



# 2015

Qualitative and quantitative disclosures relating to capital adequacy and variable components of remuneration of the ING Bank Śląski S.A. Group published for 2015

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## **I. Capital adequacy**

### **Introduction**

Pursuant to the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 and the Banking Law Act of 29 August 1997 (Journal of Laws of 2015, item 128 as amended), hereinafter referred to as the "Banking Law Act", ING Bank Śląski S.A., hereinafter referred to as the Bank, is obliged to make qualitative and quantitative disclosures relating to the capital adequacy, excluding information immaterial, proprietary or confidential.

Pursuant to the "Policy of disclosing qualitative and quantitative information on capital adequacy and variable components of remuneration of ING Bank Śląski S.A.", disclosures relating to the ING Bank Śląski S.A. Group, hereinafter referred to as the Group, are published.

Disclosures in this document are based on the data from the 2015 annual consolidated financial statements of the ING Bank Śląski S.A. Group.

### **1. Own funds**

#### **1.1 Full reconciliation of own funds items to audited financial statements**

The capital comprises: the share capital, the supplementary capital - issuance of shares over nominal value share premium account, revaluation reserve 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 charter 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 reserve represents:

- measurement of financial assets available for sale,
- measurement of financial instruments hedging cash flows,
- measurement of non-current assets at fair value, and
- recognition of actuarial gains and losses.

Charges for deferred tax connected with the abovementioned measurements are carried through the revaluation reserve.

Measurement of share-based payments - this item is presented as the fair value valuation of options granted under the Group's incentive schemes addressed to Bank employees.

Retained earnings represent the profits earned by the Group in the previous period less paid up dividends. Retained earnings comprise:

- other supplementary capital,

- capital reserve,
- general risk fund,
- undistributed profit/loss of past years, and
- 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 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 own funds include profit in the process of approval and the net profit of the current reporting period less expected charges and dividend in the amount not exceeding profit as verified by the chartered accountant.

As at 31.12.2015 in the own funds of the Group was recognized Bank's net profit in the amount of PLN 305.5 million for the period from 01.01.2015 to 06.30.2015, after deducting the expected charges and dividend, based on the decision of the Financial Supervision Authority of 29 October 2015.

Unrealised gains and losses on debt and equity instruments available for sale are recognized in own funds in accordance with the guidelines in Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 and the Banking Law Act. In accordance with the article 171a of the Banking Law Act applied the following percentages:

- unrealised gains are removed from own funds to 60%, and
- unrealised losses are included in own funds to 100%.

Group decreases own funds by the following values:

- goodwill and other intangible assets,
- difference between the amount of provisions and the amount of expected losses (the value computed for the bank calculating risk-weighted exposure amounts using IRB approach).

The table below is presents calculation of regulatory own funds.

	items of the consolidated statement of financial position	adjustments resulting from the application of prudential consolidation	items of the consolidated statement of financial position, taking into account the prudential consolidation	items not recognized in the regulatory own funds	items recognized in the regulatory own funds
<b>ASSETS</b>					
Intangible assets	419.6	-1.4	421.0	-	<b>-421.0</b>
<b>LIABILITIES AND EQUITY</b>					
Share capital	130.1	0.0	130.1	-	<b>130.1</b>
Supplementary capital - issuance of shares over nominal value	956.3	0.0	956.3	-	<b>956.3</b>
Revaluation reserve	1 485.0	3.1	1 481.9	1 326.5	<b>155.4</b>
- revaluation reserve from measurement of available- for-sale financial assets	498.5	0.0	498.5	343.1	<b>155.4</b>
- revaluation reserve from measurement of property, plant and equipment	22.9	3.0	19.9	19.9	-
- revaluation reserve from measurement of cash flow hedging instruments	960.6	0.0	960.6	960.6	-
- actuarial gains/losses	3.0	0.1	2.9	2.9	-
Revaluation of share-based payments	49.4	0.0	49.4	49.4	-
Retained earnings	8 057.1	-9.1	8 066.2	828.9	<b>7 237.3</b>
- other supplementary capital	184.2	-0.2	184.4	-	<b>184.4</b>
- reserve capital	5 510.4	0.0	5 510.4	-	<b>5 510.4</b>
- general risk fund	1 110.2	0.0	1 110.2	-	<b>1 110.2</b>
- result of past years	125.3	-1.5	126.8	-	<b>126.8</b>
- net income for the current year	1 127.0	-7.4	1 134.4	828.9	<b>305.5</b>
<b>Equity attributable to shareholders of ING Bank Śląski S.A.</b>	<b>10 677.9</b>	<b>-6.0</b>	<b>10 683.9</b>	<b>2 204.8</b>	<b>8 479.1</b>
Non-controlling interests	2.6	2.6	0.0	-	-
<b>Total equity</b>	<b>10 680.5</b>	<b>-3.4</b>	<b>10 683.9</b>	<b>2 204.8</b>	<b>8 479.1</b>
<b>Equity recognized in the regulatory own funds</b>					<b>8 479.1</b>
Deductions, including:					-559.1
- goodwill and other intangible assets					-421.0
- shortage/surplus adjustments for credit risk to the expected loss under AIRB					-138.1
<b>Regulatory own funds adopted for the calculation of the total capital ratio</b>					<b>7 920.0</b>

## 1.2 Description of the main features of capital instruments issued by the Bank

The main characteristics of the Common Equity Tier 1 instruments issued by the Bank are presented in the table below.

### The main characteristics of the capital instruments

1	Issuer	ING Bank Śląski S.A.
2	Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement)	ISIN code: PLBSK0000017
3	Governing law(s) of the instrument	Polish
	<i>Regulatory treatment</i>	Yes
4	Transitional CRR rules	Common Equity Tier 1 Partial issue reclassification to lower category of capital - not applicable.
5	Post-transitional CRR rules	Common Equity Tier 1
6	Eligible at solo/(sub-)consolidated/solo & (sub-)consolidated	Solo & (Sub-)consolidated
7	Instrument type (types to be specified by each jurisdiction)	Instrument type: ordinary share. Classification - Common Equity Tier 1 instrument in accordance with Article 28 of Regulation (EU) No. 575/2013.
		Nominal value: PLN 92.6 million (series A) PLN 37.5 million (series B)
		Agio: PLN 956.3 million (series B)
8	Amount recognised in regulatory capital (currency in million, as at the last reporting date)	Total capital worth: PLN 92.6 million (series A) PLN 993.8 million (series B)
		All parts of the instrument are included in the same category of regulatory capital. The amount recognized in regulatory capital does not differ from the amount of the issued instrument.
9	Nominal amount of instrument	PLN 130.1 million
9a	Issue price	Series A: PLN 5 (after the denomination and after the shares split*) Series B: PLN 26.5 (after the shares split*)
9b	Redemption price	Not applicable
10	Accounting classification	Equity
11	Original issue date	08 October 1991
12	Perpetual or dated	Perpetual
13	Original maturity date	No maturity
14	Issuer call subject to prior supervisory approval	No
15	Optional call date, contingent call dates and redemption amount	Not applicable
16	Subsequent call dates, if applicable	Not applicable
	<i>Coupons/dividends</i>	<i>Dividends</i>
17	Fixed or floating dividend/coupon	Floating
18	Coupon rate and any related index	Not applicable
19	Existence of a dividend stopper	Yes

20a	Fully discretionary, partially discretionary or mandatory (in terms of timing) - in relation to the payment of the coupon/dividend	Partially discretionary; causes: - decisions of the Supervisory Board - results - administrative decisions
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount) - in relation to the payment of the coupon/dividend	Fully discretionary
21	Existence of step up or other incentive to redeem	No
22	Noncumulative or cumulative	Noncumulative
23	Convertible or non-convertible	Non-convertible
24	If convertible, conversion trigger(s)	Not applicable
25	If convertible, fully or partially	Not applicable
26	If convertible, conversion rate	Not applicable
27	If convertible, mandatory or optional conversion	Not applicable
28	If convertible, specify instrument type convertible into	Not applicable
29	convertible, specify issuer of instrument it converts into	Not applicable
30	Write-down features	No
31	If write-down, write-down trigger(s)	Not applicable
32	If write-down, full or partial	Not applicable
33	If write-down, permanent or temporary	Not applicable
34	If temporary write-down, description of write-up mechanism	Not applicable
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Not applicable
36	Non-compliant transitional features	No
37	If yes, specify non-compliant features	Not applicable

\*) In 2011, the nominal value of shares was split. As a result, the nominal value of shares was reduced from PLN 10 to PLN 1 per share.

### 1.3 Information on the nature and amount of certain own funds items

The table below presents nature and amount of certain own funds items.

No.*	Description	(A) Amount at disclosure date	(B) Regulation (EU) No 575/2013 Article reference	(C) Amounts subject to pre-Regulation (EU) No 575/2013 treatment or prescribed residual amount of Regulation (EU) No 575/2013
<b>Common Equity Tier 1 capital: instruments and reserves</b>				
1	Capital instruments and the related share premium accounts	1 086.4	26 (1), 27, 28, 29, EBA list 26 (3)	
	of which: ordinary share	130.1	EBA list 26 (3)	
2	Retained earnings	126.8	26 (1) (c)	
3	Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards)	6 193.2	26 (1)	
3a	Funds for general banking risk	1 110.2	26 (1) (f)	
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	305.5	26 (2)	
6	<b>Common Equity Tier 1 (CET1) capital before regulatory adjustments</b>	8 822.1		0.0
<b>Common Equity Tier 1 (CET1) capital: regulatory adjustments</b>				
8	Intangible assets (net of related tax liability) (negative amount)	-421.0	36 (1) (b), 37, 472 (4)	252.6
12	Negative amounts resulting from the calculation of expected loss amount	-138.1	36 (1) (d), 40, 159, 472 (6)	
26a	Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468	-343.0		
	of which: filter for unrealised losses - equity instruments	0.0	468	
	of which: filter for unrealised losses - debt instruments	0.0	467	
	of which: filter for unrealised gains - equity instruments	-86.5	468	
	of which: filter for unrealised gains - debt instruments	-256.5	467	
27	Qualifying AT1 deductions that exceed the AT1 capital of the institution (negative amount)	0.0	36 (1) (j)	-252.6
28	<b>Total regulatory adjustments to Common Equity Tier 1 (CET1)</b>	-902.1		0.0
29	<b>Common Equity Tier 1 (CET1) capital</b>	7 920.0		0.0
44	<b>Additional Tier 1 (AT1) capital</b>	0.0		0.0
45	<b>Tier 1 capital (T1 = CET1 + AT1)</b>	7 920.0		0.0
58	<b>Tier 2 (T2) capital</b>	0.0		0.0
59	<b>Total capital (TC = T1 + T2)</b>	7 920.0		0.0
60	<b>Total risk weighted assets</b>	57 638.8		
<b>Capital ratios and buffers</b>				
61	Common Equity Tier 1 (as a percentage of risk exposure amount)	13.74%	92 (2) (a), 465	
62	Tier 1 (as a percentage of risk exposure amount)	13.74%	92 (2) (b), 465	
63	Total capital (as a percentage of risk exposure amount)	13.74%	92 (2) (c)	
<b>The amounts below the thresholds of deductions (before weighing risk)</b>				



75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)	61.5	36 (1) (c), 38, 48, 470, 472 (5)
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\*) numbering in accordance with Annex VI of the Commission Implementing Regulation (EU) No. 1423/2013

## 2. Capital requirements

### 2.1 Internal capital adequacy assessment

ING Bank Śląski S.A. Group defines economic capital (internal capital) as capital needed to cover all material risks identified by the Group in its activities and macroeconomic environment. The capital covers potential unexpected losses to which the Group could be exposed in the future with confidence interval corresponding with desired AA rating (99.95%) and one year horizon. For economic capital calculation purposes, the methodologies accepted by the Management Board are used.

