2013

Qualitative and quantitative disclosures relating to capital adequacy and the scope of published information of the Capital Group of ING Bank Śląski S.A. for the year 2013

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I. CAPITAL ADEQUACY

INTRODUCTION

Pursuant to Article 111 a. of the Banking Law Act dated 29 August 1997 (Journal of Laws of 2002 No. 72, item 665 as amended), hereinafter referred to as the “Banking Law Act”, ING Bank Śląski S.A., hereinafter referred to as the Bank, is obliged to reveal qualitative and quantitative disclosures relating to the capital adequacy, excluding irrelevant information and information whose disclosure might have an adverse impact on the Bank’s standing in the relevant market, within the meaning of regulations on competition and consumer protection, information covered by legal secrecy and information unavailable.

Pursuant to Resolution 7/I/2014 of the Supervisory Board of 31th January 2014, disclosures relating to the capital adequacy of the Capital Group of ING Bank Śląski S.A. (hereinafter referred to as the Group) are published.

Disclosures in this document are based on the data from the annual consolidated financial report of the Capital Group of ING Bank Śląski S.A. for the year 2013.

Other disclosures from the annual statements of ING Group (a dominant entity in the holding) are published in the separate document.

Whenever Resolutions of the Polish Financial Supervision Authority are referred to in this document, they should be construed as the regulations specified in the “Policy of disclosing qualitative and quantitative information on capital adequacy and the scope of published information of ING Bank Śląski S.A.”.

1. OWN FUNDS

1.1 OWN CAPITAL

The capital comprises: the share capital, the share premium account, revaluation capital and retained earnings. All capitals and funds are recognised at their face value.

The share capital is recognised at its face value, in accordance with the statute and entry into the commercial register.

The share premium account comprises the share premium earned from the issue of shares less the direct costs thereof.

The revaluation capital comprises:
- measurement of financial assets available for sale,
- measurement of financial instruments hedging the cashflow,
- measurement of fixed assets measured at fair value,
- recognition of actuarial gains and losses,
- measurement of share based payments.

Charges for deferred tax connected with the abovementioned measurements are carried through the revaluation capital. The revaluation capital is not subject to distribution.

Retained earnings represent the profits earned by the Group in the previous term less paid up dividends. Retained earnings comprise:
- other supplementary capital,
- capital reserve,
- general risk fund,
- undistributed profit/loss of past years,
- net financial result for shareholders of the dominant entity.

Other supplementary capital is established from earnings after tax with the aim of covering the balance sheet loss. The decision on using the supplementary capital is taken by the General Meeting.

The capital reserve is established separately from the supplementary capital from earnings after tax in the amount decided by the General Shareholders Meeting. The capital reserve is earmarked for covering special losses and expenses. The decision on using the capital reserve is taken by the General Meeting.

The General Risk Fund is established under the Banking Law Act from earnings after tax and is earmarked for covering unidentified risk of banking operations. The decisions on using the fund are taken by the Management Board.

The capital reserve includes profit in the process of approval and the net profit of the current reporting term less expected charges and dividend in the amount not exceeding the profit amount as verified by the chartered accountant.

Tier II capital comprises the Tier I capital revaluation adjustment recognised as Tier II capital in regard to unrealised earnings on debt and capital instruments available for sale.

Pursuant to PSFA Resolution 325/2011 (article 5), the Group diminished Tier I and Tier II capitals by the following values:

- value of capital exposures in financial institutions (in the event of the Capital Group of ING Bank Śląski it is the amount of exposure in the affiliated entity, ING Powszechne Towarzystwo Emerytalne S.A.),
- difference between amount of provisions and amount of expected losses (the value calculated in the event of the bank calculating risk-weighted exposure amounts using IRB approach)

The reductions decrease in 50 per cent Tier I capital and in 50 per cent Tier II capital. In case of 50 per cent value of the reductions is over than Tier II capital, the surplus decreases Tier I capital.

The short-term capital is calculated in accordance with article 5 of PSFA Resolution 76/2010.

1.2 SHORT-TERM CAPITAL

As per 31 December 2013 the short-term capital was calculated in accordance with Ordinance Fin/31/2008 of the President of the Bank Management Board dated 17 January 2008, compliant with the regulations in this area. In view of the fact that the Bank's trading activity is material, the short-term capital is used in order to determine the capital adequacy standard.
The following values were recognized as the short-term capital by the Group :

- the market profit including the daily market result on operations classified to the trading portfolio and the daily market result due to the exchange rate variations and prices of goods in operations classified to the banking portfolio, calculated on a cumulative basis until the reporting date, less the known charges,
- the losses (negative value) on all operations classified to the banking portfolio, calculated on a cumulative basis until the reporting date, excluding losses due to exchange rate variations and prices of goods.

A positive value of the short-term capital is taken into consideration when setting the capital adequacy standard, up to the level not exceeding the sum of capital requirements for market risk, settlement-delivery risk and concentration risk.

Short-term capital components

	end of year 2013	end of year 2012
Market profit on trading portfolio *	189.5	137.4
Losses on banking portfolio excluding the losses due to changes in exchange rates and goods prices, to the extent it has not been included in the own funds or divided otherwise (negative value)	0.0	0.0
Sum of capital requirements for market risk, settlement-delivery risk and concentration risk	34.7	44.4
Short-term capital (value not exceeding the sum of capital requirements for market risk, settlement-delivery risk and concentration risk)	**34.7**	**44.4**

** Market profit of current period in non audited part.*

1.3 CALCULATION OF OWN FUNDS

Disclosures relating to the capital fund per Basel II were presented in line with Article 127 of the Banking Law Act and PSFA Resolution 325/2011.

The capital fund and the short-term capital per Basel II

	end of year 2013	end of year 2012
I. Tier 1 capital	**7 025,3**	**6 252,8**
1. Core capital	1 223,2	1 183,1
- Share capital	130,1	130,1
- Issue premium	956,3	956,3
- Other supplementary capital	136,8	96,7
2. Capital reserve	5 252,4	4 558,6
- Capital reserve	4 715,1	4 004,4
- Retained earnings and result during the approval	145,9	112,8
- Minority equity	2,3	2,3
- Net profit of current period in audited part	389,1	439,1
3. General risk fund	1 010,2	960,2
4. Reductions of Tier I capital	-460,5	-449,1
- Tier I capital revaluation	-25,3	-2,0
- Revaluation reserve from measurement of equity instruments classified as available for sale (unrealised losses)	0,0	-1,2
- Revaluation reserve from measurement of debt instruments classified as available for sale (unrealised losses)	-25,3	-0,8
- Intangible assets	-365,9	-361,6
- Capital commitments in financial institutions (50%)	-20,0	-20,0
- Difference between amount of provisions and amount of expected losses (50%)	-49,3	-65,5
II. Tier II capital	**226,0**	**500,0**
- Revaluation reserve from measurement of available-for-sale financial assets (unrealised gains)	295,3	585,4
- Reductions of Tier II capital	-69,3	-85,4
- Capital commitments in financial institutions (50%)	-20,0	-20,0

- Difference between amount of provisions and amount of expected losses (50%)	-49,3	-65,4
Short-term capital	**34,7**	**44,4**
Own funds taken into account in solvency ratio calculation	**7 286,0**	**6 797,2**

2. CAPITAL REQUIREMENTS

2.1 CALCULATION OF CAPITAL REQUIREMENTS

Starting from the report as at 30 June 2013, ING Bank Śląski S.A. reports capital requirement for credit risk on the basis of the AIRB approach. The Bank applies such presentation method pursuant to the letter of De Nederlandsche Bank (DNB) dated 4 July 2013, wherein DNB together with the Polish Financial Supervision Authority give the Bank permission to apply the full AIRB approach for the exposure classes under institutions and entrepreneurs. Pursuant to PSFA Resolution 76/2010 equity exposures also were assigned.
In the prior periods, the Bank was allowed to calculate capital requirement for credit risk according to the AIRB approach, however, the Bank was obliged to include the so called supervisory floor in its calculations. Where the capital requirement for credit risk computed with the AIRB approach was lower than the capital requirement for credit risk computed under standard approach, it was necessary to supplement it up to the level of the capital requirement calculated according to the standard approach.
Irrespective of the above mentioned consent, pursuant to PFSA Resolution no. 76/2010, when determining the total capital requirement the Bank takes account of the so called regulatory floor which amounts to 80% of the total comparable capital requirement (it is the sum of capital requirements for individual risk types computed by means of the standard approach). Should the total capital requirement be lower than 80% of the total comparable capital requirement, the Bank will include the difference as “a supplement to the overall level of capital requirements”.

AIRB method may be applied in full to calculate the capital requirement for credit risk for supervisory purposes only upon fulfillment by the Bank of the requirements listed in the aforesaid decision of PFSA.

Further implementation of the AIRB approach shall apply only to the retail exposures. Retail exposures will be including to the calculation according to AIRB method consecutively, but no later than to 31 December 2015.

The Capital Group of ING Bank Śląski S.A. subsidiaries calculate capital requirements for credit risk according to SA method, except the company ING Lease (Polska) Sp. z o.o., which use AIRB method.

The standard approach compliant with Basel II is used to calculate the requirement for market risk, settlement-delivery risk and the requirement due to exposure concentration limit and large exposures limit overrun.

The capital requirement for operational risk was estimated using the Basic Indicator Approach (BIA).

Capital requirements for particular risks

	end of year 2013	end of year 2012
Capital requirement for credit risk, credit counterparty,dilution and delivery of instruments for future settlement	2 900.1	3 285.8
Capital requirement for settlement-delivery risk	10.3	13.0
Total capital requirements for the market risk, including:	24.5	31.4
- Capital requirement for foreign exchange risk	0.0	0.0
- Capital requirement for commodity price risk	0.0	0.0
- Capital requirement for equity securities price risk	0.0	0.0
- Capital requirement for specific risk of debt instruments	0.0	0.0
- Capital requirement for general interest rate risk	24.5	31.4
Total capital requirements for operational risk	437.6	405.9
Capital requirement due to exposure concentration limit overrun	0.0	0.0
Total capital requirement	**3 372.5**	**3 736.1**

The capital requirement for credit risk represents approx. 86% of the Group's overall capital requirement and has the greatest impact on capital adequacy calculation.

Please find below exposure classes divided into exposures calculated according to AIRB method and calculated according to SA method, in both instances exposures are presented by exposure classes of AIRB method.

