TRANSLATION

REPORT ON ACTIVITIES OF THE CAPITAL GROUP OF BANK HANDLOWY W WARSZAWIE S.A. IN THE FIRST HALF OF 2018

AUGUST 2018

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I. Introduction

1. Description of activities of Bank Handlowy w Warszawie S.A.

Bank Handlowy w Warszawie S.A. (further "Citi Handlowy") is a universal lending and deposit bank, which offers institutional and investment banking and consumer banking services as well as providing brokerage services.

In the institutional client segment, Citi Handlowy focuses on maintaining its leading position among the banks which service international corporations and the largest domestic companies. Enterprises from the SME sector (Small and medium Enterprises) are another group of clients that are important to the Group. Focusing on acquiring new clients while actively expanding relations with existing clients in selected sectors as well as providing support to clients planning international expansion (the Emerging Market Champions initiative) are keys to further building the Group's market position. The goal of the Group is to be the Strategic Partner for Polish companies and to actively support the expansion of Poland's industry. This is clear from the range of products offered by the Bank in which foreign exchange transactions and products related to trade finance and guarantees occupy an important place. Additionally, the Bank strives to maintain its status as one of the safest places for institutional clients to deposit their savings, providing many useful modern solutions related to operating accounts and the day-to-day management of corporate finances.

The Bank's stable capital position as well as its outstanding network of international contacts are also appreciated by consumers. The Bank uses this competitive advantage to strengthen its leading position in the affluent banking segment. To this end, the Bank continues to develop products for Citigold clients and its unique offering launched at the end of 2015 for the most affluent clients – Citigold Private Client. In the consumer segment, the Bank focuses on investment products and its unique ways of rewarding those clients who decide to use the Bank's online wealth management products. The Bank's international connections enable it to expand the range of products offered to consumers by providing them with a unique global banking experience.

The Bank also stresses the importance of other groups of consumers, and especially so-called aspiring clients for whom the Bank is developing the special Citi Priority range of products. Citi Handlowy enhances the package solutions offered to this segment, tightening the clients' deposit relations with the Bank and at the same time addressing their need for loans.

Moreover, Citi Handlowy is the unquestioned leader of the credit card market, since it offers products from the global Citi product range, which are accepted all over the world and offer exceptional value for the client, e.g. in the form of loyalty programs. The Bank's objective will be also to increase the market share of unsecured loan products by meeting the credit needs of the growing number of clients with a competitive offering of cash loans or hire purchase products as well as innovative, fast processes.

The Bank's brokerage house (Dom Maklerski Banku Handlowego S.A., further DMBH) is among the most active participants of the Polish capital market and a leading player in terms of share in Warsaw Stock Exchange turnover.

Major achievements in H1, 2018 include:

- **High profitability** – the key profitability ratios remained at a high level:
  - Return on assets (ROA) at 1.5% (vs. 1.1% in H1, 2017);
  - Return on tangible equity (ROTE) at 12.9% vs. 9.5% in the corresponding period of the previous year.
- **Significant increase in net profit** to PLN 328.2 million (or 64% YoY) due to higher revenue, which increased 14% YoY, lower cost of credit by 24% YoY and consistent control of operating costs (down by 1% YoY);
- The main factors driving revenue growth were **treasury income** due to realized profits from the sale of securities, and **net interest income.**
- The increase in net interest income was due to **higher credit volumes, both on the institutional clients side (up by 7% YoY) and the retail customers side (up by 6% YoY),** which led to **an increase in interest margin** on earning assets **to 2. 7%.**
- **High quality of capital base:** Tier 1 at 17.1%, or 6.0 p.p.[1] above the minimum capital thresholds.
- **The Bank paid out a dividend** to its shareholders in the amount of **100% of its net profit for 2017. The Dividend Yield** was **6%.**
- **The Bank confirmed its leading position in the strategic areas:**
  - FX volumes growth for institutional clients 4% up YoY;
  - Global clients' assets grew by 12% YoY and corporate clients' assets grew by 7% YoY;
  - Further development of relationship banking among retail customers – 5% growth in deposits YoY

The Bank consistently increases the number of digital users. The number of Citibank Online users increased by 9, 000 compared to the corresponding period of 2017. Significant growth is also observed in mobile banking, where the number of users increased by 34% vs. June 2017.

[1] Currently the minimum capital requirement threshold for the Group is Tier 1 of 11.1%

2. Development prospects for the Bank Handlowy w Warszawie S.A.

2.1 General development objectives of the Group

There are several strategic areas of focus for the Group of Bank Handlowy w Warszawie S.A. In the retail segment, those are credit cards and services addressed to affluent customers. In the institutional segment, the Group focuses on services to global companies and major domestic enterprises. Foreign exchange products, transactional banking and custody services also play an important role.

It is the Group's goal to keep a leading market position in those areas while leveraging its competitive edges. To grow even further, the Group strengthens its relationship with existing clients, continues its efforts to improve service quality and keeps investing in the development of remote channels and technologies that improve the functionality and safety of the solutions offered to clients. In the retail segment, those activities include the transformation of outlets, including in particular the Smart and Smart Mini branches, as well as a number of new tools that enable Asset Management via digital means. As concerns Corporate and Commercial Bank, business growth will be achieved through increasing focus on companies which operate in the e-commerce market, providing comprehensive services to global companies in Poland and fast-growing Polish companies that plan international expansion or have already tapped into the foreign markets.

Financing structure will continue to be largely based on operating accounts, with safety and a robust capital position remaining priorities in the Bank's activity.

The Group in particular stresses continued building of shareholder value by improving operational efficiency and leveraging its market advantages of a strong capital and liquidity position.

2.2 Institutional banking

In the Corporate and Commercial Bank business, maintaining its leading position in banking services for international corporates and top tier local customers is of special importance for the Group. Nevertheless, the Group also notices growing potential in the SME area. The Bank takes steps to establish strategic partnerships with small and mid-size enterprises, while providing them with comprehensive services, including current liquidity management, foreign exchange, and in particular providing support for foreign trade.

The Group aims at becoming the leader in banking services for enterprises that run or intend to run international business operations on a broad scale. It focuses both on companies with a strong market position, as well as companies that have only recently tapped into foreign markets. Through its Emerging Market Champions program, the Bank plans to become a trusted partner for companies and support their international development and expansion as well as to maintain close working relationships in the long term. To this end, the Bank is constantly enhancing its range of trade finance products and its processes for handling transactions in the foreign exchange market.

The e-commerce market is another area of strategic importance for the Bank as the Bank can offer a number of cutting edge solutions for automated management of receivables. The offer is addressed both to domestic enterprises, as well as global companies that need comprehensive financial service in Poland.

With its strong market position and stable capital position, extensive expertise and high credibility, the Bank is bound to achieve its goals. At the same time, its orientation towards innovative solutions and technology development as well as its global nature allow for further growth in the ever-changing market conditions. In this manner, the Bank not only retains a leading position in strategic areas but is also able to compete by offering state-of-the-art solutions.

2.3 Brokerage activity

The development of the consumer segment is of particular importance for DMBH as it is to help make the cooperation between DMBH and the Bank even more efficient.

DMBH implements technological projects whose purpose is the further automation and streamlining of processes and development towards offering solutions which enable the provision of cost-effective services to domestic- and international institutional clients who are interested in algorithmic trading and executing high-volume transactions.

2.4 Consumer banking

The Bank will still focus on these client segments and products where it has the competitive advantage. This implies further growth in wealth management and relational banking, focused on the affluent (CitiGold) and aspiring affluent client segments. In the Gold segment, the Bank will strive to consolidate its position as a leader and ensure that Citi Handlowy remains the bank of choice owing to its full range of banking products, auxiliary services, privileges and exceptional client-oriented service. In response to the needs of aspiring affluent clients, the Bank is launching the Citi Priority service. Product packages, a unique debit card, global privileges and a focus on digital client service make the offer truly special and address the needs of clients for whom state-of-the-art technology, a global lifestyle and flexible access to banking services are key. Self-service Smart branches and new Citibank Online functionalities support such flexibility.

The leading position in the credit card market is the main competitive advantage of the Bank and generates client acquisition. The main goal in this area is to maintain the leading position as measured by the number and volume of credit card transactions and to support the acquisition of new card clients by tailoring the credit card offer to the market environment and the clients' needs.

Along with the development of the modern Smart branch network, the Bank plans to implement further innovative technological solutions which will accelerate client service and sales processes.

