants to maintain as high as possible loan quality.

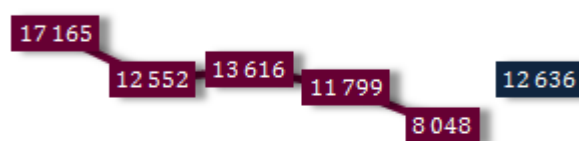


Turnover in the Warsaw real property primary and secondary market (Source: NBP)

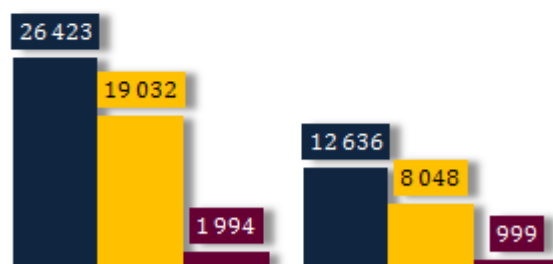
NUMBER of transactions



AMOUNT of transactions (m PLN)



2008 2009 2010 2011 2012 5-year average



Number of transactions/loans Amount of transactions/loans

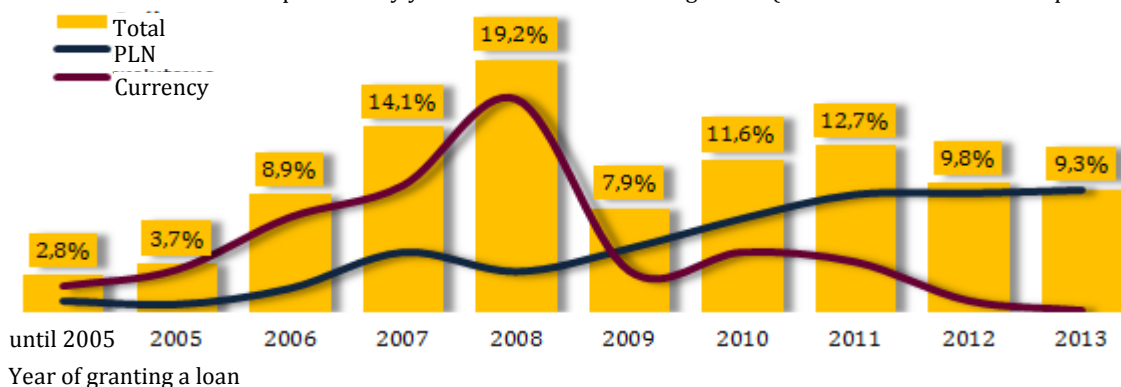
■ 2008-2012 average
■ in 2012
■ 30+ DPD loans

²² The presented account is incomplete because it does not include loans granted for other housing purposes (e.g. repairs) as well as loans that are not classified as housing loans, but are secured on residential property (e.g. consumer loans).

Structure and quality of loan portfolio by the year when a loan was granted

	until 2005	2005	2006	2007	2008	2009	2010	2011	2012	2013	TOTAL
Number of loans											
Total	155 787	113 429	183 808	213 833	233 813	141 147	189 397	199 424	170 134	170 419	1 771 191
PLN	67 242	29 685	67 538	116 176	70 135	105 013	142 711	163 156	162 527	169 443	1 093 626
Currency	88 545	83 744	116 270	97 657	163 678	36 134	46 686	36 268	7 607	976	677 565
Amount of loans (m PLN)											
Total	9 105	12 221	29 328	46 328	63 135	25 942	38 111	41 670	32 280	30 648	328 768
PLN	2 637	1 626	5 616	14 674	9 842	15 625	23 124	29 120	29 413	30 199	161 877
Currency	6 469	10 595	23 711	31 655	53 293	10 317	14 986	12 550	2 867	449	166 891
Quality of loans											
Number of loans											
Non-performing	5 313	2 996	4 586	6 865	9 071	3 528	2 661	1 561	617	349	37 547
30+ DPD	5 057	3 009	4 657	7 054	9 654	3 652	3 010	1 819	815	337	39 064
Amount of loans (m PLN)											
Non-performing	518	463	942	2 135	3 558	1 025	831	551	194	99	10 317
30+ DPD	503	509	1 005	2 293	3 823	1 084	967	639	240	84	11 147
Share in the amount of loans in a given year (%)											
Non-performing	5.7%	3.8%	3.2%	4.6%	5.6%	4.0%	2.2%	1.3%	0.6%	0.3%	3.1%
30+ DPD	5.5%	4.2%	3.4%	4.9%	6.1%	4.2%	2.5%	1.5%	0.7%	0.3%	3.4%

The structure of the loan portfolio by year in which the loan was granted (share in the amount of the portfolio)



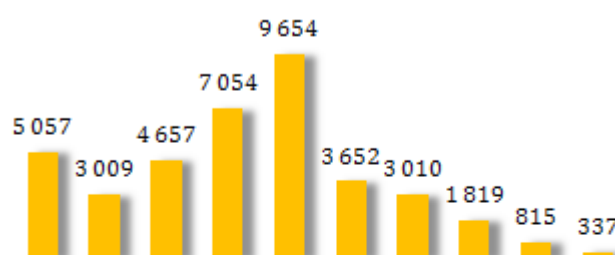
What draws attention in the portfolio's structure is a high share of loans granted at the peak of the boom in the property market and the successful limitation of sales of foreign currency loans in the years 2011-2013.

The lowest quality has the portfolio of loans from 2008, followed by the portfolio of loans from 2007, i.e. loans granted at the peak of the boom in the property market.

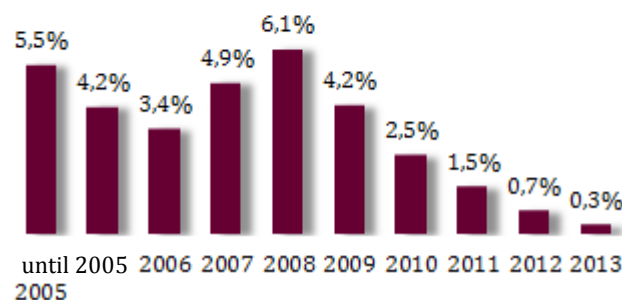
Noticeable is also quick deterioration of the quality of loans granted in 2009, with a much lower quality than in the years 2005 and 2006. The quality of 2010 loans also seems to be quite poor.

The relatively low quality of loans granted before 2005 is the result of the portfolio "maturing" process and a large number of loans repaid before maturity.

Number of 30+ DPD loans



Share of 30+ DPD loans



Reported and actual quality of loans per currency

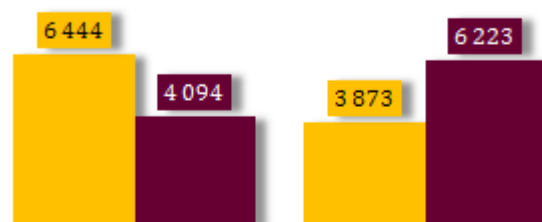
	Amount of loans (m PLN)	Number of loans (Art)
PLN LOANS		
1/ REPORTED data		
- loans in total	161 877	1 093 626
- including non-performing loans	6 444	25 948
- share of non-performing loans	4.0%	2.4%
2/ ADJUSTED reported data		
Increase (conversion of PLN loans into currency loans)		
- loans in total	3 501	12 246
- including non-performing loans	29	74
Decrease (conversion of currency loans into PLN loans)		
- loans in total	-2 921	-9 184
- including non-performing loans	-2 378	-6 709
3/ ADJUSTED data		
- loans in total	162 456	1 096 688
- including non-performing loans	4 094	19 313
- share of non-performing loans	2.5%	1.8%
CURRENCY LOANS		
1/ REPORTED data		
- loans in total	166 891	677 565
- including non-performing loans	3 873	11 599
- share of non-performing loans	2.3%	1.7%
2/ ADJUSTED reported data		
Increase (conversion of currency loans into PLN loans)		
- loans in total	2 921	9 184
- including non-performing loans	2 378	6 709
Decrease (conversion of PLN loans into currency loans)		
- loans in total	-3 501	-12 246
- including non-performing loans	-29	-74
3/ ADJUSTED data		
- loans in total	166 312	674 503
- including non-performing loans	6 223	18 234
- share of non-performing loans	3.7%	2.7%

Higher reported quality of currency loans is the result of conversion of a portion of non-performing currency loans into PLN loans and of a higher rate of early repayment of PLN loans. The reported data (appropriately adjusted) show that, as at the end of 2013, the quality of PLN loans was clearly higher as compared to currency loans. However, it should be taken into account that in recent years, the issue of currency loans was strongly restricted, and in the years 2012 and 2013 it was practically eliminated. As a result, the quality of foreign currency loans is now deteriorating faster than the quality of loans in zlotys, which have a constant “inflow” of new loans recognised as normal in the initial phase of their life cycle.

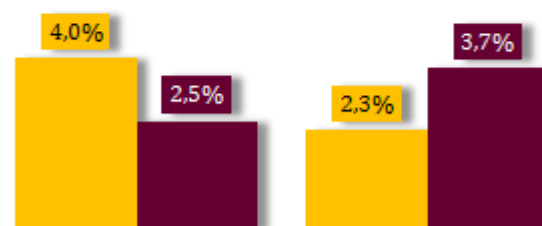
The number of non-performing loans in zlotys and in foreign currencies was similar (19,300 and 18,200, respectively).

Reporting and real quality of housing loans

AMOUNT of non-performing loans (m PLN)



SHARE of non-performing loans



PLN loans Currency loans

■ Reporting ■ Adjusted

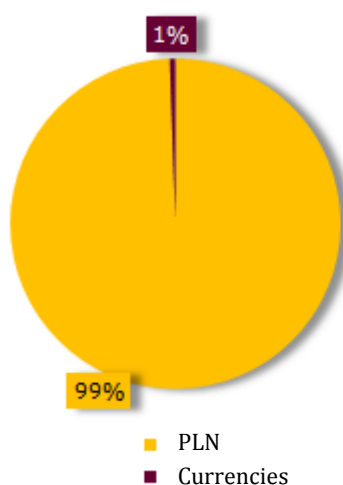
2. Lending structure and borrowers' profile in 2013

What draws attention in the structure of lending in 2013 is the elimination of the sale of foreign currency loans and marginalization of loans with maturities of over 30 years. Both these facts should be considered positive. On the other hand, an adverse increase in the share of extended loans with the highest LTV (especially in the second half of the year) was recorded. This, however, resulted from the revised Recommendation S (introducing provisions on the maximum LTV of new loans), which resulted in increased interest of some customers in this type of loans.

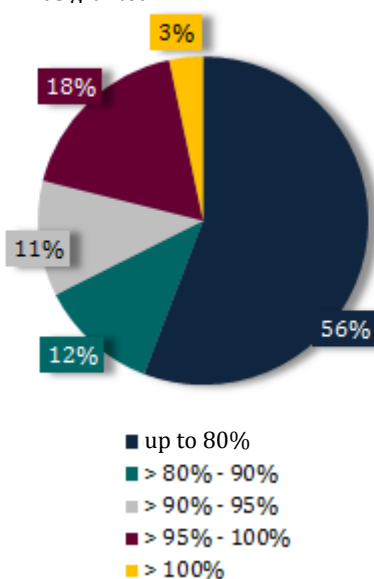
The scale and structure of lending in each quarter of 2013

	Number of loans					Amount of loans (m PLN)				
	TOTAL	Q1	Q2	Q3	Q4	TOTAL	Q1	Q2	Q3	Q4
Currency of loans										
Total	170 330	37 441	41 613	45 765	45 511	34 407	7 233	8 521	9 363	9 290
PLN	169 373	37 095	41 318	45 627	45 333	33 932	7 076	8 390	9 278	9 187
Currency	957	346	295	138	178	475	157	130	85	103
LTV of loans										
up to 80%	95 140	20 738	24 799	26 090	23 513	16 762	3 533	4 490	4 613	4 125
> 80% - 90%	19 989	4 563	4 622	5 279	5 525	5 160	1 114	1 217	1 385	1 444
> 90% - 95%	19 262	4 641	4 058	5 063	5 500	4 727	1 019	1 009	1 332	1 367
> 95% - 100%	30 259	6 577	6 845	7 701	9 136	6 844	1 413	1 618	1 783	2 031
> 100%	5 680	922	1 289	1 632	1 837	913	154	187	250	324
Crediting period										
up to 10 years	25 967	4 578	6 267	7 529	7 593	2 218	433	561	648	577
> 10 - 20	42 988	9 471	11 035	11 679	10 803	7 225	1 546	1 863	1 966	1 849
> 20 - 25	27 932	6 646	6 814	7 264	7 208	6 138	1 421	1 527	1 595	1 595
> 25 - 30	67 228	15 596	16 235	17 534	17 863	16 811	3 506	4 157	4 566	4 582
> 30 - 35	5 124	928	1 003	1 486	1 707	1 659	264	323	495	576
> 35 years	1 091	222	259	273	337	357	63	90	93	111
Amount of loan										
up to PLN 100,000	40 684	8 820	9 840	11 148	10 876	2 465	548	615	674	628
> 100 - 200	61 778	14 544	15 037	16 208	15 989	9 208	2 162	2 243	2 416	2 387
> 200 - 300	38 512	8 625	9 263	10 226	10 398	9 549	2 120	2 302	2 545	2 583
> 300 - 400	16 445	3 215	4 160	4 573	4 497	5 690	1 107	1 440	1 588	1 556
> 400 - 500	6 599	1 150	1 640	1 842	1 967	2 949	515	734	823	877
> PLN 500,000	6 312	1 087	1 673	1 768	1 784	4 546	782	1 187	1 317	1 260

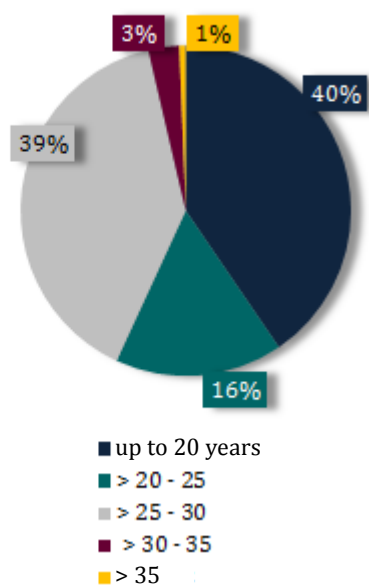
Share in the NUMBER of loans
Loan currency