Exposures calculated according to AIRB method

Exposure class according to AIRB method	Original exposure before conversion factors	Value of exposures secured by a guarantee or credit derivatives	Value of exposure	Risk-weighted exposure	Capital requirements	Value adjustments and provisions	
						End of year 2013	End of year 2012
Institutions	7 221.9	11.9	5 611.0	1 464.9	117.2	-0.7	-0.7
Entrepreneurs	38 732.9	2 360.6	29 908.9	17 344.6	1 387.6	-1 031.0	-878.2
Equity exposures *	26.6	0.0	26.6	79.3	6.3	0.0	0.0
Total	**45 981.4**	**2 372.5**	**35 546.5**	**18 888.8**	**1 511.1**	**-1 031.7**	**-878.9**

** Calculation according to simplistic method.*

Exposures calculated according to SA method

Exposure class according to AIRB method	Original exposure before conversion factors	Value adjustments and provisions associated with the original exposure		Value of exposures secured by a recognised financial collateral	Fully adjusted exposure value (pre conversion factors)	Value of exposure	Risk-weighted exposure	Capital requirements
		End of year 2013	End of year 2012					
Governments and central banks	34 533.1	0.0	0.0	0.0	34 533.1	27 577.2	25.4	2.0
Institutions - banks	4 352.2	0.0	0.0	0.0	4 352.3	3 645.5	726.8	58.2
Entrepreneurs	2 113.5	0.0	0.0	0.0	2 113.5	1 998.9	1 702.9	136.2
Retail	20 742.9	-509.9	-533.9	-20.9	20 212.1	19 072.6	13 830.2	1 106.4
Other assets that are not debt obligations	4 380.7	0.0	0.0	0.0	4 380.7	4 380.7	1 077.5	86.2
Total	**66 122.4**	**-509.9**	**-533.9**	**-20.9**	**65 591.6**	**56 674.9**	**17 362.8**	**1 389.0**

2.2 CREDIT RISK - ADVANCED INTERNAL RATING-BASED METHOD (AIRB)

2.2.1 INTERNAL RATING SYSTEMS STRUCTURE AND RELATION BETWEEN INTERNAL AND EXTERNAL RATINGS

Rating systems are managed in the Group based on conception of models life cycle, and include:

a) methods of model development,
b) process of assignment of rating classes using rating models,
c) mechanisms of model and process control,
d) data warehouse systems to collect statistical data for purpose of model development and monitoring/validation of models,
e) IT systems,

that the Group use for:

– credit risk assessment,
– classification of exposure to particular quality class or pools (rating assignment) and
– measurement of default obligations and losses for defined type of exposures.

Central element of rating system in the Group are models for estimation of PD, EAD and LGD parameters that are governed under strict supervision and control procedures.

The Group use PD, LGD and EAD models in many places of credit risk management area, first of all in:

a) calculation of Regulatory Capital (RECAP),

b) calculation of Economic Capital or in other words internal capital (INCAP),
c) estimation of loan loss provisions according to IFRS rules,
d) customer credit capacity assessment in process of credit analysis,
e) calculation of transactions profitability in credit pricing process (Sanity Check Tool, UMFA, Loan Pricer),
f) setting of limits and risk appetite.

All of above mentioned areas use parameters modified to particular tasks.

Governance on models life cycle is performed through set of politics, procedures and instructions, including among others:

- initiation of model development or model refinement,
- model development and it's testing,
- preapproval validation,
- model acceptance,
- model implementation,
- validation of model implementation,
- model use and it's periodical monitoring,
- periodical validation.

Each entity with the Group's credit exposure must have a rating assigned as is used in a standard manner at the Group. Determination of the customer risk class forms an integral part of the Bank's credit risk evaluation process for corporate clients.

Exposures to corporates and institutions

As far as the exposures to corporates and institutions is concerned a 22-grade rating scale with respect to entrepreneurs where classes reflect borrower risk. Some credit risk models used in the Group assign rating sub-classes to have better granulation of rating scale.
The Group most often applies 17 risk classes (6-22). Sometimes a better risk class may be applicable, usually in the strategic clients portfolio.

The customer is assigned to a given risk class based on the:

- financial model, using the data from the debtors' financial reports,
- evaluation of qualitative factors,
- financial standing of the parent company.

Risk classes may be divided into 3 basic groups:

1) *Investment grades (1-10)* include borrowers with solid income and margin levels, strong balance sheet structure and stable long-term perspectives. In the top grades of this range, the borrowers occupying the position of market leaders are classified who are relatively less susceptible to adverse market fluctuations. Such borrowers have free, that is 'at their discretion', access to the financing available on the markets at any time.

2) *Speculative grades (11-17)* include grades characterised by relatively wider range of risk, and can be divided into:
   a) The borrowers with the best grades within this class, who currently meet their financial obligations, however their debt servicing capacity (the principal and interest) may turn out to be uncertain over a longer period of time. So the safety margin is limited. In adverse business environment or unfavourable economic conditions there is a real threat that credit risk may increase.
   b) The borrowers assigned higher risk grades (the worst grades in this class) which, in a longer perspective, may be characterised by: uncertainty as to their income, lower quality of assets and risk of the capital level mismatch that may translate into possible losses.

3) *Problem loan grades (18- 22)*. This risk class includes the borrowers who show clear indications of problems with debt servicing or are in the situation referred to as an event of default' has already occurred.

Description of investment grades (1-10)

Grades 1-2

Entities included in this class are characterised by the lowest level of risk. In a longer perspective they have solid and stable income, substantial liquidity and extremely strong balance sheet structure. The probability of default by one of these borrowers is very low.
Entities classified in this group usually:

a) operate in large markets characterised by attractive margins, a strong potential for growth and high entry barriers,
b) experience weak or no pressure on prices thanks to no or few direct competitors present,
c) have strong position versus suppliers, and strong and well-known brand(s),
d) are subject to no foreseeable threats.

Grades 3-4

High quality entities, with slightly higher long-term risk potential than the entities classified into risk class 1 or 2. Nevertheless, in a longer perspective they are assessed as very strong entities with stable income, good financial liquidity and strong balance sheet structure.

Grades 5-7

These classes include strong entities who operate on a cycle basis or entities in good condition whose income is to some extent fluctuating. The analysis of these entities may prove that they are prone to future weakening of their financial situation.
The entities classified in this group:

a) often operate on more competitive markets with low customer loyalty levels,
b) have a good debt profile, characterised by relatively low risk and thus are fully capable of meeting their financial obligations,

c) have to allocate substantial company resources to maintain their market share,
d) have limited ability to dictate prices and/or terms and conditions of cooperation with suppliers,
e) have no delayed principle and interest payments.

Grades 8-10

Entities classified in this range are susceptible to fluctuations in economic climate that may affect their creditworthiness, yet their current situation is still acceptable.
Entities classified in this group are usually characterised by:

a) ability to differentiate products or services from those offered by competitors when faced with pressure from the market,
b) small or no influence on prices of materials they purchase,
c) management who may implement riskier strategies or who may be judged as less stable than the management of a company with a higher rating,
d) no delays in principal and interest payment.

Description of speculative grades (11-17)

Grades 11-13

Entities classified in this class are characterised by a relatively good financial standing but their ability to service debt over a longer period is not guaranteed. Past cash flows of these companies show some irregularity. These companies may have suffered losses in the previous years. Although at present they are more or less profitable, they show a certain margin of safety and they are still ranked among the acceptable borrowers. However they may already show the signs of potential problems with maintaining the current level of income and profitability.
In addition, the entities classified in this range:

a) may have problems with maintaining their position in the market in the face of growing competition,
b) have little or no influence on prices of materials they purchase,
c) it is possible that their management is not of the highest quality,
d) there are no delays in principle and interest payment, or a delay is shorter than 31 days.

Grades 14-17

The companies classified in this range enter the endangered financial standing zone. Symptoms: considerable decrease in profitability, substantial weakening of the balance sheet structure, irregular cash flows with outflows predominating over inflows, and small capability to service its debts.
Such entities often:

a) operate in a sector that is in a downward phase;
b) have to face the increasing pressure from their competitors (including the increasing one);
c) have very limited or no influence on prices of materials they purchase and their relations with suppliers;
d) may have a weak management characterised by e.g. lack of experience, no stability or

poor commitment;
e) there are no delays in principle and interest payment, or a delay is shorter than 31 days.

The borrowers classified in the 16-17 range are additionally characterised by the occurrence of the following circumstances:
a) despite servicing of all obligations by the borrower on an ongoing basis there are strong premises that the borrower's financial standing or creditworthiness may diminish,
b) at present there are no predictions as to the occurrence of the situation referred to as 'default' but more intensive monitoring is necessary,
c) actions aimed at improvement of the Group's position as the creditor are required, or the limitation or complete cancellation of the Group's involvement in a borrower or transaction financing.

Grade 15 / (potential) restructuring

Apart from the overall conditions presented above based on which an entity is classified in the range 14-17, grade 15 is additionally characterised by occurrence of the following circumstances:
- material indications of the borrower's weakening economic and financial standing/creditworthiness, and
- substantial indications of the risk profile impairment that will result in the borrower's failure to timely meet all of its debt obligations in the future,

but all of the following conditions have been met:
- the borrower has not applied for any change (extension) of the employed capital repayment date, and
- in a short term perspective (up to 1 year) the borrower will not require additional financing that would have resulted from the financial liquidity impairment, and
- the borrower is sufficiently capable of servicing its debts, and
- positive assessment of the borrower's main markets prospects.

Furthermore, as far as the customers with risk grade 15 are concerned, for whom additional covenants have been defined, the following events of default may occur:
- the Group predicts that a borrower will breach one or more conditions, and
- the Group may waive a condition, on a one-off basis, for the period of up to one year.

Grade 16 / (potential) restructuring

Apart from the overall conditions presented above based on which an entity is classified in the range 14-17, the following circumstances occur:
- material indications of the borrower's weakening economic and financial standing/creditworthiness,
- substantial indications of the risk profile impairment that will result in the borrower's failure to timely meet all of the debt obligations in the future,

no certainty as to whether the customer will be able to service his debts, even though all the conditions mentioned below have been met:

– the borrower has not applied for any change (extension) of the employed capital repayment date, and
– in a short term perspective (up to 1 year) the borrower will not require additional financing that would have resulted from the financial liquidity impairment, and
– positive or neutral assessment of the borrower's main markets prospects.

Furthermore, as far as the customers with risk grade 16 are concerned, for whom additional covenants have been defined, the following events of default may occur:
– the borrower failed to meet one or more conditions, or
– the borrower advised the Group that he would not be able to meet one or more of these conditions.

Grade 17 / (potential) restructuring

Apart from the overall conditions presented above based on which an entity is classified in the range 14-17, the following circumstances occur:
– material indications of the borrower's weakening economic and financial standing/creditworthiness;
– substantial indications of the risk profile impairment that will result in the borrower's failure to timely meet all of the debt obligations in the future.

In addition, one or more of the following symptoms have occurred:
– the borrower has applied for a change (extension) of the employed capital repayment term, or there is high probability that he may submit such an application where the change (extension) of the employed capital repayment term does not (will not) result in the Group's loss because the terms of such prolongation fully compensate for the delay in repayment of the capital,
– the borrower is not or probably will not be capable of servicing his debts in a long term, however, in a short term perspective (up to 1 year) will not require additional financing that would have resulted from the impairment of his financial liquidity,
– neutral or negative assessment of the borrower's main markets prospects.

Furthermore, as far as the customers with risk class 17 are concerned for whom additional covenants have been defined, it may happen that the borrower has failed to meet one or more conditions.

Description of problem loan grades (18-22)

Grade 18 - Under watch / Restructuring

The borrower continues its business and meets his obligations towards the Group (i.e. there are no delays in the principal or interest repayment or any delay is shorter than 31 days), and at least one of the circumstances mentioned below has already occurred:

- the borrower has applied for a change (extension) of the employed capital repayment term, however the change (extension) of the employed capital repayment term does not result in the Group's loss because the terms of such prolongation fully compensate for the delay in the repayment of capital,
- in a short-term perspective (up to 1 year) the borrower will need additional financing resulting from the impairment of his financial liquidity, but in the Group's assessment, in the short period there will be no problems with obtaining such financing (beyond the Group),
- the customer is not sufficiently capable of servicing its debt,
- negative assessment of the borrower's main markets prospects.

Furthermore, as far as the customers with risk class 18 are concerned for whom additional covenants have been defined, it may happen that the borrower has failed to meet one or more conditions.