3. Awards and honors

In the first half of 2018, the Bank, DMBH and the Leopold Kronenberg Foundation at Citi Handlowy received a number of prestigious titles and awards:

- Citi Handlowy won the competition of the Ministry of Finance for **Treasury Securities Dealers (TSDs) in 2018**. This was yet another (the eighth) victory of the Bank in this prestigious competition organized since 2002 and a confirmation of its strong position in this market segment.
- For the third time in a row, the jury of the ***Złoty Bankier*** ranking found the Citi Simplicity credit card to be the best one on the market. In the 9th edition of the ranking, the Citi Handlowy cash loan was also on the podium.
- Citi Handlowy was honored for the innovative sales strategy of the Credit Card: The innovative strategy of the Citi Handlowy Credit Card acquisition, relying on cooperation with the largest players on the e-commerce market, won the main prize in the **Innovation Award** Competition organized by the SAR Marketing Communication Association.
- The prestigious British financial magazine ***Euromoney*** awarded yet another distinction to Citi Handlowy. In the 15th edition of the annual private banking market survey, the Bank was honored in two categories – for the best private banking offer and for the best offer for global clients.
- Citi Handlowy was honored with the **"Super Ethical Firm"** title. Nine companies with the highest ethical standards were selected during the fourth edition of the "2017 Ethical Firm" competition organized by *Puls Biznesu* business daily. Citi Handlowy was the only bank to receive the "Super Ethical Firm" title.
- **Sixteen initiatives in the field of corporate social responsibility (CSR) launched by Citi in Poland were featured in this year's 16th edition of the Responsible Business Forum report.** "Responsible Business in Poland. Good Practices" is the only publication summarizing the most important projects in the field of CSR in Poland. Among long-term practices, initiatives such as, inter alia, the Citi Employee Volunteering Program, the "Poles' Attitudes Towards Finance" survey and the Aleksander Gieysztor Award have been taken into account.
- In the **12th Corporate Responsibility Ranking 2018** compiled by the Gazeta Prawna daily, Citi Handlowy was ranked 11. The ranking comprises companies operating in Poland which are evaluated in terms of the quality of the CSR business management system.

II. Poland's economy in the first half of 2018

1. Macroeconomic conditions and the situation in money and foreign exchange markets

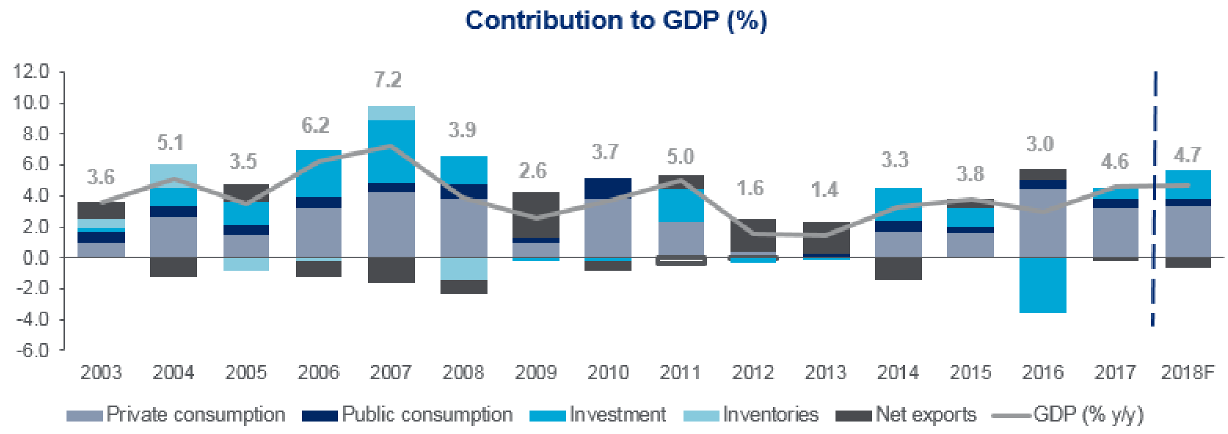
External environment

The first months of the year brought disappointing data on economic activities in Germany and the Eurozone, as well as in the US. Given weaker data on the GDP from the Eurozone, the European Central Bank (EBC) retained a relatively moderate tone of comments, which postponed expectations of interest rate increases until late 2019. At the same time, EBC announced extension and gradual discontinuation of the asset purchase programme by the end of this year. The increase in risk aversion and the increase in profitability of Italian bonds were partly affected by results of the parliamentary elections in Italy, won by parties deemed populist by the markets. Meanwhile, the US central bank continued to tighten the monetary policy, by increasing interest rates twice, March and June this year. In the years to come, the increase will be supported by the tax cuts approved last year, while the trade disputes among the US, China and the European Union may adversely affect the US and global growth. This year, we expect an acceleration in the global growth to 3.4% YoY from 3.3% YoY in 2017 and further tightening of the US monetary policy.

In the first half of the year, most of major stock indices in the international financial markets did not considerably change or fell slightly, apart from the NASDAQ technology index, which recorded a major increase. The yield of 10-year German bonds did not basically change, while the yield of 10-year US bonds grew by approx. 50 base points, exceeding 3%. Short-term US bonds recorded a greater loss, which resulted in flattening of the return curve in the US.

Gross Domestic Product

The GDP growth in the first half of this year was higher than expected, despite weak data from the Eurozone. In the first half of 2018, the GDP growth was very high and was close to 5% YoY. In the first quarter of this year, the increase unexpectedly accelerated to 5.2% YoY, and the second quarter was just slightly lower. The increase was driven by domestic demand, which most likely accelerated compared to 2017, reaching an increase of 6.8% YoY in Q1 2018 with the increase in private consumption by 4.8% YoY and acceleration in investments to 8.1% YoY. In Q2, private consumption was similar to Q1 and investments accelerated even more. Foreign trade had a negative impact on the GDP, when trade decelerated and major trading partners experienced faster GDP growth. The final balance was influenced by greater weakening in imports than exports, which was consistent with the high growth in domestic demand and the growing oil prices. On the other hand, the relatively weak Polish zloty continued to provide support for exports. Monthly figures demonstrated a slight slowdown of industrial production in the first half of the year to 6.8% YoY from 7.5% YoY in the second half of 2017 and compared to 6.5% YoY over the entire 2017, in turn construction production accelerated to 24.5% YoY from 18.6% YoY and 12.5% YoY respectively. Retail sales slowed down to 7.1% YoY from 7.7% YoY and 7.3% YoY respectively. Considering strong figures for the first half of the year, we expect that economic growth will accelerate in 2018 to 4.7% YoY from 4.6% YoY with a minor slowdown of consumption and acceleration of investments. Despite the slowdown, consumption is still on the fast increase and is supported by the labour market, while the growing inflow of EU funds supports investments.



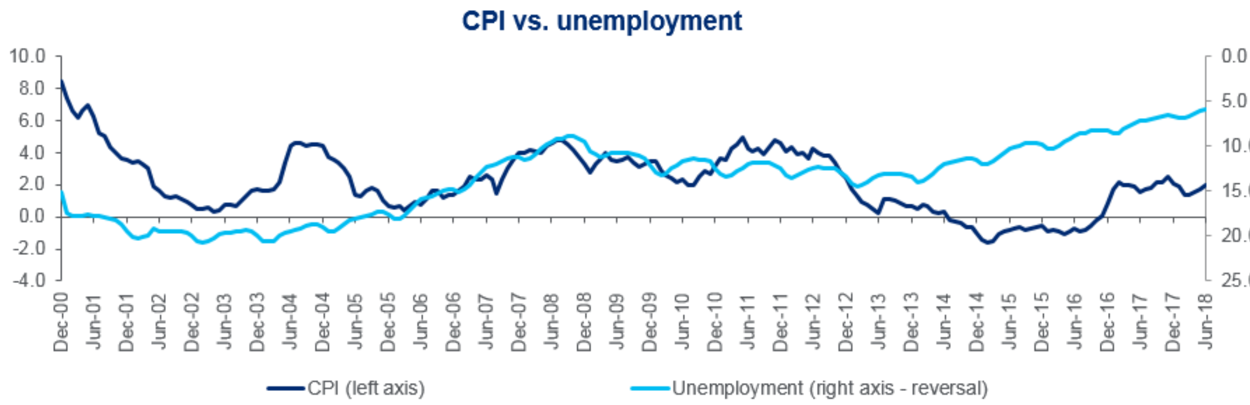
Source: Central Statistical Office, Citi Handlowy forecasts

Labour market

Conditions on the labour market further improved, and the unemployment rate declined at the end of June 2018 to 5.9% YoY from 6.6% YoY at the end of 2017. Demand for work remained solid and enterprises reported growing issues with finding the employees. As a result, nominal wage growth accelerated to 7.2% YoY from 6.5% YoY in the second half of 2017 and 5.6% YoY over the entire 2017 and employment decelerated to 3.7% YoY from 4.5% YoY in 2017. By the end of this year and in 2019 we expect these trends to be maintained, i.e. continued drop in the rate of unemployment, accelerated growth in salaries and a slowdown in employment growth.