LTV at the time when the loan was granted



Crediting period



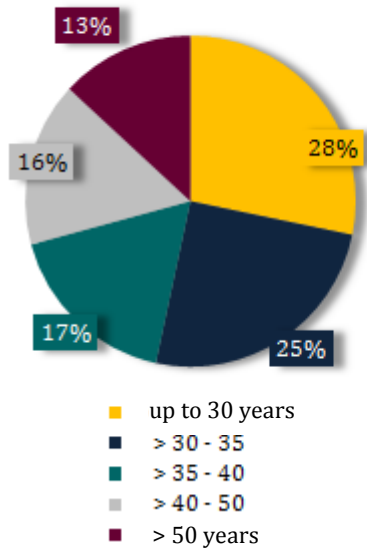
Borrowers' profile in 2013 and loan purpose

	Number of loans	Amount of loans (m PLN)	Average loan amount ('000 PLN)	Share in the number of loans	Share in amount of loans
Borrower's age					
up to 25 years	7 396	1 189	161	4.2%	3.4%
> 25 - 30	42 156	8 043	191	24.0%	22.9%
> 30 - 35	44 019	9 305	211	25.1%	26.5%
> 35 - 40	30 534	6 920	227	17.4%	19.7%
> 40 - 50	28 234	5 881	208	16.1%	16.8%
> 50 years	22 998	3 751	163	13.1%	10.7%
Borrower's education					
- primary	7 141	968	135	4.1%	2.8%
- secondary	46 402	7 230	156	26.6%	20.7%
- incomplete higher and higher	120 838	26 758	221	69.3%	76.5%
Borrower's characteristics					
- a single person	48 865	8 968	184	28.0%	25.7%
- a single person together with another member(s) of the family	10 766	2 107	196	6.2%	6.0%
- married couple	96 957	20 267	209	55.6%	58.0%
- married couple together with another member(s) of the family	7 094	1 262	178	4.1%	3.6%
- other	10 697	2 352	220	6.1%	6.7%
Primary source of income					
- permanent employment contract	117 639	23 242	198	67.1%	66.2%
- fixed-term employment contract	17 506	2 970	170	10.0%	8.5%
- self-employment	22 102	5 652	256	12.6%	16.1%
- other	18 089	3 226	178	10.3%	9.2%
The average monthly net income of borrowers (per loan application)					
up to PLN 2,000	12 428	1 672	135	7.1%	4.8%
> 2 - 4	65 372	9 342	143	37.3%	26.6%
> 4 - 6	46 390	9 056	195	26.5%	25.8%
> 6 - 8	22 225	5 283	238	12.7%	15.1%
> 8 - 10	11 241	3 181	283	6.4%	9.1%
> PLN 10,000	17 680	6 556	371	10.1%	18.7%
DTI at the time when the loan was granted					
up to 20%	21 368	2 845	133	12.2%	8.1%
> 20% - 30%	39 817	6 293	158	22.7%	17.9%
> 30% - 40%	50 159	9 804	195	28.6%	27.9%
> 40% - 50%	42 257	9 872	234	24.1%	28.1%
> 50% - 60%	16 520	4 697	284	9.4%	13.4%
> 60%	5 215	1 579	303	3.0%	4.5%
Purpose of the loan					
1/ Purchase of a flat	95 918	19 263	201	55.1%	55.1%
- Warsaw	13 981	4 481	320	8.0%	12.8%
- Kraków	5 059	1 250	247	2.9%	3.6%
- Wrocław	5 379	1 284	239	3.1%	3.7%
- Poznań	3 699	831	225	2.1%	2.4%
- Łódź	3 414	575	169	2.0%	1.6%
- Katowice agglomeration	5 141	717	139	3.0%	2.0%
- Tricity (Gdańsk, Gdynia, Sopot)	5 490	1 292	235	3.2%	3.7%
- other	53 755	8 833	164	30.9%	25.3%
2/ Purchase of a house /construction plot	30 029	7 500	250	17.3%	21.4%
3/ Other purposes (e.g. renovation, superstructure etc.)	48 130	8 215	171	27.6%	23.5%

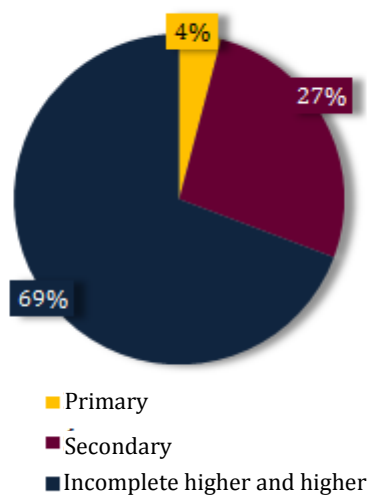
Notes:

- For some borrowers, the relevant amounts for the main borrower were adopted as a basis for the classification under a particular age, educational and source of income group.
- As far as monthly net income of borrowers is concerned (per loan application) it should be borne in mind that most of these loans are taken out by married couples (often with children), and therefore income is divided among several persons in the household.

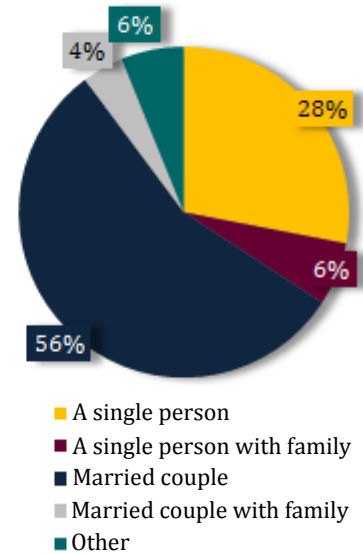
Share in the number of loans
Age



Education

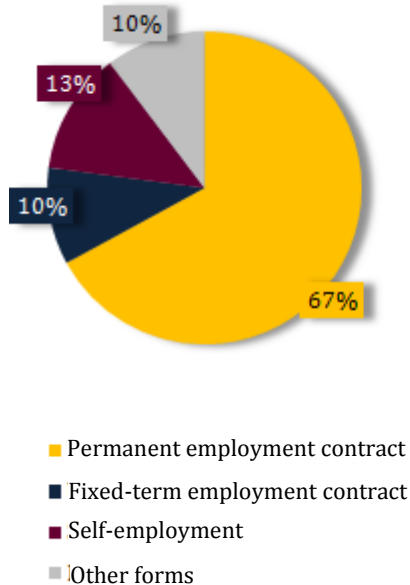


Family situation

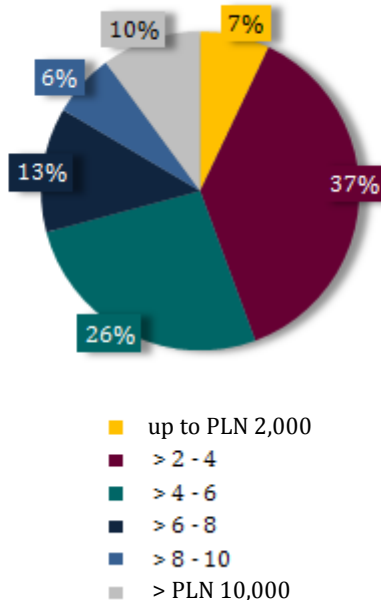


A characteristic feature of the structure of borrowers taking out a loan in 2013 is a strong dominance of people with higher or incomplete higher education. At the same time, most of the loans were taken out by married couples, some of whom were supported by other family members. More than half of the loans were granted to young people of 35 years of age or less.

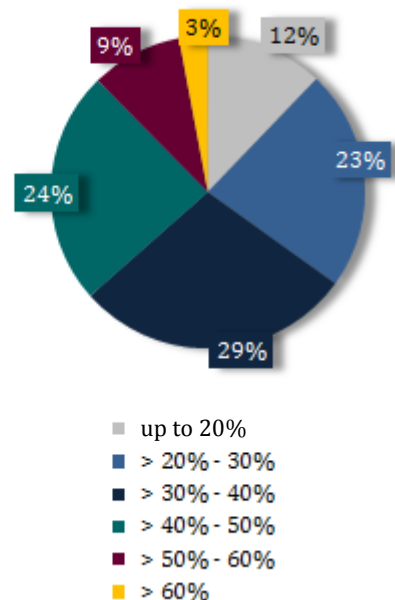
Form of employment



Monthly net income



DTI at the time when the loan was granted



The vast majority of loans were granted to persons whose primary source of income was hired labour exercised on the basis of a contract concluded for an indefinite period. The income situation of the majority of borrowers can be described as average or slightly better than average (it should be noted that most of the loans were granted to married couples, often with children, and therefore the appropriate income brackets should be divided by the number of people in the household). Most loans were granted at low or moderate DTI values (up to 40%). This, however, does not necessarily mean low risk for the bank and for the customer (the income situation and the structure of a household are of crucial importance - for some households, DTI at

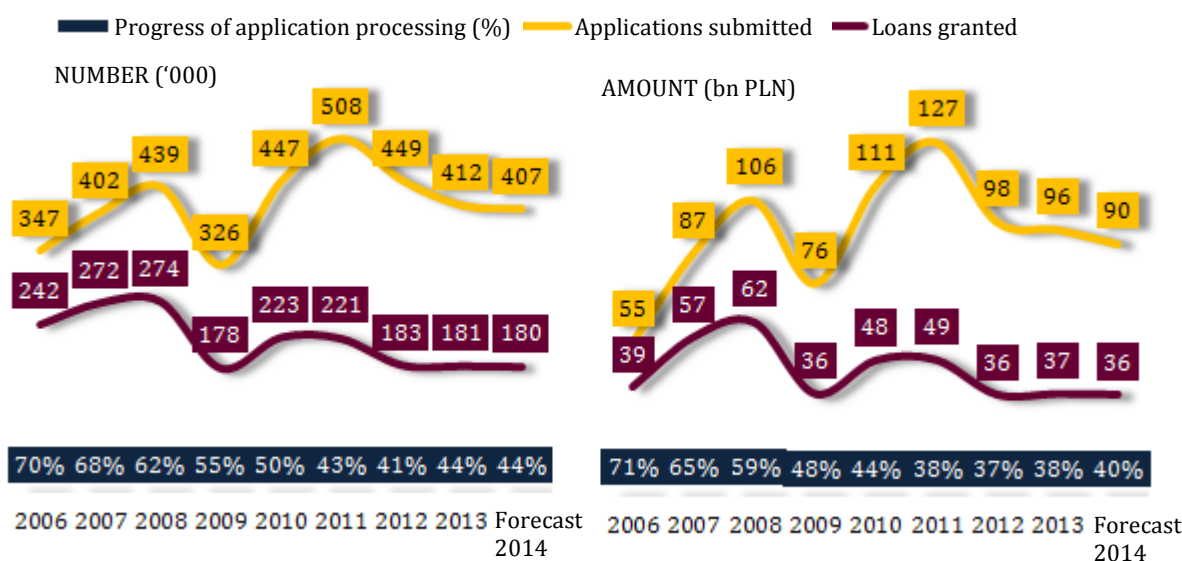
the level of 20-40% will also mean high risk). At the same time, more than one third of loans were granted at elevated or high DTI values (of over 50%), which in most cases will adversely affect the financial position of borrowers and limit their ability to incur large expenses and create savings. Although the increase in wages and salaries will reduce this ratio, it should be borne in mind that there is a parallel increase in the cost of living.

3. Demand for, and supply of, loans

The analysis of supply and demand²³ indicates that after a strong credit boom in the years 2007 and 2008, lending weakened in subsequent years due to reduced demand and the tightening of banks' credit policy (this is reflected in a lower level of acceptance of submitted applications). This is a consequence of both the experience gained in recent years, as well as the growing degree of satisfaction of credit needs.

Demand for, and supply of, loans

	2006	2007	2008	2009	2010	2011	2012	2013	Q1	Q2	Q3	Q4	Forecast 2014
Number of loans ('000)													
Applications	347	402	439	326	447	508	449	412	92	105	108	107	407
- PLN	182	253	157	252	333	408	437	410	91	104	108	107	406
- currency	165	149	282	74	114	100	12	2	1	1	0	0	1
Granted	242	272	274	178	223	221	183	181	40	45	49	47	180
- PLN	113	166	98	140	173	183	174	180	40	45	49	46	180
- currency	129	106	176	38	50	38	8	1	0	0	0	0	0
Progress	70%	68%	62%	55%	50%	43%	41%	44%	44%	43%	46%	43%	44%
- PLN	62%	66%	63%	56%	52%	45%	40%	44%	44%	43%	46%	43%	44%
- currency	78%	71%	62%	51%	44%	38%	72%	43%	46%	46%	35%	43%	50%
Amount of loans (bn PLN)													
Applications	55	87	106	76	111	127	98	96	21	25	25	26	90
- PLN	23	45	28	51	70	88	93	94	20	24	24	26	90
- currency	32	42	78	25	41	39	5	1	0	0	0	0	0
Granted	39	57	62	36	48	49	36	37	8	9	10	10	36
- PLN	14	28	16	25	32	35	33	36	8	9	10	10	36
- currency	25	29	47	11	17	14	3	0	0	0	0	0	0
Progress	71%	65%	59%	48%	44%	38%	37%	38%	38%	37%	40%	38%	40%
- PLN	60%	62%	55%	49%	45%	40%	35%	38%	38%	37%	40%	38%	40%
- currency	79%	69%	60%	45%	41%	35%	64%	40%	42%	38%	36%	43%	41%



²³ Caution should be exercised when analysing data on demand and supply, since not all banks were able to carry out an appropriate expert estimation.

4. Other mortgages

In the context of the housing loans-related risk, one must take into account that the banks' portfolios also include other mortgaged household loans.