#### Material risk types identification

In 2015 at the ING Bank Śląski S.A. Group the process of material risk types identification defined in the “Risk Materiality Assessment Policy at ING Bank Śląski S.A.” and “Difficult-to-Measure Risks Management Policy at ING Bank Śląski S.A.” was included in the Capital Management and ICAAP Process Policy. This document details the process of material risk types identification, the basic elements for their quantification and capital adequacy management rules. On the basis of above-mentioned document, the Group identifies the following types of risk.

- permanently material risk - the risk which, in view of the nature of the Group's business, is currently material and will be material in the future. The nature of the Group's business shall be understood as deposit and credit services along with related: financial result, liquidity, interest rate and FX risk management and risk management systems connected with inappropriate and unreliable internal processes, people and technical systems or external events,
- material risk - the risk that may cause potential losses with the frequency of occurrence value qualifying it as material in line with the table below:

Frequency	At least once a year				
	At least once in 5 years				
	Less frequently than once in 5 years				
	Potential losses (PLN)	up to 0.2% of capital base	from 0.2% to 1% of capital base	from 1% to 5% of capital base	above 5% of capital base

non-material
  material

- difficult-to-measure risk - the risk for which in the Group's opinion it is not possible to build qualitative or quantitative metrics, which would properly quantify this risk.

During the 2015 Risk Assessment Workshops, the following risk classification was adopted:

	Risk type	Permanently material	Material	Non-material	Difficult-to-measure
<b>Credit risk</b>					
	Default risk and counterparty risk*	✓			
	Residual risk**	✓			✓
	Concentration risk	✓			
	Residual value risk	✓			
	Transfer risk			✓	
	Other non-credit obligation assets risk		✓		
	Default" definition risk			✓	
<b>Market risk</b>					
	Exchange rate risk	✓			
	Interest rate general and specific risk in trading book	✓			
Trading risk	Interest rate risk in banking book: total mismatch	✓			
	Interest rate risk in banking book: base risk			✓	
	Interest rate risk in banking book: option risk			✓	
	Commercial property investment and property in own use risk			✓	
	Capital securities investment risk in banking book			✓	
Equity investment risk	Capital securities investment general and specific risk in trading book			✓	
<b>Business risk</b>					
	Financial result risk	✓			
	Macroeconomic risk		✓		
	Portfolio of currency mortgages risk		✓		
	Excessive of financial leverage risk			✓	
<b>Liquidity and funding risk</b>					
	Liquidity and funding risk	✓			
<b>Operational risk</b>					
	Operational risk***	✓			
<b>Model risk</b>					
	Model risk		✓		✓

\*) Risk definition includes settlement risk.

\*\*) Capital requirement assessed under the default and counterparty risk methodology.

\*\*\*) Includes inter alia compliance risk and legal risk as well as IT risk, which is managed under this risk.

### **Economic capital assessment methodology**

At present, ING Bank Śląski S.A. Group calculates capital for the following risks:

- Default and counterparty risk and residual risk - the risk of potential losses due to counterparty/debtor's failure to fulfill their obligations towards the Group (including

transaction settlement and delivery of financial instrument at agreed date) and the risk of value decline for credit exposure due to deterioration of client's creditability. Capital requirement is calculated using modified AIRB method (INCAP) and completed with central counterparty credit risk capital and the capital for the credit valuation adjustment (CVA) risk as well as the requirement due to settlement/delivery risk which are calculated in compliance with Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013. Since June 2014 recession LGD parameter has been also used to calculate capital (residual risk).

- Other non-credit obligation assets risk - the risk of not recovering the value of balance non-credit obligation assets by the Group. The capital is calculated in compliance with Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013.
- Concentration risk - the risk resulting from an excessive exposure towards one entity, affiliated entities or groups of entities with similar characteristics, which are therefore exposed to increased credit risk (e.g., sector concentration). The capital requirement is calculated based on the following rules:
  - for individual borrowers or groups of borrowers with capital or organizational ties - according to the rules for determining regulatory capital requirements defined in Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013.
  - for borrowers from the same economy sector/geographic sector, running the same business or trading in similar goods - as the excess of the set concentration limit for this exposures group, net of write-offs.
- Residual value risk - the risk 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 Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013.
- Trading risk - the risk of losses connected with interest rate and exchange rate changes - capital requirement is calculated using the VaR approach.
- Financial result risk - the risk associated with taking adverse or erroneous decisions, the lack of or imperfect implementation of the assumptions/actions and changes in the external environment as well as an inappropriate response to these changes causing the financial results to be below those required to conduct ongoing business and develop, mainly in order to ensure an adequate capital supply. Capital requirement is estimated based on potential losses versus planned financial result.
- Macroeconomic risk - the risk arising from macroeconomic changes and their impact on the minimum capital requirements. The capital requirement determination methodology uses in-house stress tests for mild recession and required capital adequacy metrics.
- FX mortgage portfolio risk - the risk of losses connected with FX mortgage loans conversion into PLN mortgage loans. In connection with potential changes in the legislative environment the ING Bank Śląski S.A Group prudentially approached to the relevant risks.
- Liquidity and funding risk - the risk involving the inability to satisfy, at a reasonable price, financial obligations resulting from the balance sheet and off-balance sheet. The Bank and subsidiaries maintain liquidity in such a way that the monetary liabilities of the Bank and its subsidiaries can always be paid with the available funds, proceeds from maturing trades, 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 overrunning over M1 and M2.

- Model risk - the 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 model operation. Capital requirement is calculated for material models with increased or high model risk using expert judgement.
- Operational risk - the risk of direct or indirect material loss resulting from inadequate or unreliable internal processes, bank employees and systems or from external events. Operational risk includes the risk of non-compliance, legal risk and IT risk which is managed under this risk. To calculate the economic capital requirement, the Group applies the Advanced Measurement Approach (AMA). The model applied is a hybrid model, allowing the Group to measure risk with the use 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 Group prepares separate and consolidated reports on realised capital requirements for all types of material risks and planned values. These reports are received by the Assets and Liabilities Committee (ALCO) and the Management Board. The Supervisory Board is informed about the Bank's and Group's capital adequacy, including internal capital, on the regular basis.

Once a year, ICAAP review process is performed. The review report is sent to the Management Board and Supervisory Board of ING Bank Śląski S.A. Additionally, once a year, an independent ICAAP audit is carried out by the Internal Audit Department.

### **ICAAP at subsidiaries**

ICAAP was implemented in three ING Bank subsidiaries: ING Securities S.A., ING Commercial Finance S.A. and ING Lease (Polska) Sp. z o.o. ICAAP in these units is independent from the Bank's process. The Capital Management Department with the units responsible for risk management at the Bank supervise the risk management processes at subsidiaries. ICAAP Review reports from above-mentioned companies are attached to the Bank's report and are sent to the Bank Management Board and Supervisory Board.

## **2.2 Regulatory capital requirements calculation**

ING Bank Śląski S.A. reports capital requirement for credit risk under the AIRB approach for exposure classes: institutions and entrepreneurs. The Bank applies such presentation method pursuant to the letter of De Nederlandsche Bank (DNB) of 04 July 2013, wherein DNB together with the Polish Financial Supervision Authority approved application of the full AIRB approach by the Bank therefor.

Irrespective of the above-mentioned approval, pursuant to Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013, when determining the total capital requirement the Group 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 approaches). Should the total capital requirement be lower than 80% of the total comparable capital requirement, the Group will include the difference as "a supplement to the overall level of capital requirements".

Pursuant to the requirements of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013, the total capital ratio should not be less than 8%, while the Group is required to maintain the ratio of at least 12%. This obligation stems from the PFSA guidelines.

As per the PFSA guidelines, as of 01 January 2016 the total capital ratio should be 13.25% at least. At present, the total capital ratio of the Group is above the requirement from the 2015 yearend and the 2016 minimum.

AIRB approach shall be further implemented for the retail exposures (consumer lending and mortgage finance). The Bank submitted a pre-application to the European Central Bank/Polish Financial Supervision Authority (ECB/PFSA) for approval to use the AIRB method for these portfolios. The Bank expects that the ECB (after obtaining the opinion of the PFSA) will issue a decision no later than 31.12.2016.

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

The standard approach compliant with Basel III 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).

#### Risk-weighted exposure and capital requirements for particular risks

	Risk-weighted exposure	Capital requirements
Credit risk, counterparty credit risk, dilution risk and risk of delivery of instruments for future settlement, including:	49 188.8	3 935.1
- IRB approach - for exposure classes: institutions and entrepreneurs	24 578.4	1 966.3
- SA approach - for other classes	24 153.4	1 932.3
- risk of contribution to fund the CCP in case of default	136.7	10.9
- credit valuation adjustment risk (CVA)	320.3	25.6
Settlement/delivery risk	0.0	0.0
Position, foreign exchange and commodities risks	1 304.1	104.3
Operational risk	6 197.1	495.8
Supplement to the overall level of capital requirements	948.8	75.9
<b>Total</b>	<b>57 638.8</b>	<b>4 611.1</b>

The capital requirement for credit risk represents approx. 85% of the Group's overall capital requirement and has the greatest impact on capital adequacy calculation.

The capital requirement for credit valuation adjustment risk (CVA) refers to the adjustment of the market value in accordance with the provisions of Basel III. The Bank calculates the adjustment for overhead capital requirement under the standard method in accordance with Article 384 of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013.

To calculate the capital requirement for risk of contribution to fund the CCP in case of default, the Bank uses an alternative method, described in Article 310 of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013. London Clearing House (LCH) and KDPW\_CCP SA are the eligible central counterparty for ING Group and ING Bank Śląski S.A. Group.

The table below presents exposures by class according to the AIRB and SA methods.

### Exposures calculated according to AIRB method

Exposure class according to AIRB method	Original exposure before conversion factors	Value of exposure secured by a guarantee or credit derivatives	Value of exposure secured by eligible financial collateral or other eligible collateral	Value of exposure	The remaining unfunded credit collateral in the form of guarantees (double default)	Risk-weighted exposure	Capital requirements	Value adjustments and provisions
Exposures to institutions*	6 763.8	12.9	1 153.3	5 300.6	0.0	1 314.2	105.1	-0.5
Exposures to corporates, including:	52 127.9	2 632.5	34 534.0	42 164.9	387.5	22 464.8	1 797.2	-1 075.4
- SME	14 376.6	700.0	11 336.6	11 927.8	105.6	5 956.4	476.5	-202.6
- specialized lending**	7 299.0	160.3	10 234.9	7 238.4	0.0	2 720.7	217.7	-81.8
- other	30 452.3	1 772.2	12 962.5	22 998.7	281.9	13 787.7	1 103.0	-791.0
Equity exposures	216.1	0.0	0.0	216.1	0.0	799.4	64.0	0.0
<b>Total</b>	<b>59 107.8</b>	<b>2 645.4</b>	<b>35 687.3</b>	<b>47 681.6</b>	<b>387.5</b>	<b>24 578.4</b>	<b>1 966.3</b>	<b>-1 075.9</b>

\*) Local government units are permanently excluded from the institutions exposure class in the IRB approach and are permanently reported under the SA method as a result of the AIRB approach approval.