Grade 19 - Below standard / Restructuring

The borrower continues its business and meets its obligations towards the Group (if there are delays in the repayment any delay is shorter than 90 days), and at least one of the circumstances mentioned below has already occurred:

- the borrower has applied for a change (extension) of the employed capital repayment term, however the change (extension) of the employed capital repayment term does not result in the Group's loss because the terms of such prolongation fully compensate for the delay in the repayment of capital,
- in a short-term perspective (up to 1 year) the borrower will need additional financing resulting from the impairment of its financial liquidity and, in the short period, such financing will be probably available (beyond the Group),
- the customer is not sufficiently capable of servicing its debt,
- negative assessment of the borrower's main markets prospects.

Furthermore, as far as the customers with risk grade 19 are concerned, for whom additional covenants have been defined, it may happen that the borrower has failed to meet one or more conditions.

Grade 20 – Dubious / Default and impairment occurred and recoveries and actions before forced collateral realisation

In general: it has been assessed that the customer will not repay its obligations towards the Group in full, but the Group has not initiated (yet) the compulsory realisation of collateral. However the Bank may have already undertaken actions aimed at voluntary sale of items constituting collateral by the customer himself (or the owner of the items) to designate the proceeds from the sale for repayment of the debt to the Group.

The inability to repay in full the obligations towards the Group results from one or more of the following circumstances:

- the Group has assessed that the impairment of financial involvement has occurred, or
- the Group has decided to dispose of credit claims at a discount higher than 10%, and such a disposal does not result from management of concentration risk.

Grade 21 – Lost / Default occurred and forced recoveries and actions for collateral realization – without losses

In the case of borrowers classified in risk grade 21, the following circumstances have occurred:

– the Group initiated the realisation of collateral,
– there are no prospects for rebuilding the borrower's creditworthiness and re-commencement of debt servicing,
– all potential opportunities for the involvement restructuring have been exhausted and no desired effects have been obtained,
– no loss on the impairment is expected because the current value of the realised collateral fully covers (is expected to cover) the debt to the Group.

Grade 22 – Lost / Default and impairment occurred and forced recoveries and actions for collateral realization – with losses

In the case of customers classified in risk grade 22, the following circumstances have occurred:

– the Group initiated the realisation of collateral,
– there are no prospects for rebuilding the borrower's creditworthiness and re-commencement of debt servicing,
– all potential opportunities for the involvement restructuring have been exhausted and no desired effects have been obtained,
– due to the absence of collateral or its insufficient value, the involvement has been (or will be) remitted in part or in full.

Default definition (grade 20 – 22)

Exposures to corporates and institutions have the following default defintion:

1) Group puts the credit obligation on non-accrued status,
2) Group writes off or creates specific provision resulting from a significant perceived decline in credit quality subsequent to taking on the exposure,
3) Group sells the credit obligation at a material credit-related economic loss ,
4) Group consents to a distressed restructuring of the credit obligation where it is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement of principal, interest tor (where relevant) fees,
5) Group has filed for the obligor's bankruptcy or a similar order in respect of an obligor's credit obligation to the bank's group,
6) The obligor has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of a credit obligation to the bank's group,
7) The obligor is past due more than 90 days on any material credit obligation to the bank's group. Days past due commence once an obligor has breached an advised limit or has been advised a limit smaller than current outstandings.

Capital exposures

As far as capital exposures is concerned the Group applies simple risk weight approach according to the Appendix No 5 of PSFA Resolution no 76/2010.

FM products have the following default definition:

1) failure to perform obligations under the agreement and executed transactions, in particular failure to perform in a timely manner any due payment,
2) occurrence of any factual or legal event exposing the client to bankruptcy or liquidation,
3) occurrence of any factual or legal events increasing the risk that the client shall fail to perform its obligations under transactions, in particular:
   a) any material, permanent worsening of the client's economic or financial standing, including appointment of compulsory administration or another receiver towards the client's enterprise,
   b) initiation against the client of one or more court, arbitrary, administrative or enforcement proceedings, or proceeding to secure claims, aimed to satisfy the creditors' claims towards the client,
   c) discontinuation to pay obligations, admitting in written form the inability to repay obligations in a timely manner or start negotiations with one or several creditors with the intention of altering the amount, legal basis or date of payment,
   d) the client's failure to perform or improper performance of due financial liabilities under any agreement to which the client is a party, executed with the Group or any other financial institution,
   e) the Group ascertaining from an economic information bureau that the client is in arrears in satisfying its payment obligations.
4) actions have been undertaken to question the rights of the Group under the agreement, transactions or any granted security, or such rights are questioned through any other means, in particular by the client's statements about non-recognition of the Group's claims or by the client's demanding that the competent authority declare the invalidity of the agreement or any transaction,
5) circumstances occur, which in the opinion of the Group could have a material negative impact on the client's activities or standing (financial or other), in particular on the Group's possibility to exercise any of its rights under the agreement or any granted security,
6) the issuance of any false or misleading statements,
7) the client has failed to establish a security for the performance of the client's obligations under the transactions as agreed with the Group or any factual or legal event has occurred causing partial or complete invalidity, loss, reduction or worsening of the legal conditions of the security established by the client or the security provider.

In the table below is presented the structure of connections between internal and external rating systems.

The structure of connections between internal and external rating systems

ING rating	S&P/Fitch IBCA	Moody's
1	AAA	Aaa
2	AA+	Aa1
3	AA	Aa2
4	AA-	Aa3
5	A+	A1
6	A	A2
7	A-	A3
8	BBB+	Baa1
9	BBB	Baa2
10	BBB-	Baa3
11	BB+	Ba1
12	BB	Ba2
13	BB-	Ba3
14	B+	B1
15	B	B2
16	B-	B3
17	CCC	Caa1
18	CC	Ca
19	C	C
20	D	C
21	D	C
22	D	C

2.2.2 DESCRIPTION OF THE PROCESS OF AWARDING INTERNAL CREDIT RATINGS

The system of risk rating in the Group is applied for customers, securities issuers or cover provider. Rating is the measure of probability of default PD.

Each entity can have simultaneously only one final risk rating and it shall be binding for all the entities from ING Group.

The risk rating symbol fixed in the course of the risk rating process consists of:
1) double letter prefix denoting a type of the PD model used,
2) one of the numbers ranging from 1-22, which is risk grade.

The first letter of the prefix denotes the type of the client or the segment of the clients. The second letter of the prefix denotes the method used for risk rating of the client. Descriptions of some of the prefixes used in Group are available in the tables below.

Description of the selected first letters of the prefixes in PD models

No.	First letter of the prefix	The purpose of the model
1.	B	Banks
2.	F	Financial institution other than a bank
3.	C	Corporate client with revenues above € 100m
4.	K	Corporate client in the Bank (revenues below € 100m)
5.	G	Institutions (e.g. government or local government unit)
6.	R	Income producing real estate
7.	J	Project finance
8.	Y	Country

Description of the selected second letters of the prefixes in PD models

No.	Second letter of the prefix	Description of selected methods of risk rating
1.	C	risk rating defined in KC rating model for corporate clients from the East-Central Europe (excluding Germany)
2.	L	(a) rating for large customers based on PD model (b) rating for local governments or institutions
3.	I	(a) financial institutions rating based on PD model (b) implied rating

E.g.:

a) CL prefix - corporate client with revenues above € 100m but not under any model for specialist financing,
b) KC prefix - corporate client in the Bank (revenues below € 100m) but not under any model for specialist financing,
c) BC prefix - rating for commercial bank,
d) GC prefix - rating for central government,
e) YD prefix - rating for country,
f) FU prefix - rating for:
   - financial institutions without retail deposits,
   - company granting consumer loans only for private persons,
   - leasing, factoring company.

Risk grade description used to rating process is described in the chapter 2.2.1.

Entrepreneurs

In the case of entrepreneurs, specialised lending, and accounts receivable purchasing, the internal rating process is based on appropriate rating models.
In such a process an AM (business line) collects information needed for a rating model and enters it in an IT system supporting the assignment of rating to an institution. RM (Credit and Market Risk Management Division) assigns a rating on the basis of the AM's proposal. There is

room for appeal in the rating process.
The RR rating model is an example of a specialised lending rating model. The CL (large enterprises) rating model and the KC (small and medium enterprises) rating model are examples of enterprise rating models. When accounts receivable are purchased the parties of such transaction are rated with the appropriate enterprise rating model.

Institutions - banks

In the case of institutions - banks, internal rating process is analogous to the enterprise rating, and takes into account an institution-appropriate rating model.
In such a process an AM (business line) collects information needed for a rating model and enters it in an IT system supporting the assignment of rating to an institution. RM (Credit and Market Risk Management Division) assigns a rating on the basis of the AM's proposal. There is room for appeal in the rating process.

2.2.3 THE PROCESS OF MANAGING AND RECOGNISING METHODS FOR MITIGATING CREDIT RISK

Bank

Collateral is an essential tool for limiting credit risk, however it may not replace a financed entity's creditworthiness which is the determining factor of granting credit exposure.
The collateral in place has the following functions:

1) financial:
   - it should limit the credit exposure losses when credit risk materialises i.e. when the debtor has stopped meeting the contractual obligations,
   - if it meets the conditions set out in the Bank's regulations on collateral it may be taken into account when assessing capital requirements for credit risk and collective provisions for impairment of assets in a credit portfolio. The recovery rates assigned to individual categories of collateral have been determined on the basis of the LGD model,
2) non-financial:
   - it strengthens the control authority of the Bank as a creditor by limiting the collateral provider's ability to dispose of the assets pledged to the Bank,
   - it strengthens the Bank's position in negotiations with the debtor (client), the debtor's other creditors and the collateral provider.

The Bank applies the following credit risk mitigation techniques:

- funded credit protection linked to tangible collateral,
- unfunded credit protection linked to personal collateral items.

Reduction of the Bank's credit risk under credit exposure if the debtor defaults on the obligations, is insolvent, goes bankrupt or in the situation of another breach of the loan agreement, general terms and conditions and/or collateral agreement, in the case of:

- funded credit protection - stems from the Bank's right to liquidate, transfer, acquire or

retain particular assets,
- unfunded credit protection - stems from a third party's obligation to pay a specified amount of money.

The Bank's regulations on collateral include (inter alia):
- the criteria for recognising collateral in the process of calculation of capital requirements for credit risk,
- the general rules for selecting collateral applied by the Bank taking into account acceptable credit risk level,
- detailed rules for specific types of tangible and personal collateral participating in the recovery ratio estimation (including rules on collateral value setting, tangible collateral insurance coverage requirements, preferred legal forms of collateral, requirements for providers of personal collateral, other requirements concerning personal and tangible collateral).

Furthermore, the Bank's regulations on collateral specifically take into account the aspects of PSFA Resolution 76/2010 as amended which refer to the application of the LGD models, legal certainty of collateral and its monitoring.

There is a recovery rate, defined by an appropriate LGD model, assigned to every type of collateral. Such a rate is estimated on the basis of the long-term observation of recovery rates within specific collateral groups which are registered in the Bank's database.

The Bank's regulations define also the way the collateral is presented and approved in the process of granting credit exposure and the rules of presenting and approving collateral monitoring.

The Bank has verified the legal certainty and scope of jurisdiction assigned to the applied risk mitigation instruments with an external, reputable legal office.