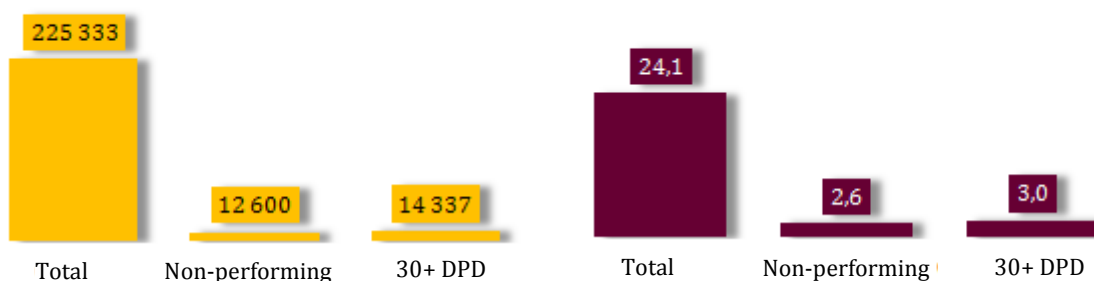
Other loans/mortgaged household loans²⁴

	Number of loans			Amount of loans (m PLN)		
	TOTAL	Non-performing	Past due > 30 days	TOTAL	Non-performing	Past due > 30 days
TOTAL	324 241	23 849	24 373	46 052	5 684	6 040
- consumer loans	176 938	12 897	14 473	16 024	2 386	2 905
- investment loans	54 000	6 187	4 518	15 095	2 077	1 736
- other real property loans	20 144	749	816	3 721	272	277
- other	73 159	4 016	4 566	11 212	948	1 122
Secured on residential property	225 333	12 600	14 337	24 142	2 588	3 006

Other loans to households secured on residential real property

NUMBER of loans

AMOUNT of loans

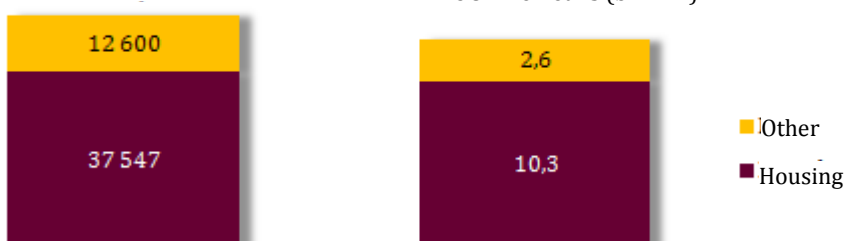


Among these loans, there were more than 200,000 loans secured on residential property, of which 12,600 loans were classified as non-performing and 14,300 loans were more than 30 days past due²⁵.

Non-performing loans secured on residential real property

NUMBER of loans

AMOUNT of loans (bn PLN)

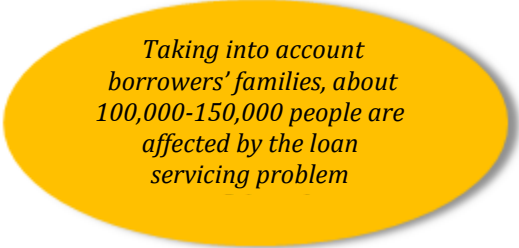


Taking into account other loans secured on residential property, it may be concluded that in banks' portfolios at the end of 2013 there were 50,100 non-performing loans worth PLN 12.9bn and secured on residential property (there were 53,400 loans more than 30 days past due, and their value amounted to PLN 14.1bn).

²⁴ The data presented does not take into account co-operative banks, which were not covered by the survey but have a portfolio of such loans worth nearly PLN 18bn. This data also does not include other commercial banks that were not covered by the survey. For the whole sector, the value of those loans was PLN 67.5bn (including PLN 22.5bn of investment loans, PLN 19.4bn of consumer loans, PLN 9.1bn for funding of other properties and PLN 16.6bn for other loans and receivables).

²⁵ As indicated above, the data does not include all banks.

Assuming in simplified terms that loans were incurred by a 2-3 person households, we can conclude that at the end of 2013, about 100,000-150,000 people were probably affected by the problem of servicing the debt on housing loans or other loans secured on residential property. It should be also noted that with the “maturation” of the portfolio, this number will gradually increase.



Taking into account borrowers' families, about 100,000-150,000 people are affected by the loan servicing problem

To sum up, despite the high quality of housing loans in comparison to other types of loans, the portfolio generates significant risk due to its size and unfavourable structure. In addition, a number of other risks should be borne in mind. Those risks arise from factors such as the lack of a fully satisfactory sources of funding, a limited volume of turnover in the housing market, imperfections associated with real estate market databases and the constraints associated with the possibilities of effective debt enforcement. High quality of the portfolio of these loans is also crucial for other participants in the real estate market, and, due to the scale of funding and the role of banks in the economy, also for long-term stability of the whole economy.

Consequently, it is necessary that banks fully adapt to best practices contained in Recommendation S, as amended by the PFSA in June 2013, which in the light of experience gained in recent years (domestic and foreign) sets a minimum framework for safe and socially responsible development of lending in this area. Full incorporation into the universal banking practice of provisions contained therein lies not only in the interest of banks and their customers (whose position and protection was further strengthened), but, as indicated above, also in the interest of other participants in the real estate market and the whole economy.

**SELECTED RESULTS OF THE ANALYSIS
OF CONSUMER LOANS
AS AT THE END OF 2013**

The material was prepared based on a survey of banks with a dominant position in the consumer credit market. The study reflects data as at the end of 2013 and covers 31 entities holding 95.1% of the total value of these loans²⁶.

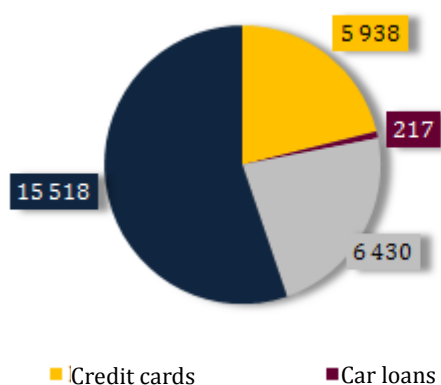
1. Selected characteristics of the consumer loan portfolio structure

As at the end of 2013, banks' portfolios comprised 28.1m consumer loans for the total amount of PLN 120.5bn and average amount of PLN 4,300.

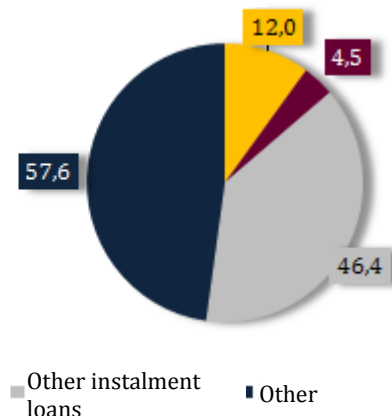
Loan portfolio structure according to FINREP reporting system

	Number ('000)		Amount (m PLN)		Average value ('000 PLN)	
	2013	2014 Forecast	2013	2014 Forecast	2013	2014 Forecast
Consumer loans in total	28 102	28 735	120 463	133 215	4,3	4,6
- credit cards	5 938	5 651	12 002	12 827	2,0	2,3
- car installment loans	217	219	4 507	4 542	20,8	20,8
- other installment loans ²⁷	6 430	6 150	46 351	52 690	7,2	8,6
- other consumer loans ²⁸	15 518	16 715	57 603	63 156	3,7	3,8

NUMBER of loans ('000)



AMOUNT of loans (bn PLN)



According to the classification in accordance with the FINREP reporting system, the loan portfolio is dominated by loans classified in category "other loans" and "other instalment loans" (without car loans). However, this system is not very transparent and provides a limited amount of information, and therefore the survey made an attempt to describe more precisely consumer loans' structure.

²⁶While interpreting the results, one must take into account that a significant portion of data provided by banks was expert estimates. In addition, not all banks provided complete data, or the data provided was not fully internally consistent and it was not possible to eliminate the such inconsistency entirely.

²⁷ This category also includes cash loans repaid on instalment basis.

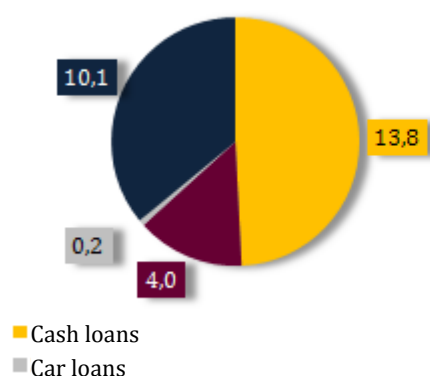
²⁸ This category also includes overdrafts and cash loans repaid on a one-off basis.

Loan portfolio structure according to the classification of banks - portfolio as at the end of 2013

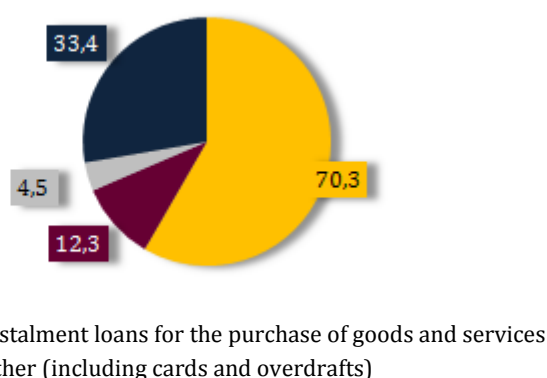
	Loan amount at the time when the loan was granted (PLN)									Total
	up to 2,000	> 2-4	> 4-6	> 6-8	> 8-10	> 10-15	> 15-30	> 30-50	over 50,000	
Number of loans ('000)										
Total	9 240	5 590	3 269	1 807	1 376	2 126	2 873	1 058	763	28 102
- cash loans	1 726	2 531	1 765	1 303	877	1 761	2 401	872	593	13 828
- instalment loans	1 948	1 263	370	91	36	40	123	45	41	3 956
- car loans	1	1	3	4	5	19	74	68	41	216
- other	5 565	1 795	1 132	409	458	306	274	73	89	10 101
of which non-performing	1 633	991	604	403	261	467	599	227	155	5 339
- cash loans	457	689	478	364	226	439	558	210	135	3 557
- instalment loans	177	127	38	7	4	3	7	4	2	368
- car loans	1	1	1	2	2	6	15	8	6	42
- other	998	174	86	30	28	18	19	6	12	1 372
share of non-performing	17.7%	17.7%	18.5%	22.3%	18.9%	21.9%	20.9%	21.5%	20.3%	19.0%
- cash loans	26.5%	27.2%	27.1%	27.9%	25.8%	24.9%	23.2%	24.1%	22.8%	25.7%
- instalment loans	9.1%	10.1%	10.2%	7.9%	9.8%	7.7%	5.3%	8.6%	5.8%	9.3%
- car loans	67.4%	74.1%	56.4%	46.9%	40.5%	31.6%	20.9%	11.3%	14.8%	19.6%
- other	17.9%	9.7%	7.6%	7.4%	6.2%	6.0%	6.9%	8.0%	13.2%	13.6%
Amount (m PLN)										
Total	6 871	7 488	7 068	4 563	5 060	9 550	23 030	15 839	40 995	120 463
- cash loans	939	2 019	2 858	2 515	2 609	7 069	17 686	11 821	22 786	70 302
- instalment loans	1 425	2 106	1 073	380	192	309	1 467	936	4 411	12 299
- car loans	3	3	8	16	27	134	989	1 559	1 758	4 497
- other	4 504	3 360	3 129	1 652	2 231	2 037	2 888	1 523	12 040	33 365
of which non-performing	1 168	974	1 063	728	737	1 448	3 118	2 284	6 496	18 015
- cash loans	312	364	604	518	477	1 200	2 515	1 829	3 641	11 460
- instalment loans	115	219	117	33	20	22	87	90	341	1 045
- car loans	1	3	5	9	12	45	213	179	311	778
- other	740	388	337	169	228	180	303	185	2 203	4 732
share of non-performing	17.0%	13.0%	15.0%	16.0%	14.6%	15.2%	13.5%	14.4%	15.8%	15.0%
- cash loans	33.2%	18.0%	21.1%	20.6%	18.3%	17.0%	14.2%	15.5%	16.0%	16.3%
- instalment loans	8.0%	10.4%	11.0%	8.6%	10.6%	7.2%	6.0%	9.6%	7.7%	8.5%
- car loans	41.4%	78.3%	63.7%	52.9%	43.9%	33.9%	21.5%	11.5%	17.7%	17.3%
- other	16.4%	11.6%	10.8%	10.2%	10.2%	8.8%	10.5%	12.2%	18.3%	14.2%

Assuming the actual purpose of loan granting as the basis for classification, i.e. cash loans, instalment loans for the purchases of goods and services, loans for the purchase of a car and loans for other purposes (including credit card account loans and current account loans), it can be stated that:

NUMBER of loans (m)

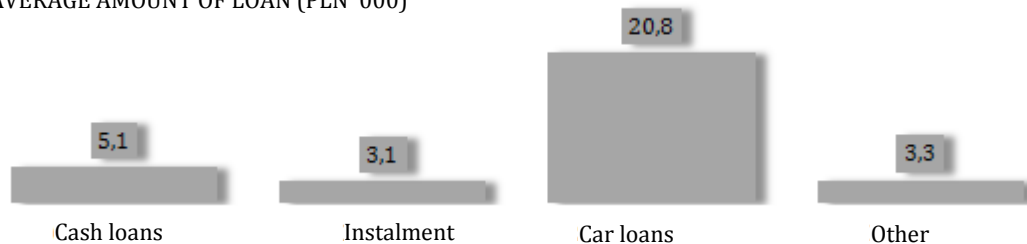


AMOUNT of loans (bn PLN)



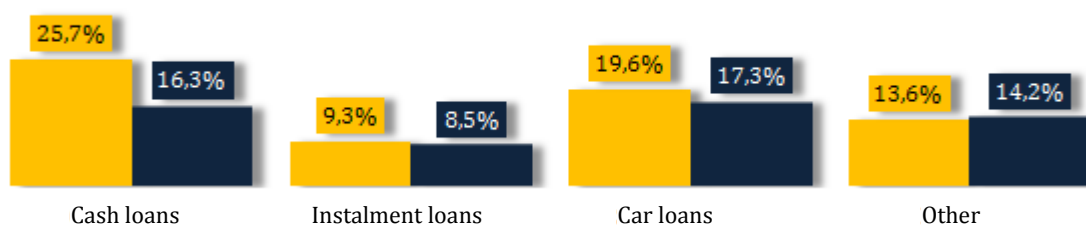
- the portfolios of banks are dominated by cash loans, which represent 49.2% of total loans and 58.4% of their total value. Cash loans are followed by other loans, a significant portion of which are credit card loans and current account loans, which also represent a type of cash loans;

AVERAGE AMOUNT OF LOAN (PLN '000)



- the highest average amount of loans is visible in the portfolio of car loans, whereas the lowest - in instalment and other loans;