\*\*) As far as corporate exposures are concerned, the Bank and the whole ING Group identify the so-called specialized lending transactions that comprise the following types of financing: Commercial Property Finance, Trade and Commodity Finance as well as Project Finance, out of which Commercial Property Finance stands for the largest exposure of the Bank. For those types of financing, the Bank uses dedicated PD rating models developed on the ING Group's level.

### Exposures calculated according to SA method

Exposure class according to SA method	Original exposure before conversion factors	Value adjustments and provisions associated with the original exposure	Value of exposure secured by a guarantee or credit derivatives	Value of exposure secured by eligible financial collateral or other eligible collateral	Fully adjusted exposure value (pre conversion factors)	Value of exposure	Risk-weighted exposure	Capital requirements
Exposures to central governments or central banks	29 684.4	-0.9	0.0	0.0	29 683.4	29 683.4	153.8	12.3
Exposures to regional governments or local authorities	4 104.4	-0.7	0.0	0.0	4 103.7	3 957.7	791.5	63.3
Exposures to public sector entities	2.2	0.0	0.0	0.0	2.2	2.1	1.1	0.1
Exposures to institutions	25.0	0.0	0.0	0.0	25.0	25.0	12.5	1.0
Exposures to corporates	5 525.8	-1.9	0.0	0.0	5 523.9	2 927.1	2 855.2	228.4
Retail exposures	24 736.6	-102.4	0.0	0.0	24 600.0	23 125.6	16 807.6	1 344.6
Exposures secured by mortgages on immovable property	4 186.1	-1.5	0.0	0.0	4 184.4	4 171.1	2 427.9	194.2
Exposures in default	547.1	-499.2	0.0	0.0	47.8	47.4	49.7	4.0
Other items	2 179.9	0.0	0.0	0.0	2 179.9	2 179.9	1 054.2	84.4
<b>Total</b>	<b>70 991.5</b>	<b>-606.6</b>	<b>0.0</b>	<b>0.0</b>	<b>70 350.3</b>	<b>66 119.3</b>	<b>24 153.5</b>	<b>1 932.3</b>

Equity exposures are calculated using the following approaches:

- simplified method (for the risk weight of 290% and 370%), and
- using exemption thresholds for deductions from own funds items (for the risk weight of 250%).

Under the simplified risk weighting method, the weight of 290% is used for traded equity exposures; the weight of 370% is applied to the other exposures identified in the portfolio covered by the simplified method and not included in the weight of 190% under this method.

The table below presents a breakdown of equity exposures by risk weight.

#### Equity exposures

Risk weight	Original exposure before conversion factors	Value of exposure	Risk-weighted exposure	Capital requirements
250%	0.0	0.0	0.0	0.0
290%	0.0	0.0	0.0	0.0
370%	216.1	216.1	799.4	64.0
<b>Total</b>	<b>216.1</b>	<b>216.1</b>	<b>799.4</b>	<b>64.0</b>

### 3. Leverage ratio

The calculation of regulatory leverage ratio in the ING Bank Śląski S.A. Group as at 31 December 2015, was based on provisions of Commission Delegated Regulation (EU) 2015/62 of 10 October 2014 amending Regulation (EU) No. 575/2013 of the European Parliament and of the Council with regard to the leverage ratio (hereinafter referred to as the "Regulation 2015/62").

Leverage ratio is calculated as Tier 1 capital measure divided by the total exposure measure and expressed as a percentage. Total exposure measure is the sum of the exposure value calculated in accordance with the Regulation 2015/62 of all assets and off-balance sheet items not deducted when calculating the Tier 1 capital measure.

#### Summary reconciliation of total assets as per published financial statements and leverage ratio exposures

<b>Total assets as per published financial statements</b>	<b>108 893.1</b>
Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	-38.0
Adjustment for fiduciary assets recognized on the balance sheet pursuant to the applicable accounting framework but excluded from the leverage ratio exposure measure in accordance with Article 429(13) of Regulation (EU) No. 575/2013	-
Adjustments for derivative financial instruments (result of replacing the valuation of these instruments by their balance)	-1 870.8
Adjustments for securities financing transactions (SFTs)	10.2
Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	7 037.4
Adjustment for intragroup exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (7) of Regulation (EU) No. 575/2013	-
Adjustment for exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (14) of Regulation (EU) No. 575/2013	-
Other adjustments	-3 174.9
<b>Total leverage ratio exposure</b>	<b>110 857.0</b>



Calculation of the leverage ratio at 31 December 2015 for the ING Bank Śląski S.A. Group

<b>On-balance sheet exposures (excluding derivatives and SFTs)</b>	
On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	101 311.8
Asset amounts deducted in determining Tier 1 capital	-902.0
<b>Total on-balance sheet exposures</b>	<b>100 409.8</b>
<b>Derivatives exposures</b>	
Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	1 790.0
Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	784.9
Exposure determined under Original Exposure Method	-
Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	-
Deductions of receivables assets for cash variation margin provided in derivatives transactions	-692.4
Exempted CCP leg of client-cleared trade exposures	-
Adjusted effective notional amount of written credit derivatives	-
Adjusted effective notional offsets and add-on deductions for written credit derivatives	-
<b>Total derivatives exposures</b>	<b>1 882.5</b>
<b>Securities financing transaction exposures</b>	
Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	1 517.1
Netted amounts of cash payables and cash receivables of gross SFT assets	-
Counterparty credit risk exposure for SFT assets	10.2
Derogation for SFTs: Counterparty credit risk exposure in accordance with Article 429b (4) and 222 of Regulation (EU) No. 575/2013	-
Agent transaction exposures	-
Exempted CCP leg of client-cleared SFT exposure	-
<b>Total securities financing transaction exposures</b>	<b>1 527.3</b>
<b>Other off-balance sheet exposures</b>	
Off-balance sheet exposures at gross notional amount	24 243.1
Adjustments for conversion to credit equivalent amounts	-17 205.7
<b>Other off-balance sheet exposures</b>	<b>7 037.4</b>
<b>Exempted exposures in accordance with Article 429 (7) and (14) of Regulation (EU) No. 575/2013 (on and off balance sheet)</b>	
Exemption of intragroup exposures (solo basis) in accordance with Article 429(7) of Regulation (EU) No. 575/2013 (on and off balance sheet)	-
Exposures exempted in accordance with Article 429 (14) of Regulation (EU) No. 575/2013 (on and off balance sheet)	-
<b>Capital and total exposures</b>	
Tier 1 capital	7 920.1
Total leverage ratio exposures	110 857.0
<b>Leverage ratio</b>	
<b>Leverage ratio (%)</b>	<b>7.14</b>
<b>Choice on transitional arrangements and amount of derecognized fiduciary items</b>	
Choice on transitional arrangements for the definition of the capital measure	transitional
Amount of derecognized fiduciary items in accordance with Article 429(11) of Regulation (EU) No. 575/2013	-

On the basis of CRD IV Directive and implementing standards, the Group prepared and implemented "The procedure of preparing the report: Leverage Ratio". This document describes the recipients and detailed rules of leverage ratio calculation in LIREP application for NBP reporting.



As a consequence of leverage ratio calculation process, the Group during risk assessment workshops for the year 2015 identified excessive financial leverage risk. The risk is defined as risk resulting from a vulnerability of an institution to threats connected to leverage ratio, which might require some unintentional corrective actions to its business plan, including emergency sale of assets that could result in losses or in need of valuation adjustments of the remaining assets. The Group implemented management process, including: "Excessive financial leverage risk management policy" and "Leverage ratio planning procedure". The documents provision responsibilities of departments and ALCO Committee. In the Policy, the limit of leverage ratio level was also set and the actions to maintain the ratio on required level are defined. The Group also included the leverage ratio in stress tests.

In 2015 the leverage ratio was at the level above internal and regulatory minimum. The massive influence on the leverage ratio resulted from credit volumes dynamics and inclusion of 2014 and first half of 2015 net result to Tier 1 capital.

## 4. Credit risk adjustments

### 4.1 Accounting definitions of past due and impaired items

For the accounting purposes, the Bank classifies the past due exposures as material financial exposures with the capital or interest default. Days past due are calculated from the due date of the earliest payment defined in the credit agreement with the client. The Bank defined the materiality of the financial assets item for current accounts for corporate and retail clients as PLN 1 000 and PLN 500 respectively. The materiality of the financial assets item in subsidiaries is determined by the specificity of their operations.

The Bank classifies to impaired portfolio those credit exposures that are impaired and the loss resulting from the impairment has been incurred providing the following two conditions were met:

- there is evidence(s) that the impairment loss on loans and receivables or held-to-maturity investments measured at amortized cost was incurred, and
- the event(s) causing the loss has/have impact on the expected future cash flows under the balance sheet credit exposure or a group of balance sheet credit exposures that can be reliably estimated.

The Bank defined the objective evidences of impairment loss, whose occurrence has a direct impact on the estimates of future cash flows related to the particular exposure. The objective evidences of impairment loss mirror the specificity of retail and corporate portfolios (including financial institutions and banks) and meet the requirements of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013, in particular:

- the Bank discontinues to recognise the credit obligation on the accrual basis,
- the Bank writes off or forms specific provisions for the observed significant decline in the credit quality after the exposure takeover,
- the Bank sells the credit obligation at a material credit-related economic loss,
- the Bank consents to a distressed restructuring of the credit obligation where it is likely to result in a diminished financial obligation caused by the material forbearance, or postponement of principal, interest or (where relevant) fees payment,
- the Bank has filed for the obligor's bankruptcy or a similar request in respect of an obligor's credit obligation to the Group,

- 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 Group,
- the obligor is past due more than 90 days on any material credit obligation to the Group. Days past due commence once an obligor has breached the limit awarded or has been awarded a limit smaller than current outstandings, and
- the results of the analyses (impairment tests) on potential losses resulting from the impairment trigger identification - only for corporate clients.

Credit exposure is assessed for impairment during defined periods in the monitoring process for performing and non-performing portfolios. In addition, the Bank monitors the client's debt repayment timeliness (both for performing and non-performing portfolios) with the use of available tools and reports, which results in early identification of the threat of objective evidences of impairment loss or impairment trigger occurrence in the future before its actual materialization. In case of impairment trigger identification on any of client's account, impairment is calculated for the whole credit exposure of the client. In case the objective evidence of impairment loss is identified the client is reclassified to impaired portfolio directly without analyses (impairment tests) performance. The Bank defines the events enabling impairment loss reversal. Later occurrence of the circumstances specified in the definition of default would lead to the next default event.

Subsidiaries have analogous rules of classification of exposures to impaired financial assets and the list of impairment triggers.