Inflation

In the first half of 2018 prices of consumer goods and services slowed down to 1.6% YoY from 2.0% YoY in 2017, although after a temporary drop at the beginning of the year the inflation returned to 2% YoY in the middle of the year. The drop in inflation was affected by a slowdown in the rise in prices of foods and fuels. Additionally, net inflation, i.e. excluding food, fuel and energy prices, fell slightly to 0.7% YoY from 0.8% YoY in 2017. Despite the robust growth, the MPC decided to maintain the benchmark rate at a historically low level of 1.50% given the still relatively low inflation. As a result, interest rates were retained below zero in real terms. Additionally, members of the Monetary Policy Council indicated that interest rates may remain unchanged in 2018 and 2019. In our opinion, the Monetary Policy Council will raise rates no sooner than in 2020.



Source: National Bank of Poland, Central Statistical Office, own calculations

2. Money and foreign exchange markets

After good performance of the zloty in 2017, when it was one of the best performing currencies to the euro compared to other currencies of emerging economies, in the first half of 2018 the domestic currency lost its value. The zloty has weakened to the euro by -4.7% since December 2017 from 4.18 to 4.37 and by -7.5% to the dollar from 3.48 to 3.74. The zloty was part of the falling trend of the emerging economy currencies to the main currencies, as a result of major appreciation of the dollar and the response to the weakening of the Chinese yuan. This situation was the result of poor data from the Eurozone and the results of elections in Italy, which negatively affected the euro, and the increase in rates by the Fed, which positively affected the dollar. In addition, protectionist steps taken by the US and the Chinese response led to poorer performance of the yuan.

Money market rates remained relatively stable in the first half of 2018. WIBOR 3M stood at 1.70% at the end of June against 1.72% at the end of 2017. The swap rates basically did not change; at the end of the first half of 2018 the rates were similar to the rates at the end of December 2017, while the yield of bonds has dropped since the beginning of the year by approx. 8-9 base points, as a result of the relatively low supply of debt owing to good budget results, just as in 2017. As a result, the yield of 2-year Treasury bonds decreased to 1.63% at the end of June from 1.71% at the end of 2017 while the yield of 10-year ones fell from 3.30% to 3.21%.

3. Capital market

The first half of 2018 saw a marked downturn on the Warsaw Stock Exchange. The situation resulted, among other things, from lower sentiments on the global markets caused by the worries about the consequences of the US-China trade war. There was also an additional internal factor, specifically the growing redemptions of investments funds with an exposure to the domestic equities market.

As a consequence, all the main indices recorded significant drops in the first half of the year. Despite reaching record highs in January, the WIG broad market index has lost 12.2% since the beginning of the year. The WIG20 blue chip index fell by 13.2%. The mWIG40 mid-cap index lost 12.9%. Meanwhile, the sWIG80 index (the small-cap index) closed the first half of 2018 with a result that was 13.1% lower compared to the end of 2017.

As far as the sector sub-indices are concerned, only the index of the media sector companies saw an improvement in performance (+1.1%). The pressure was the highest on the share prices of construction companies (-24%), chemical companies (-22%), as well as the companies from the energy sector (-22%) and from the mining sector (-20%).

In the first half of 2018, there was little activity on the domestic IPO market. During that period, there were five new companies listed on the main WSE market (one of which moved from the New Connect alternative market). The value of initial public offerings was only slightly higher than PLN 279 million compared with more than PLN 2.3 billion in the same period a year ago. Meanwhile, share of 14 companies were delisted from the WSE. In the end, the number of companies listed on the WSE in the first half of 2018 dropped to 473 (including 49 foreign entities).

Since the beginning of the year, the total capitalization of all companies listed on WSE lost 11% and went down to PLN 1,229 billion, with the market value of domestic companies at PLN 569 billion (down by 15% from the end of 2017).

Warsaw Stock Exchange (WSE) Equity Indices as of June 30, 2018

Index	30.06.2018 (1)	31.12.2017 (2)	Change (%) (1)/(2)	30.06.2016 (3)	Change (%) (1)/(3)
WIG	55,954.44	63,745.30	(12.2%)	61,018.36	(8.3%)
WIG-PL	57,060.37	65,263.00	(12.6%)	62,194.79	(8.3%)
WIG-div	1,045.17	1,213.88	(13.9%)	1,180.44	(11.5%)
WIG20	2,135.47	2,461.21	(13.2%)	2,299.80	(7.1%)
WIG20TR	3,690.51	4,261.88	(13.4%)	3,925.88	(6.0%)
WIG30	2,464.89	2,825.27	(12.8%)	2,663.68	(7.5%)
mWIG40	4,219.73	4,847.27	(12.9%)	4,907.43	(14.0%)
sWIG80	12,689.02	14,595.76	(13.1%)	16,069.01	(21.0%)
Sector sub-indices					
WIG-Banks	7,219.40	8,481.97	(14.9%)	7,261.87	(0.6%)
WIG-Construction	2,143.10	2,819.16	(24.0%)	3,470.78	(38.3%)
WIG-Chemicals	11,891.50	15,297.93	(22.3%)	14,778.71	(19.5%)
WIG- Energy	2,344.45	2,990.57	(21.6%)	3,037.52	(22.8%)
WIG- Mining	3,509.32	4,394.93	(20.2%)	4,106.07	(14.5%)
WIG-IT	1,894.21	2,041.80	(7.2%)	2,287.84	(17.2%)
WIG-Media	4,845.23	4,791.34	1.1%,	5,126.77	(5.5%)
WIG- Developers	2,088.32	2,198.05	(5.0%)	2,130.39	(2.0%)
WIG- Fuel	6,011.42	7,140.43	(15.8%)	7,128.31	(15.7%)
WIG- Food	3,463.23	3,627.59	(4.5%)	4,473.78	(22.6%)
WIG-Telecoms	651.38	745.44	(12.6%)	713.40	(8.7%)

Source: WSE, Dom Maklerski Banku Handlowego S.A. ("DMBH")

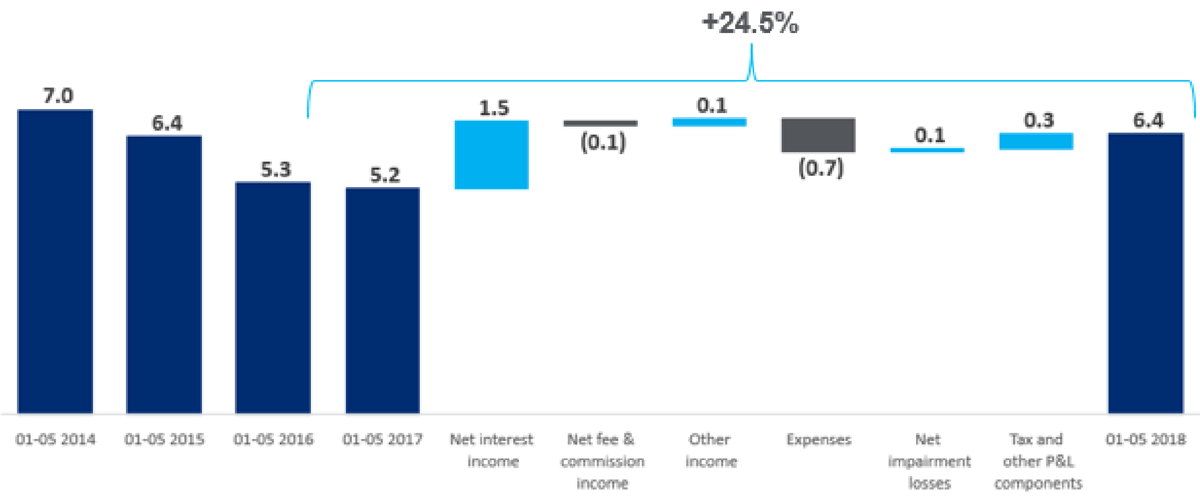
Equity, bond and derivatives trading volumes on WSE in the first half of 2018

	1st half of 2018 (1)	2nd half of 2017 (2)	Change (%) (1)/(2)	1st half of 2017 (3)	Change (%) (1)/(3)
Equity (PLN million)*	209,855	240,251	(12.7%)	281,706	(25.5%)
Bonds (PLN million)	1,619	1,408	15.0%	1,485	9.0%
Futures ('000 contracts)	8,072	6,540	23.4%	8,097	(0.3%)
Options ('000 contracts)	305	270	13.0%	339	(10.0%)

** figures excluding calls*
Source: WSE, DMBH

4. Banking sector

Net profit of the banking sector (PLN billion)