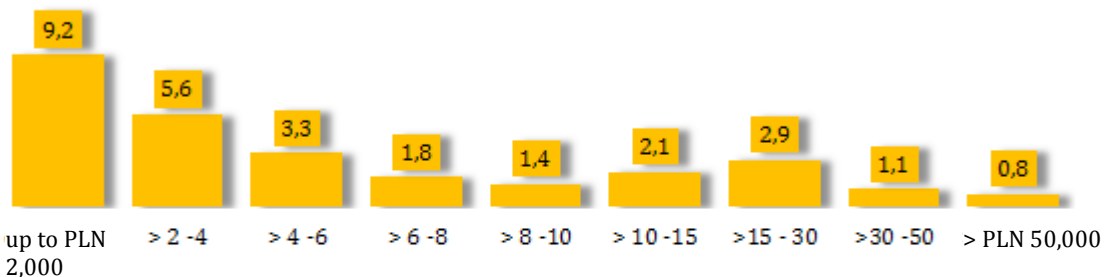
SHARE of NON-PERFORMING loans



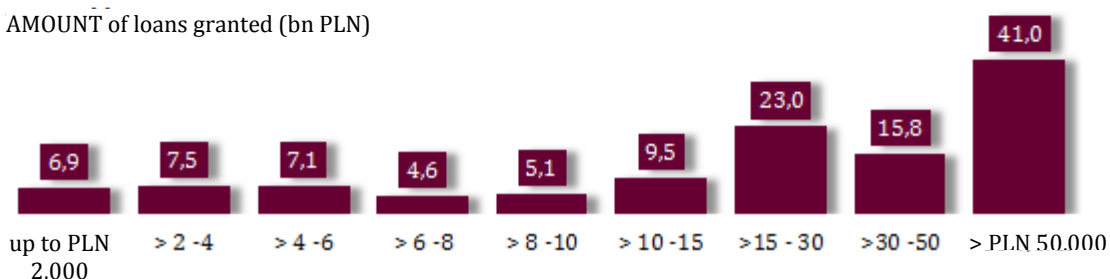
- taking into account the share of non-performing loans in the total number of loans granted, the highest "loss ratio" is visible in cash loan portfolio, whereas the lowest loss ratio in instalment loan portfolio (the ratios are similar in value terms, although the share of non-performing cash loans is significantly lower). It is worth noting that the low quality of car loans is probably related to the "aging" process of this portfolio (lending in this area has been decreasing for several years);

STRUCTURE of consumer loans by original loan amount

NUMBER of loans granted (m)



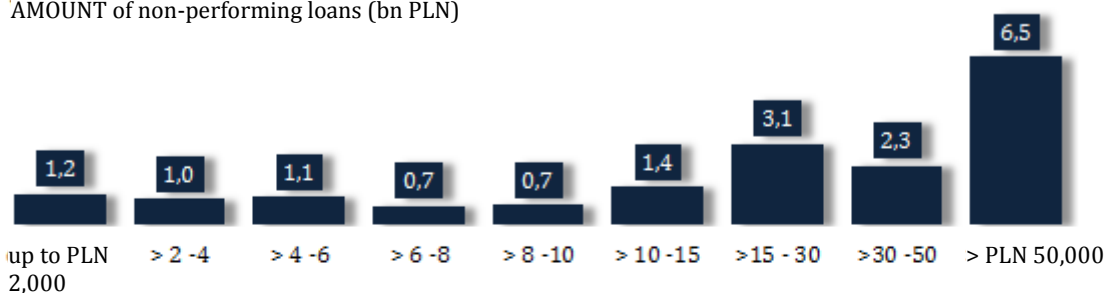
AMOUNT of loans granted (bn PLN)



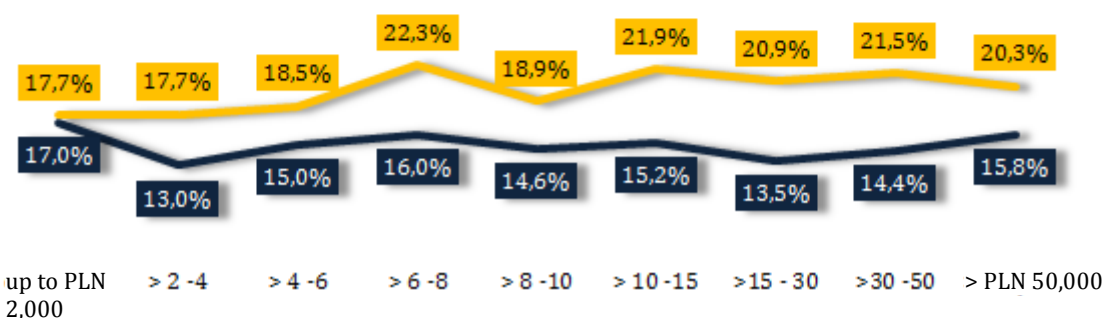
- the characteristic feature of the consumer loan portfolio is strong asymmetry - low-amount loans are dominant in the total number of loans (loans up to PLN 2,000 account for nearly one third of the total number of loans, but only 5.7% of the total portfolio value), and loans with highest amounts are dominant in the total amount of loans (loans of over PLN 50,000 represent more than one third of the entire loan portfolio, although their share in the total number of loans amounts to only 2.7%);

QUALITY of consumer loans by loan amount

AMOUNT of non-performing loans (bn PLN)



SHARE of NON-PERFORMING loans — in the amount of loans — in the number of loans granted



- the highest amount of non-performing loans is visible in loans with the highest amounts, which results from their dominance in the total value of the portfolio (non-performing loans in the portfolio of loans of over PLN 50,000 amount to PLN 6.5bn and represent 36.1% of the total value of non-performing loans).

The quality of the loan portfolio, due to the amount of the loan granted, is similar - the share of non-performing loans in the total number of loans amounts to 18-22%, and in their total amount - to 13-17% (it seems that the highest "loss ratio" concerns loans of over PLN 6,000, although the differences are small).

2. Loans granted under simplified rules

The revised Recommendation T, as adopted in February 2013, introduced, under certain conditions, a possibility to apply the so-called simplified rules for the creditworthiness assessment (the conditions refer to the nature of credit and the period of a customer's co-operation with the bank).

Loans granted under simplified rules

	Number and amount of loans granted			Loans at the end of the period				
	2013	Share	2014 forecast	Share	2013	Share	2014 forecast	Share
Number ('000)								
Total	7 063	100.0%	9 197	100.0%	28 102	100.0%	28 735	100.0%
under simplified rules	2 382	33.7%	4 597	50.0%	2 356	8.4%	4 094	14.2%
including 30+ DPD					29		129	
Amount (m PLN)								
Total	54 911	100.0%	83 813	100.0%	120 463	100.0%	133 215	100.0%
under simplified rules	8 548	15.6%	16 031	19.1%	6 679	5.5%	12 544	9.4%
including 30+ DPD					104		442	
Average loan amount ('000 PLN)								
Total	7.8		9.1		4.3		4.6	
under simplified rules	3.6		3.5		2.8		3.1	
including 30+ DPD					3.6		3.4	

Based on the data obtained it can be concluded that in 2013, banks granted 2.4m loans (or 33.7% of the total number of loans granted in 2013) for the total amount of PLN 8.5bn (i.e. 15.6% of the total amount of loans granted) under the simplified creditworthiness assessment rules²⁹.

A total of 23 out of 31 entities covered by the survey decided to grant such loans, and in the market of these loans, 3 entities specializing in providing instalment and cash loans were of key significance. They granted nearly 80% of loans (the amount of loans granted by these entities accounted for over 70% of the total amount of loans granted under the simplified rules). It is interesting that a few major participants of the consumer credit market have not decided to grant such loans at all or such loans are of marginal importance in their business. What is more, they also have no plans to introduce such loans in 2014, or to significantly expand the scale of operations in this segment.

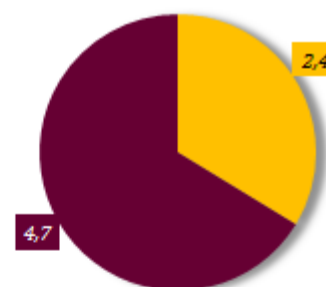
Despite a very high share in the total number of loans granted and a significant share in the total amount of loans granted, at the end of 2013 they accounted for only 8.4% of total number of consumer loans and only 5.5% of their total amount.

Their low share in the balance sheet resulted from relatively low amounts of these loans (average value of a loan granted according to the simplified rules was about PLN 3,600 compared to 9,900 for other loans) and short-term nature.

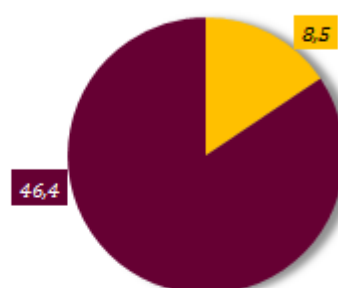
Due to the short history, it is difficult to assess the quality of these loans (at the end of 2013, 29,000 out of 2.4m loans in banks' balance sheets were more than 30 days past due, which accounted for only 1.2% of total number of loans), and the relevant forecasts presented by the banks tend to be overly optimistic in light of the experience arising from the nature of this business, and from the earlier quality of the portfolio of these banks.

LENDING IN 2013

NUMBER of loans granted (m)



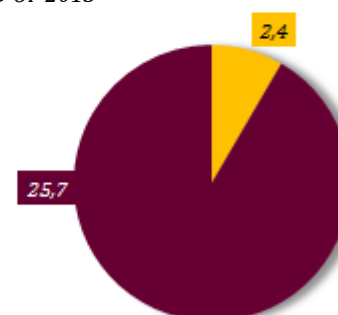
AMOUNT of loans granted (bn PLN)



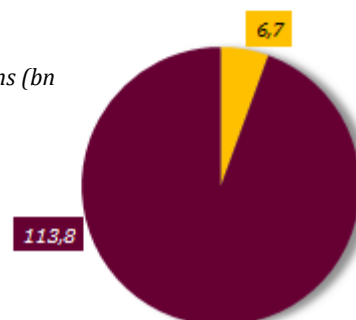
■ Under simplified rules ■ Other

LOANS AT THE END OF 2013

NUMBER of loans (m)



AMOUNT of loans (bn PLN)



■ Under simplified rules ■ Other

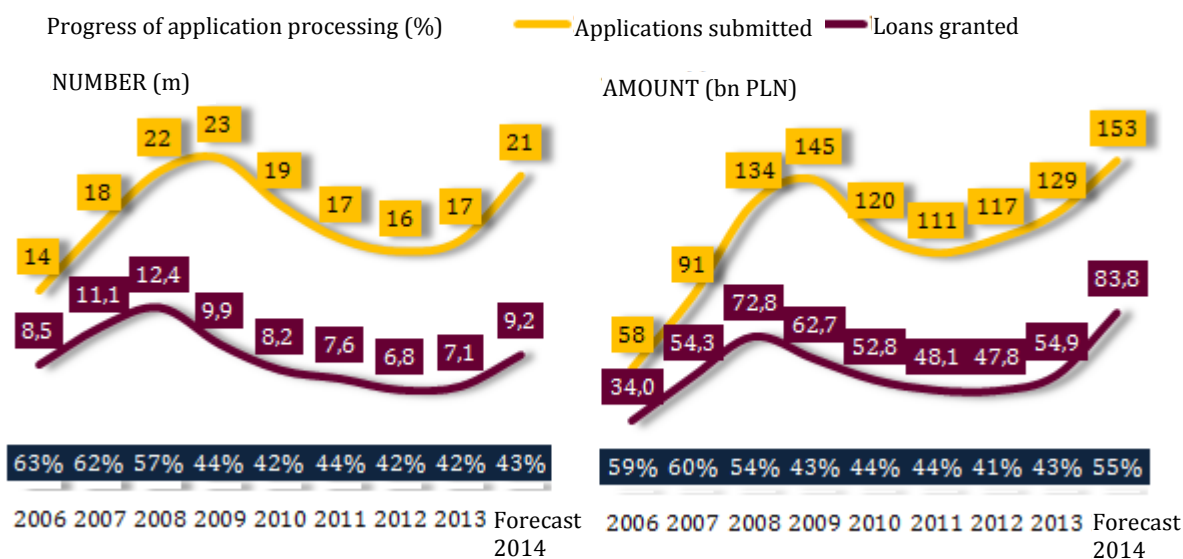
²⁹ The Bank may apply these principles in the case loans extended to retail customers, that is: 1/ installment loans for which the loan amount does not exceed four times the average salary in the corporate sector; 2/ to customers whose co-operation with the bank have lasted for least 12 and 6 months to the amount of 12 and 6 times the average monthly salary in the corporate sector, respectively, and to other customers - one average salary.

3. Demand for, and supply of, loans

The analysis of supply and demand³⁰ indicates that after a strong credit boom in the years 2008 and 2009, lending weakened in subsequent years due to reduced demand and the tightening of banks' credit policy (this is clearly reflected in a lower level of acceptance of submitted applications).

Demand for, and supply of, loans

	2006	2007	2008	2009	2010	2011	2012	2013	Q1	Q2	Q3	Q4	Forecast 2014
Number of loans (m)													
Applications	13.5	17.9	21.7	22.6	19.4	17.1	16.2	17.0	4.1	4.0	4.0	4.9	21.4
<i>under simplified rules</i>								4.6	0.3	0.6	1.4	2.3	7.8
Granted	8.5	11.1	12.4	9.9	8.2	7.6	6.8	7.1	1.4	1.6	1.8	2.2	9.2
<i>under simplified rules</i>								2.4	0.0	0.1	0.8	1.4	4.6
Progress	63%	62%	57%	44%	42%	44%	42%	42%	34%	40%	45%	46%	43%
<i>under simplified rules</i>								52%	2%	25%	60%	60%	59%
Amount of loans (bn PLN)													
Applications	57.9	90.6	133.6	144.7	119.8	110.7	117.0	129.0	31.0	31.3	31.8	34.9	153.4
<i>under simplified rules</i>								15.0	0.6	1.5	5.2	7.7	28.7
Granted	34.0	54.3	72.8	62.7	52.8	48.1	47.8	54.9	11.5	13.2	14.3	15.9	83.8
<i>under simplified rules</i>								8.5	0.1	0.6	3.1	4.8	16.0
Progress	59%	60%	54%	43%	44%	44%	41%	43%	37%	42%	45%	46%	55%
<i>under simplified rules</i>								57%	9%	39%	60%	62%	56%



In 2013, banks recorded an increase in demand, which should be attributed largely to the revision of Recommendation T and introduction of simplified rules for granting loans to its provisions. According to forecasts, in 2014 banks expect a significant strengthening of demand for, and supply of, loans, which will in their opinion be at levels similar or higher than those recorded in 2008 and 2009. In addition, much of the demand and supply is to be realised in the area of loans granted under the simplified rules. It is worth adding that these loans are characterized by significantly higher level of acceptance of applications by banks (this is justified due to their relatively low amounts of such loans).