#### **4.2 Description of approaches and methods adopted for determining specific and general credit risk adjustments**

The Bank calculates the provisions for impaired financial assets measured at amortized cost (loans, receivables and held-to-maturity investments) and provisions for off-balance part of credit exposures. The Bank distinguishes two types of methodologies of provisions calculation for impaired credit exposures, namely: individual approach of provisions calculation (individual provisions) and collective approach to provisions calculation (collective provisions). Subsidiaries do not calculate provisions for off-balance part of credit exposures due to the specificity of their operations.

##### ***Individual provisions***

Individual provisions are formed for the impaired individually significant financial assets (ISFA) when there is evidence that the impairment loss on the single financial assets item or group of financial assets was incurred and results from one or more default events, whose occurrence impacts the estimates of future cash flows related to the particular financial assets item. Individual provisions are calculated for financial assets classified to 20, 21 or 22 risk class.

Individual provisions are calculated with the use of discounted future cash flows methodology. To define future cash flows it is necessary to determine the exact amount and the date of the particular cash flow. The estimated proceeds may stem from different sources and be positive (cash inflow to the Bank) or negative (cash outflow from the Bank). They include in particular: debt repayment, additional disbursement, repayment from operational activity of the client, proceeds from collection and workout activities - collateral liquidation, sale of the loan.

In terms of collection and workout activities, in ISFA provisions calculation, the appropriate recovery rates are applied for particular collaterals which are included in the estimation of future cash flows.

The recovery rate ratios are determined, among others, by the type of the collateral, the value of the mortgage-backed exposure, valuation date and the book value of the collateral. Amounts and dates of proceeds inflows are based mainly on expert knowledge, however, the Bank defined the principles of application of the future cash flows scenarios and the maximum recovery rates from the collateral liquidation. Subsidiaries estimate future cash flows on the basis of expert knowledge only.

### **Collective provisions**

Collective provisions are formed for impaired individually not significant financial assets (INSFA) when there is evidence that the impairment loss on a single financial assets item or group of financial assets was incurred and results from one or more default events. Collective provisions are calculated for financial assets classified to 20, 21 or 22 risk class. If, on the basis of the assessment, no objective evidence that the impairment loss is recognised, the financial asset is included to group of financial assets with the similar credit risk characteristics, which indicates that the client is capable to fully repay the loan in accordance with conditions stipulated in credit agreement. The provisions calculated in such groups are estimated in accordance with IFRS 39 and are described as provisions for incurred but not reported losses (IBNR). The expected losses resulting from the future events are not identified. IBNR provisions are calculated for financial assets classified to 1-19 risk classes.

Collective provisions are calculated in accordance with collective provisions methodology that is based on adjusted risk parameters (PD, LGD and EAD/CCF) in line with requirements specified in IFRS 37 and 39. Risk parameters models for portfolios covered by advanced internal rating-based approach (AIRB) and those in use-test within AIRB roll-out plan were developed in compliance with Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26th June 2013 on prudential requirements for credit institutions and investment firms. Models for portfolio permanently excluded from AIRB approach fulfill the requirements specified in IFRS 37 and 39.

In the case of equity exposures, the Bank defined the methodology, calculation and reporting processes of provisions/value adjustments for exposures stemming from financial markets transactions. The Bank identifies two categories of such exposures for which the provisions/value adjustments are made:

- Bank receivables identified from the settlement of transactions on financial markets that were not repaid by the counterparty - Failed Settlement,
- potential receivables of the Bank that may arise at the moment transactions on financial markets are settled - Credit and Debit Value Adjustments (CVA/DVA).

Subsidiaries do not calculate the provisions/ value adjustments for the exposures stemming from financial markets transactions due to the specificity of their operations.

### **4.3 Quantitative information on the adjustments for credit risk**

The table below presents the following information:

- total amount of exposures after the settlement of balancing transactions without taking into account the effects of credit risk mitigation, and the average amount of exposure in a given period by class of exposure,
- geographical distribution of exposure,
- the residual maturity for all the exposures broken down by exposure class.

Method	Exposure class	Exposure net of value adjustments and provisions (31.12.2015)	Average exposure after deduction of value adjustments and provisions (4 quarters of 2015)	Original exposure - Poland	Original exposure - other countries*	Residual maturity of the exposure (days)**
SA	Exposures to central governments or central banks	29 683.5	29 927.6	29 176.1	508.3	1 310
SA	Exposures to regional governments or local authorities	4 103.7	4 190.6	4 104.4	0.0	1 557
SA	Exposures to public sector entities	2.2	4.5	2.0	0.2	120
SA	Exposures to institutions	25.0	7.1	25.0	0.0	1 255
SA	Exposures to corporates	5 523.9	4 996.2	5 525.7	0.1	289
SA	Retail exposures	24 634.2	23 085.0	24 735.5	1.1	5 959
SA	Exposures secured by mortgages on immovable property	4 184.6	4 153.5	4 186.1	0.0	7 715
SA	Exposures in default	47.9	100.7	547.1	0.0	1 118
SA	Other items	2 179.9	2 152.0	2 179.9	0.0	-
IRB	Exposures to institutions	6 763.3	6 606.7	3 202.5	3 561.3	1 004
IRB	Exposures to corporates - SME	14 174.0	13 355.5	14 347.5	29.1	517
IRB	Exposures to corporates - specialized lending	7 217.2	6 571.8	6 742.8	556.2	613
IRB	Exposures to corporates - other	29 661.3	29 150.8	30 275.9	176.4	577
IRB	Equity exposures	216.1	86.4	216.1	0.0	-
<b>Total</b>		<b>128 416.8</b>	<b>124 388.4</b>	<b>125 266.6</b>	<b>4 832.7</b>	<b>-</b>

\*) The largest share in the amount of original exposure to countries other than Poland falls to the following countries: United Kingdom (PLN 1, 359.3 million), France (PLN 905.3 million) and the Netherlands (PLN 699,0 million).

\*\*\*) Residual maturity refers to the exposure-weighted average weighted maturity.

Past due exposure is minimal outside Poland. Since the geographic concentration within Poland is small and does not increase the credit risk, ING Bank Śląski S.A. has not recognized the need to determine geographical limits yet.

The table below presents the distribution of exposures and adjustments for specific credit risk by counterparty type.

Method	Exposure class	Counterparty type	Original exposure	Adjustments for specific credit risk
	<b>Exposures to institutions</b>		<b>6 763.8</b>	<b>-0.5</b>
		including: Credit institutions - commercial and listed banks	2 604.0	0.0
		including: Credit institutions - government and ING banks	1 053.5	0.0
IRB		including: Credit institutions - other banks	6.2	0.0
		including: Other financial institutions - government	200.7	0.0
		including: Other financial institutions - listed	493.2	-0.2
		including: Other financial institutions - other	2 406.3	-0.2
IRB	<b>Exposures to corporates - specialized lending</b>		<b>7 299.0</b>	<b>-81.8</b>

	including: Property management	2 559.7	-37.4
	including: Property management - SPV	2 613.7	-42.3
	including: Other	2 125.5	-2.1
	<b>Exposures to corporates - SME</b>	<b>14 376.6</b>	<b>-202.6</b>
	including: Treasury and Leasing companies	64.1	0.0
IRB	including: Non-profit and governmental organizations	105.2	-0.8
	including: Businesses	1 119.0	-10.8
	including: Listed companies	277.9	-36.1
	including: Other small and medium-sized companies	12 810.3	-154.9
	<b>Exposures to corporates - other</b>	<b>30 452.3</b>	<b>-791.0</b>
	including: Listed companies	6 320.3	-208.1
IRB	including: Treasury and Leasing companies	687.3	-0.1
	including: Non-profit and governmental organizations	1 048.4	-0.4
	including: Other companies	22 396.3	-582.5
IRB	<b>Equity exposures</b>	<b>216.1</b>	<b>0.0</b>
	<b>Exposures to central governments or central banks</b>	<b>29 684.4</b>	<b>-0.9</b>
SA	including: Central Bank	12 808.8	-0.7
	including: Government	16 875.5	-0.3
SA	<b>Exposures to regional governments or local authorities</b>	<b>4 104.4</b>	<b>-0.7</b>
SA	<b>Exposures to public sector entities</b>	<b>2.2</b>	<b>0.0</b>
SA	<b>Exposures to institutions</b>	<b>25.0</b>	<b>0.0</b>
	<b>Exposures to corporates</b>	<b>5 525.8</b>	<b>-1.9</b>
SA	including: Listed companies	294.5	-0.2
	Including: SMEs	623.6	-0.5
	<b>Retail exposures</b>	<b>24 736.6</b>	<b>-102.4</b>
SA	including: SMEs	3 456.9	-28.8
	including: Residential mortgage secured	16 272.7	-31.4
	<b>Exposures secured by mortgages on immovable property</b>	<b>4 186.1</b>	<b>-1.5</b>
SA	including: Mortgaged on residential property	3 941.6	0.0
	including: Mortgaged on commercial property	244.5	-1.5
	<b>Exposures in default</b>	<b>547.1</b>	<b>-499.2</b>
SA	including: Sole traders	137.4	-101.6
SA	<b>Other items</b>	<b>2 179.9</b>	<b>0.0</b>
<b>Total</b>		<b>130 099.3</b>	<b>-1 682.5</b>

The table below presents impaired exposures by counterparty type. Impaired exposures are understood as:

- exposures in the SA method - where the delay is more than 90 days, in accordance with Article 178 of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013,
- exposures in the IRB approach- including ratings from 20 to 22,

Method	Exposure class	Counterparty type	Original exposure	Value adjustments and provisions
	<b>Exposures to corporates - specialized lending</b>		<b>309.4</b>	<b>-78.5</b>
IRB	including: Property management		135.2	-36.9
	including: Property management - SPV		174.2	-41.6
	including: Other		0.0	0.0
	<b>Exposures to corporates - SME</b>		<b>360.6</b>	<b>-180.3</b>
IRB	including: Listed companies		48.5	-35.9
	including: Businesses		17.7	-9.0
	including: Other small and medium-sized companies		294.5	-135.4
	<b>Exposures to corporates - other</b>		<b>1 129.1</b>	<b>-746.4</b>
IRB	including: Listed companies		447.0	-206.6
	including: Non-profit and governmental organizations		0.5	-0.2
	including: Businesses		13.3	-7.0
	including: Other companies		668.3	-532.5
SA	<b>Exposures in default</b>		<b>547.1</b>	<b>-499.2</b>
	including: Sole traders		137.4	-116.5
<b>Total</b>			<b>2 346.2</b>	<b>-1 504.4</b>

For the exposures relating to the countries other than Poland, there was no significant share of impaired exposures identified.

The tables below present the breakdown of exposures for which there is any overdue amount, by days past due.

number of days past due	total		corporate exposures	
	on-balance	off-balance	on-balance	including: impaired off-balance
0	42 081.4	20 378.1	907.0	90.2
1-30	279.0	2.1	23.4	0.0
31-60	365.0	0.0	12.9	0.0
61-90	71.3	0.0	7.2	0.0
91-180	32.2	0.0	26.5	0.0
181-365	93.8	0.0	92.4	0.0
>365	670.7	4.0	656.8	0.1
<b>Total</b>	<b>43 593.4</b>	<b>20 384.2</b>	<b>1 726.2</b>	<b>90.3</b>

		<b>retail exposures</b>			
		total		including: impaired	
number of days past due	on-balance	off-balance	number of days	on-balance	
0	25 376.1	2 987.6	80.7	1.5	
1-30	500.6	20.2	24.8	0.1	
31-60	121.8	1.7	15.2	0.0	
61-90	39.0	0.2	10.6	0.0	
91-120	14.9	0.2	13.7	0.1	
121-150	17.8	0.1	17.0	0.0	
151-180	13.0	0.0	12.3	0.0	
>180	370.3	0	367.9	0.0	
<b>Total</b>	<b>26 453.5</b>	<b>3 010.0</b>	<b>542.2</b>	<b>1.7</b>	

The table below presents reconciliation of adjustments for specific and general credit risks for impaired exposures.