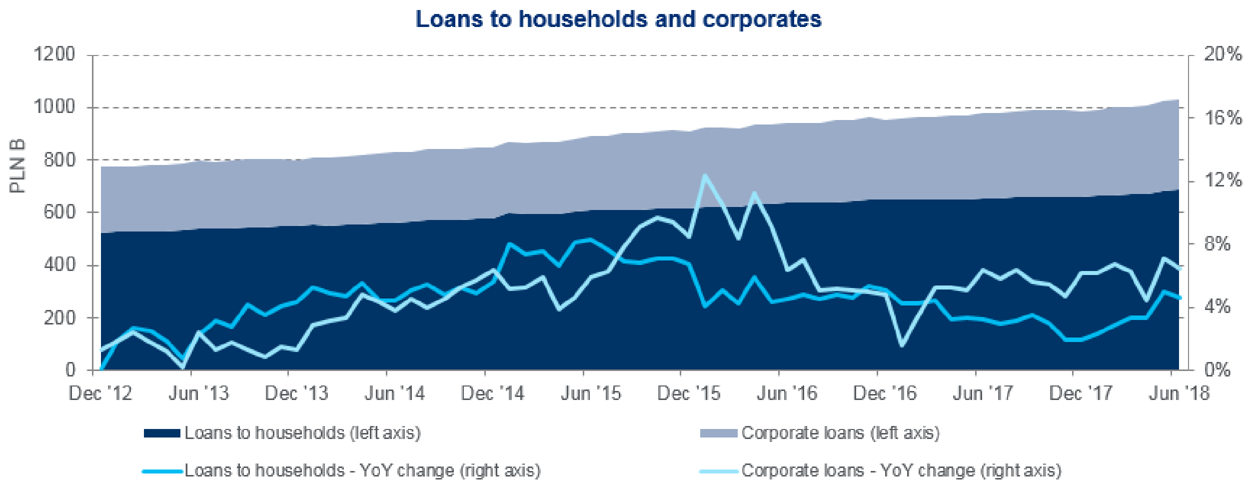


Source: PFSA, own calculations

Financial results

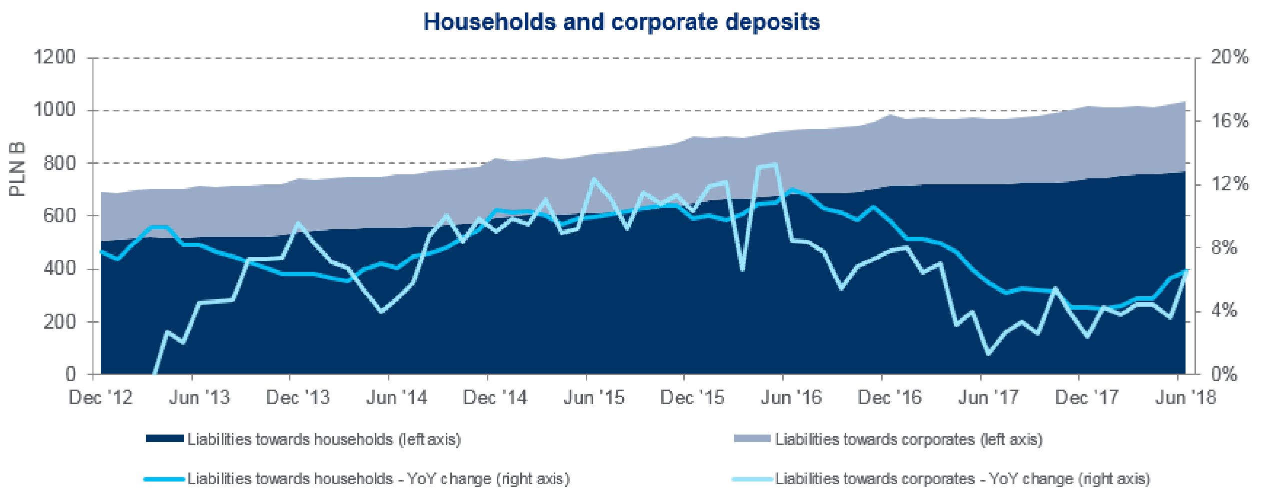
According to PFSA figures, net profit of the banking sector between January and May 2018 went up by 24.5% (or, PLN 1,265 million) from the same period a year ago and reached PLN 6.4 billion. An improvement in the banks' net interest income (+9.1% YoY, PLN 1.5 billion), which was achieved through an increase in lending and further optimization of the banks' balance sheet structure, was the most important factor that contributed to an improvement of net income. As regards the banks' income, the growth of other income (+4.8% YoY, PLN 143 million) also had a positive impact; meanwhile, net commission income was slightly lower than the one generated in the same period last year (-1.7% YoY, PLN 96 million). In consequence, total income generated by the banking sector during the first five months of the year stood at PLN 27.3 billion, up by 6.2% (or, PLN 1.6 billion) from the same period of 2017. The costs incurred by the banking sector between January and May 2018 grew considerably (+4.8% YoY, PLN 739 million) which had a negative impact on net profit. That negative effect was partially compensated by an improvement in net impairment losses, which went down by 1.9% YoY (PLN 64 million). Owing to the simultaneous increase in the banks' income and costs, no major changes in the efficiency of the banking sector were recorded, with the cost/income ratio remaining at 59% (-0.8 p.p. YoY).

Early in 2018, banks had to implement a new financial reporting standard (IFRS 9) which brought some material changes; those changes were visible, among other things, in the level of impairment losses for financial assets, and most notably in the quality of the banks' lending portfolio as measured by the non-performing loans ratio (NPL ratio). As at the end of May 2018, the quality of loans extended to entities from the non-financial sector (along with the public sector), as measured by the NPL ratio, saw a deterioration to 7.1%, up by +0.8 p.p. YoY. However, the rate of deterioration of the lending portfolio quality differed depending on the client segment. The highest increase in the NPL ratio was observed in the small and mid-size enterprises segment (+2.0 p.p. YoY to 11.9%); it was slightly lower for large corporates (+1.1 p.p. YoY to 6.9%). As a consequence, the NPL ratio for the Corporate and Commercial Bank stood at 9.7% (+1.5% YoY). The impact IFRS 9 had on the quality of the loan portfolio in the retail segment turned out to be much lower; the ratio of non-performing household loans went up by 0.3 p.p. YoY and reached 6.5% as at the end of May 2018. However, that growth was mainly observed in loans extended to sole traders and individual farmers (who belong to the household segment). At the same time, the NPL ratio for mortgage loans of households and consumer loans remained unchanged (2.9% and 11.6% respectively).



Source: NBP, own calculations

In the first half of 2018, the growth rate of lending to the non-financial sector went up from +4.0% YoY (PLN 52 billion) as at the end of June 2017 to +5.7% YoY (PLN 63 billion) as at the end of June 2018. Loans to households, which totaled PLN 688 billion (+4.7% YoY; PLN 31 billion), had the most significant impact on the acceleration of lending growth rate. Out of the loans extended in that segment, consumer lending saw the fastest growth rate (up by +9.5% YoY, or PLN 15 billion, to PLN 176 billion). Mortgage loans grew at a much slower rate (+3.2% YoY; PLN 13 billion) which was mostly due to PLN appreciation vis-a-vis foreign currencies and resulted in a negative growth rate of FX housing loans (-9.6% YoY; PLN 14 billion). In the same period, PLN housing loans reached PLN 272 billion, up by +10.9% (PLN 27 billion) compared to the end of June 2017. As regards other loans, current loans to sole traders and individual farmers also stood out and recorded a high growth rate (up by +7.9%, or PLN 4 billion, to PLN 49 billion). At PLN 31 billion (-0.4% YoY), loans for capital expenditures remained at an almost unchanged level. In the first half of 2018, loans for non-financial enterprises maintained their high growth rate, as was the case a year earlier (up by +0.1 p.p. to +6.5% YoY). Their total volume stood at nearly PLN 342 billion, up by PLN 21 billion from the end of June 2018. In terms of loan purpose, real estate loans saw the highest growth rate (+13.7% YoY; PLN 7 billion), followed by current loans (+10.1% YoY; PLN 13 billion). The investment loans volume (for investments other than in real estate) remained at a level similar to the one observed a year earlier (-0.2% YoY; PLN 212 million). In terms of tenor, the loan portfolio was definitely dominated by loans with long maturity dates (above 5 years), up by +12.1% YoY (PLN 18 billion), followed by short-term loans (up to 1 year) (+5.0% YoY; PLN 4 billion); the medium-term loans remained nearly unchanged (+0.2% YoY; PLN 155 million).



Source: NBP, own calculations

As at the end of the first half of 2018, the deposits of non-financial enterprises totaled PLN 263 billion, up by +6.5% on a year-on-year basis; however, the absolute majority of funds was in current deposits, which totaled PLN 171 billion (+7.9%, PLN 13 billion). In the same period, term deposits gained +3.9% (PLN 4 billion). The advantage of current deposits in terms of growth rate was even more evident in the household segment. Their growth rate was nearly +13% YoY (PLN 55 billion), while the volume of term deposits decreased by 2.5% YoY. (PLN 8 billion). The total value of household deposits in the banking sector was nearly PLN 770 billion (+6.5% YoY; PLN 47 billion).