In the collateral selection process the Bank seeks to optimise the catalogue of collateral for a given exposure by means of:
- first choosing the collateral with the highest recovery rate and less costly monitoring,
- diversifying the types of collateral for a specific credit exposure,
- avoiding securing the same credit exposure with collateral items which are correlated in such a way that a deterioration in the quality of one collateral item results in a deterioration in the quality of another collateral item.

ING Lease (Polska) Sp. z o.o. (ING LP)

The main security of lease transactions is the lessor's ownership of the asset financed within lease agreement. Such security pays both financial and non-financial role.

Sales of leased assets in case of termination of the lease agreement reduces or completely

eliminates the loss on the credit exposure. In addition remarketability of the financed assets affects the level of LGD (recovery rate is attributed to individual types of leased assets) and in consequence the level provisions. Remarketability of the leased assets is assessed based on the expert method at the stage of applying for a lease facility and is one of the main parameters to be taken into account when assessing the proposed lease transactions and affecting the final credit decision (often the remarketability is more important than the financial situation of the client).

As the owner of the financed asset, ING LP after termination of the lease agreement, can take physical control over the asset and as an owner may sell it to a 3rd party. The threat of the loss of the leased asset by the lessee causes that customers often pay back the overdue lease debt in the first place comparing to other entities (especially if the market value of the leased asset exceeds the credit exposure or the asset is crucial for the customer’s activity).

ING Commercial Finance S.A. (ING CF)

Basic collateral of financing granted in the factoring form is assignment of trade receivables, which are financed by ING CF. Financing grated for the client should be paid by debtors from the receivables transferred to factoring by the client or in the case of non-recourse factoring transaction by insurer who covers debtors insolvency risk, which causes that credit risk is divided and potential losses on factoring exposure limited in the case of the client's financial problems.
Collaterals are taken into account in the calculation of capital requirements for credit risk and provisions calculation.
ING CF regulations include an indication of the rules for determining the collateral value and collateral monitoring and include criteria for the recognition of collateral in calculating the capital requirement. Each collateral is assigned adequate recovery rate in the LGD model.

2.2.4 RATING SYSTEMS CONTROL MECHANISMS

Group applies rules of rating assignment, definitions, methods and data for estimation and approval of PD, EAD and LGD credit risk parameters, as described below.

Reviews and Credit Risk Rating

Model governance in the Group is regulated in document „Risk Model and Valuation Model Management Policy of ING Bank Śląski S.A.”. This document precise that models used in the Group are build according to “Methodology Standards for development of credit risk models”.
The Standard fulfill all requirements of PSFA Resolutions, particularly includes among others: definition of risk parameters, size of samples required for model development, minimal length of time series in data sets, methodology of models development including basic distinction for statistical, expert and hybrid models. Document includes also many other aspects necessary to fill in regulatory requirements.

Operational use of models is described in Credit Instruction.

Commercial functions who grant credits are separated from the process of transaction- and client risk rating (four-eye control principle). Credit risk is rated (by the Risk Manager) based on the principle of separation from the commercial functions (relationship manager).

The following parties are involved in the process of risk rating: Rating Owner (relationship manager) and Risk Manager.

The Rating Owner inputs the financial data related to the client and has exclusive responsibility for the correctness of the risk rating, including review. There is only one owner of a borrower's risk rating. The risk management unit responsible for restructuring and debt collection (i.e. Corporate Credit Restructuring Department) becomes a rating owner for borrowers rated 18 to 22. The final rating is determined by the Risk Manager, or by the Appeal Judge if an appeal has been made.

The Risk Manager is responsible for:

- verifying that the appropriate rating model has been used for the borrower,
- verifying that financial and non-financial data entered are correct,
- challenging unaudited financial data,
- finalizing the rating.

The outcomes of specific models may be subjects to arbitrary adjustments in that the ultimate rating grades are determined as part of the appeal process.
A one notch difference (positive or negative) between the rating calculated by the rating model and the view of the appellant (the person initiating an appeal) is sufficient to start a rating appeal.
Reasons for a rating appeal are for example:

- the rating model is not appropriate for the borrower,
- circumstances that may not (yet) be captured by the rating model but which are likely
- to have a (usually negative) effect on the borrower's PD, especially if:
  - borrower has or is expected to default on any financial obligation to any party,
  - major disruption of activities,
  - change in legislation that will seriously impact the financial performance.

IT system in the Group, used also in whole ING Group, supports credit risk assessment process and enables, as well, centralized gathering data on risk rating grades of clients.

Frequency of Risk Rating Reviews and Updates (if any)

Only the Rating Owner can review the risk rating. The following rules will apply to rating reviews:

- a risk rating must be reviewed at least annually; a risk rating is considered overdue after 12 months from the last approval date of the risk rating,
- the Rating Owner should take appropriate action to either review or cancel the risk rating if

the Group has terminated the relationship with the borrower and no credit risk remains; the Rating Owner should perform an interim re-rating when the value of one or more risk drivers has materially changed. Events that could cause a consideration for a re-rating are for example a change of risk rating of the influencing parent or a change of any of the qualitative risk drivers,
- without a review till the end of 18 months from the last approval date of the risk rating, a risk rating will automatically expire (not applicable for irregular borrowers whose ratings do not expire).

Monitoring and validation of rating systems

In line with internal model governance policy in the Bank, models are regularly monitored and validated by independent validation unit.

Model monitoring is a periodic verification of the results generated by the model compared with the theoretical assumptions of the model. During the monitoring the Group make sure that the inputs to the model have not been subject to distortion, and the results presented by the model are adequate to the changes that have occurred in the environment, as well as in the Group and the processes occurring in it.

Model validation is an independent verification of the correct functioning of the model, conducted by non-modellers and persons not involved in making decisions related to the choice of the methodology used for model development. The validation process consists in an independent validation of the model results. Its purpose is to check:
a) the adequacy of the chosen method and accuracy of assumptions that underlie the model,
b) the quality of the data,
c) functionality of the model,
d) completeness and quality of documentation of the model,
e) the adequacy of the expert input into the model,
f) the course of process modelling and model results with regard to compliance with applicable regulatory requirements, internal procedures of the Bank and the Group and best market practices,
g) proper implementation of the model.

Verification of the above components is one of the ways to reduce the model risk. Validation Unit drafts detailed reports of the validation, which highlight the main weaknesses (if any) and the limitations of the model. Issued recommendations aimed at reducing the risks and weaknesses of the model and contributes to the sustainable development of the models. Reports from validation are presented to adequate Committee. Monitoring of the implementation of post-validation recommendations is carried out in accordance with the Regulations of monitoring of the implementation of risk mitigating measures in force in the Group. Detailed information on the operation of the Validation Team and the rules of the validation process can be found in the Policy of Model Validation. Detailed information on how to carry out the validation of models of specific risk areas can be found in the validation instructions for the credit, market and

operational risk respectively.

Conception of model life cycle and list of responsibilities of each unit within model life cycle is defined in „Risk Model and Valuation Model Management Policy of ING Bank Śląski S.A.”.

2.2.5 THE SCOPE OF APPLICATION OF INTERNAL ESTIMATES FOR PURPOSES OTHER THAN CALCULATION OF RISK WEIGHTED EXPOSURE AMOUNTS USING THE IRB INTERNAL RATING APPROACH

The Capital Group of ING Bank Śląski S.A. and the whole ING Group have PD, LGD and EAD models developed in line with the requirements of Basel and the Polish Financial Supervision Authority resolutions (including the PSFA Resolution 76/2010) also for the purposes other than calculation of the regulatory capital.
According to the supervisory authorities' guidelines, there are three areas where the IRB approach components should be applied:

- measurement and management of credit exposure;
- the process of planning and formulation of strategy;
- reporting.

These three areas are used as a quick test whether the Group actually applies the IRB approach components in its risk management processes.

In this document various notions of capital are used. It is important to distinguish between the following types of capital and their purposes:

- the Regulatory Capital (Basel) is defined by the regulators and consists of: the core shareholders' equity (Tier 1), supplementary capital (Tier 2) and reserves required for the absorption of an unexpected loss. The Regulatory Capital measures the portfolio risk by simply summing up individual risks. And, as a consequence, ignores the internal relations between various types of risks. Nevertheless the Group's internal risk is partly diversified by the use of the credit risk correlations defined by the regulator (in the IRB approach). The Regulatory Capital is calculated only for the credit, operational and market risk. In the IRB approach only PD, LGD, EAD and maturity components are used for calculating the Regulatory Capital for credit risk;
- The Economic Capital (EC) is defined according to the ING's own methodology as the minimum amount of capital required to cover an unexpected loss (for all material types of risk) on a specific level of trust, and within a specified time horizon. The concept of Economic Capital typically applied in ING treats EC as a measure of risk used for making alternative decisions aimed at eliminating risk in such processes as transaction valuation or profitability measurement. EC includes all types of risk (credit, transfer, market, operational and business).

Credit exposure - measurement and management

The Capital Group of ING Bank Śląski S.A. and the whole ING Group use the PD, LGD and EAD

models for many areas related to the credit risk management. Apart from the Regulatory Capital calculations (RECAP), the PD, LGD and EAD models are used also in:

a) the calculation of the Economic Capital otherwise known as internal capital,
In calculation of INCAP, ING methodology approach base on regulatory formulas for calculation of regulatory capital, described in PSFA Resolution 76/2010. Input data for INCAP calculation are PD, EAD and LGD parameters, generated by the same models that are used for calculation of Regulatory Capital, modified by corrects described in INCAP methodology. Moreover the formulas for calculation of risk weights and capital are modified (e.g. confidence interval equals to 99,95%, lack of scale coefficient equal 1,06 for capital calculation etc.).

b) the calculation of provisions according to IFRS,
PD, LGD and EAD models are used for calculation of collective provisions with respect of IBNR portfolio (Incurred But Not Recognized) - portfolio in which loss occurred, but at the day balance sheet is prepared the loss is not already recognized. Parameters are also used for calculation of provisions for INSFA portfolio (Individually Not-Significant Financial Assets) with recognized loss on debts individually not significant.
There are a few discrepancies between PD, LGD and EAD model parameters used for calculation of Regulatory Capital and used for provisions calculation e.g.: PD for provisions is corrected by loss identification period, from LGD parameter indirect costs are excluded etc.

c) credit granting process,
In corporate customer segment models are directly use in:
– credit risk assessment of customer,
– decentralized process of credit transactions approval,
– determination of maximum risk appetite of ING BSK for particular groups of debtors.
Ratings are also used in the Group to determine reference limits for corporate customers.

In retail segment customers:
– PD model is used in credit approval process, in process of creditworthiness assessment of the customer. Customers with risk level not accepted by Group are rejected in credit process,
– additionally for consumption credits (segment CLN) model is a part of integrated customer assessment process. In this process several “risk groups” of customers are determined, which influence on different parts of credit process and available credit product i.e.: credit decision competence level, maximum credit amount, maximum tenor of credit,
– LGD models are used in process setting of cut-off point (criterion the credit application from customer is rejected).

d) credit price calculation,
   The Capital Group of ING Bank Śląski for credit pricing use relation of income (diminished by cost of money i.a. liquidity premia) to risk weighted assets of the transaction (i.a. risk profile of the customer depending on among others its rating and quality of the collaterals), calculated at the level of transaction and/or customer and/or customer capital group.
   In the Group minimum profitability levels are applied, attributed to each transaction and also to single customer or customer capital group.
   Subsidies of the Bank for small transactions use simplified credit pricing process.

e) reference limits definition.
   Ratings are used in the Group during determination of reference limits for corporate customers segment.
   Reference limit is a theoretical maximum appetite of the Group for risk from one legally connected group of corporate customers. The limit is stated as concentration limit, reflecting limits for credit, investment, pre-settlement and money market products. This reference limit corresponds with consumption of economic capital for credit and transfer risk.
   In the Group reference limit is not a base to place a credit offer to particular customer. This role is assigned to limit calculated in Fast Track procedures.