	Corporate banking segment	Retail banking segment
<b>As at 31.12.2014</b>	<b>1 074.3</b>	<b>478.7</b>
Movements in the period, including:	-123.3	-64.6
- Recognised and reversed during the period	156.2	62.4
- Receivable written off	-282.2	-136.7
- Amounts recovered from loans previously written off	2.4	6.9
- Unwinding interest	4.9	2.1
- Other	-4.5	0.7
<b>As at 31.12.2015</b>	<b>951.0</b>	<b>414.1</b>

## 5. Use of credit risk mitigation techniques

### 5.1 Rules and procedures as well as the scope of on- and off-balance sheet netting

In line with the rules applicable at the Bank, prior to initiation of a derivative transaction, each corporate client and financial institution is obliged to sign an appropriate Agreement with the Bank which enables the set-off of transactions made. The system entry of the limits awarded to the customer, which are necessary to make a transaction, is conditioned upon signing legal documents by the customer. Conclusion of derivative transactions without appropriate Agreements signed with the Counterparties, is forbidden.

The Bank holds letters of legal advice and monitors changing regulations.

### 5.2 Rules and procedures of 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 identifies the following collateral values:

- face value,
- adjusted face value, and
- 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 realigned 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 an adverse impact on collateral value.

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

The fair value is corrected in the case of mismatch between the date of collateral maturity and the exposure maturity day.

For example, the face value of property is calculated on the basis of its market value arising from 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 Polish Financial Supervision Authority's recommendations.

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

Depending on the type of collateral, the value is monitored at specified intervals, aligned with the provisions of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013.

The list of the aspects analysed 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), and
- verification of the guarantor's financial standing (setting the risk rating).

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

Such circumstances are, inter alia:

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



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

Monitoring performed at shorter intervals, e.g. in the case of property, is required under the circumstances of substantial fluctuations in the market conditions; the frequency of monitoring also depends on the specific nature of such property 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 condition of machines and equipment, means of transport, etc.

The Bank's regulations also define the way in which collateral is presented and approved in the process of credit exposure award in accordance with the credit mandates and the rules of collateral monitoring presentation and approval.

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

For lease facilities, ownership of the leased object is the main security collateral of lease transactions. Principles of collateralizing arise from the nature of leasing. The principles of valuation of the collaterals in terms of requirements under Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 are governed not only by the nature of leasing itself but also from the Collateral Management Policy referring to the estimation of the recoveries and capital requirements calculation at ING Lease (Polska) Sp. z o.o. introduced in 2015.

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 use. The purchase from the supplier of the assets item to be leased, under the law, is made at the market price. Acquisition value of the leased assets item from the supplier is the initial value of the lease transaction.

The principles for verifying the leased assets at ING LP are included in two regulations. For movables it is the "Supplier and leased asset verification procedure", for properties it is a the "Real estate policy paper".

The purchase price (market value) of the new object - movable acquired from a supplier unrelated to the lessee is not verified. The value of second-hand assets item - movable (regardless who is the seller) or the value of the new assets item - movable but purchased from a customer or a company associated with the customer is verified with an independent expert's valuation or, if possible, internal market value verification.

The value of the property to be financed is always verified in an appraisal prepared by an independent valuator.

The values of financed movables are not verified throughout the lease contract duration.

Market values of financed properties 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 property is not required, ING LP prepares an internal market value verification of the financed property.

### **ING Commercial Finance S.A. (ING CF)**

In the case of standard factoring (with recourse and without recourse), the receivables purchased from the Client in respect of the debtors transferred to factoring form the primary a transaction collateral.

At the stage of the factoring application analysis and throughout the factoring agreement duration, ING CF makes ongoing assessments of the quality of receivables (analysis of the history of collaboration between client and debtor, quality of the settlements, the provisions of trade agreements) and monitors the debtors' financial situation.

ING CF occasionally uses other forms of collateral, such as mortgage, assets alienation or bank guarantees. The principles of collateral value verification are defined in the ING CF's "Credit Risk Manual". In accordance with these principles in the case of establishment of:

- mortgages - at the proposal stage clients are obliged to provide property appraisal, no older than 12 months, an extract from the land and property register and a copy of property insurance policy. In the case the mortgage is registered to another bank, the information on the current status of the debt secured by the mortgage.
- pledge on assets/assets alienation - at the proposal stage, clients are obliged to provide the documents proving the value of assets such as an insurance policy or stock value reports.
- bank guarantee - Front Office is required to obtain the opinion of the Bank on the risk of the bank issuing the guarantee.
- the factor guarantee (credit cover) - taking over the risk of foreign debtor's insolvency by the foreign factor, ING CF verifies whether the factor is one from the list of the factors accepted by ING Group.

Since additional collateral is very rarely used by ING CF, the "Credit Risk Manual" includes a clause that collateral liquidity assessment and valuation are made in accordance with the Bank's rules.

In ING CF for non-recourse factoring the secondary risk management procedure is applied. ING CF accepts insurance policies within the limits granted to insurers, whereby they can monitor the risk secured by individual insurers.

### **5.3 Description of the main types of collateral taken by the Bank**

#### **Bank**

The Bank accepts all permitted legal forms of collateral, at the same time specifying their preference as to their application in the collateral regulations.

Yet, the collateral should be chosen based on:

- correlating the value and quality of collateral with the probability of 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 accounting for 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, and
- optimising the collateral catalogue for a given credit exposure when there is a specific pool of collateral items available.

In retail area, the Bank uses the standard method for regulatory capital calculation. To use preferential risk weights for mortgaged exposures, the quality criteria described in Articles 124, 208 and 229 section 1 of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 have to be fulfilled.

The Bank has identified the following collateral groups:

- 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:

- properties,
  - 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-end Mutual Funds, and
  - purchased receivable with recourse.
- 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, and
  - debt accession.
- In some LGD models applied by the Bank the recovery rate on the unsecured part of exposure is also 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 the 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.
  - There are also additional types of collateral used by the Bank that strengthen their position in negotiations or expand the Bank's control entitlements as the 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, and
    - 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 is the following:

- mortgages - their share results from the fact that mortgage is usually used to secure long-term capex loans. In addition, mortgage is the main collateral in the case of commercial property loans,
- corporate sureties and guarantees - this group of collateral includes guarantors from various industries having diversified 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 the guarantor's financial standing and assign a risk rating thereto,
- non-current and current assets, and
- accounts receivable.

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

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

In the case of lease facilities, ownership of the leased assets item is the main security of lease transactions. The principles for pledging collateral and determining their value stem from the very nature of leasing itself and the "Collateral Management Policy concerning estimation of recoveries and capital requirements at w ING Lease (Polska) Sp. z o.o." referring to capital requirements calculation at ING Lease (Polska) Sp. zo.o. introduced in 2015.

#### **ING Commercial Finance S.A. (ING CF)**

In the case of standard factoring (both with recourse and without recourse), the receivables purchased from the Client in respect of the debtors transferred to factoring form the primary a transaction collateral.

In addition to the assignment of receivables as collateral, ING CF also acquires a promissory note issued by the client, often guaranteed by the client's shareholders, a power of attorney to the customer's bank account and in the case of factoring without recourse we use insurance of the risk of debtor's insolvency in one of the insurance companies providing receivables insurance. In the case of reverse factoring, ING CF does not use additional collateral as this product is targeted only at selected customers (in a very good financial situation ) from the strategic customers 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, assets alienation or bank guarantees.

### **5.4 Main types of guarantors and credit derivative counterparties and their creditworthiness**

The following table presents the main types of guarantors and own their collateral value. The Bank does not use credit derivatives.

Guarantee delivery type	Value of collateral*	Share%
Companies – "investment" category (rating below 10)	1 907.0	71%
Companies – "speculative" category (ratings 11-17)	671.7	25%
Companies – "irregular" category (ratings 18-22)	17.0	1%
Local authorities (GL prefix)	99.4	4%
<b>Total</b>	<b>2 695.1</b>	<b>100%</b>

\*) The value presented in the table is the value of collateral, and not of exposure.

## 5.5 Market or credit risk concentrations within the credit mitigation taken

Since the institution has a significant exposure to financing the purchase of residential and commercial properties, mortgages (83% of the total) form the main collateral.

Collateral type	Collateral value *	Share %
Mortgages	48 978.0	83%
Guarantees	2 695.1	5%
Inventory	3 756.7	6%
Machinery and equipment	2 378.6	4%
Debts	686.7	1%
Cash	351.6	1%
<b>Total</b>	<b>58 846.8</b>	<b>100%</b>

\*) The value presented in the table is the value of collateral, and not of exposure.

## 6. Use of IRB Approach to credit risk

### 6.1 Structure of internal rating systems and relations between internal and external ratings

Determination of the client's risk class is an integral part of the Bank's credit risk evaluation process for credit exposures. The risk class itself is determined by coherently-used rating system. The rating assignment process is finalized before the credit decision is made.

#### **Exposures to companies and institutions**

As far as the exposures to companies and institutions are concerned, ING Group applies a 22-grade rating scale with respect to entrepreneurs where classes reflect the borrower's risk. Some credit risk models used by the Bank assign rating sub-classes to have better granularity of the rating scale. Those subclasses should be treated as a part of the full rating class.

The Bank most often applies 17 full 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 rating models, using the data from the customer's financial reports, evaluation of qualitative factors and, in particular cases, financial standing of the parent company.

Risk rating is assigned to the customer in the first place in line with the value of probability of default given by rating model. The following description of characteristics for each risk class is treated alternatively, in particular when ratings assigned on the basis of models are subject to appeal.

Risk classes can be divided into 3 basic groups:

- group equivalent to investment grades (risk classes 1-10),
- group equivalent to speculative grades (risk classes 11-17), and
- problem loan grades (risk classes 18-22).

Group of low risk classes (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.

Group of medium and increased risk classes (11-17) covers a relatively large range of risk levels, and can be divided into:

- 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 unfavorable economic conditions there is a real threat that credit risk may increase.
- The borrowers assigned higher risk grades (the worst grades in this class) which, in a longer perspective, may be characterized by: uncertainty as to their income perspectives, lower quality of assets and risk of the capital level mismatch that may translate into possible losses.

Problem loan grades (18-22) is a group that 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. This group includes also the clients whose exposures are in forbearance status in case the delinquency of debt repayment exceeded 30 calendar days on the exposure with forbearance status or having granted the consecutive forbearance on the particular exposure.

#### *Risk classes 1-2*

Entities included in this range are characterised by the lowest risk. In a longer perspective, they have solid and stable income, substantial liquidity and extremely strong balance sheet structure maintained for a long period of time. The probability of default by those borrowers is very low. Entities classified to this group usually:

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

#### *Risk classes 3-4*

High quality entities, with slightly higher long-term risk potential than the entities classified to risk classes 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.