³⁰ Caution should be exercised when analyzing data on demand and supply, since not all banks were able to carry out an appropriate expert estimation.

4. The loan portfolio “cleaning” process

One of the main reasons for a decrease in consumer loans, as observed in 2011 and 2012, was the process of “cleaning” the loan portfolio from “bad” loans generated in the years of the credit boom, and negligence in assessing creditworthiness and credibility of clients.

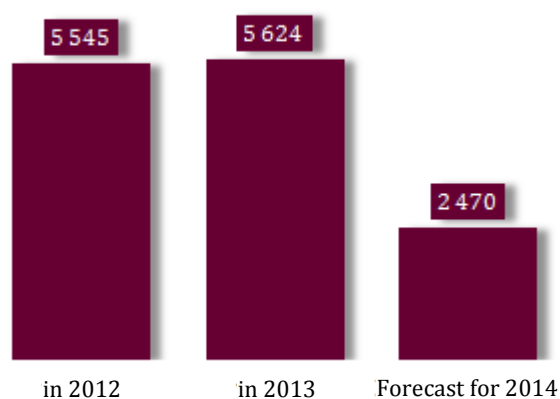
Sale and transfer to off-balance-sheet records of consumer loans

	Amount of loans (m PLN)		
	2012	2013	2014 forecast
Sale	4 278	4 231	1 756
Transfer to off balance-sheet records	1 267	1 393	714
Total	5 545	5 624	2 470

In 2013, banks continued the process of “cleaning” their balance sheets, as a result of which they sold or transferred to off-balance-sheet records consumer loans totalling PLN 5.6bn.

In 2014, this process will continue, but according to forecasts, its scale will be half lower than in previous years.

Sale and transfer of loans to off-balance-sheet records



SITUATION OF THE LARGEST BANKS AND THEIR STRATEGIC INVESTORS

Due to legal restrictions, the PFSA cannot publish the reporting data on individual banks. Therefore, the annex is based on consolidated data available through Bloomberg information agency.

Entities with total assets exceeding PLN 10bn and their dominant/strategic investors (as of 31/12/2013)

	Dominant/strategic investor
1 Powszechna Kasa Oszczędności Bank Polski	State Treasury
2 Bank Pekao	UniCredit
3 Bank Zachodni WBK	Banco Santander
4 BRE Bank	Commerzbank
5 Bank Gospodarstwa Krajowego	State Treasury
6 ING Bank Śląski	ING Bank
7 Getin Noble Bank	Leszek Czarnecki
8 Bank Millennium	Banco Comercial Portugues
9 Raiffeisen Bank Polska	Raiffeisen Bank International
10 Bank Handlowy w Warszawie	Citigroup
11 Bank Gospodarki Żywnościowej	Rabobank
12 Bank BPH	General Electric
13 Nordea Bank Polska	Nordea Bank
14 Deutsche Bank PBC	Deutsche Bank
15 Alior Bank	Carlo Tassara
16 Bank Polskiej Spółdzielczości	Co-operative banks
17 BNP Paribas Bank Polska	BNP Paribas
18 Bank Ochrony Środowiska	State Treasury
19 Credit Agricole Bank Polska	Credit Agricole
20 Santander Consumer Bank	Banco Santander
21 SGB-Bank	Co-operative banks
22 Euro Bank	Societe Generale

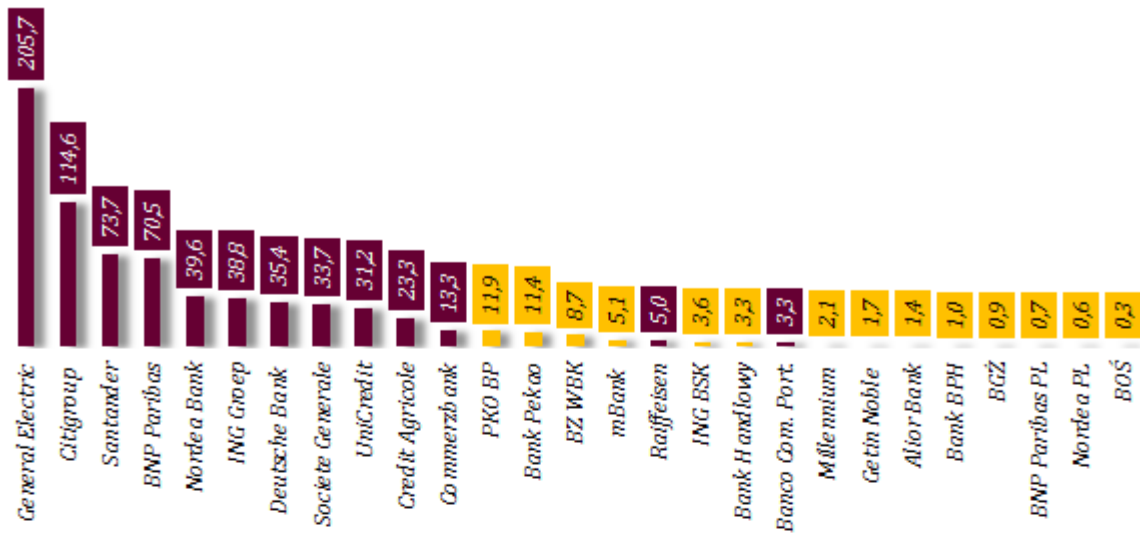
As at the end of 2013, the banking sector comprised 22 banks with total assets exceeding PLN 10bn; they jointly accounted for 86.3% of the sector's assets. 6 of the banks were controlled by the Polish capital, and the other by the foreign capital.

Despite the local nature of Polish banks' operations, as well as lower level of development of the economy and financial markets, and, in consequence, a lower scale of operations (measured by, for example, total assets³¹), the current financial position and valuation of Polish banks looks good as compared to other European banks (for ratings, the restricting/determining condition are also ratings of Poland and of the strategic investor). This is the effect of better development perspectives of Polish banks in the long-term and higher operating efficiency (more stable performance, lower C/I, higher ROE etc.).

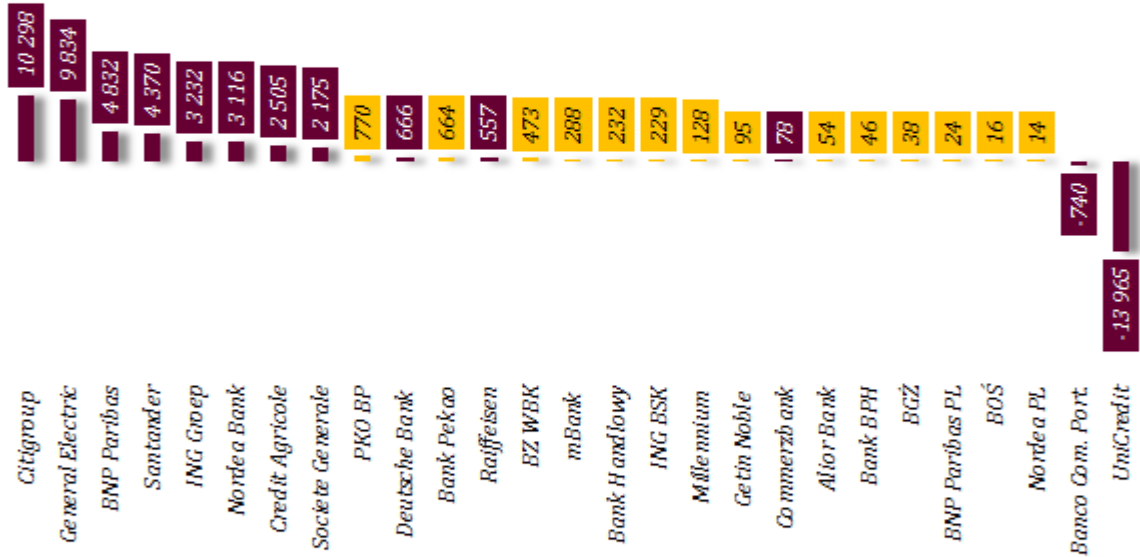
As far as profits generated by Polish banks are concerned, it should be noted that in recent years Polish banks had a significant favourable effect on the performance of some strategic investors (this concerned, in particular, Bank Pekao and UniCredit, mBank and Commerzbank as well as Bank Millennium and Banco Comercial Portugues).

³¹ Disproportions in terms of amounts of loans granted, deposits collected and equity are smaller (high total assets of the European banks are, to a large extent, the effect of a large scale of transactions with other instruments, which result in a strong increase in their total assets).

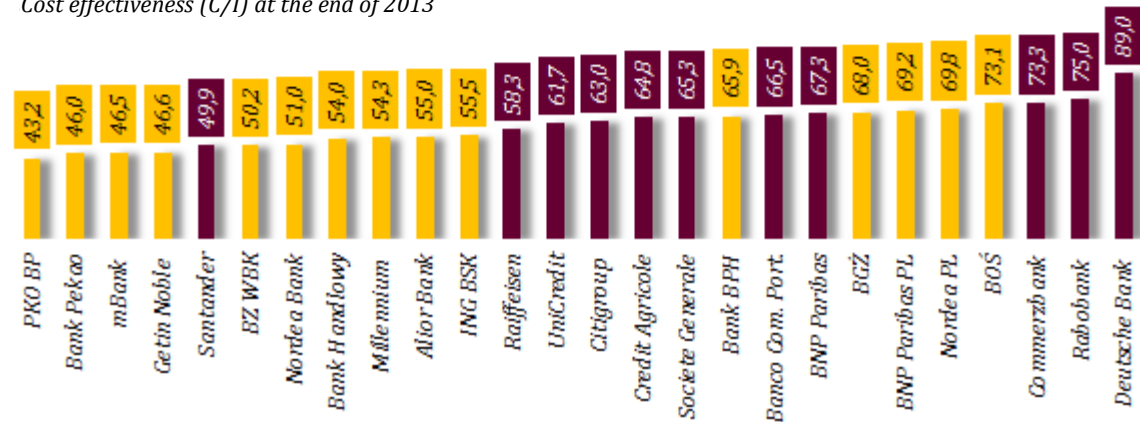
Market value at the end of 2013 (bn EUR)



Net income at the end of 2013 (EUR m)



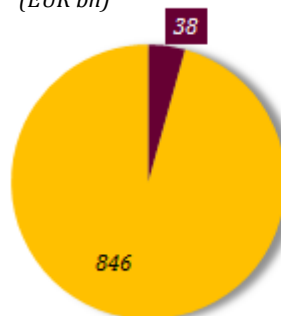
Cost effectiveness (C/I) at the end of 2013



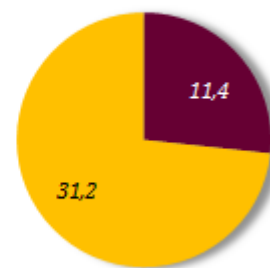
Bank Pekao versus UniCredit (EUR m)

	Bank Pekao	UniCredit
Total assets 2013	38 215	845 838
Net financial profit or loss		
2009	559	1 702
2010	633	1 323
2011	706	-9 206
2012	704	865
2013	664	-13 965
TOTAL	3 264	-19 281
Capitalization 2013	11 358	31 165

Total assets at the end of 2013 (EUR bn)



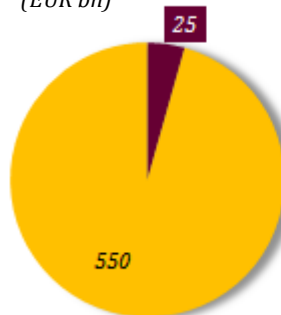
Market value



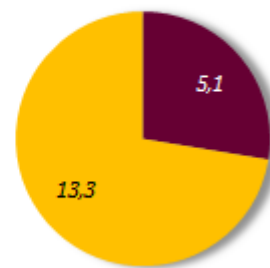
mBank versus Commerzbank (EUR m)

	mBank	Commerzbank
Total assets 2013	25 140	549 661
Net financial profit or loss		
2009	30	-4 537
2010	161	1 430
2011	276	638
2012	286	-47
2013	288	78
TOTAL	1 041	-2 438
Capitalization 2013	5 083	13 332

Total assets at the end of 2013 (EUR bn)



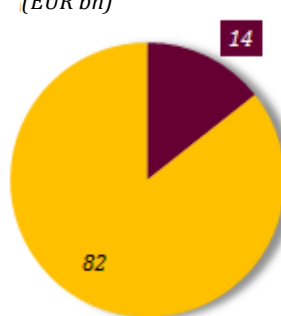
Market value



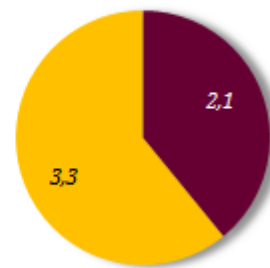
Bank Millennium versus Banco Comercial Portugues (EUR m)

	Millennium	Banco C. P.
Total assets 2013	13 745	82 007
Net financial profit or loss		
2009	0	225
2010	82	344
2011	114	-849
2012	113	-1 219
2013	128	-740
TOTAL	436	-2 238
Capitalization 2013	2 106	3 279

Total assets at the end of 2013 (EUR bn)



Market value



Selected figures as at the end of 2013 (EUR m)