Process of planning and formulation of strategy

Planning and strategy processes despite financial part includes also capital part. Capital part is being prepared by Capital Management Department in cooperation with appropriate Group units responsible for particular types of risk. The element of this process is credit risk planning, which is based on internal rating based method parameters (PD, LGD, EAD) - with reference PSFA/DNB decision regarding AIRB implementation, standardized approach elements – for retail exposures, and economic capital. Planning methodology includes Group development and expected changes in external environment. Calculated values are the basis for capital adequacy assessment, capital limits setting and credit risk management strategy in risk appetite statement (RAS). Capital plan is ratified by Management Board and Supervisory Board.

Reporting

Corporate Credit Risk Modelling and Reporting Department prepares monthly reports on corporate credit risk (including exposures managed under AIRB approach), whereas in the case of retail exposure risk such reports are prepared by the Retail Credit Risk Management Department. According to retail exposures the Group executes roll-out plan of AIRB implementation for retail and conditional retail exposures, with permanent exclusion of small business portfolio.

The Accounting Department generates obligatory quarterly reports on risk weighted assets and the minimum Regulatory Capital (COREP). The basic reporting tool, both in the Capital Group of ING Bank Śląski, and the whole ING Group, is VORTEX - a global, centralised database on

credit risk that provides a wide spectrum of information on various aspects of credit exposure, both on a transaction level and various aggregation levels. The Vortex reports contain information on risk parameters: PD, LGD, EAD, EC, RWA, the minimum Regulatory Capital, balance, and collateral. The data is available to all authorised users at all levels of management (as per specified access rights) from the risk, front-office and finances areas.

2.2.6 DETAILED INFORMATION REGARDING PARTICULAR EXPOSURE CLASSES BY OBLIGOR GRADES

Exposure classes by obligor grades is described in the tables below.

Exposure classes by obligor grades: institutions

INSTITUTIONS					
Obligor grade	Total exposure	The average value of loss given default (LGD), weighted by the exposure amount expressed as percentage	Average risk weight, weighted by the exposure amount	Amount of granted undrawn off-balance sheet liabilities	Average exposure value at the time of default on granted undrawn off-balance sheet liabilities
1	0.0			0.0	0.0
2	0.0			0.0	0.0
3	0.4	38.13	13%	0.4	0.4
4	110.6	19.03	8%	0.0	0.0
5	934.2	30.18	15%	65.5	32.2
6	460.4	23.81	14%	0.7	0.3
7	3 986.9	35.06	28%	1 193.4	30.8
8	810.7	36.79	34%	407.1	138.6
9	255.6	38.99	50%	77.4	22.0
10	359.8	40.16	52%	87.7	62.1
11	86.6	47.37	67%	32.3	12.1
12	122.1	36.60	66%	109.6	80.5
13	17.7	20.12	56%	0.0	0.0
14	7.9	63.13	103%	0.7	0.5
15	34.5	40.17	116%	0.0	0.0
16	0.4	38.13	152%	0.0	0.0
17	13.9	60.77	223%	6.8	2.3
18	12.5	14.41	80%	4.0	0.4
19	7.7			7.7	0.0
20	0.0	63.13	789%	0.0	0.0
21	0.0			0.0	0.0
22	0.0			0.0	0.0
Total	**7 221.9**	**-**	**-**	**1 993.3**	**382.2**

Exposure classes by obligor grades: entrepreneurs

ENTREPRENEURS					
Obligor grade	Total exposure	The average value of loss given default (LGD), weighted by the exposure amount expressed as percentage	Average risk weight, weighted by the exposure amount	Amount of granted undrawn off-balance sheet liabilities	Average exposure value at the time of default on granted undrawn off-balance sheet liabilities
1	0.0			0.0	0.0
2	0.0			0.0	0.0
3	0.1	48.82	275%	0.1	0.1
4	0.0			0.0	0.0
5	0.0			0.0	0.0
6	775.9	45.85	14%	622.3	127.8
7	2 456.2	41.84	28%	951.5	316.6
8	626.3	35.77	20%	270.9	54.4
9	3 304.4	31.78	33%	2 053.5	670.9
10	4 443.8	28.25	35%	2 346.2	704.4
11	7 209.6	29.22	50%	2 674.0	893.6
12	4 681.1	30.84	69%	1 233.1	460.7
13	6 792.2	27.53	68%	1 745.5	742.4
14	2 127.3	28.33	84%	574.6	244.4
15	2 940.1	23.75	79%	693.9	291.0
16	906.4	20.46	91%	224.6	101.7
17	254.6	25.40	122%	57.4	34.7
18	307.7	20.78	113%	31.1	10.7
19	322.7	27.05	146%	46.5	29.1
20	1 063.6	30.26	58%	68.8	56.5
21	0.9	67.55	49%	0.0	0.0
22	520.0	46.30	47%	8.1	5.9
Total	**38 732.9**	**-**	**-**	**13 602.1**	**4 744.9**

2.2.7 FACTORS AFFECTING LOSSES INCURRED IN PRECEDING PERIOD

Within the process of verifying levels and sources of losses the Group monitors, among other:

a) non performance rate (default rate),
b) the level of losses according to the LGD parameter, including its components (no loss rate, recovery rate on collateral, uncollateralised debt recovery rate, etc.),
c) conversion factor (for various EAD models and types of products).

In the last year the Group did not record loss which would be higher than the average loss in previous years.

2.2.8 COMPARISON OF FORECASTS WITH ACTUAL RESULTS OVER A LONGER PERIOD OF TIME

In the cyclical (at least one a year) credit risk models monitoring and validation process dedicated to individual exposure classes the Group compares the risk model parameters (PD, LGD, CCF) forecasts with their actual levels. In line with the internal model monitoring and validation procedures such comparison is based on the sufficiently long period of observation which permits a reliable assessment of the internal rating process functioning. The monitoring and validation of models performed within the reporting period showed that the departure of parameter forecasts from their actual levels remains within the assumed acceptable range, including the required level of conservatism.

2.3 INFORMATION ON CREDIT RISK MITIGATION TECHNIQUES

2.3.1 INTERNAL REGULATIONS ON THE BALANCING OF ON-BALANCE SHEET AND OFF-BALANCE SHEET EXPOSURES

In line with the rules applicable in the Bank each corporate client or a non-banking financial institution prior to initiation of a derivative transaction is obliged to sign an appropriate Framework Agreement with the Bank which enables the set-off of executed transactions. The entry of the limits awarded to a customer, which are necessary to execute a transaction, is conditioned upon signing of legal documents by a customer.
Excluded from that rule are the bank customers who are obliged to sign Framework Agreements for transactions with over 1 year maturity. Nevertheless, the Bank signed appropriate agreements with the majority of its banking partners, except for just a few banks with whom the bank enters into short (usually 1-2 days) currency exchange transactions. The Bank has pieces of legal advice and it monitors changing regulations as required under PFSA Resolution 76/2010.

2.3.2 INTERNAL REGULATIONS ON CREDIT COLLATERAL VALUATION AND MANAGEMENT

Bank

The Bank's regulations on collateral describe the valuation method for each type of collateral across the tangible and personal collateral group.

The Bank distinguishes the following collateral values:
- face value,
- adjusted face value,
- fair value.

Collateral face value is the value expressed in the collateral currency, established on the basis of current prices, excluding the influence of other factors (in particular: market value, book value, value of the accounts receivable transferred to the Bank), and set for each collateral individually. Adjusted face value is the value of collateral made real taking into account the factors omitted in the calculation of face value. Such value is worked out if in the Bank's opinion there exist factors which were omitted while calculating collateral face value or were included but to an insufficient degree and have adverse impact on collateral value.

Collateral fair value is calculated as a product of recovery rate on collateral (defined on the basis of parameters of an appropriate LGD model) multiplied by face value, or adjusted face value of collateral if there were reasons why such adjusted value should be calculated.

For example, the grounds for calculating real estate face value is its market value based on an external surveyor's appraisal and verified additionally by the Bank's Appraisal Team. The aforementioned obligation to verify the value by the Bank arises from the Recommendations imposed by the Polish Financial Supervision Authority (PSFA).

When appraising the value and liquidity of tangible collateral one takes into account the asset usage/occupancy period, age of the assets and market for specialist collateral items.

Depending on the type of collateral, the value is monitored at specified intervals, adjusted to the provisions of PSFA Resolution 76/2010 as amended.

A list of the aspects analysed and examined in the course of the credit approval process, collateral establishment and collateral monitoring includes the following issues:

- verification of the collateral value,
- physical check of the tangible collateral (inspections),
- check of the collateral formal-and-legal status (if put in place, if legally binding, if insured),
- verification of the guarantor's business-and-financial condition (setting the risk rating)

At the same time it is recommended for the decision-makers to contemplate that if certain circumstances occur, the frequency of monitoring should be increased.

Such circumstances are, inter alia:

- collateral risk,
- collateral value fluctuation risk,
- reputation risk.

If the Bank decides that collateral value should be monitored at shorter intervals it should take into consideration economic effectiveness i.e. the relation between the cost and effects of monitoring.

Monitoring performed at shorter intervals, e.g. in case of real estate, is required in the face of substantial fluctuations in the market conditions, the frequency of monitoring depends on the specific nature of such real estate and individual factors affecting its value.
With respect to other tangible collateral, beside the material fluctuations in the market conditions, more frequent monitoring may be dictated by the technical state of machines and equipment, means of transport, etc.

The Bank's regulations also define the way the collateral is presented and approved in the process of granting credit exposure in accordance with the credit mandates and the rules of presenting and approving collateral monitoring.

Relevant recovery weights from the collateral adopted for estimation of future cash flows are specified in individual computations of impairment losses under the impaired balance sheet credit exposures and provisions for off-balance sheet liabilities for clients from the ISFA portfolio. The weight, from the 0 to 80% brackets, depends on inter alia: the type of assets being the collateral of the Bank's receivables, the amount of the receivables secured with a given real property, the valuation date, and the booking value.

ING Lease (Polska) Sp. z o.o. (ING LP)

In case of lease facilities, ownership of the leased asset is the main security of lease transactions. ING LP has no separate regulations concerning the security of lease transactions. Principles of collaterals and their values arise from the nature of the lease product.
ING LP as a lease company buying the leased object from a supplier becomes its owner and then, as the owner, gives the lease object to the lessee (customer) for usage. The purchase from the supplier of the asset to be leased, under the law, is based on the market price. Acquisition value of the leased asset from the supplier is the initial value of the lease transaction.

Principles for verifying the leased assets in ING LP are included in 2ch regulations. For movables it is the "Manual of verification, suppliers and the subject of the lease", for real estates it is a "Real estate policy".
The purchase price (market value) of the new asset - movable acquired from suppliers unrelated to the lessee is not verified. The value of second-hand asset - movable (regardless who is the seller) or the value of the new asset - movable but purchased from a customer or a company associated with the customer is verified by an independent expert valuation or, if possible, internal market value verification. The value of the real estate to be financed is always verified in an appraisal prepared by an independent valuator.

While a contract is pending, value of financed movables are not verified .