The conditions prevailing in the banking sector in the first half of 2018 will most probably continue for the remainder of the year. According to the declarations of the Monetary Policy Council, interest-rate hikes may not be in sight for as long as 2020. Meanwhile, banks will continue to be under pressure from high BGF contributions and the tax on certain financial institutions. The regulations concerning capital adequacy will continue to force some banks to increase the capital level while limiting their ability to pay out dividend. On the other hand, most banks already got used to those conditions which is evident when looking at the high net income level of the sector, for example.

The appreciation of the zloty against the Swiss franc considerably mitigated the risk for banks arising from foreign-currency mortgage loans. In the current circumstances, the probability of systemic solutions in this respect whose introduction could prove costly for the sector appears very low. On the other hand, considerable risk persists in connection with the poor financial standing of many credit unions.

Rapid economic growth and high growth of private consumption combined with the expected growth in corporate investment expenditures offer a number of development opportunities for banks. This gives rise to hope that lending will accelerate even further and the results will improve.

The banking sector in Poland continues to undergo major transformation in terms of competitive environment. With the high number of mergers and acquisitions observed in recent years and the transactions announced to take place this year, the sector becomes more and more concentrated. On the other hand, there are still new entrants on the market and, combined with the growing competition from non-banking institutions, all this leads to a high level of competition in the financial services sector.

5. Trends in the Polish and global economy in the second half of 2018

The intensification of protectionist measures by the United States and the accompanying response from other countries is an important risk factor. The rise in trade barriers may affect demand for products of the Polish and European exporters and thus adversely affect the economic activities in Poland. A possible slowdown in China resulting from the outbreak of trade wars could result in a slowdown of the growth in countries that are part of the German chain of supply, including Poland.

The pace of monetary policy tightening in developed economies is one of the factors that will have a significant impact on equity flows to and from emerging markets. In the scenario of rapid interest rate rises in the US or the Eurozone, outflows of foreign capital could be triggered and thus the domestic currency might weaken. A potential effect would be an increase in profitability of the State Treasury debt and the interest rate on the debt of Polish enterprises.

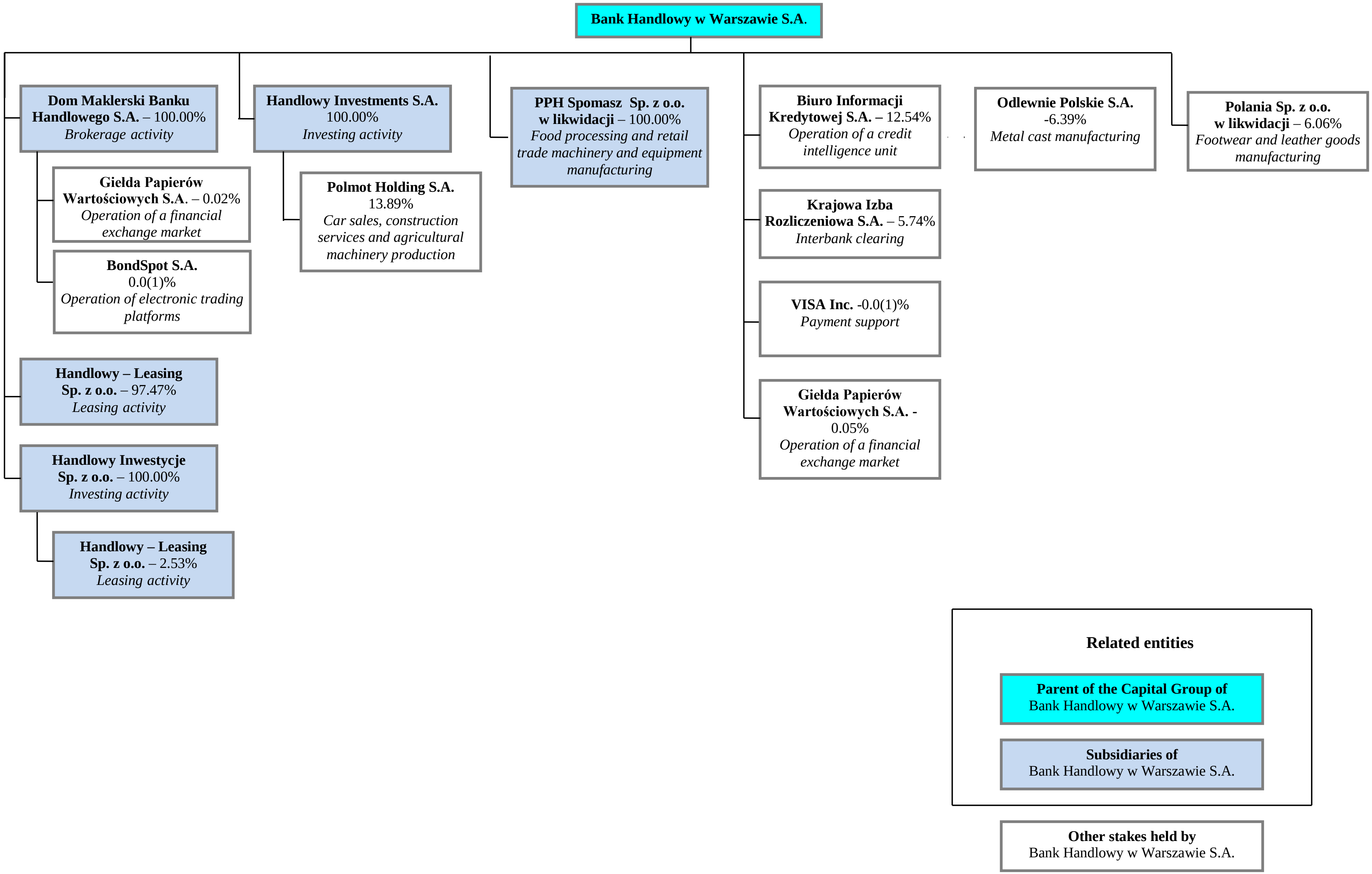
Uncertainty concerning changes in domestic economic policy, especially with respect to future changes to the tax system, may contribute to Polish corporations putting off new investment projects. Reduced scale of investments could have a negative impact on the potential of the Polish economy, reducing its growth rate over the next few years.

Brexit is one of the factors that has led to discussions on reducing the pool of EU funds available for the Polish enterprises and local governments. Although the new EU financial perspective will be effective from 2021, the perspective of changes in the pool of available funds may affect sentiment of the Polish enterprises and their investment plans over the next quarters.

A high pace of the economic growth and the low interest rates contribute to increase tensions on the labour market and increased salary demands. In time, the increase in unit costs of labour may lead to reduced competitiveness of the Polish enterprises and weakening of the export growth rate. One of the potential consequences is the risk of increased price pressure over the quarter to come.

III. Organizational chart of the Capital Group of Bank Handlowy w Warszawie S.A.

The organizational chart below depicts the structure of the Capital Group of Bank Handlowy w Warszawie S.A. (“Bank”) as of June 30, 2018; the Bank’s share interest in each specified.


Bank Handlowy w Warszawie S.A.
Dom Maklerski Banku Handlowego S.A. – 100.00% Brokerage activity
Giełda Papierów Wartościowych S.A. – 0.02% Operation of a financial exchange market
BondSpot S.A. 0.0(1)% Operation of electronic trading platforms
Handlowy – Leasing Sp. z o.o. – 97.47% Leasing activity
Handlowy Inwestycje Sp. z o.o. – 100.00% Investing activity
Handlowy – Leasing Sp. z o.o. – 2.53% Leasing activity
Handlowy Investments S.A. 100.00% Investing activity
Polmot Holding S.A. 13.89% Car sales, construction services and agricultural machinery production
PPH Spomasz Sp. z o.o. w likwidacji – 100.00% Food processing and retail trade machinery and equipment manufacturing
Biuro Informacji Kredytowej S.A. – 12.54% Operation of a credit intelligence unit
Krajowa Izba Rozliczeniowa S.A. – 5.74% Interbank clearing
VISA Inc. -0.0(1)% Payment support
Giełda Papierów Wartościowych S.A. - 0.05% Operation of a financial exchange market
Odlewnie Polskie S.A. -6.39% Metal cast manufacturing
Polania Sp. z o.o. w likwidacji – 6.06% Footwear and leather goods manufacturing
Related entities
Parent of the Capital Group of Bank Handlowy w Warszawie S.A.
Subsidiaries of Bank Handlowy w Warszawie S.A.
Other stakes held by Bank Handlowy w Warszawie S.A.