	Assets	Loans	Deposits	Net profit or loss	C/I	ROE	Equity	Own funds	CAR	Market value	P/E	P/BV	Moody's financial strength	Employment
Banks listed at WSE														
PKO BP	48 029	37 673	36 223	770	43.2	13.0	6 064	5 136	13.6	11 879	15.3	2.0	C-	27 387
Bank Pekao	38 215	26 312	27 995	664	46.0	12.0	5 669	4 809	18.8	11 358	16.9	2.0	C-	18 916
Bank Zachodni WBK	25 575	17 256	18 894	473	50.2	17.4	3 491	2 808	13.9	8 741	18.3	2.6	D+	11 917
mBank	25 140	16 223	13 752	288	46.5	12.2	2 473	2 748	19.4	5 083	17.5	2.1	D	6 073
ING Bank Śląski	20 913	12 969	16 231	229	55.5	11.5	2 080	1 756	17.3	3 555	15.3	1.7	D+	8 619
Getin Noble Bank	15 336	12 636	12 412	95	46.6	8.8	1 152	1 415	12.4	1 706	17.5	1.5	D-	6 417
Bank Millennium	13 745	10 385	10 922	128	54.3	10.5	1 293	1 284	14.5	2 106	16.3	1.6	E+	5 881
Bank Handlowy w Warszawie	10 944	3 885	6 320	232	54.0	13.2	1 762	1 183	17.5	3 307	14.1	1.9	D+	4 812
Bank Gospodarki Żywnościowej	8 625	6 633	6 387	38	68.0	4.6	846	855	13.3	944	24.4	1.1	D	5 586
Bank BPH	7 956	6 030	3 221	46	65.9	4.0	1 196	9 019	14.0	1 007	21.7	0.8	D	5 449
Nordea Bank Polska	7 921	6 628	3 494	14	69.8	2.6	565	788	14.1	617	42.9	1.1	x	1 958
Alior Bank	6 159	4 933	5 034	54	55.0	11.0	527	563	12.1	1 374	22.7	2.6	x	6 512
BNP Paribas Bank Polska	5 091	4 260	2 626	24	69.2	5.8	435	524	12.4	650	26.4	1.5	x	2 794
Bank Ochrony Środowiska	4 440	2 980	3 181	16	73.1	4.5	357	372	13.3	259	14.9	0.7	x	1 913
Strategic investors for the largest Polish banks														
BNP Paribas	1 800 139	643 777	552 649	4 832	67.3	5.8	91 162	80 048	14.3	70 499	15.4	0.9	C-	185 000
Deutsche Bank	1 611 400	382 171	527 750	666	89.0	1.2	54 966	55 464	18.5	35 351	51.8	0.6	C-	98 254
Credit Agricole	1 536 873	312 536	473 355	2 505	64.8	6.4	47 889	47 300	15.8	23 277	9.4	0.6	D	75 529
Citigroup	1 363 700	501 230	702 207	10 298	63.0	6.9	149 491	131 959	16.6	114 620	10.6	0.8	x	251 000
Societe Generale	1 235 262	358 400	320 417	2 175	65.3	4.2	54 101	46 364	14.7	33 721	17.6	0.7	C-	154 000
Banco Santander	1 115 638	680 537	566 050	4 370	49.9	6.1	79 902	71 453	14.6	73 735	16.2	1.0	C-	182 958
ING Groep	1 080 624	x	474 320	3 232	x	6.4	52 843	46 496	16.5	38 783	15.5	0.8	x	76 050
UniCredit	845 838	545 688	410 930	-13 965	61.7	-25.5	50 175	57 651	13.6	31 165	29.5	0.5	D+	147 864
Rabobank	674 139	464 508	329 400	1 960	75.0	4.8	40 037	41 650	19.8	x	x	x	B-	56 870
Nordea Bank	630 434	345 243	200 743	3 116	51.0	10.9	29 209	28 040	18.1	39 619	12.7	1.4	C	29 429
Commerzbank	549 661	224 132	226 633	78	73.3	0.3	26 936	36 651	19.2	13 332	130.1	0.5	D+	52 944
General Electric	476 148	x	x	9 834	x	10.3	99 197	x	x	205 664	17.1	2.2	x	307 000
Raiffeisen Bank International	130 640	80 635	66 437	557	58.3	3.6	10 364	12 686	15.9	5 009	14.0	0.5	D+	57 901
Banco Comercial Portugues	82 007	60 222	48 960	-740	66.5	-26.4	3 276	6 421	14.6	3 279	2.5	1.4	E	18 660

Scale of operations

	Assets				Loans				Deposits				Employment		
	2012	2013	Change		2012	2013	Change		2012	2013	Change		2012	2013	Change
Banks listed at WSE (m PLN)															
PKO BP	193 151	199 231	6 080	3.1%	150 259	156 274	4.0%	145 342	150 256	3.4%	28 556	27 387	-4.1%		
Bank Pekao	150 755	158 522	7 767	5.2%	102 416	109 147	6.6%	102 898	116 129	12.9%	19 816	18 916	-4.5%		
Bank Zachodni WBK	60 019	106 089	46 070	76.8%	41 397	71 581	72.9%	47 077	78 376	66.5%	8 295	11 917	43.7%		
mBank	102 145	104 283	2 138	2.1%	67 451	67 295	-0.2%	56 100	57 044	1.7%	6 138	6 073	-1.1%		
ING Bank Śląski	78 267	86 751	8 484	10.8%	50 415	53 798	6.7%	57 858	67 330	16.4%	8 687	8 619	-0.8%		
Getin Noble Bank	58 485	63 617	5 132	8.8%	48 031	52 415	9.1%	50 185	51 486	2.6%	6 402	6 417	0.2%		
Bank Millennium	52 742	57 017	4 274	8.1%	41 470	43 078	3.9%	41 434	45 305	9.3%	6 001	5 881	-2.0%		
Bank Handlowy w Warszawie	43 509	45 398	1 890	4.3%	17 352	16 115	-7.1%	23 793	26 217	10.2%	4 812	4 812	0.0%		
Bank Gospodarki Żywnościowej	37 247	35 777	-1 470	-3.9%	27 394	27 514	0.4%	26 942	26 493	-1.7%	5 637	5 586	-0.9%		
Bank BPH	34 416	33 004	-1 412	-4.1%	27 825	25 013	-10.1%	13 015	13 361	2.7%	5 606	5 449	-2.8%		
Nordea Bank Polska	33 326	32 856	-470	-1.4%	26 770	27 494	2.7%	13 467	14 492	7.6%	2 011	1 958	-2.6%		
Alior Bank	21 181	25 550	4 369	20.6%	14 796	20 464	38.3%	17 463	20 880	19.6%	4 873	6 512	33.6%		
BNP Paribas Bank Polska	20 831	21 117	286	1.4%	17 362	17 671	1.8%	10 065	10 894	8.2%	2 815	2 794	-0.7%		
Bank Ochrony Środowiska	16 867	18 417	1 551	9.2%	11 420	12 360	8.2%	11 816	13 196	11.7%	1 979	1 913	-3.3%		
Strategic investors for the largest Polish banks (m EUR, m USD)															
BNP Paribas	1 907 200	1 800 139	-107 061	-5.6%	657 045	643 777	-2.0%	532 209	552 649	3.8%	188 551	185 000	-1.9%		
Deutsche Bank	2 022 275	1 611 400	-410 875	-20.3%	402 069	382 171	-4.9%	577 210	527 750	-8.6%	98 219	98 254	0.0%		
Credit Agricole	1 842 361	1 536 873	-305 488	-16.6%	325 294	312 536	-3.9%	462 162	473 355	2.4%	79 282	75 529	-4.7%		
Citigroup	1 864 660	1 880 382	15 722	0.8%	677 954	691 146	1.9%	930 560	968 273	4.1%	259 000	251 000	-3.1%		
Societe Generale	1 250 889	1 235 262	-15 627	-1.2%	371 564	358 400	-3.5%	305 153	320 417	5.0%	154 009	154 000	0.0%		
Banco Santander	1 269 600	1 115 638	-153 962	-12.1%	725 151	680 537	-6.2%	578 884	566 050	-2.2%	186 763	182 958	-2.0%		
ING Groep	1 166 191	1 080 624	-85 567	-7.3%	x	x	x	455 003	474 320	4.2%	77 835	76 050	-2.3%		
UniCredit	926 827	845 838	-80 989	-8.7%	553 506	545 688	-1.4%	368 479	410 930	11.5%	162 864	147 864	-9.2%		
Rabobank	752 410	674 139	-78 271	-10.4%	489 151	464 508	-5.0%	334 271	329 400	-1.5%	59 628	56 870	-4.6%		
Nordea Bank	668 178	630 434	-37 744	-5.6%	349 071	345 243	-1.1%	200 678	200 743	0.0%	29 491	29 429	-0.2%		
Commerzbank	636 023	549 661	-86 362	-13.6%	252 276	224 132	-11.2%	233 908	226 633	-3.1%	53 601	52 944	-1.2%		
General Electric	684 999	656 560	-28 439	-4.2%	x	x	x	x	x	x	305 000	307 000	0.7%		
Raiffeisen Bank International	136 116	130 640	-5 476	-4.0%	83 343	80 635	-3.2%	66 297	66 437	0.2%	60 084	57 901	-3.6%		
Banco Comercial Portugues	89 744	82 007	-7 737	-8.6%	66 861	60 222	-9.9%	49 346	48 960	-0.8%	21 297	18 660	-12.4%		

Financial performance

	Net profit or loss				Interest margin		C/I		ROA		ROE	
	2012	2013	Change		2012	2013	2012	2013	2012	2013	2012	2013
Banks listed at WSE (m PLN)												
PKO BP	3 739	3 230	-509	-13.6%	4.5	3.7	40.3	43.2	1.9	1.6	15.8	13.0
Bank Pekao	2 943	2 785	-158	-5.4%	3.6	3.1	45.6	46.0	2.0	1.8	13.2	12.0
Bank Zachodni WBK	1 434	1 982	548	38.3%	4.2	4.3	43.9	50.2	2.4	2.4	17.7	17.4
mBank	1 197	1 206	9	0.8%	2.5	2.3	45.7	46.5	1.2	1.2	13.6	12.2
ING Bank Śląski	832	962	129	15.5%	3.0	2.9	56.9	55.5	1.1	1.2	11.4	11.5
Getin Noble Bank	333	400	66	20.0%	2.4	2.2	38.1	46.6	0.6	0.7	7.8	8.8
Bank Millennium	472	536	64	13.5%	2.3	2.3	57.4	54.3	0.9	1.0	10.0	10.5
Bank Handlowy w Warszawie	970	973	3	0.3%	3.7	3.0	52.0	54.0	2.3	2.2	14.0	13.2
Bank Gospodarki Żywnościowej	130	160	30	23.1%	3.1	3.0	69.7	68.0	0.4	0.4	4.3	4.6
Bank BPH	259	192	-66	-25.6%	3.7	3.0	65.9	65.9	0.7	0.6	5.6	4.0
Nordea Bank Polska	145	60	-85	-58.9%	2.1	1.9	58.8	69.8	0.4	0.2	6.5	2.6
Alior Bank	61	228	167	272.8%	4.8	4.5	71.1	55.0	0.3	1.0	4.0	11.0
BNP Paribas Bank Polska	31	102	71	231.6%	2.6	2.7	x	69.2	0.1	0.5	2.0	5.8
Bank Ochrony Środowiska	34	66	32	94.7%	1.9	1.7	80.5	73.1	0.2	0.4	2.6	4.5
Strategic investors for the largest Polish banks (m EUR, m USD)												
BNP Paribas	6 564	4 832	-1 732	-26.4%	1.3	1.3	67.9	67.3	0.3	0.3	8.6	5.8
Deutsche Bank	263	666	403	153.2%	1.5	1.5	92.5	89.0	0.0	0.0	0.5	1.2
Credit Agricole	-6 471	2 505	x	x	0.9	0.9	64.8	64.8	-0.4	0.1	-16.7	6.4
Citigroup	7 541	13 673	6 132	81.3%	2.8	2.8	72.0	63.0	0.4	0.7	4.1	6.9
Societe Generale	790	2 175	1 385	175.3%	1.1	1.0	65.6	65.3	0.1	0.2	1.2	4.2
Banco Santander	2 295	4 370	2 075	90.4%	2.8	2.6	46.0	49.9	0.2	0.4	3.1	6.1
ING Groep	4 161	3 232	-929	-22.3%	x	x	x	x	0.3	0.3	8.0	6.4
UniCredit	865	-13 965	x	x	1.6	1.5	59.8	61.7	0.1	-1.6	1.5	-25.5
Rabobank	2 017	1 960	-57	-2.8%	1.4	1.4	65.6	75.0	0.3	0.3	4.7	4.8
Nordea Bank	3 119	3 116	-3	-0.1%	0.9	0.9	51.0	51.0	0.5	0.5	11.5	10.9
Commerzbank	-47	78	x	x	1.0	1.1	71.3	73.3	0.0	0.0	-1.2	0.3
General Electric	13 641	13 057	-584	-4.3%	x	x	x	x	1.9	1.9	11.4	10.3
Raiffeisen Bank International	730	557	-172	-23.6%	2.6	3.0	61.5	58.3	0.5	0.4	5.3	3.6
Banco Comercial Portugues	-1 219	-740	x	x	1.2	1.1	66.6	66.5	-1.3	-0.9	-35.6	-26.4

Capital adequacy

	Equity				Own funds				CAR		Tier 1	
	2012	2013	Change		2012	2013	Change		2012	2013	2012	2013
Banks listed at WSE (m PLN)												
PKO BP	24 436	25 154	718	2.9%	20 178	21 305	1 127	5.6%	12.9	13.6	11.2	11.2
Bank Pekao	23 264	23 514	251	1.1%	19 510	19 949	439	2.2%	18.8	18.8	17.0	18.6
Bank Zachodni WBK	8 978	14 483	5 505	61.3%	4 029	11 647	7 619	189.1%	16.5	13.9	x	x
mBank	9 619	10 256	638	6.6%	11 565	11 400	-165	-1.4%	18.7	19.4	13.0	14.2
ING Bank Śląski	8 136	8 629	493	6.1%	6 928	7 286	358	5.2%	14.8	17.3	13.5	14.2
Getin Noble Bank	4 359	4 780	422	9.7%	5 072	5 868	796	15.7%	11.5	12.4	x	x
Bank Millennium	4 824	5 363	539	11.2%	5 218	5 328	110	2.1%	13.2	14.5	11.6	13.4
Bank Handlowy w Warszawie	7 391	7 307	-84	-1.1%	6 421	4 909	-1 513	-23.6%	18.1	17.5	15.5	15.5
Bank Gospodarki Żywnościowej	3 473	3 509	37	1.1%	3 177	3 545	368	11.6%	11.8	13.3	x	x
Bank BPH	4 767	4 960	193	4.1%	40 244	40 244	0	0.0%	14.0	14.0	11.6	11.6
Nordea Bank Polska	2 283	2 343	60	2.6%	3 237	3 270	33	1.0%	14.2	14.1	x	x
Alior Bank	1 971	2 185	214	10.8%	2 152	2 336	184	8.6%	15.2	12.1	12.8	10.3
BNP Paribas Bank Polska	1 731	1 805	74	4.3%	2 375	2 174	-200	-8.4%	13.8	12.4	x	9.7
Bank Ochrony Środowiska	1 442	1 481	39	2.7%	1 532	1 543	11	0.7%	15.2	13.3	11.5	10.0
Strategic investors for the largest Polish banks (m EUR, m USD)												
BNP Paribas	94 017	91 162	-2 855	-3.0%	85 452	80 048	-5 404	-6.3%	15.5	14.3	13.6	12.8
Deutsche Bank	54 240	54 966	726	1.3%	57 015	55 464	-1 551	-2.7%	17.1	18.5	15.1	16.9
Credit Agricole	45 232	47 889	2 657	5.9%	38 600	47 300	8 700	22.5%	13.2	15.8	11.7	10.9
Citigroup	190 997	206 133	15 136	7.9%	167 686	181 958	14 272	8.5%	17.3	16.6	14.1	13.6
Societe Generale	53 551	54 101	550	1.0%	41 308	46 364	5 056	12.2%	12.7	14.7	12.5	13.4
Banco Santander	81 275	79 902	-1 373	-1.7%	72 936	71 453	-1 483	-2.0%	13.1	14.6	11.2	12.6
ING Groep	55 108	52 843	-2 265	-4.1%	47 270	46 496	-774	-1.6%	16.9	16.5	14.4	13.5
UniCredit	66 453	50 175	-16 278	-24.5%	62 018	57 651	-4 367	-7.0%	14.5	13.6	11.4	10.1
Rabobank	44 627	40 037	-4 590	-10.3%	42 375	41 650	-725	-1.7%	19.0	19.8	17.2	16.6
Nordea Bank	28 005	29 209	1 204	4.3%	27 274	28 040	766	2.8%	16.2	18.1	14.3	15.7
Commerzbank	26 250	26 936	686	2.6%	37 123	36 651	-472	-1.3%	17.8	19.2	13.1	13.5
General Electric	128 470	136 783	8 313	6.5%	x	x	#ARG!	#ARG!	x	x	x	x
Raiffeisen Bank International	10 873	10 364	-509	-4.7%	12 885	12 686	-200	-1.5%	15.6	15.9	11.2	11.2
Banco Comercial Portugues	4 000	3 276	-724	-18.1%	6 773	6 421	-352	-5.2%	12.7	14.6	11.7	12.9