Market values of financed real estates are verified at least every two years on the basis of an appraisal prepared by an independent valuator. Additionally, in those years when the external valuation of the real estate is not required, ING LP prepares internal market value verification of the financed real estate.

ING Commercial Finance S.A. (ING CF)

In case of standard factoring (with and without recourse) a basic transactions collateral are purchased from the Client receivables against debtors transferred to factoring.

At the stage of the factoring application analysis and during the term of the factoring agreement is made by ING CF current assessment of the quality of receivables (analysis of the history of collaboration between client and debtor , the provisions of trade agreements) and is carried out monitoring of the debtors financial situation.

ING CF occasionally uses other forms of collateral, such as mortgage, pledge on assets or bank/other factor guarantees. Principles of verification collateral values are defined in the ING CF Credit Instruction. In accordance with these principles in the case of establishment:

a) mortgages - at the proposal stage client is obliged to provide real estate appraisal, no older than before 12 months, an extract from the real estate land register and copy of property insurance policy. In the case of entries the mortgage to another bank information on the current state of the debt secured by a mortgage.
b) pledge on assets - at the proposal stage the client is obliged to provide documents proving the value of assets such as an insurance policy, information about stocks value.
c) bank guarantee – Front Office is required to obtain the opinion of the Bank in relation to the risk of the bank issuing the guarantee.
d) the factor guarantee (credit cover) - taking a risk foreign debtor insolvency by the foreign factor, ING CF verifies whether the factor is one from the list of factors accepted by ING Group .

In view of the very rare cases of the use of additional collateral in ING CF Credit Instructions includes a clause that the assessment of liquidity and collateral valuation ING CF carried out in accordance with the Bank's applicable rules.

2.3.3 MAIN TYPES OF CREDIT COLLATERAL

Bank

The Bank accepts all permitted legal forms of collateral, at the same time specifying its preference as to their application in the regulations on collateral.
Yet the collateral should be chosen based on:

- connecting the value and quality of collateral to the probability of the client's default; It means that the worse the client's risk rating is, the better the collateral for credit exposure should be put in place,
- seeking to fulfil the conditions specified in the regulations which enable, inter alia, including the recovery rates assigned to collateral items in the process of calculation of capital requirements and provisions,
- respecting the limitations in accepting collateral and including the guidelines presented in the regulations, aimed at the minimisation of the negative departure of the actual recovery rates from those estimated in the LGD model,

– optimisation of the collateral catalogue for a given credit exposure when there is a specific pool of collateral items available.

The Bank has identified the following collateral groups:

1) Tangible collateral which makes it possible for the Bank to recover debt in the event of a client's default by liquidating the collateral provider's specific assets – funded credit protection.
   The Bank recognises the following types of assets that may serve as tangible collateral for the Bank's receivables under credit exposure:
   – real estate,
   – movable assets - things with specified identity,
   – movable assets - inventory or things of a specified type,
   – cash (security deposits, term deposits and funds deposited as letter of credit coverage),
   – accounts receivable,
   – treasury bonds,
   – bonds traded on a stock exchange,
   – bonds not traded on a stock exchange/investment certificates,
   – shares traded on a stock exchange,
   – shares not traded on a stock exchange,
   – participation units in Open Investment Funds.

2) Personal collateral which makes it possible for the Bank to recover debt in the event of a client's default by resorting to any component of the collateral provider's assets - unfunded credit protection.
   The Bank recognises the following forms of personal collateral:
   – surety under the Bills of Exchange Law or Civil Code,
   – bank guarantee/reguarantee and corporate guarantee,
   – assuming joint and several liability for the debt.

3) In some LGD models applied in the Bank the recovery rate on the unsecured part of exposure is affected by the so-called “negative pledge” covenant which obliges a client not to create any collateral on the client’s assets or to significantly limit collateral created in favour of other creditors. The client’s acceptance of such a clause increases the recovery rate on the unsecured part of exposure.

4) Since April 2013 the product called “discounted receivable subject to recourse factoring” has been treated by the Bank as collateral. Given this, the Bank has adapted its internal regulations so as to meet the provisions of Attachment 5 to the PSFA Resolution 76/2010 and, in particular, with regard to the legal certainty, monitoring and detection possibility of a deterioration in the quality of the discounted receivables. Simultaneously, the conditions allowing to take the collateral into account in the recovery rate estimation have been described in the regulations. The monitoring process is divided between Local Business

Unit (LBU/JK/) and Risk Management Unit (RM/JR/) on the one hand and the Bank's Operations Unit (OU/JO/) on the other.

The Operations Unit monitors on a daily basis the promptness of payments and other cases of the occurrence of warning signals evidencing a deterioration in the quality of the receivables discounted and keeps LBU informed on these issues.

LBU takes note of the information within the ongoing monitoring and, additionally, within the periodic monitoring and analyses any extra information which may impact negatively on the quality of the discounted receivables taken as collateral.

5) There are also additional types of collateral used by the Bank that strengthen its position in negotiations or expand the Bank's control entitlements as a creditor. Additional collateral includes (inter alia):
   – letter of intent/letter of comfort/statement of comfort,
   – blank promissory note,
   – assignment of rights under property insurance policy,
   – credit insurance coverage from an insurance company,
   – insurance coverage for domestic accounts receivable (an insurance policy issued to ING BSK or insurance policy assignment).

   Structure of individual collateral groups is diversified. The collateral with the biggest share:
   – corporate sureties and guarantees - this group of collateral includes guarantors from various industries having diversified economic and financial standing. Therefore, there is no material risk of concentration. If a particular recovery rate has been assumed, higher than 0%, it is necessary to investigate a guarantor's economic and financial standing and assign a risk rating,
   – mortgage - its share results from the fact that usually mortgage is used to secure long-term investment loans. In addition, mortgage is the main collateral in the case of commercial real estate mortgage loans,
   – fixed and current assets,
   – accounts receivable.

Bank guarantees and securities have small share in the general pool of the collateral accepted by the Bank.

ING Lease (Polska) Sp. z o.o. (ING LP)

In case of lease facilities, ownership of the leased asset is the main security of lease transactions. ING LP has no separate regulations concerning the security of lease transactions . Principles of collaterals and their values arise from the nature of the lease product

ING Commercial Finance S.A. (ING CF)

In case of standard factoring (with and without recourse) a basic transactions collateral are purchased from the client receivables against debtors transferred to factoring.

In addition to the assignment of receivables as collateral ING CF acquiring also promissory note issued by the client, often guaranteed by the client's shareholders, power of attorney for the customer's bank account and in the case of without recourse factoring we use of the insurance risk of debtors insolvency in one of the insurance companies providing receivables insurance. In the case of reverse factoring ING CF does not use additional collateral due to the targeting of this product only to selected customers (in a very good financial situation) with strategic customer segment. The basic collateral of these transactions is a power of attorney to the client's bank account.

ING CF occasionally uses other forms of collateral, such as mortgage, pledge on assets or bank/other factor guarantees.

2.3.4 MAIN TYPES OF GUARANTORS AND CREDIT DERIVATIVE COUNTERPARTIES AND THEIR CREDIT RATING

The main credit underwriter of ING Bank Śląski S.A. is Bank Gospodarstwa Krajowego S.A. The below table lists the top ten business partners along with the collateral held by them. The Bank does not use credit derivatives.

No.	Underwriter	Collateral value	ING Bank Rating 31.12.2013
1.	Underwriter 1	636.3	BC07
2.	Underwriter 2	107.4	CL08
3.	Underwriter 3	99.9	CI08
4.	Underwriter 4	71.9	CL12
5.	Underwriter 5	50.8	FU06
6.	Underwriter 6	39.2	CL11
7.	Underwriter 7	32.9	KC15
8.	Underwriter 8	32.7	GL09
9.	Underwriter 9	30.7	GL07
10.	Underwriter 10	30.0	BC07

2.3.5 MARKET OR CREDIT RISK CONCENTRATION WITHIN THE APPLIED RISK MITIGATION INSTRUMENTS

The most frequent type of collateral is a mortgage (80% of the total amount) due to the fact that the institution is significantly involved in financing the purchase of residential real properties and financing commercial real properties.

The value of exposure secured with the acknowledged financial collateral constitutes PLN 20.9 million and applies to retail exposures.

3. INFORMATION ON OPERATIONAL RISK

3.1 GENERAL DESCRIPTION OF THE OPERATIONAL RISK MANAGEMENT PROCESS AT THE BANK

ING Bank Śląski S.A. manages operational risk pursuant to the laws, recommendations and resolutions of the Polish Financial Supervision Authority and of other regulators.

The operational risk management process is an integral element of the Bank management process which means that information received in the operational risk management process is taken into consideration in the decision-taking processes concerning business activity.

The operational risk management system covers all spheres of the Bank's activity and the Bank Capital Group's activity, cooperation with outsourcers, clients and partners and is a consistent and permanent practice covering the following elements:

a) internal environment,
b) goal setting,
c) risk identification,
d) risk assessment,
e) response to risk,
f) control activities,
g) risk monitoring, and
h) reporting and transparency of actions.

The Supervisory Board supervises of operational risk management and, based on periodic management information, executes at quarterly meetings assessment of activities in this area.

Having obtained the Supervisory Board's approval, the Bank Management Board determines the strategy for operational risk management by implementing a coherent set of internal prescriptive documents governing the scope, principles and duties of Bank employees related to mitigation of effects and probability of incidents occurrence in that area.

The role of the Bank Non-Financial Risk Committee covering the operational risk, compliance risk and internal and external anti-fraud actions is particularly crucial for ensuring continuity and consistency of risk management. Non-Financial Risk Committees in business lines support the Bank Committee.

The structure of operational risk management takes account of the scope and specific nature of the Bank's operations, existing business lines, client segments, and product groups. The management structure is underpinned by the Three Lines of Defence Model.

1st line of defence

Managerial staff is responsible for developing, implementing and performing risk mitigation controls. 1st line of defence is responsible for adherence to the principles arising from approved policies, bylaws, manuals, and procedures.
The scope of responsibilities includes in particular:

a) risk assessment aimed at risk mitigation,
b) implementation and application of key controls arising from policies and standards,
c) monitoring of changes to the risk profile,
d) ensuring adequacy and effectiveness of key controls, and
e) maintenance and testing of business continuity/ disaster recovery plans.

2nd line of defence

It is composed of the Departments involved in risk and specific controls management in the non-financial risk area, credit risk, market risk, financial risk and human resources management and supporting the 1st line of defence in risk management by:

a) setting the policy and other internal regulations as well as ensuring risk management methods and tools,
b) verifying application of the regulations referred to hereinabove by the 1st line of defence,
c) monitoring key controls, and
d) ensuring that other mitigating actions are taken.

3rd line of defence

Internal Audit assesses effectiveness of activities taken by the 1st and 2nd lines of defence. These are assessing and advising activities. Neither the 1st line of defence nor 2nd line of defence are exempted from their accountability for adequacy, efficiency and effectiveness of internal control mechanisms, mitigation the risk taken.

3.2 METHODS APPLIED TO QUANTIFY CAPITAL REQUIREMENT FOR THE OPERATIONAL RISK

For the regulatory capital requirement for the operational risk, at present the Bank applies Basic Indicator Approach.