IV. The organizational structure of the Capital Group of Bank Handlowy w Warszawie S.A.

The Capital Group of Bank Handlowy w Warszawie S.A. ("Group") consists of a parent company and subsidiaries:

BANK HANDLOWY W WARSZAWIE S.A. GROUP ENTITIES FULLY CONSOLIDATED

Entity	Core business	Capital relationship	% of authorized capital held	Accounting method	Equity (PLN '000) 30 Jun 2018
Bank Handlowy w Warszawie S.A.*	Banking	parent	-	-	6,642,569
Dom Maklerski Banku Handlowego S.A. ("DMBH")	Brokerage activities	subsidiary	100.00%	full consolidation	98,504
Handlowy - Leasing Sp. z o.o.	Leasing activities	subsidiary	100.00%**	full consolidation	22,197
Handlowy Investments S.A.	Investing activity	subsidiary	100.00%	full consolidation	18,391
PPH Spomasz Sp. z o.o. w likwidacji	Ceased operations	subsidiary	100.00%	full consolidation	Entity under liquidation

** Equity of Bank Handlowy w Warszawie S.A. as per statement of financial position of the Bank for the first half of 2018*
*** Including indirect participations*

BANK HANDLOWY W WARSZAWIE S.A. GROUP ENTITIES NOT FULLY CONSOLIDATED

Entity	Core business	Capital relationship	% of authorized capital held	Accounting method	Equity (PLN '000) 30 Jun 2018
Handlowy Inwestycje Sp. z o.o.	Investing activity	subsidiary	100.00%	equity valuation	11,090

V. Selected financial data of the Capital Group of Bank Handlowy w Warszawie S.A.

1. Summary financial data of the Group

PLN million	30 Jun 2018	31 Dec 2017*
Total assets	44,101.2	43,037.6
Total equity	6,692.5	6,938.9
Amounts due from customers**	21,029.9	19,849.0
Customer deposits**	32,217.1	31,945.2
Net profit***	328.2	200.6
Total capital adequacy ratio	17.1	17.9

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*
*** Amounts due from and deposits of non-banking entities of the financial sector, entities of the non-financial sector, including the public sector.*
**** Net profit for the first half of adequately 2017 and 2018.*

2. Financial result of the Group for the first half of 2018

The following financial results are presented on the basis of the abridged semi-annual financial statement of the Group for the period of the first 6 months of the year ended June 30, 2018.

2.1 Income statement

In the first half of 2018 the Group delivered a consolidated net profit of PLN 328.2 million, up by PLN 127.6 million (or 63.6%) compared to PLN 200.6 million in H1, 2017. The consolidated profit before tax in the first half of 2018 amounted to PLN 427.1 million, up by PLN 151.0 million compared to the corresponding period of the previous year. The consolidated profit before tax in the first half of 2018 went up due to growth in all major profit and loss account items, i.e. revenue increased by PLN 136.9 million YoY to PLN 1,128.4 million, general administrative expenses and depreciation dropped by PLN 6.6 million YoY and amounted to PLN 626.3 million, net impairment losses decreased by PLN 10.2 million YoY to PLN 32.5 million vs. PLN 42.7 million a year ago.

The revenues of the Group increased, first of all as a consequence of: increase in treasury result[2] by PLN 103.1 million (that is +61.1% YoY), and improvement of net interest income by PLN 29.4 million (+5.7% YoY), mainly, as a result of lower interest expenses.

Selected income statement items

	1st half of		Change	
PLN'000	**2018**	**2017***	**PLN'000**	**%**
Net interest income	547,761	518,349	29,412	5.7%
Net fee and commission income	280,412	289,666	(9,254)	(3.2%)
Dividend income	8,950	8,948	2	0.0%
Net income on trading financial instruments and revaluation	192,743	152,931	39,812	26.0%
Net gain/(loss) on debt investment financial assets measured at fair value through other comprehensive income[a]	79,193	15,861	63,332	399.3%
Net gain/(loss) on equity and other instruments measured at fair value through income statement [b]	6,792	3,377	3,415	101.1%
Net gain/loss on hedge accounting	3,682	3,554	128	3.6%
Net other operating income	8,899	(1,173)	10,072	-
Total income	**1,128,432**	**991,513**	**136,919**	**13.8%**
General administrative expenses and depreciation:	(626,331)	(632,921)	6,590	(1.0%)
General administrative expenses	(588,970)	(597,442)	8,472	(1.4%)
Depreciation and amortization	(37,361)	(35,479)	(1,882)	5.3%
Profit on sale of non-financial assets	(836)	30	(866)	-
Net impairment on financial assets and provisions for off–balance sheet commitments[c]	(32,524)	(42,706)	10,182	(23.8%)
Share in net profits/losses of entities valued at equity method	255	265	(10)	(3.8%)
Tax on some financial institutions	(41,933)	(40,111)	(1,822)	4.5%
Profit before tax	**427,063**	**276,070**	**150,993**	**54.7%**
Income tax expense	(98,851)	(75,431)	(23,420)	31.0%
Net profit	**328,212**	**200,639**	**127,573**	**63.6%**

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

a. Corresponds to the 'Net gain on debt investment securities available-for-sale' in accordance with IAS 39.

b. Corresponds to the 'Net gain on equity investment instruments available-for-sale' in accordance with IAS 39.

c. Corresponds to the 'Net impairment due to financial assets and provisions for granted financial liabilities and guarantees' in accordance with IAS 39

2.1.1 Revenues

Net interest income was the most important source of revenue of the Group in the first half of 2018 (49% of total revenue). It amounted to PLN 547.8 million compared to PLN 518.3 million in H1, 2017, up by PLN 29.4 million (or 5.7%).

Interest income in the first half of 2018 increased by PLN 2.7 million (or 0.4%) to PLN 645.0 million. Interest on amounts due from customers, which were the main source of interest income, amounted to PLN 468.5 million, up by PLN 21.1 million (or 4.7%) compared to H1, 2017. It was mainly due to an increase in average credit volumes of both individual and institutional clients. On the other hand, interest income on debt investment assets measured at fair value through other comprehensive income dropped by PLN 16.1 million (or 10.7%) vs. H1, 2017, primarily due to a lower average balance of this portfolio.

Interest expenses in the first half of 2018 decreased by PLN 26.7 million (or 21.5%) compared to the corresponding period of the previous year. Interest expenses due to amounts due to clients (from the financial and non-financial sectors) constituting the main source of interest expenses, reached the level of PLN 70.9 million, down by PLN 14.0 million (or 16.5%) vs. H1, 2017, which was mainly due to lower interest rates on these deposits.

Consequently, the total net interest margin in relation to average interest-earning assets in the first half of the year 2018 improved to 2.70% from 2.53% reported in the first half of 2017.

Net fee and commission income in the first half of 2018 amounted to PLN 280.4 million compared to PLN 289.7 million in the corresponding period of 2017 – down by PLN 9.3 million (or 3.2%). The biggest – in percentage terms – year-on-year decrease in net fee and commission income was observed in brokerage operations (-26.5%), primarily due to one-off transactions conducted in the stock exchange market in H1, 2017. At the same time, the deterioration of sentiment on the capital markets as well as an increase in risk aversion led to a decline in fee and commission income from the sale of investment and insurance products.

Net income on trade financial instruments and revaluation in the first half of 2018 amounted to PLN 192.7 million compared to PLN 152.9 in the corresponding period of 2017 – up by PLN 39.8 million (or 26.0%), mainly as a result of the improved result on the Bank's proprietary management;

Net income on investment debt financial assets measured at fair value through other comprehensive income in H1, 2018 amounted to PLN 79.2 million, up by PLN 63.3 million compared to the corresponding period of the previous year.

[2] Treasury income consists of: net income on trading financial instruments and revaluation and net gain/(loss) on debt investment financial assets measured at fair value through other comprehensive income.

Net income on equity and other instruments measured at fair value through income statement grew in I half of 2018 by PLN 3.4 million (or 101.1%), compared to the corresponding period of 2017, primarily as a result of the higher valuation of shares of the companies the Bank has exposure to.

Net other operating income in H1, 2018 amounted to PLN 8.9 million, up by PLN 10.1 million compared to the corresponding period of the previous year, mainly as a result of the reimbursement of the fine paid by the Group in one of the litigations. (Details are described in note 35 of Consolidated Financial Statement)

2.1.2 Expenses

In the first half of 2018 the Group's general administrative and depreciation expenses amounted to PLN 626.3 million vs. PLN 632.9 million in the corresponding period of the previous year. The decrease by PLN 6.6 million (or. 1.0%) was generally due to lower administrative costs, partially offset by higher staff and depreciation expenses.

The administrative costs were affected by a decrease in Bank Guarantee Fund charges by PLN 11.3 million YoY (a lower annual contribution to the obligatory Resolution Fund) and lower technology costs. On the other hand, the expenses associated with the sale of banking products and with marketing investments aimed at building the Citi Handlowy brand awareness increased.

Staff expenses increased slightly by PLN 1.3 million YoY as a result of higher personnel costs in line with the current market trends. The average employment in the Group in the reporting period dropped by 136 FTEs.

Depreciation of property and equipment and amortization of intangible assets increased by PLN 1.9 million YoY as a result of the implementation of technology projects.