Ratings

	Financial strength	Moody's			Standard & Poor's			Viability rating	FITCH		Support rating	Outlook
		Long-term	Short-term	Outlook	Long-term	Short-term	Outlook		Long-term	Short-term		
Banks listed at WSE												
PKO BP	C-	A2	P-1	negative	A-	A-2	negative	x	x	x	2	x
Bank Pekao	C-	x	x	stable	BBB+	A-2	stable	a-	A-	F2	2	stable
Bank Zachodni WBK	D+	Baa1	x	negative	x	x	x	bbb	BBB	F3	2	stable
mBank	D	Baa3	P-3	stable	BBB+	A-2	negative	bbb-	A	F1	1	negative
ING Bank Śląski	D+	Baa1	P-2	negative	x	x	x	bbb+	A	F1	1	negative
Getin Noble Bank	D-	Ba2	x	stable	x	x	x	bb	x	x	3	stable
Bank Millennium	E+	Ba2	NP	negative	x	x	x	bbb-	BBB-	F3	3	stable
Bank Handlowy w Warszawie	D+	Baa3	x	stable	x	x	x	bbb+	A-	F2	1	stable
Bank Gospodarki Żywnościowej	D	Baa3	x	stable	x	x	x	x	x	x	x	x
Bank BPH	D	Baa2	P-2	stable	x	x	x	x	x	x	x	x
Nordea Bank Polska	x	x	x	x	x	x	x	x	x	x	x	x
Alior Bank	x	x	x	x	x	x	x	bb	x	x	5	stable
BNP Paribas Bank Polska	x	x	x	x	x	x	x	x	x	x	x	x
Bank Ochrony Środowiska	x	x	x	x	x	x	x	bb	BBB	F3	2	negative
Strategic investors for the largest Polish banks												
BNP Paribas	C-	A1	x	stable	A+	A-1	negative	a+	A+	F1	1	stable
Deutsche Bank	C-	A2	x	negative	A	A-1	stable	and	A+	F1+	1	negative
Credit Agricole	D	A2	x	stable	A	A-1	negative	and	A	F1	1	stable
Citigroup	x	(P)Baa2	x	stable	A-	A-2	negative	and	A	F1	1	stable
Societe Generale	C-	A2	x	stable	A	A-1	negative	a-	A	F1	1	negative
Banco Santander	C-	Baa1	x	stable	BBB	A-2	stable	bbb+	BBB+	F2	2	stable
ING Groep	x	A3	x	negative	A-	A-2	stable	x	A	F1	1	negative
UniCredit	D+	Baa2	x	stable	BBB	A-2	negative	bbb+	BBB+	F2	2	negative
Rabobank	B-	Aa2	x	negative	AA-	A-1+	negative	x	AA-	F1+	1	negative
Nordea Bank	C	Aa3	P-1	stable	AA-	A-1+	negative	aa-	AA-	F1+	1	stable
Commerzbank	D+	Baa1	x	stable	A-	A-2	negative	bbb	A+	F1+	1	negative
General Electric	x	Aa3	x	stable	AA+	A-1+	stable	x	x	x	x	x
Raiffeisen Bank International	D+	A2	P-1	negative	A	A-1	negative	bbb	A	F1	1	negative
Banco Comercial Portugues	E	B1	x	negative	B	B	negative	b	BB+	B	3	negative

Marking-to-market

	Market value		Change (m, %)		P/E		P/BV	
	2012	2013			2012	2013	2012	2013
Banks listed at WSE (m PLN)								
PKO BP	46 125	49 275	3 150	6.8%	12.3	15.3	1.9	2.0
Bank Pekao	43 962	47 113	3 151	7.2%	14.9	16.9	1.9	2.0
Bank Zachodni WBK	18 055	36 258	18 203	100.8%	12.5	18.3	2.0	2.6
mBank	13 737	21 087	7 350	53.5%	11.5	17.5	1.4	2.1
ING Bank Śląski	11 839	14 747	2 908	24.6%	14.2	15.3	1.5	1.7
Getin Noble Bank	4 744	7 076	2 332	49.2%	12.7	17.5	1.1	1.5
Bank Millennium	5 362	8 734	3 372	62.9%	11.4	16.3	1.1	1.6
Bank Handlowy w Warszawie	12 844	13 719	875	6.8%	13.2	14.1	1.7	1.9
Bank Gospodarki Żywnościowej	2 805	3 915	1 110	39.6%	19.2	24.4	0.8	1.1
Bank BPH	3 748	4 178	430	11.5%	14.5	21.7	0.8	0.8
Nordea Bank Polska	1 382	2 558	1 176	85.1%	4.7	42.9	0.6	1.1
Alior Bank	3 983	5 698	1 715	43.0%	52.4	22.7	2.0	2.6
BNP Paribas Bank Polska	1 435	2 697	1 262	88.0%	43.0	26.4	0.8	1.5
Bank Ochrony Środowiska	686	1 075	389	56.7%	17.6	14.9	0.5	0.7
Strategic investors for the largest Polish banks (m EUR, m USD)								
BNP Paribas	53 404	70 499	17 095	32.0%	8.2	15.4	0.7	0.9
Deutsche Bank	30 627	35 351	4 724	15.4%	117.7	51.8	0.6	0.6
Credit Agricole	15 198	23 277	8 079	53.2%	62.9	9.4	0.4	0.6
Citigroup	116 011	158 050	42 039	36.2%	8.7	10.6	0.6	0.8
Societe Generale	22 113	33 721	11 608	52.5%	42.9	17.6	0.5	0.7
Banco Santander	62 959	73 735	10 776	17.1%	27.4	16.2	0.9	1.0
ING Groep	27 055	38 783	11 729	43.4%	11.4	15.5	0.5	0.8
UniCredit	21 468	31 165	9 697	45.2%	20.3	29.5	0.3	0.5
Rabobank	x	x			x	x	x	x
Nordea Bank	251 502	350 928	99 426	39.5%	9.5	12.7	1.0	1.4
Commerzbank	8 360	13 332	4 972	59.5%	8.0	130.1	0.4	0.5
General Electric	220 107	283 590	63 482	28.8%	13.9	17.1	1.8	2.2
Raiffeisen Bank International	6 150	5 009	-1 141	-18.6%	11.6	14.0	0.6	0.5
Banco Comercial Portugues	1 478	3 279	1 801	121.8%	2.5	2.5	0.5	1.4

DIVISION OF THE LOAN PORTFOLIO – METHODOLOGY APPLIED BY THE PFSA

Financial sector (excluding banks and branches of credit institutions)

Non-financial sector

- Business enterprises
 - SMEs
 - Operating
 - Investment
 - Real property
 - Other loans and receivables
 - Large companies
 - Operating
 - Investment
 - Real property
 - Other loans and receivables
- Households
 - Housing
 - PLN
 - Currency
 - Consumer
 - Credit cards
 - Car loans
 - Instalment loans
 - Other
 - Other
 - Operating
 - Investment
 - Real property
 - Other loans and receivables
- Non-profit institutions serving households

General government

- Central government institutions
- Self-government institutions
- Social security funds

Operating loans - loans for funding current operations of a company or a farm, i.e., for example, for payment of liabilities to suppliers, for salaries and running costs. This item also includes discount loans, export loans and overdrafts (except for overdrafts for individuals).

Investment loans – loans for funding new (or for increasing existing) production and service capabilities of the borrower and for other undertakings carried out as joint or accompanying investments, granted for funding undertakings aimed at: reconstruction, modernisation or extension of fixed assets, except for car loans and real property loans (reported under a separate item). If a loan is granted for various purposes (purchase of a land, construction of a plant, purchase of machines and equipment etc.), then such loan should be classified according to the purpose to which the largest portion of the loan was allocated.

Housing loans – by convention, these are loans granted to households for: purchase, construction, reconstruction, expansion or for a superstructure of a house or a flat (being a separate real property) or for adaptation of non-residential premises (buildings) into residential ones, purchase of a co-operative title to a residential unit or a separate ownership right to a residential unit from a housing co-operative, for repair of a house or a unit referred to above, for purchase of a construction plot (or of its part) for construction of a single-family house or an apartment building comprising a given residential unit, for other purposes connected with satisfying housing needs, in particular for covering costs of participation in the flat construction costs by social construction societies.

Real property loans – other housing loans (granted to entities other than households), loans for commercial real properties and loans for other real properties.

Consumer loans – loans for individuals for purposes other than business activity or operating a farm. Those loans include:

- **credit card** loans – funds used under a credit limit granted by a bank for a given credit card, with no restrictions as to purpose of a loan and independently of the adopted form of repayment;
-
- **car** loans;
- **instalment** loans – loans repaid in instalments (usually during 1-3 years), granted for consumption-related purposes (e.g. purchase of household appliances) or for funding current expenses of households (e.g. holiday loans, etc.). This category also include balloon loans. **This category does not include car loans and single payment loans;**
- **other** – loans repaid in a **single transaction**. This item also includes **overdraft facilities** for households, for purposes other than business activity or operation of a farm.

Other loans and receivables – other loans (not allocated to any of the groups listed above) and other receivables.

DIVISION OF THE ECONOMY BY SECTORS³²

Financial sector

- Monetary financial institutions
 - Central banks
 - NBP
 - Central banks – non-resident
 - Other monetary financial institutions
 - Banks and branches of credit institutions
 - Other monetary financial institutions
 - Co-operative savings and loan unions
 - Money market funds
- Other financial sector institutions
 - Insurance institutions
 - Pension funds
 - Other financial intermediaries
 - Investment funds (except for money market funds)
 - Other financial intermediaries (except for investment funds)
 - Financial auxiliaries
 - International financial organisations (only non-residents)

Non-financial sector

- Business enterprises
 - SMEs
 - Large companies
- Households
 - Individual entrepreneurs
 - Individuals
 - Individual farmers
- Non-profit institutions serving households

General government

- Central government institutions
- Self-government institutions
- Social security funds

³² This is a slightly modified extract from the *Supplementary Instructions to the FINREP Package*, NBP.

FINANCIAL SECTOR – entities whose main object is financial intermediation, i.e. purchasing financial assets and incurring liabilities for their own account, as a result of carrying out financial transactions in the market, as well as entities providing services auxiliary to financial intermediation.

Central banks – the National Bank of Poland – operating under the Act of 29 August 1997 on the National Bank of Poland (Dz.U. of 2005, No 1, item 2, as amended). **Central banks – non-resident** – an institution in the non-resident’s country, acting as a monetary authority, whose basic objective is to issue domestic currency and to maintain all, or a portion of, currency reserves of the state. A central bank can also provide other services, such as control of the money and loan supply in the economy, the exchange rate policy, financial services for the state sector, supervision of the banking system, maintenance of banks’ reserves and refinancing of banks, organising money settlements. Some of the above services can be provided by other institutions. This category also includes the European Central Bank.

Other monetary financial institutions – financial institutions whose object is to accept deposits and/or close substitutes of deposits from entities other than monetary financial institutions, and to grant loans and/or invest in securities for their own account. In case of EU countries, those institutions are classified in accordance with regularly updated list published in the Internet (www.nbp.pl) at the ECB’s website (www.ecb.int). As for other countries, other monetary financial institutions mean banks (excluding central bank).

Banks (excluding banks in bankruptcy, liquidation or organisation) – entities established and operating in accordance with the Act of 29 August 1997 “Banking Law” (Dz.U. No 140, item 939, as amended), or, as regards co-operative banks, in accordance with the Act of 16 September 1982 “Co-operative Law” (Dz.U. of 1995, No 54, item 288, as amended), or, as regards associating banks, in accordance with the Act of 28 December 2000 on the operation and association of co-operative banks and on associating banks (Dz.U. No 119, item 1252, as amended), or, as regards mortgage banks, in accordance with of the Act of 29 August 1997 on mortgage bonds and mortgage banks (Dz.U. No 140, item 940, as amended).

Branches of credit institutions – organisational units of a credit institution, which perform, for and on behalf of the credit institution, all or any activities specified in a license granted to such credit institution; all such organisational units of a given credit institution which are established in Poland and correspond to the above-mentioned characteristics are considered a single branch.

Co-operative savings and loan unions – units established and operating under the Act of 14 December 1995 on co-operative savings and loan unions (Dz.U. of 4 January 1996, No 1, item 2, as amended)

Monetary market funds – funds created in accordance with the Act of 27 May 2004 on investment funds (Dz.U. 146/04, item 1546).

Insurance institutions – institutions that provide insurance services (insurance products) and implement their objectives and tasks through an insurance undertaking (insurance company) operating in the form of a joint stock company or a mutual insurance company, under the Act of 22 May 2003 on insurance activity (Dz.U. No 124, item 1151, as amended). The term “insurance institution” does not comprise entities operating in the social security area (Zakład Ubezpieczeń Społecznych [*Polish Social Security Institution*], Kasa Rolniczego Ubezpieczenia Społecznego [*Farmers’ Social Security Fund*], Narodowy Fundusz Zdrowia [*National Health Fund*], Fundusz Pracy [*Labour Fund*]) and entities supervising insurance institutions and pension funds (Komisja Nadzoru Finansowego [*Polish Financial Supervision Authority*]), all of which are classified as government and self-government institutions.