In order to calculate the economic capital requirement, the Bank applies the Advanced Measurement Approach.
The model applied by the Bank is a hybrid model combining the actual loss data and the data collected on the basis of expert judgments. It is based on the Loss Distribution Approach which is applied to set capital requirements by combining the frequency distribution and severity distribution of the events in the operational risk area. Severity describes a possible risk level (loss value) and loss value distribution, whereas frequency describes how often a given risk occurs throughout the year. Following the PFSA requirements and the New Capital Accord (Basel II) regulations, the four sources of data are used in the Bank's AMA framework:

– Internal loss data,
– External loss data,
– Scenario analyses, and
– Business environment and internal control factors.

The AMA model categorises risks and applies the aforementioned data for risk modelling within two segments. One segment stands for the body distribution risk which corresponds to operational risk events of high frequency and low severity. The second segment, being the tail distribution risk, corresponds to losses of high severity but low frequency. The two segments are combined together in order to obtain an aggregate risk model.

3.3 INFORMATION ABOUT GROSS LOSSES DUE TO THE OPERATIONAL RISK

In 2013, the Capital Group of ING Bank Śląski reported operational risk losses of PLN 3.9 million; out of which PLN 0.7 million, being 17.9% of the total gross actual losses, was recovered through direct recovery and insurance recovery.

The actual gross losses due to the operational risk and compliance risk totalled of PLN 3.8 million that is 0.12% of the Bank's total income and settled at 16.71% of the loss limit set by the Bank Management Board and Supervisory Board in the Non-Financial Risk Appetite Statement of ING Bank Śląski S.A. for 2013 for this group of events. Losses of the other companies of the Capital Group of ING Bank Śląski amount PLN 0.1 million.

Following the operational risk events, last year the Bank created provisions of PLN 1.4 million. The pool of provisions was reduced by PLN 0.2 million due to payments and the provision of PLN 0.1 million was released as related triggers ceased to apply. The amount paid from the provisions was recognised in the actual gross losses. Provisions established for operational risk events in other ING Bank Śląski Capital Group companies were amounted to PLN 0,1 million.

Actual losses distribution of the Capital Group of ING Bank Śląski as per type and category of events with losses ≥ PLN 0.1 million

No.	Event type	Event category	Gross losses in PLN million
1.	Internal fraud	Theft and fraud	0.3
2.	External fraud	Theft and fraud	0.4
		Safety of systems used by bank clients	1.0
3.	Principles concerning employment	Employee relations	0.2
4.	Losses in non-current assets	Natural disasters and other events (acts of vandalism)	1.2

5.	Transaction execution. delivery and operational processes management	Transaction input, execution, settlement and service (system and employee errors)	0.8
Suma strat			**3.9**

In 2013, no material losses were reported due to criminal attacks on the Bank and other companies of the Capital Group of ING Bank Śląski IT infrastructure.

The highest losses were caused by:
- external fraud, mainly due to criminal attacks on the IT systems of the clients using the electronic banking services. In justified circumstances Bank reimbursed the aggrieved parties for stolen funds,
- the damage related to non-current assets that arose due to acts of vandalism on the Bank's property,
- losses due to human errors and incorrect transaction execution in ATMs and CDMs of ING Bank Śląski S.A.

The actions to mitigate negative financial consequences of operational risk events concentrated mainly on:
1) further increasing the safety of the internet banking services used by retail and corporate clients. To this end, the Bank launched a Project targeted at systematic development of technical equipment as well as raising clients' and employees' awareness of threats,
2) enhancing security mechanisms of the external devices and Bank's facilities and to streamline the management system of physical security. The risk of financial losses in this category of events is also mitigated by transferring the risk into the insurance market,
3) systematic upgrading of the infrastructure of 792 ATMs and 723 CDMs. In 2014, the Bank is planning to replace 150 machines,
4) limiting the number of employee errors when executing transactions and servicing clients by developing IT mechanisms for data validation and providing obligatory employee training courses, inter alia as regards product procedures, ethics, principles of bank secrecy protection, anti-money laundering and unfair competition.

4. SOLVENCY RATIO

The solvency ratio is calculated as percentage, namely a fraction whose:
- numerator is the value of the capital fund plus short-term capital,
- denominator is the overall capital requirement multiplied by 12.5, multiplied by 100.

The consolidated solvency ratio of the ING Bank Śląski S.A. Capital Group as at 31 December 2013 is 17.28 %.

Calculation of solvency ratio

	end of year 2013	end of year 2012
Own funds taken into account in solvency ratio calculation	7 286.0	6 797.2
Total capital requirement	3 372.5	3 736.1
Solvency ratio	**17.28%**	**14.55%**

5. INTERNAL CAPITAL

At the Capital Group of ING Bank Śląski S.A. Economic Capital (internal capital) is defined as capital needed to cover all material risks identified by Group in its activities and macroeconomic environment. Capital covers potential unexpected losses on which the Group is exposed in future with confidence interval corresponding with AA rating (99,95%) and one year horizon. For economic capital calculation purposes only methodologies accepted by Management board are used.

Material risk types identification

At the Capital Group of ING Bank Śląski S.A. process of material risk types identification is described in "Risk Materiality Assessment Policy at ING Bank Śląski S.A.". This document in details describe rules of risk identification and methods of risk types, influencing the Group, materiality assessment. Additionally in 2013 it is implemented "Difficult to Measure Risks Manangement Policy at ING Bank Śląski S.A.", which set rules of difficult to measure risk types. On the basis of above mentioned documents, Bank identifies following types of risk:

- permanently material risk - a risk which, in view of the nature of the business, is currently material and will be material in the future, irrespectively of the risk management. The nature of the Group's business shall be understood as deposit and credit services, connected with it Bank's liquidity management, functioning in macroeconomic environment and risk management connected with inappropriate and deficiencies of internal processes, people and technical systems or external events,
- material risk - the risk shall be regarded as material if the risk may cause potential losses with the probability of occurrence and value qualifying it as material in line with the table below:

Frequancy					
	At least once a year	non-material	material	material	material
	At least once in 5 years	non-material	non-material	material	material
	Less frequently than once in 5 years	non-material	non-material	non-material	material
	Potential losses (PLN) on Capital Base	up to 0,2% capital base	from 0,2% to 1% capital base	from 1% to 5% capital base	above 5% capital base

non-material material

– difficult to measure risk is risk for which in Bank opinion there is no possibility to build qualitative or quantitative measures, which in appropriate way quantify this risk.

During Risk Assessment Workshops for 2013 year the following risk classification has been accepted:

Risk type		Permanently material	Material	Non-material		Difficult to measure
Credit risk						
	Default risk and counterparty risk	✓				
	Concentration risk	✓				
	Residual risk	✓				✓
	Residual value risk	✓				
	Transfer risk		✓			
Market risk						
Trading risk	Exchange rate risk	✓				
	Interest rate general risk in trading book	✓				
	Interest rate specific risk in trading book	✓				
	Interest rate risk banking book: total mismatch	✓				
	Interest rate risk banking book: base risk			✓		
	Interest rate risk banking book: option risk			✓		
Property in own use risk			✓			
Property investment risk			✓			
Equity investment risk	Capital securities investment risk banking book		✓			
	Capital securities investment general and specific risk trading book			✓		
Business risk						
	Strategic risk	✓				
	Macroeconomic risk		✓			
Liquidity and funding risk						
	Liquidity and funding risk	✓				
Operational risk						
	Operational risk	✓				
Model risk						
	Model risk		✓			✓
Settlement risk						
	Settlement risk		✓			

Economic capital assessments methodology

The Capital Group of ING Bank Śląski S.A. is calculating capital for following risks:

1) Default risk and counterparty risk - risk of potential losses due to clients failure of fulfilling their obligations and the risk of economic value decrease of credit exposure due to deterioration of clients creditability - is calculated using modified AIRB method (INCAP).
2) Transfer risk - risk related to the potential losses due to foreign clients obstruction to fulfill their obligations resulting from local authorities restrictions in capital transfer or/and currency transfer - only for countries with rating lower then 9, capital is equal to 1% of exposure
3) Residual risk - economic capital for residual risk, arising from less than assumed effectiveness of recognized credit risk mitigation techniques, is determined as the difference of economic capital for credit risk determined by the reduced value of collateral and economic capital for credit risk, measured according to the method of INCAP.
4) Concentration risk - economic capital for concentration risk arising from exposures against:
   - individual borrowers or group of related borrowers - is determined according to the rules determining regulatory capital requirements defined in the PSFA Resolution 76/2010 . Detailed rules for the calculation of capital are described in the "Calculation of the capital requirement for exceeding the concentration limit and large exposure limit",
   - borrowers from the same economy sector/geographic sector - is calculated as the excess of the set concentration limit for this exposures group, net of write-offs.
5) Residual value risk - Risks arising from the residual value of the leased asset, which is the difference between the value of the asset and the sum of the lease payments. The contractor has the right to purchase the leased asset, but it is not absolutely obliged to do this. Capital requirement is calculated according to PSFA Resolution 76/2010.
6) Risks of operations on financial markets - risk related to losses connected with interest rate and exchange rate changes - capital is calculated on the basis of VaR.
7) Strategic risk - risk associated with taking adverse or erroneous strategic decisions, the lack of or faulty execution of the strategy and changes in the external environment and an inappropriate response to these changes which result in the financial results under the requirements arising from the need to conduct current operations and development mainly in order to ensure an adequate supply of capital. Capital requirement is estimated on the basis of surplus of potential strategic risk losses (historically estimated deviation from the plan) over planned financial result.
8) Macroeconomic risk - risk arising from macroeconomic changes and their impact on the minimum capital requirements. Capital requirements are based on Banks stress tests for mild recession and required capital adequacy metrics level.
9) Equity investment risk, property investment risk and property in own use risk – risk connected with changes in equity and property valuation - capital is calculated on the basis of historical volatility and/or expert judgement and portfolio valuation.
10) Liquidity and funding risk - a risk involving the inability to meet, at a reasonable price, financial obligations resulting from the balance sheet and off-balance sheet. The Bank maintains liquidity in such a way that the monetary liabilities of the Bank and its subsidiaries may have always done with the available funds, proceeds from maturing options available funding sources at market prices and / or the liquidation of marketable assets. Capital requirement for this type of risk is calculated as a sum of two elements:

replicating portfolio valuation based on Monte Carlo simulation and internal liquidity limits excess over M1 and M2.

11) Model risk - risk of introducing incorrectly built (defined) models, tariffs or parameters, inappropriate application of models or lack of their necessary update. It is also a risk of improper control and monitoring during the functioning of the model. Capital requirement is calculated for material models with increased or high level of model risk and expert judgement.
12) Settlement risk - risk of failure of fulfilling by counterparty obligations regarding transaction settlement and delivery of financial instrument on agreed date. Capital requirement is calculated according to PSFA Resolution 76/2010.
13) Operational risk - risk of direct or indirect loss - material or reputational - resulting from inadequate or failed internal processes, bank's employees and systems or from third parties/external events. Operational risk include legal risk. To calculate the economic capital requirement, the Bank applies the Advanced Measurement Approach. The model applied is a hybrid model allowing the Bank to measure risk on the basis of internal and external data on operational risk events, scenario analysis as well as business environment and internal control factors.

ICAAP Review Process

Every month the Bank is preparing reports on realised capital requirements for all types of material risks and planned values. These reports are received by Assets and Liabilities Committee (ALCO) and Management Board. Supervisory Board on the regular basis informed on Banks and Group capital adequacy, including internal capital.
Once a year ICAAP review process is performed and report from this review is sent to Management Board of Bank, Audit Committee and Supervisory Board of ING Bank Śląski S.A. Additionally once a year independent ICAAP process audit is carried out by Internal Audit Department.