2.1.3 Net impairment on financial assets

Net impairment losses and provisions

PLN'000	1st half of		Change	
	2018	2017*	PLN'000	%
Net impairment losses on financial assets	(35,665)	(43,019)	7,354	(17.1%)
Net impairment losses on financial assets - Stage 1	(6,445)	n/a	n/a	n/a
Net impairment losses on financial assets – Stage 2	(2,235)	n/a	n/a	n/a
Net impairment losses on financial assets – Stage 3	(26,985)	n/a	n/a	n/a
Net impairment losses on provisions for financial and guarantee liabilities	2,521	313	2,208	705.4%
Net impairment losses on debt investment financial assets measured at fair value through other comprehensive income	620	-	620	(100%)
Net impairment losses on financial assets and provisions for granted financial liabilities and guarantees	**(32,524)**	**(42,706)**	**10,182**	**(23.8)%**

***** *On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

In the first half of 2018 net impairment due to financial assets and provisions value losses for granted financial and guarantee liabilities amounted to PLN -32.5 million compared to PLN -42.7 million in the first half of 2017. The Institutional Banking Segment reported an decrease in net impairment losses by PLN 4.5 million mainly due to reversals of provisions for individually assessed impaired loans and repayment of part of loan portfolio. In the Consumer Banking Segment net impairment losses in the first half of 2018 decreased by PLN 5.7 million, mainly due to implementation of changes that increased effectiveness of a recovery process, partially offset by rising volumes of unsecured loans.

2.1.4 Tax on assets of certain financial institutions

The total charge to the income statement of Bank Handlowy w Warszawie S.A. Capital Group due to the tax on certain financial institutions for the first six months of 2018 amounted to PLN 41.9 million compared to PLN 40.1 million in H1, 2017.

2.1.5 Ratio analysis

Selected financial ratios

	1st half of 2018	1st half of 2017*
Return on equity (ROE) **	10.4%	7.6%
Return on assets (ROA) ***	1.5%	1.1%
Cost/Income (C/I)	56%	64%
Non-financial sector loans to non-financial sector deposits	73%	66%
Non-financial sector loans to total assets	43%	40%
Net interest income to total revenue	49%	52%
Net fee and commission income to total revenue	25%	29%

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

*** Net profit to average equity (excluding net profit for the current year) calculated on a quarterly basis.*

**** Net profit to average total assets calculated on a quarterly basis.*

Employment within the Group

FTEs	1st half of 2018	1st half of 2017	Change	
			FTEs	%
Average no. of jobs in the period	3,452	3,588	(136)	(3.8%)
No. of jobs at the end of the period	3,427	3,546	(119)	(3.4%)

2.2 Consolidated statement of financial position

As of June 30, 2018, total assets of the Group stood at PLN 44.1 billion, up by 2.5% compared to the end of 2017.

Consolidated statement of financial position

PLN'000	As of		Change	
	30 Jun 2018	31 Dec 2017*	PLN'000	%
ASSETS				
Cash and balances with the Central Bank	509,566	462,126	47,440	10.3%
Amounts due from banks	961,204	836,774	124,430	14.9%
Financial assets held-for-trading	3,532,588	2,179,925	1,352,663	62.1%
Debt financial assets measured at fair value through other comprehensive income[d]	15,708,747	17,439,439	(1,730,692)	(9.9%)
Equity investments valued at equity method	10,676	10,664	12	0.1%
Equity and other investments measured at fair value though the income statement [e]	49,037	26,500	22,537	85.0%
Amounts due from customers	21,029,880	19,849,033	1,180,847	5.9%
Tangible fixed assets	350,408	376,775	(26,367)	(7.0%)
Intangible assets	1,373,867	1,352,413	21,454	1.6%
Current income tax receivables	841	667	174	26.1%
Deferred tax asset	208,219	175,904	32,315	18.4%
Other assets	366,177	325,448	40,729	12.5%
Non-current assets held-for-sale	-	1,928	(1,928)	(100.0%)
Total assets	**44,101,210**	**43,037,596**	**1,063,614**	**2.5%**
LIABILITIES				
Amounts due to banks	2,067,750	1,568,376	499,374	31.8%
Financial liabilities held-for-trading	1,618,568	1,353,215	265,353	19.6%
Hedging derivatives	-	50,191	(50,191)	(100.0%)
Amounts due to customers	32,499,621	32,136,698	362,923	1.1%
Provisions	38,037	18,300	19,737	107.9%
Current income tax liabilities	50,530	52,340	(1,810)	(3.5%)
Other liabilities	1,134,181	919,593	214,588	23.3%
Total liabilities	**37,408,687**	**36,098,713**	**1,309,974**	**3.6%**
EQUITY				
Ordinary shares	522,638	522,638	-	-
Share premium	3,003,290	3,003,969	(679)	-
Revaluation reserve	27,873	(9,118)	36,991	(405.7%)
Other reserves	2,886,750	2,895,598	(8,848)	(0.3%)
Retained earnings	251,972	525,796	(273,824)	(52.1%)
Total equity	**6,692,523**	**6,938,883**	**(246,360)**	**(3.6%)**
Liabilities and equity	**44,101,210**	**43,037,596**	**1,063,614**	**2.5%**

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

***d.** Corresponds to the 'Debt securities available-for-sale' in accordance with IAS 39.*

***e.** Corresponds to the 'Equity investments available for sale' in accordance with IAS 39.*

2.2.1 Assets

Gross amounts due from customers

PLN'000	As of		Change	
	30 Jun 2018	31 Dec 2017*	PLN'000	%
Non-banking financial institutions	2,139,300	2,012,490	126,810	6,3%
Non-financial companies	12,173,521	11,255,032	918,489	8,2%
Individuals	7,308,554	7,092,665	215,889	3,0%
Public sector entities	77,082	76,626	456	0,6%
Non-commercial institutions	13	3	10	-
Total gross receivables from clients	**21,698,470**	**20,436,816**	**1,261,654**	**6,2%**

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

In the first half of 2018 amounts due from customers (gross) increased by PLN 1.3 billion (or 6.2%) compared to the end of 2017 to PLN 21.7 billion, primarily due to increased lending for the non-financial sector clients (PLN +1.1 billion, or 5.9%). Amounts due from customers grew on both the institutional customers' side (PLN+0.8 billion, or 8.6%; in all customer segments: GSG clients, Corporate Banking clients and CCB clients) and the retail customers side (PLN +0.2 billion, or 3.0%; due to unsecured loans and mortgage loans increase).

Customer net receivables

PLN '000	As of		Change	
	30.06.2018	31.12.2017*	PLN '000	%
Receivables from financial sector entities	**2,137,266**	**1,995,017**	**142,249**	**7.1%**
Receivables from non-financial sector entities, including:	**18,892,614**	**17,854,016**	**1,038,598**	**5.8%**
Institutional customers*	11,949,493	11,056,890	892,603	8.1%
Individual customers, including:	6,943,121	6,797,126	145,995	2.1%
Unsecured receivables	5,413,507	5,323,199	90,308	1.7%
Mortgage loans	1,529,614	1,473,927	55,687	3.8%
Total net customer receivables	**21,029,880**	**19,849,033**	**1,180,847**	**5.9%**

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*
***Institutional clients include enterprises, public sector, public and private companies, cooperatives, individual enterprises, non-commercial institutions operating for households.*

Debt securities portfolio

PLN'000	As of		Change	
	30 Jun 2018	31 Dec 2017	PLN'000	%
Treasury bonds, including:	17,338,694	17,020,453	318,241	1.9%
Bonds hedged in the fair value hedge accounting	-	2,492,215	(2,492,215)	(100.0%)
Bonds issued by banks, including:	34,782	32,577	2,205	6.8%
Bonds issued by financial institutions	417,471	130,604	286,867	219.6%
Bonds and notes issued by Central Bank	199,992	1,399,713	(1,199,721)	(85.7%)
Debt securities, total	**17,990,939**	**18,583,347**	**(592,408)**	**(3.2%)**

The debt securities portfolio decreased as of the end of the first half of 2018 by PLN 0.6 billion (or 3.2%), primarily as a result of the decreased position in NBP monetary bills.