#### *Risk classes 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 to this group:

- often operate on more competitive markets with low customer loyalty levels,
- have a good debt profile, characterised by relatively low risk, and thus are fully capable of meeting their financial obligations,
- have to allocate substantial company resources to maintain their market share,
- have limited ability to dictate prices and/or terms and conditions of cooperation with suppliers.

For global models (which are commonly used at ING Group) and local models (used only by the Bank) for certain risks classes (8-17) different descriptions are used for the customers classified in those classes.

#### *Risk classes 8-10 for global models*

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

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

#### *Risk classes 11-13 for global models*

Entities classified to 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. In addition, the entities classified to this range:

- may have problems with maintaining their position in the market in the face of growing competition,
- have little or no influence on prices of materials they purchase,
- it is possible that their management is not of the highest quality.

#### *Risk classes 14-17 for global models*

The companies classified to this range enter the endangered financial standing zone. Possible symptoms: considerable decrease in profitability, substantial weakening of the balance sheet



structure, irregular cash flows with outflows predominating over inflows and tighten capability to service debts. Such entities often:

- operate in a sector that is in a downward phase,
- have to face the increasing pressure from their competitors,
- have very limited or no influence on prices of materials they purchase and their relations with suppliers,
- may have a weak management characterized by e.g. lack of experience, no stability or poor commitment.

The borrowers classified to the 16-17 range are additionally affected by the following circumstances:

- despite servicing all obligations by the borrower on an ongoing basis there are strong premises that the borrower's financial standing or creditworthiness may diminish,
- at present there are no predictions as to the occurrence of the situation referred to as "default" but more intensive monitoring is necessary, and
- actions aimed at improvement of the Bank's position as the creditor, or limitation or complete cancellation of the Bank's involvement in a borrower or transaction financing are required.

#### *Risk class 15/only for global model for large corporates*

Apart from the general conditions presented above and used to classify an entity to the range 14-17, grade 15 is additionally characterised by the following circumstances:

- material symptoms of the borrower's financial standing/creditworthiness deterioration, and
- substantial symptoms of the risk profile impairment that will result in the borrower's failure to timely meet all of their debt obligations in the future.

While all of the following conditions have been met:

- the borrower has not applied for any change (extension) of the principal repayment date,
- in a short term perspective (up to 1 year) the borrower will not require additional financing that would have resulted from the financial liquidity deterioration,
- the borrower is sufficiently capable of servicing their debt, and
- a 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 Bank predicts that a borrower will breach one or more conditions, or
- the Bank may waive a condition, on a one-off basis, for the period of up to one year .

#### *Risk class 16/only for global model for large corporates*

Apart from the overall conditions presented above and used to classify an entity to the range 14-17, the following circumstances occur:

- material symptoms of the borrower's financial standing/creditworthiness deterioration, and
- substantial symptoms of the risk profile impairment that will result in the borrower's failure to timely meet all of their 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 principal repayment date,
- in a short term perspective (up to 1 year) the borrower will not require additional financing that would have resulted from the financial liquidity deterioration, 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 Bank that they would not be able to meet one or more of these conditions.

#### *Risk class 17/only for global model for large corporates*

Apart from the overall conditions presented above and used to classify an entity to the range 14-17, the following circumstances occur:

- material symptoms of the borrower's financial standing/creditworthiness deterioration, and
- substantial symptoms of the risk profile impairment that will result in the borrower's failure to timely meet all of their 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 principal repayment term, or there is high probability that they may submit such an application where the change (extension) of the principal repayment term does not (will not) result in the Bank's loss because the terms of such prolongation fully compensate for the delay in principal repayment,
- the borrower is not or probably will not be capable of servicing their debts in a long term, however, in a short-term perspective (up to 1 year) they will not require additional financing that would have resulted from their financial liquidity deterioration, and
- 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.

#### *Risk classes 8-10 for local models*

Entities classified in this range are customers with sound economic status and usually are characterized with:

- exceptional financial standing and ability to meet financial obligations in long term,
- high safety margin for debt repayment in long time perspective,
- ability to differentiate products or services from those offered by competitors when faced with pressure from the market,
- well experienced management.

#### *Risk classes 11-12 for local models*

Entities classified in this range are customers with very good economic status and usually are characterized with:

- very good financial standing and ability to meet financial obligations in long term, which however can be negatively affected by macroeconomic factors,
- limited ability to differentiate products or services in comparison to competitors,
- experienced management able to implement riskier strategies or who may be judged as less stable than the management of a company with a higher rating.

#### *Risk classes 13-14 for local models*

Majority of entities classified in this range is characterized with good financial status, however weaker than entities with better ratings. These clients still have acceptable safety margin and are perceived as good borrowers. Entities classified to this group are usually characterized with:

- good financial standing and ability to meet financial obligations in long term, which however can be negatively affected by macroeconomic factors,
- limited or no ability to differentiate products or services in comparison to competitors,
- management with experience adequate to the business activity,
- for some entities long term debt service ability may be assessed as more risky due to past irregular cash flows or loss bared in past years.

#### *Risk classes 15-16 for local models*

Entities classified in this range are still acceptable borrowers. However some of them may be characterized with higher credit risk. Entities in this group may have:

- problems with maintaining their position in the market in the face of growing competition,
- little or no influence on prices of materials, goods or services they purchase,
- it is possible that their management is not of the highest quality or high turnover in the management,
- decrease in profitability, substantial weakening of the balance sheet structure, irregular cash flows with outflows predominating over inflows.

#### *Risk class 17 for local models*

The companies classified in this rating enter the endangered financial standing zone. They show material indications of the borrower's weakening economic and financial standing/creditworthiness. Actions aimed at improvement of the Bank's position as the creditor are required, or the limitation or complete cancellation of the Bank's involvement in a borrower or transaction financing. At present there are no predictions as to the occurrence of the situation referred to as 'default' but more intensive monitoring is necessary.

Material symptoms of risk profile deterioration, which results in increasing threat that all financial obligations will not be meet on time in the future, which may include one or more of following:

- 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 Bank's loss because the terms of such prolongation fully compensate for the delay in repayment of the capital,
- 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,

- 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.

The entities classified in this rating often:

- operate in a sector that is in a downward phase,
- have to face the increasing pressure from their competitors,
- have very limited or no influence on prices of materials they purchase and their relations with suppliers,
- may have a weak management characterized by e.g. lack of experience, no stability or poor commitment.

#### *Risk class 18 - Under observation/Restructuring*

The borrower continues their business and meets their obligations towards the Bank (i.e. there are no delays in the principal or interest repayments 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 principal repayment term, however the change (extension) of the principal repayment term does not result in the Bank's loss because the terms of such prolongation fully compensate for the delay in the principal repayment,
- in a short-term perspective (up to 1 year) the borrower will need additional financing resulting from their financial liquidity deterioration, but the Bank assesses that in the short period there will be no problems with obtaining such financing (outside the Bank),
- the customer is not sufficiently capable of servicing their debt, and
- 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.

#### *Risk class 19 - Below standard/Restructuring*

The borrower continues their business and meets their obligations towards the Bank (if there are delays in the repayment, they are 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 principal repayment term, however the change (extension) of the principal repayment term does not result in the Bank's loss because the terms of such prolongation fully compensate for the delay in the principal repayment,
- in a short-term perspective (up to 1 year) the borrower will need additional financing resulting from their financial liquidity deterioration and, in the short period, such financing will be probably available (outside the Bank),
- the customer is not sufficiently capable of servicing its debt, and
- 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.

*Risk class 20 - Doubtful/Default and impairment occurred and recoveries and actions before forced collateral liquidation*

The Bank assesses that the customer will not repay their obligations towards the Bank in full, but the Bank has not initiated (yet) the compulsory liquidation 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 Bank. The inability to repay in full the obligations towards the Bank results from one or more of the following circumstances:

- the Bank has assessed that the impairment of exposure has occurred, or
- the Bank 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, or
- on the exposure with the forbearance status the default in repayment exceeded 30 calendar days or the Bank granted the consecutive forbearance facility to client.

*Risk class 21 Lost/Default occurred and forced recoveries and actions for collateral liquidation without losses*

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

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

*Risk class 22 - Lost/Default and impairment occurred and forced recoveries and actions for collateral liquidation with losses*

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

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

In case of exposures to companies and institutions, the default definition determines the client's reclassification to risk classes 20-22.

The table below presents the structure of correlations between internal and external rating systems:

ING Rating Risk class	S&P/Fitch IBCA Rating	Moody's Rating
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

### Equity exposures

As far as equity exposures are concerned, the Bank applies simple risk weight approach according to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013. Due to the specific nature of their business, subsidiaries do not identify equity exposures.

Transactions concluded on financial markets have the following default definition:

- failure to perform obligations under the agreement and made transactions, in particular failure to make in a timely manner any payment due,
- occurrence of any factual or legal event exposing the client to bankruptcy or liquidation,
- occurrence of any factual or legal events increasing the risk that the client shall fail to perform their obligations under transactions, in particular:
  - any material, permanent deterioration of the client's financial standing, including appointment of compulsory administration or another receiver towards the client's enterprise,
  - 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,
  - discontinuation to pay obligations, admitting in written form the inability to repay obligations in a timely manner or commencement of negotiations with one or several creditors with the intention of altering the amount, legal basis or date of liability payment,

- the client's failure to satisfy or improper satisfaction of due liabilities under any agreement to which the client is a party, made with the Bank or any other financial institution, or
- the Bank ascertaining from the business intelligence bureau that the client is in arrears in satisfying its payment obligations,
- actions have been undertaken to question the rights of the Bank under the agreement, transactions or any granted security, or such rights are questioned through any other means, in particular with the client's statements about non-recognition of the Bank's claims or by the client demanding that the competent authority declare the invalidity of the agreement or any transaction,
- circumstances occur, which in the opinion of the Bank could have a material negative impact on the client's business or standing (financial or other), in particular on the Bank's possibility to exercise any of its rights under the agreement or any granted security,
- issuance of any false or misleading statements, and
- the client has failed to establish a security for the performance of the client's obligations under the transactions as agreed with the Bank or any factual or legal event has occurred causing partial or complete invalidity, loss, reduction or deterioration of the legal conditions of the security established by the client or the security provider.

Following the requirement of the continuous compliance with the advanced internal-ratings based approach (AIRB) for the purpose of regulatory capital calculation, the Bank developed, implemented, monitored and validated local and global models for the following basic risk parameters:

- PD (probability of default),
- LGD (loss given default), and
- EAD (exposure at default)

for classes of assets in line with AIRB.

As far as corporate exposures are concerned, the following models, among others, are applied by the Group:

- for the strategic clients segment covering businesses with annual sales proceeds above EUR 100 million:
  - global ING Group PD (expert and statistical) rating model developed at the ING Group level which accounts for and is monitored regularly with the local data,
  - global LGD and EAD (hybrid, expert and statistical models) models also developed at ING Group level which account for and monitored regularly with the local data.
- for the local mid-sized and mid-corporate segments (SME assets class) covering clients with annual income from EUR 0.8 to 100 million:
  - local PD (expert and statistical) rating model developed under the supervision of the ING Group based on the Bank's internal data, applied at ING also as a regional model for Central and Eastern European states,
  - local LGD and EAD models (hybrid, expert and statistical models) developed under the supervision of ING based on the Bank's internal data and applied at ING as regional models for the Central and Eastern European states.