ICAAP in subsidiaries

ICAAP Process has been implemented in three ING Bank subsidiaries: ING Securities S.A., ING Commercial Finance S.A. and ING Lease (Polska) Sp. z o.o. ICAAP Process in these units is independent from Bank and Group process. Capital Management Department with units responsible for risk management at bank supervise risk management processes at the Group units. ICAAP Review Reports from above mentioned subs are attached to the Banks report and are sent to the Management Board of Bank, Audit Committee and Supervisory Board.

II. VARIABLE REMUNERATION POLICY

INTRODUCTION

Pursuant to Article 111 a. of the Banking Law Act dated 29 August 1997 (Journal of Laws of 2002 No. 72, item 665 as amended) ING Bank Śląski S.A., hereinafter referred to as the Bank, is obliged to reveal qualitative and quantitative disclosures relating to the Variable remuneration policy.

Pursuant to Resolution 7/I/2014 of the Supervisory Board of 31th January 2014, disclosures relating to the Variable remuneration policy of ING Bank Śląski S.A. are published.

Whenever Resolutions of the Polish Financial Supervision Authority are referred to in this document, they should be construed as the regulations specified in the "Policy of disclosing qualitative and quantitative information on capital adequacy and the scope of published information of ING Bank Śląski S.A.".

1. QUALITATIVE INFORMATION

1.1 SOME DETAILS OF THE PROCESS OF DETERMINATION OF THE VARIABLE REMUNERATION POLICY, INCLUDING COMPOSITION AND SCOPE OF TASKS OF THE REMUNERATION AND NOMINATION COMMITTEE, EXTERNAL CONSULTANT AND DECISION-TAKING PROCESS PARTICIPANTS WHEN DEVELOPING THE SAID POLICY, INCLUDING THEIR ROLE IN THE PROCESS

As regards the variable remuneration, in 2012 the Bank implemented the solutions under PSFA Resolution 258/2011. The Supervisory Board approved the Variable Remuneration Policy of Persons Holding Managerial Positions Having Material Impact on the Risk Profile of ING Bank Śląski S.A. (the Policy), the Executive Compensation Bylaw for Members of the Management Board of ING Bank Śląski S.A., the General Conditions of Bonus Award to Persons Holding Managerial Positions Having Material Impact on the Risk Profile of ING Bank Śląski S.A. and the General Conditions of Phantom Equity Plan of ING Bank Śląski S.A.

The content of the above mentioned regulations was developed by a team supervised by the Bank Executive Director for HR Area. In their works in 2012, the team used the services rendered by the external consultant being PricewaterhouseCoopers Polska Sp. z o.o.

As far as the Policy is concerned, the Remuneration and Nomination Committee has the following responsibilities:

1) they present the Supervisory Board with opinions about and recommendations on the Policy,
2) they present the Supervisory Board with recommendations on Policy observance, following the report developed by the Internal Audit Department,
3) they advise upon and monitor variable remuneration of persons holding managerial positions.

The other competences of the Committee which may be applicable when pursuing the Policy are specified in the Bylaw of the Remuneration and Nomination Committee of ING Bank Śląski S.A.

Committee composition: Ms Anna Fornalczyk (Remuneration and Nomination Committee Chairwoman, Independent Member), Mr Brunon Bartkiewicz, Mr Nikolaas Cornelis Jue as well as Mr Wojciech Popiołek (Independent Member).

In 2013 the Remuneration and Nomination Committee held five meetings. Moreover, in one case the Committee took its decision on a circular basis.

1.2 KEY FACTS ABOUT REMUNERATION DEVELOPMENT, PERFORMANCE-BASED REMUNERATION INCLUDED

ING Bank Śląski S.A. develops its remuneration policy based on market data.
The total remuneration is divided into the fixed and variable remuneration. The maximum relation of the fixed remuneration to the variable remuneration was established. The relation of fixed to variable remuneration is set as 1 to maximum 2.5 and in case of persons responsible for Control Functions as 1 to 1. Fixed remuneration is as large a part of the total remuneration as needed to ensure that a fully flexible variable remuneration policy is pursued, including but not limited to allowing to apply reduction or not to award the variable remuneration at all.
Additionally, the variable remuneration shall be as large part of the fixed remuneration as to encourage the persons concerned to care about the long-term and sustained development of the Bank.
Under PFSA Resolution 258/2011, the variable remuneration is deferred and at least 50% thereof is paid in phantom stock entitling to cash conditional on the price of ING Bank Śląski S.A. shares.

Variable remuneration is established based on the assessment of work performed by a given person and given organisational unit as well as results in the area of responsibility of a given person while taking into account the entire Bank's result.

In keeping with the Capital Management Procedure at ING Bank Śląski S.A., the Bank tests capital to ensure that the total variable remuneration pool of all employees does not limit the ING Bank Śląski S.A.'s ability to maintain an adequate capital base. Should such a limitation apply, a decision not to activate the variable remuneration pool can be taken.

1.3 KEY FACTS ABOUT PERFORMANCE MEASUREMENT CRITERIA AND PERFORMANCE ADJUSTMENT WITH RISK AS WELL AS KEY PARAMETERS AND PRINCIPLES OF DETERMINING REMUNERATION FOR PERSONS HOLDING MANAGERIAL POSITIONS AT THE BANK

The Bank employs advanced measurement approach to estimate the capital base and the stress-testing policy, whereby adequate risk management and adequate assessment of present and future capital requirements are ensured.
At the time defined, the direct superior determines the performance-related annual goals which ensure coherence with the long-term strategy of the Bank. The goals support creating long-term value of the Bank and account for the risk cost of the Bank and liquidity risk. The goals have the following nature:

1) financial, inclusive of Bank performance-related tasks and a given employee area of responsibility (e.g. Bank net profit, financial risk costs),
2) non-financial, inclusive of quality indicators related to execution of the Bank strategy and/ or related to performance of a given control function, non-financial risk.

The goals and their weights - set in accordance with the rules adopted in the Bank - are approved by the Management Board of Bank; for ING Bank Śląski S.A. Management Board Members - by the Supervisory Board, based on the recommendation of the Remuneration and Nomination Committee.
The goals of a person holding a managerial position responsible for control functions are based in at least 75% on the function-based objectives and comprise quality tasks. When determining the financial tasks, they are not related to the results achieved in areas controlled by the given person.
Assessment and its verification is performed by the immediate superior and is approved by the Management Board of Bank, following the advice of the Remuneration and Nomination Committee; for ING Bank Śląski S.A. Management Board Members - by the Supervisory Board, based on the recommendation of the Remuneration and Nomination Committee. Assessment and verification take place by 31 March of the subsequent calendar year at the latest.
In keeping with the Policy, the Executive Compensation Bylaw for Members of the Management Board and the General Conditions of Bonus Award to Persons Holding Managerial Positions Having Material Impact on the Risk Profile of ING Bank Śląski S.A., both financial and non-financial criteria as well as risk-adjusted criteria are employed to assess individual performance.
Bank's policy provides for adjustment for remuneration cost. It is made under the Policy, whereunder based on the ex post risk adjustment, the Bank has the right to reduce or not to disburse the variable remuneration when it could potentially have the negative impact on the Bank's results.

The Bank specifically regulated the terms and conditions of bonus award in case of labour relationship termination or expiry.

In accordance with the Policy, the Bank does not award additional remuneration as may be due because of termination of the employment contract understood as a part of the variable remuneration package.

2. QUANTITATIVE INFORMATION

The analysis covers all persons holding managerial positions having material impact on the risk profile of the Bank – in keeping with Enclosure No. 1 with the Variable Remuneration Policy.

Below, the quantitative information is presented required by the Policy of disclosing information as regards the variable remuneration:

1) Aggregate quantitative information about remuneration by business line used in Bank management:

No.	Business line	Total remuneration (fixed + variable)
1	Management Board Members managing business lines used in Bank management	6.9
2	Management Board Members - other	10.9
3	Retail banking segment	10.1
4	Corporate banking segment	27.4
	Total	**55.3**

2) Aggregate quantitative information about remuneration of persons holding managerial positions at the Bank, in split into:
   a) Management Board Members and persons reporting directly to the Management Board member irrespective of their employment basis, Branch Directors and Branch Deputy Directors and the Chief Accountant when considered the persons having material impact on the risk profile of the Bank,
   b) other persons holding managerial positions at the Bank when considered the persons having material impact on the risk profile of the Bank,

comprising the following data:

- aggregate remuneration for a given accounting year in split into fixed and variable remuneration and number of its beneficiaries:

	Group	Number of persons	Remuneration fixed	Variable remuneration	Total remuneration (fixed and variable)
A	Management Board Members	7	10.2	7.6	17.8
B	Persons reporting directly to the Management Board member irrespective of their employment basis, Branch Directors and Branch Deputy Directors and the Chief Accountant when considered the persons having material impact on the risk profile of the Bank	43	21.4	10.6	32.0
C	Other persons holding managerial positions at the Bank when considered the persons having material impact on the risk profile of the Bank	6	3.9	1.6	5.5
	Razem	**56**	**35.5**	**19.8**	**55.3**

- aggregate amount and form of variable remuneration in split into the remuneration paid in cash and instruments referred to in §29 (7) of Resolution 258/2011, adopted at the Bank:

	Group	Variable remuneration - paid in cash	Variable remuneration - paid in phantom stock	Variable remuneration total
A	Management Board Members	3.8	3.8	7.6
B	Persons reporting directly to the Management Board member irrespective of their employment basis, Branch Directors and Branch Deputy Directors and the Chief Accountant when considered the persons having material impact on the risk profile of the Bank	5.3	5.3	10.6
C	Other persons holding managerial positions at the Bank when considered the persons having material impact on the risk profile of the Bank	0.8	0.8	1.6
	Razem	**9.9**	**9.9**	**19.8**

– aggregate deferred remuneration in split into the awarded and still not awarded parts:

	Group	Deferred variable remuneration - not-awarded part	Deferred Variable remuneration total
A	Management Board Members	3.0	5.3
B	Persons reporting directly to the Management Board member irrespective of their employment basis, Branch Directors and Branch Deputy Directors and the Chief Accountant when considered the persons having material impact on the risk profile of the Bank	4.2	7.4
C	Other persons holding managerial positions at the Bank when considered the persons having material impact on the risk profile of the Bank	0.7	1.2
	Razem	**7.9**	**13.9**

– aggregate remuneration with deferred payment, granted in the accounting year, paid and reduced as part of the adjustment related to results:

Since the variable remuneration policy implementation-related regulations were adopted in the year 2012, deferred payouts will be subject of grant, payment and adjustment in the coming years.

– aggregate amount of payments related to employment start and termination in a given accounting year, number of beneficiaries as well as the top payment per person:

Group		The value of payment related to the termination of employment	Number of persons	Top payment per person
A	Management Board Members	-	-	-
B	Persons reporting directly to the Management Board member irrespective of their employment basis, Branch Directors and Branch Deputy Directors and the Chief Accountant when considered the persons having material impact on the risk profile of the Bank	0.6	1.0	0.6
C	Other persons holding managerial positions at the Bank when considered the persons having material impact on the risk profile of the Bank	0.8	1.0	0.8
	Razem	**1.4**	**2.0**	

The amounts shown above do not include the damages due under the non-competition agreements.

In 2013 total remuneration of any person employed at ING Bank Śląski S.A. Capital Group did not exceed the amount of EUR 1 million.