Pension funds – institutions whose business objective is to collect funds and to invest them, in order to pay old-age pension to pension fund members after they reach the retirement age; pension funds operate under the Act of 28 August 1997 on organisation and operation of pension funds (Dz.U. of 2004 No 159, item 1667 as amended).

Other financial intermediaries – financial institutions whose key business object is financial intermediation performed through incurring liabilities in forms other than cash, deposits and/or substitutes of deposits at institutional units other than monetary financial institutions.

Investment funds (except for money market funds) – legal persons listed in the Act of 27 May 2004 on investment funds (Dz.U. No 146/04, item 1546), whose exclusive object is to invest cash collected through public (or, in certain cases expressly specified in the Act, non-public) offering of units or investment certificates, in securities, money market instruments of other property rights, as listed in the Act. This category also includes the National Investment Funds.

Other financial intermediaries (excluding investment funds) – financial institutions whose key object is financial intermediation performed through incurring liabilities in forms other than cash, deposits and/or substitutes of deposits at institutional units other than monetary financial institutions. This subsector includes: financial lease companies (companies providing operating lease services must be reported in non-financial sector, item: companies), factoring companies, brokerage houses, Private Equity/ Venture Capital institutions, companies established for the purposes of securitisation of assets, banks in bankruptcy, in liquidation or in organisation.

Financial auxiliaries – financial institutions that do not provide financial intermediation services on their own behalf, but create conditions for providing such services. This subsector includes, among others: brokers, insurance and pension agents and advisers, investment advisers, exchange offices, stock exchanges, commodity exchanges, institutions that create infrastructure for financial markets (e.g. clearing houses and centres, e.g. Polcard), securities depositories (e.g. Krajowy Depozyt Papierów Wartościowych SA), guarantee institutions (e.g. Bankowy Fundusz Gwarancyjny [*Bank Guarantee Fund*]), funds and foundations (including: the Co-operation Fund), investment fund companies, pension fund companies, instalment sales institutions, asset management companies, the Polish Bank Association, the National Co-operative Savings and Credit Union, representative offices of foreign banks.

International financial organisations – financial organisations dealing with multilateral co-operation and providing aid to member states and third countries, e.g. the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (the World Bank), the Bank for International Settlements (BIS), the European Bank for Reconstruction and Development (EBRD). This category also includes the international financial institutions within the meaning of Article 4(3) of the Act of 29 August 1997 “Banking Law” (Dz.U. of 2002 No 72, item 665, as amended).

NON-FINANCIAL SECTOR – entities whose main object is production of, and trading in, goods or providing non-financial services (including operating lease), entities performing non-financial functions and natural persons. The non-financial sector **includes companies, households and non-commercial institutions.**

Enterprises – all entities whose main object is the production of, or trading in, goods or rendering of non-financial services. This category also includes natural persons running businesses for their own account, provided that the number of their employees was more than 9 at the end of the last closed financial year.

Small and medium-sized enterprises (SMEs) – entities in which the number of employees at the end of the last closed financial year was less than 250 persons and natural persons running businesses for their own account provided that the number of their employees was more than 9 and less than 250 at the end of last closed financial year. This category also includes microenterprises (the enterprises in which the number of employees at the end of the last closed financial year was no more than 9). Natural persons running businesses for their own account and having, at the end of last closed financial year, not more than 9 employees, are classified as individual entrepreneurs (households).

Large companies – entities where the number of employees at the end of the last closed financial year was at least 250 persons and natural persons running businesses for their own account provided that the number of their employees was, at the end of the last closed financial year, at least 250.

Households – individuals or groups of individuals being consumers and/or individuals or groups of individuals who produce goods and non-financial services intended for their own use.

Individual entrepreneurs – natural persons running businesses for their own account, for whom the reporting bank provides services related to their business, where the number of their employees was, at the end of the last closed financial year, no more than 9 (e.g. independent professionals, provided they meet the above-listed conditions). Loans granted to persons running businesses, for their consumer or own housing needs, should be reported as loans to individuals. The same applies to deposits of those persons: if they are opened separately for private purposes, they must be reported as deposits of individuals. This category also includes non-public health centres, non-public schools run by natural persons, provided that the number of employees was no more than 9 at the end of the last closed financial year.

Individuals – natural persons, except for persons running businesses and/or farms (i.e. except for persons classified as individual entrepreneurs or individual farmers). This category also includes: employee social benefits and loans schemes run by employers, school savings schemes, parents' councils at schools, kindergartens and other institutions.

Individual farmers – natural persons whose main source of income is agricultural production and whose business has not been registered as an enterprise, company, co-operative or producers' groups. Loans granted to individual farmers, for their consumer or own housing needs, should be reported as loans to individuals. The same concerns deposits of those persons: if they are opened separately for private purposes, they must be reported as deposits of individuals.

Non-profit institutions serving households – non-profit institutions that are separate legal entities providing services to households. Their basic income is, in addition to income from occasional sales, voluntary cash or in-kind contributions from households, subsidies from government and self-government institutions and property income. This category includes: trade unions, professional and scientific societies and associations, consumer associations, political parties, churches and religious associations, voluntary fire service, funds and foundations serving households, social clubs, culture clubs, recreation and sports clubs, housing co-operatives, non-public health centres and non-public schools, provided that they are run by churches and religious associations, foundations serving households, trade unions, professional self-governing bodies and associations and other entities classified as non-profit institutions, charities, humanitarian aid institutions funded from voluntary cash transfers or in-kind contributions from other institutional bodies.

GOVERNMENT AND SELF-GOVERNMENT INSTITUTION SECTOR – this sector includes public authorities and subordinated organisational units, state legal persons and other state organisational units not entered in the National Court Register, financed fully or predominantly from public funds, except for state enterprises, state banks and commercial law companies.

Central government institutions – all ministries and other central institutions, whose scope of responsibility typically covers the whole economic area of Poland, except for social security fund management. This subsector includes central government administration authorities and subordinated organisational units, whose activities are funded to a certain extent from the state budget.

Self-government institutions – self-government administration bodies (at the level of gmina (municipality), powiat (*district*) and województwo (*province*)) and subordinated organisational units, whose activities are funded from self-government institutions' budgets, except for regional branches of social security funds. The scope of responsibility of self-government institutions covers only local parts of the economic territory of Poland.

Social security funds – include all central and local institutions, whose basic object is to ensure social benefits, provided that two following criteria are jointly met: by operation of law or pursuant to relevant regulations, specific groups of people are obliged to participate in a scheme (e.g. pension scheme) or to pay contributions and the government is responsible for management of that institution in terms of determining

and approving the amount of contributions and types of benefits. This subsector includes: Zakład Ubezpieczeń Społecznych [*Polish Social Security Institution*] and Kasa Rolniczego Ubezpieczenia Społecznego [*Farmers' Social Security Fund*] and funds managed by them (Social Security Fund, the Demographic Reserve Fund, the Contribution Fund, the Prevention and Rehabilitation Fund, the Old-Age and Disability Fund, the Administration Fund, the Incentive Fund, the Reserve Fund and the Labour Fund), Narodowy Fundusz Zdrowia [*National Health Fund*] and its regional branches.

GLOSSARY OF SELECTED TERMS³³

Nominal value of financial instruments – the amount of a receivable, a liability, an off-balance sheet liability or a security, which corresponds to the amount of principal (including capitalised interest) at the reporting date to be paid by a debtor to the creditor under a contract. In case of debt liabilities, such as bonds or promissory notes, that amount corresponds to the amount that will be payable at the time of redemption (including capitalised interest). For shares, the nominal value is the value derived from the Memorandum of Association and entered in a court register.

Carrying amount – it is a value that corresponds to the value as at the balance-sheet date, i.e.:

- financial assets shall be measured at amortised cost using the effective interest rate, less impairment losses / special purpose provisions, or at fair value and for financial assets classified as held for sale the fair value shall be reduced by impairment losses, or at cost less impairment losses,
- shares in subordinated entities shall be measured at cost less impairment loss or in accordance with IAS 39,
- shares in other entities: banks that prepare financial statements in accordance with IAS shall apply measurement in accordance with IAS 39; banks that prepare financial statements in accordance with the Polish Accounting Standards shall measure financial assets at cost less impairment losses,
- financial liabilities shall be measured at fair value or amortised cost using the effective interest rate,
- tangible fixed assets shall be measured at cost less depreciation and impairment losses, or at revalued amount that corresponds to their fair value less depreciation and impairment losses,
- Investment properties shall be measured at fair value or at cost less depreciation and impairment losses,
- intangible assets shall be measured at cost less amortisation and impairment losses or at revalued amount that corresponds to their fair value less amortisation and impairment losses,
- non-current assets classified as held for sale shall be measured at the lower of their carrying amount and fair value less costs to sell (IFRS 5)
- inventories shall be measured at the lower of cost and net realisable value.

Net carrying amount – carrying amount.

Gross carrying amount – carrying amount not reduced by amortisation/depreciation, impairment losses or special purpose provisions.

Net assets – an entity's assets less its liabilities; in terms of value, net assets correspond to equity.

Portfolio A – other receivables from the portfolio Financial Assets, measured at fair value through profit or loss and the Financial Assets held for trading.

Portfolio B – other receivables from the portfolio Available-for-Sale Financial Assets and Held-to-Maturity Investments as well as the entire portfolio Loans and Other Receivables.

Receivables without impairment (for banks applying IAS) – financial assets without impairment. The receivables subject to IBNR must be reported in columns “without impairment”. Receivables without impairment **for banks applying the Polish Accounting Standards** – credit exposures classified as: performing or watch-list.

Receivables with impairment (for banks applying IAS) – financial assets as to which there is objective evidence of impairment referred to in § 59 of IAS 39 and which were classified as impaired assets in accordance with the rules of IAS 39. Receivables with impairment **(for banks applying the Polish Accounting Standards)** – credit exposures classified as non-performing.

³³ This is a slightly modified extract from the “Supplementary Instructions to the FINREP Package”, NBP.

Gross carrying amount of exposures without recognised impairment – banks applying the Polish Accounting Standards report performing and watch-list receivables, whereas banks applying the IAS report exposures without recognised impairment and exposures for which there are indications that they may be impaired but an impairment loss has not been recognised. **Gross carrying amount of exposures with recognised impairment** – banks applying the Polish Accounting Standards report non-performing receivables, whereas banks applying the IAS should recognise exposures with recognised impairment, for which an impairment loss has been recognised.

Impairment losses recognised for assets individually assessed for impairment - banks applying the Polish Accounting Standards report special purpose provisions for credit exposures, excluding special purpose provisions for exposures arising from retail loans classified as “performing”, whereas banks applying IAS report impairment losses for individual exposures.

Impairment losses recognised for financial assets assessed for impairment in terms of a portfolio – banks applying the Polish Accounting Standards report special purpose provisions for credit exposures arising from retail loans classified as “performing”, whereas banks applying IAS report impairment losses on credit exposures that were jointly assessed for impairment.

Impairment loss /special purpose provision is the excess of the carrying amount of a given asset over its recoverable amount.

Recoverable value –corresponds to fair value less cost of sale or a useful value of an asset or a cash-generating center, whichever is higher (IAS 36.6) or current value of estimated future cash flow discounted using the effective interest rate (IAS 39.63).

Original term (of performance) – the period for which a contract with a customer was concluded. The contractual period is also the period as amended by an annex forming an integral part of the contract. For deposits, this will be the period for which a deposit was opened at a bank. For loans, the original term is the period for which a loan was granted taking into account the date of repayment of the last instalment. For securities, the original term is the period from issuance to redemption of those securities. For deposits where the date of depositing funds differs from the date of the contract (e.g. interbank deposits T/N, S/W), the original term starts on the date of opening a deposit (i.e. reclassification from a bank’s off-balance sheet item to a balance-sheet item) and ends on the date when funds are returned.

Maturity date (receivables) – the period from the reporting date to the payment date of a receivable, as specified in the contract; for receivables paid in a single payment, the date of payment of the whole debt, as specified in the contract; for receivables paid in instalments, the date of repayment of each individual instalment, as specified in the contract.

Maturity date (liabilities) – the period from the reporting date to the date of payment of a liability, as specified in the contract.

Year of commitment by a bank – the year when a bank receivable accrued.

Non-past due receivable – a receivable that is paid in accordance with the repayment schedule resulting from the contract, i.e. there were no delays in payment of the receivable or interest.

Past due receivable – a receivable with unpaid, as at the dates specified in the agreement, amount of interest or principal instalments. A past due period means the period from the maturity date specified in the contract (the specified date of payment of an instalment, interest or the whole receivable) until the balance-sheet date. For receivables paid in instalments, the length of the past due period counts from the date of maturity of the first instalment with a delay in payment.

Defaulted receivables – receivables for which the contractual payment date (taking into account the period from the payment date specified in the contract until the reporting date) has been exceeded by more than 3 months. All receivables shall be reported as defaulted receivables, even if the delay in payment concerns individual principal instalments or the payment of interest. This item shall also include receivables with a delay in payment of interest (by more than 3 months) and no delay in payment of principal instalments.

Deposits – a bank’s liabilities arising from funds deposited in the customer’s accounts, excluding liabilities resulting from cash collaterals accepted.

Current deposits – funds deposited in entities’ current accounts maintained with a reporting institution, payable on demand.

Term deposits – funds deposited with a reporting institution for a predefined period of time.

Deposits with period of notice – funds deposited with a reporting institution for indefinite period of time, which cannot be withdrawn without notifying the reporting institution in advance of the intention to withdraw the deposit in full or in part. The period of notice is specified in the contract. It is impossible to withdraw the deposit without notice or such withdrawal results in a loss of a considerable part or of all interest accrued.

Restricted deposits – funds deposited with the reporting institution, which cannot be freely disposed of by the depositor due to the fact they are intended for specific purposes, including settlement of letters of credit or for hedging the risk of the reporting institution (e.g. the risk related to a loan granted, payment card transactions, etc.). If it is possible to determine the original performance date, then such deposits shall be classified under the relevant time bracket of term deposits. If it is not possible to determine the performance date, then such deposit should be classified under “Restricted deposits”.

Loans recognised as liabilities – liabilities of the reporting institution, arising from loans received. This category excludes liabilities arising from issued securities.



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