Besides the above, the Group also uses global (central) models for exposures to banks and other financial institutions, to sovereign and local governments as well as for specialised lending exposures.

## 6.2 Use of internal estimates for the purposes other than calculation of risk-weighted exposure amounts

ING Bank Śląski S.A. Group uses PD, LGD and EAD models developed in line with the requirements of Part III, Title II, Chapter 3 of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 for the purposes of regulatory capital calculation and in the key risk management processes - in measurement and management of credit exposure, the process of planning and formulation of strategy and reporting.

### **Credit exposure - measurement and management**

ING Bank Śląski S.A. Group uses PD, LGD and EAD risk parameters models in key areas associated with credit risk management, in particular:

- the calculation of the regulatory and economic capital otherwise known as internal capital,
- the calculation of provisions, and
- lending process, credit price calculation, reference limits definition and risk appetite.

Each of the above-mentioned areas uses a certain alignment of parameters to the purposes to be accomplished by a given area.

### **Process of planning and formulation of strategy**

Supervisory requirement to maintain the sufficient level of regulatory capital in Group results in the maintenance of the safe level of economic capital. Planning and management of economic capital in Group is conducted within defined market strategies, whose parameters comprise AIRB approach parameters estimated by the particular credit risk models. Planning and management of economic capital in Group aims to maximize the return on economic capital in acceptable risk frame. These parameters, allocated on business lines, are regularly reported on the Bank's Management Board by Capital Management Department. The planning methodology includes projected 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 the risk appetite statement (RAS). Capital plan is ratified by the Bank Management Board and Supervisory Board.

### **Reporting**

The Credit Risk Reporting Department prepares monthly reports on corporate and retail credit risks. In addition, the Accounting Department generates obligatory quarterly reports on risk weighted assets and the minimum regulatory capital/capital adequacy ratio. The basic reporting tool, both in the ING Bank Śląski S.A. Group and in the whole ING Group, is Vortex as a part of Vantage - integrated IT environment for credit risk management - is a global, centralised database on credit risk that provides a wide spectrum of information on various aspects of credit exposures, both on a transaction level and various aggregation levels. Vortex generates the reports in various dimensions using data on: PD, LGD, EAD, economic capital, risk weighted assets, the minimum regulatory capital, balance, and collateral. The data are available to all authorised users, at all levels of management, (as per specified access rights) from the Risk Management, Front-Office and Finance areas.



### 6.3 Credit risk mitigation management and recognition

#### Bank

Collateral is an essential tool for limiting credit risk, however it may not replace a financed entity's creditworthiness which is the determinant of credit exposure award.

The collateral in place has the following functions:

- financial:
  - it should limit the credit exposure losses when credit risk materialises i.e. when the debtor has discontinued to satisfy the contractual obligations, and
  - 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,
- non-financial:
  - it strengthens the control authority of the Bank as the creditor by limiting the collateral provider's ability to dispose of the assets pledged to the Bank, and
  - 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, and
- 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, or
- 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,
- the detailed rules for specific types of tangible and personal collateral considered in the recovery ratio estimation (including inter alia the rules on collateral valuation, tangible collateral insurance coverage requirements, preferred legal forms of collateral, requirements for providers of personal collateral and other requirements concerning personal and tangible collateral).

Furthermore, the Bank's regulations on collateral specifically take into account the aspects of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 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 in which collateral is presented and approved in the process of granting credit exposures and the rules of collateral monitoring presentation and approval.

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

In 2015, the requirement under Article 1 section 1 of the Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 concerning obtainment of written legal opinion to the collateral-related documents confirming that the latter are legally effective and enforceable in all relevant jurisdictions (for the collateral in question).

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 deterioration in the quality of one collateral item results in 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 assets item financed under the lease contract. Such security pays both financial and non-financial roles.

Sale of leased assets in case of termination of the lease contract reduces or completely eliminates the loss on the credit exposure. In addition, re-marketability of the financed assets affects the level of LGD (recovery rate is assigned to individual types of leased assets) and in consequence the level of both collective and specific provisions. Re-marketability of the leased assets is assessed using the expert method at the stage of a lease facility application assessment 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 re-marketability is more important than the financial situation of the client).

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

#### **ING Commercial Finance S.A. (ING CF)**

The basic collateral of the financing granted in the factoring form is assignment of trade receivables, which are financed by ING CF. Financing granted to 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 the insurer who covers debtor's insolvency risk, which causes the credit risk to be divided and potential losses on factoring exposure to be limited in the case of the client's financial problems.

Collateral is taken into account in the calculation of capital requirements for credit risk and provisions.

ING CF regulations include the rules for determining the collateral value and collateral monitoring and the criteria for collateral recognition when calculating the capital requirement. Each collateral item is assigned adequate recovery rate in the LGD model.

## 6.4 Control mechanisms for rating systems

### ***Credit risk rating and review***

Commercial functions who grant credit facilities 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 risk rating process: Rating Owner (Relationship Manager) and Risk Manager.

The Rating Owner inputs the financial data of the client and has sole responsibility for the correctness of the initial risk rating, including rating review and update. There is only one owner of a borrower’s risk rating. The risk management unit responsible for restructuring and debt collection (i.e. the Corporate Credit Restructuring Department) becomes the rating owner for the borrowers rated 18 to 22. The Rating Owner rates the exposure using the rating model dedicated to a given group of clients. 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, and
- finalizing the rating.

The outcomes of specific models may undergo arbitrary adjustments in that the ultimate rating grades are determined as part of the appeal process. At least 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 circumstances that has not (yet) have been captured by the rating model but which are likely to have a (usually negative) effect on the borrower’s PD, especially if:

- borrower has defaulted or is expected to default on any financial obligation to any party,
- a major disruption of activities occurred, or
- a change in legislation has occurred that will seriously impact the financial performance.

The IT system at the Group, used also in the whole ING Group, supports the 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 initiate review of the risk rating. The following rules apply to rating reviews:

- a risk rating must be reviewed at least annually; a risk rating is considered overdue after at most 12 months from the last approval date of the risk rating,
- the Rating Owner should take appropriate action to review the risk rating for a borrower; the Rating Owner should perform an interim re-rating when the value of one or more risk

drivers has materially changed. Events that could entail a re-rating procedure are for example a change of risk rating of the parent or a change of any of the qualitative risk drivers, and

- without a review until the expiry of 18 months from the last approval date of the risk rating, the risk rating will automatically downgrade and after additional 6 months - it will expire (automatic downgrade and expiation is not applicable to irregular borrowers' ratings).

## 6.5 Description of the factors that impacted on the loss experience in the preceding period

Within the process of credit risk models management ING Bank Śląski SA verifies levels and sources of losses by monitoring, among other:

- non-performance rate (referred as "default" rate),
- level of losses according to the LGD parameter, including its components (no loss rate/recovery rate, recovery rate on collateral, unsecured debt recovery rate, etc.), and
- conversion factor CCF (for various EAD models and types of products).

Tables below show the values of the following parameters: PD, LGD, exposure value (READ), risk weighted assets (RWA) and RWA density (RWA/READ) per class of exposures in AIRB approach for performing and impaired (defaulted) portfolios as of 31.12.2015, 31.12.2014 and their annual change presented in percentage terms.

	As at 31.12.2015	Institutions	Corporate	Total
Average PD (READ weighted)		0.15%	5.73%	5.10%
Average LGD (READ weighted)		10.18%	29.88%	27.68%
READ (in PLN million)		5 300.6	42 165.0	47 465.6
RWA (in PLN million)		1 314.2	22 464.8	23 779.0
RWA density (RWA/READ)		24.79%	53.28%	50.10%

	As at 31.12.2014	Institutions	Corporate	Total
Average PD (READ weighted)		0.19%	6.32%	5.34%
Average LGD (READ weighted)		16.52%	29.50%	27.41%
READ (in PLN million)		6 905.0	36 027.0	42 932.0
RWA (in PLN million)		1 957.9	17 971.2	19 929.1
RWA density (RWA/READ)		28.35%	49.88%	46.42%

Results on the total level of portfolio covered by AIRB approach reflect the features of exposures to corporates class due to its relatively high share in total READ (89% of READ covered by AIRB approach).

	Change (y/y in %)	Institutions	Corporate	Total
Average PD (READ weighted)		-21.05%	-9.42%	-4.35%
Average LGD (READ weighted)		-38.38%	1.27%	0.96%
READ (in PLN million)		-23.23%	17.04%	10.56%
RWA (in PLN million)		-32.88%	25.00%	19.32%
RWA density (RWA/READ)		-12.56%	6.81%	7.92%

Over the course of 2015, average PD decreased by more than 4% and average LGD increased by 1%. Meanwhile RWA density showed stronger increase than READ. It resulted from the recalibration of LGD risk parameters model for SME segment at the very beginning of 2015. This model covers 47% of exposures to corporates class.

The decrease of average PD reflected the increase in the quality of portfolio. In case of exposures to institutions class, ING Bank Śląski SA significantly reduced READ limiting the risk of this portfolio in the same time (visible decrease of average PD and LGD).

Tables below provide a historical verification (backtesting) of PD and LGD risk parameters. Their average model estimates per exposures class covered by AIRB approach were compared to realized values in the defined timeframe. Backtesting was performed on SME clients (nearly half of exposures to corporates class) covered by internal models - SME PD and SME LGD. The remaining exposures to corporates and exposures to institutions class are low-default portfolios, hence, their reliable statistical backtesting was not possible to perform.

See below the comparison between average one-year PD from SME PD model as of 31.12.2014 for performing portfolio and actual default rate observed during model monitoring in 2015 for those clients.

Indicators	Institutions	Corporate
Average PD (READ weighted) as of 31.12.2014 (performing portfolio)	0.19%	2.52%
Actual default rate observed during model monitoring in 2015	n/a*	2.50%

\*) No possibility to perform reliable statistical backtesting due to limited number of defaults.

Next table shows average LGD from SME LGD for performing portfolio estimated on long time-series and observed (actual) loss ratio for those clients observed in the last 10 years.

Indicators	Institutions	Corporate
Average LGD (READ weighted) as of 31.12.2014 (performing portfolio)	34.21%	31.58%
Actual loss observed in the last 10 years	n/a*	29.20%

\*) No possibility to perform reliable statistical backtesting due to limited number of defaults.

Average LGD is higher than actual loss in the presented timeframe and reflects the required conservatism of model's estimates.

## 6.6 Risk-weighted exposure average risk weight broken down by obligor grades

The following table shows the risk-weighted exposure average risk weight broken down by obligor grades.

Rating	Exposures to institutions	Average risk weight		
		Exposures to companies - SME	Exposures to companies - specialized lending	Exposures to companies - other
1	-	-	-	-
2	-	-	-	-
3	6.97%	-	-	-
4	3.96%	-	-	5.19%
5	12.74%	-	-	9.80%
6	26.14%	-	-	25.14%
7	25.11%	-	-	25.90%
8	28.30%	26.84%	16.09%	25.83%
9	52.79%	6.02%	7.36%	35.40%
10	37.15%	33.00%	12.86%	44.31%
11	60.53%	38.20%	22.50%	53.12%
12	42.84%	37.64%	36.62%	57.98%
13	102.12%	54.54%	28.71%	72.65%
14	99.49%	55.29%	38.84%	91.44%
15	115.14%	64.15%	90.09%	96.10%
16	145.98%	81.87%	67.57%	144.36%
17	145.92%	63.77%	306.29%	90.10%
18	-	59.55%	124.64%	155.21%
19	-	96.43%	-	109.12%
20	164.07%	125.83%	189.91%	147.92%
21	-	12.48%	-	207.67%
22	-	53.58%	163.34%	10.05%

## 7. Operational risk

### 7.1 General description of the operational risk management process at the ING Bank Śląski S.A. Group

ING Bank Śląski S.A. Group 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 ING Bank Śląski S.A. Group's 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 the spheres of the ING Bank Śląski S.A. Group's activity cooperation with outsourcers, clients and partners and is a consistent and permanent practice covering the following elements:

- internal environment,
- goal setting,
- risk identification,
- risk assessment,
- risk mitigation,
- control activities,
- risk monitoring, and
- reporting and transparency of actions.

The Supervisory Boards of the Bank and subsidiaries supervise the operational risk management and, based on periodic management information, assess at the activities in this area.

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

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

The structure of operational risk management takes account of the scope and specific nature of the Bank and subsidiaries 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:

- risk assessment aimed at risk mitigation,
- implementation and application of key controls arising from policies and standards,
- monitoring of changes to the risk profile,
- ensuring adequacy and effectiveness of key controls, and
- 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:

- setting the policy and other internal regulations as well as ensuring risk management methods and tools,
- verifying application of the regulations referred to hereinabove by the 1st line of defence,
- monitoring key controls, and
- 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 mitigating the risk taken.

## **7.2 Methods applied to quantify capital requirement for the operational risk**

For the regulatory capital requirement for the operational risk, at present the ING Bank Śląski S.A. Group applies the Basic Indicator Approach.

To calculate the economic capital requirement, the ING Bank Śląski S.A. Group applies the Advanced Measurement Approach.

The model applied by the ING Bank Śląski S.A. Group 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's requirements and the New Capital Accord (Basel II) regulations, the four sources of data are used in the ING Bank Śląski S.A. Group'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 in risk modelling within two segments. One segment stands for the body-region distribution risk which corresponds to operational risk events of high frequency and low severity. The other segment, being the tail-region 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.

### 7.3 Gross losses due to the operational risk

In 2015, the ING Bank Śląski S.A. Group reported operational risk losses<sup>1</sup> at the level of PLN 20.5 million; out of which PLN 0.7 million, including ING Bank Śląski S.A. PLN 20.5 million, while the remaining subsidiaries did not exceed a total of PLN 0.1 million of losses.

Following the operational risk events, last year the companies of ING Bank Śląski S.A. Group created provisions of PLN 0.6 million. The pool of provisions was reduced by PLN 16 million due to payments and the provision of PLN 2 million was released as related triggers ceased to apply. The amount paid from the provisions in 2015 was recognized in the actual gross losses.

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

No.	Event type	Event category	Gross losses in PLN million
1.	Clients, products & operational practices	Improper business or market practices	14.7
2.	Internal fraud	Theft and fraud	0.3
3.	External fraud	Theft and fraud	2.5
4.	Principles concerning employment and workplace security	Employee relations	0.1
5.	Losses in non-current assets	Natural disasters and other events (acts of vandalism)	1.2
6.	Transaction performance, delivery and operational processes management	Transaction input, processing, settlement and service (system and employee errors)	1.7
<b>Total</b>			<b>20.5</b>

Bank did not exceed the actual losses limit set by the Bank Management Board and Supervisory Board in the “Non-Financial Risk Appetite Statement of ING Bank Śląski S.A. for 2015”. The utilization level of actual losses was 76.26%.

Simultaneously, as a result of direct recoveries and damages Bank regained the amount of PLN 0.7 million, which represents 3.41% of the total gross actual losses.

The highest losses were caused by:

- the payment obligations arising from the final decisions of the President of the Office of Competition and Consumer Protection,
- losses due to human errors and incorrect transaction processing,
- external fraud, mainly due to criminal attacks on the IT systems of the clients using the electronic banking services. In justified circumstances, the Bank reimbursed the aggrieved parties for stolen funds,
- damages relating to non-current assets that occurred due to acts of vandalism on the Bank's property.

The actions to mitigate negative financial consequences of operational risk events concentrated mainly on:

- limiting the number of employee errors when processing 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,
- ongoing monitoring of offered products, services and processes,
  - further increasing the safety of the internet banking services used by retail and corporate clients. The Bank launched a project targeted at systematic development of technical equipment as well as raising clients' and employees' awareness of threats, and
  - enhancing security mechanisms of the external devices and Bank's facilities and streamlining 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.

## **II. Variable remuneration policy**

### **Intruduction**

Pursuant to the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 and the Banking Law Act of 29 August 1997 (Journal of Laws of 2015, item 128 as amended), hereinafter referred to as the "Banking Law Act", ING Bank Śląski S.A., hereinafter referred to as the Bank, is obliged to make qualitative and quantitative disclosures relating to the "Variable Remuneration Policy".

Pursuant to the "Policy of disclosing qualitative and quantitative information on capital adequacy and variable components of remuneration of ING Bank Śląski S.A." disclosures relating to the Variable Remuneration Policy of ING Bank Śląski S.A. are published.

### **1. Qualitative information**

#### **1.1 Information concerning the process of determination of the variable remuneration policy, number of meetings organized in the financial year by the remuneration supervisory authority, including composition and scope of tasks of the Remuneration and Nomination Committee, external consultant who assisted when developing remuneration policy, and role of the relevant participants**

As regards the variable remuneration, in 2012 the Bank implemented the solutions under Polish Financial Supervision Authority Resolution No. 258. The Bank 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 Bank Supervisory Board Remuneration and Nomination Committee has the following responsibilities:

- they present the Supervisory Board with opinions about and recommendations on the Policy,

- they present the Supervisory Board with recommendations on Policy observance, following the report developed by the Internal Audit Department, and
- 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:

- in the period from 01 January 2014 to 10 April 2014:
  - Mr Aleksander Galos (Chairman),
  - Mr Brunon Bartkiewicz (Member),
  - Mr Nikolaas Cornelis Jue (Member),
  - Mr Ronald Boekhout (Member),
- in the period 01 February 2015 to 30 March 2015:
  - Mr Aleksander Kutela (Chairman),
  - Mr Brunon Bartkiewicz (Member),
  - Mr Nicolaas Cornelis Jue (Member),
  - Mr Roland Boekhout (Member),
- in the period 31 March 2015 to 31 December 2015:
  - Mr Aleksander Kutela (Chairman),
  - Mr Brunon Bartkiewicz (Member),
  - Mr Roland Boekhout (Member),
  - Mr Diederik van Wassenaeer (Member).

In 2015 the Remuneration and Nomination Committee held six regular meetings and one held on a circular basis.

## **1.2 Key facts about performance-based remuneration**

ING Bank Śląski S.A. develops their 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. 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.

Under PFSA Resolution No. 258/2011, the variable remuneration is deferred and at least 50% thereof is paid in phantom shares 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 the 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 the remuneration system characteristics, including performance measurement criteria and performance adjustment with risk as well as payment deferral policy and vesting criteria**

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:

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

The goals and their weights - set in accordance with the rules adopted by the Bank - are approved by the Management Board; for ING Bank Śląski S.A. Management Board Members - by the Supervisory Board, based on the recommendation of the Supervisory Board 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 are performed by the immediate superior and are approved by the ING Bank Śląski S.A. Management Board, following the advice of the Supervisory Board Remuneration and Nomination Committee; for ING Bank Śląski S.A. Management Board Members - by the Supervisory Board, based on the recommendation of the Supervisory Board Remuneration and Nomination Committee. Assessment and verification take place by 31 March of the subsequent calendar year at the latest; for ING Bank Śląski S.A. Management Board Members - by 30 April.

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 employment 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.

In 2015 Bank implemented the provisions of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD IV).

## 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 Policy, i.e. those employed in the ING Bank Śląski S.A. Group companies.

As at the disclosure date hereof, the variable remuneration of persons holding managerial positions, was not granted yet. The disclosure presents the maximum obtainable level of variable remuneration.

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

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

No.	Business line	Total remuneration (fixed + variable)
1	Management Board Members supervising business lines used in Bank management	8.8
2	Management Board Members - other	11.4
3	Retail banking segment	10.2
4	Corporate banking segment	36.7
<b>Total</b>		<b>67.1</b>

- Aggregate quantitative information about remuneration of persons holding managerial positions at the Bank, in split into:
  - 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, and
  - 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 beneficiaries:

	Group	Number of persons	Remuneration fixed	Variable remuneration	Total remuneration (fixed and variable)
A	Management Board Members	8	11.9	8.3	20.2
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	51	25.0	13.1	38.1
C	Other persons holding managerial positions at the Bank when considered the persons having material impact on the risk profile of the Bank	20	5.8	3.0	8.8
<b>Total</b>		<b>79</b>	<b>42.7</b>	<b>24.4</b>	<b>67.1</b>

- aggregate amount and form of variable remuneration in split into cash and share-linked instruments, adopted at the Bank:

	Group	Variable remuneration - paid in cash	Variable remuneration - paid in phantom stock	Variable remuneration total
A	Management Board Members	4.2	4.2	8.3
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	6.5	6.5	13.1
C	Other persons holding managerial positions at the Bank when considered the persons having material impact on the risk profile of the Bank	1.5	1.5	3.0
<b>Total</b>		<b>12.2</b>	<b>12.2</b>	<b>24.4</b>

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

	Group	Deferred variable remuneration - awarded part	Deferred variable remuneration - not-awarded part	Deferred Variable remuneration total
A	Management Board Members	2.5	3.3	5.8
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	3.9	5.2	9.1
C	Other persons holding managerial positions at the Bank when considered the persons having material impact on the risk profile of the Bank	0.9	1.2	2.1
<b>Total</b>		<b>7.3</b>	<b>9.7</b>	<b>17.0</b>

- aggregate remuneration with deferred payment, granted in the accounting year, paid and reduced under the results-driven adjustment:

	Group	Deferred part of variable remuneration for 2012 and 2013 - granted in 2015	Deferred part of variable remuneration for 2012 and 2013 - paid in 2015
A	Management Board Members	2.1	1.6
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	3.0	2.2
C	Other persons holding managerial positions at the Bank when considered the persons having material impact on the risk profile of the Bank	0.6	0.5
<b>Total</b>		<b>5.7</b>	<b>4.2</b>

The remuneration with deferred payment was not reduced under the results-driven adjustment.

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

	Group	Amount of payments relating to employment commencement and termination	Number of beneficiaries	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	0.6
C	Other persons holding managerial positions at the Bank when considered the persons having material impact on the risk profile of the Bank	-	-	-
<b>Total</b>		<b>0.6</b>	<b>1</b>	<b>0.6</b>

In 2015, no total remuneration of any person employed at ING Bank Śląski S.A. Group exceeded the amount of EUR 1 million.