2.2.2 Liabilities

Liabilities towards customers

PLN'000	As of		Change	
	30 Jun 2018	31 Dec 2017	PLN'000	%
Deposits from financial sector entities	**6,386,459**	**4,853,148**	**1,533,311**	**31.6%**
Deposits of non-financial sector entities, including:	**25,830,642**	**27,092,005**	**(1,261,363)**	**(4.7%)**
non-financial companies	12,660,659	13,403,515	(742,856)	(5.5%)
non-commercial institutions	552,179	416,064	136,115	32.7%
individual customers	11,001,310	10,348,720	652,590	6.3%
public sector units	1,616,494	2,923,706	(1,307,212)	(44.7%)
Other liabilities	**282,520**	**191,545**	**90,975**	**47.5%**
Liabilities towards customers, total	**32,499,621**	**32,136,698**	**362,923**	**1.1%**

Deposits of financial and non-financial sector entities, including:				
in PLN	24,275,301	23,764,217	511,084	2.2%
in foreign currency	7,941,800	8,180,936	(239,136)	(2.9%)
Deposits from financial and non-financial sector entities, total	**32,217,101**	**31,945,153**	**271,948**	**0.9%**

In the first six months of 2018 amounts due to customers constituted the dominant source of financing of the Group's activity and constituted 73.7% of the Group's liabilities and equity. Total amounts due to customers as of the end of June 2018 amounted to PLN 32.5 billion, up by PLN 0.4 billion (or 1.1%) compared to the end of 2017, which was due to an increase in deposits of the financial sector clients by PLN 1.5 billion or 31.6%, partially offset by a decrease in liabilities in the non-financial sector. Deposits in the non-financial sector dropped on the institutional clients side (down by PLN 1.9 billion, or 11.4%, mainly in the public sector). On the other hand, deposits in the non-financial sector on the individual customers side increased, for another quarter in a row, by PLN 0.7 billion, or 6.3%.

2.2.3 Source and use of funds

PLN'000	30 Jun 2018	31 Dec 2017*
Source of funds		
Banks	2,067,750	1,568,376
Customers	32,499,621	32,136,698
Own funds including net income	6,692,523	6,938,883
Other	2,841,316	2,393,639
Total source of funds	**44,101,210**	**43,037,596**
Use of funds		
Amounts due from banks	961,204	836,774
Amounts due from customers	21,029,880	19,849,033
Securities, shares and other financial assets	19,301,048	19,656,528
Other	2,809,078	2,695,261
Total use of funds	**44,101,210**	**43,037,596**

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

2.3 Equity and total capital adequacy ratio

As compared to the end of 2017 the value of equity (excluding the financial result) of the Group as of the end of the first half of 2018 decreased slightly by PLN 39.0 million (or 0.6%). The decrease related to the changes resulting from the application of IFRS 9 in other capitals.

Equity**

	As of		Change	
PLN'000	30 Jun 2018	31 Dec 2017*	PLN'000	%
Ordinary shares	522,638	522,638	-	-
Share premium	3,003,290	3,003,969	(679)	(0.0%)
Revaluation reserve	27,873	(9,118)	36,991	-
Reserve capital	2,886,750	2,895,598	(8,848)	(0.3%)
General risk reserve	540,200	540,200	-	-
Retained earnings	(76,240)	(9,770)	(66,470)	(680.4%)
Total equity	**6,364,311**	**6,403,317**	**(39,006)**	**(0.6%)**

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*
*** Retained earnings for the first half of adequately 2017 and 2018.*

The equity level is fully sufficient to ensure the financial security of the company and the security of funds deposited in the Bank as well as it fully supports growth opportunities of the Group.

The following table presents financial data for the calculation of the CAR based on the consolidated financial statements of the Group.

Capital adequacy

PLN '000	30.06.2018	31.12.2017
Common Equity Tier I	4,956,443	4,981,895
Tier I Capital	4,956,443	4,981,895
Own Funds	4,956,443	4,981,895
The total amount of risk exposure	28,968,791	27,882,101

PLN '000	**30.06.2018**	**31.12.2017**
Common Equity Tier I	17.1%	17.9%
Tier I Capital ratio	17.1%	17.9%
Total capital ratio	17.1%	17.9%
Total leverage ratio exposures	48,291,510	47,250,960
Leverage	10.3%	10.5%

As of June 30, 2018 the total capital adequacy ratio of the Group was 17.1%, down by 0.8 p.p. compared to the end of 2017. The change in the total capital adequacy ratio was mainly due to an increase in capital requirements, especially concerning credit risk as a result of credit volumes growth.

Information regarding own funds

PLN '000		**30.06.2018**	**31.12.2017**
1	**OWN FUNDS**	**4,956,443**	**4,981,895**
1.1	**TIER 1 CAPITAL**	**4,956,443**	**4,981,895**
1.1.1	**COMMON EQUITY TIER 1 CAPITAL**	**4,956,443**	**4,981,895**
1.1.1.1	**Capital instruments eligible as CET1 Capital**	**3,008,172**	**3,008,172**
1.1.1.1.1	Paid up capital instruments	522,638	522,638
1.1.1.1.3	Share premium	2,485,534	2,485,534
1.1.1.2	**Retained earnings**	(76,419)	(9,771)
1.1.1.2.1	Previous years retained earnings	(1,636)	(9,771)
1.1.1.2.2.1	Profit or loss attributable to owners of the parent	253,608	535,566
1.1.1.2.2.2	(-) Part of interim or year-end profit not eligible	(328,392)	(535,566)
1.1.1.3	**Accumulated other comprehensive income**	27,395	(9,828)
1.1.1.4	**Other reserves**	2,864,785	2,874,545
1.1.1.5	**Funds for general banking risk**	540,200	540,200
1.1.1.9	**Adjustments to CET1 due to prudential filters**	**(21,359)**	**(21,465)**
1.1.1.9.5	(-) Value adjustments due to the requirements for prudent valuation	(21,359)	(21,465)
1.1.1.10	**(-) Goodwill**	**(1,245,976)**	**(1,245,976)**
1.1.1.10.1	(-) Goodwill accounted for as intangible asset	(1,245,976)	(1,245,976)
1.1.1.11	**(-) Other intangible assets**	**(127,891)**	**(106,437)**
1.1.1.11.1	(-) Other intangible assets gross amount	(127,891)	(106,437)
1.1.1.26	**Other transitional adjustments to CET1 Capital**	-	(19,527)
1.1.1.28	**CET1 capital elements or deductions - other**	(12,463)	(28,017)
1.1.2	**ADDITIONAL TIER 1 CAPITAL**	-	-
1.2	**TIER 2 CAPITAL**	-	-

Reconciliation of the Group's own funds for the Group's equity

PLN '000	**30.06.2018**	**31.12.2017**
Total Equity	**6,692,523**	**6,938,884**
Goodwill & other intangible assets	(1,373,867)	(1,352,413)
Adjustments to Equity Tier I in respect of prudential filters - value adjustments in respect of the requirements for the prudence	(21,359)	(21,465)
Other adjustments in transition Common Equity Tier I	(12,463)	(47,544)
Net profit for the Bank's shareholders	(328,391)	(535,566)
Total Deductions	**(1,736,080)**	**(1,956,989)**
Total Own funds	**4,956,443**	**4,981,896**

Own funds in the interim period

PLN '000		(A) Amount at disclosure date 30.06.2018	(A) Amount at disclosure date 31.12.2017	(B) Regulation
	COMMON EQUITY TIER 1 CAPITAL: INSTRUMENTS AND RESERVES			
1	Capital instruments and the related share premium accounts	3,008,172	3,008,172	26 (1), 27, 28, 29,
	of which: Series A	260,000	260,000	EBA list 26 (3)
	of which: Series B	112,000	112,000	EBA list 26 (3)
	of which: Series C	150,638	150,638	EBA list 26 (3)
2	Retained earnings	(76,419)	(9,771)	26 (1) (c)
3	Accumulated other comprehensive income (and other reserves)	2,892,180	2,864,717	26 (1)
3a	Funds for general banking risk	540,200	540,200	26 (1) (f)
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	6,364,133	6,403,317	
	Common Equity Tier 1 : regulatory adjustments			
7	Additional value adjustments (negative amount)	(21,359)	(21,465)	36 (1) (b), 37, 472
8	Intangible assets (net of related tax liability) (negative amount)	(1,373,867)	(1,352,413)	26 (1), 27, 28, 29, EBA list 26 (3)
26b	The amount to be deducted from or added to the amount of core tier I capital for additional (liters and deductions required before the adoption of the CRR	(12,463)	(28,017)	480
28	Total regulatory adjustment to Common Equity Tier 1 (CET1)	(1,407,690)	(1,421,423)	
29	Common Equity Tier 1 (CET1) capital	4,956,443	4,981,895	
	ADJUSTMENTS ADDITIONAL TIER 1 (AT1) CAPITAL: INSTRUMENTS			
36	Additional Tier 1 (AT1) capital before regulatory adjustments		-	
37	Additional Tier 1 (AT1) : regulatory adjustments		-	
43	Total regulatory adjustments to Additional Tier 1 (AT1) capital		-	
44	Additional Tier 1 (AT1) capital		-	
45	Tier 1 capital (T1= CET1+AT1)	4,956,443	4,981,895	
	ADJUSTMENTSTIER 2 (T2) CAPITAL: INSTRUMENTS AND PROVISIONS			
51	Tier 2 (T2) capital before regulatory adjustments		-	
	TIER 2 (T2) CAPITAL: REGULATORY ADJUSTMENTS			
57	Total regulatory adjustments to Tier 2 (T2) capital		-	
58	Tier 2 (T2) capital		-	
59	Total capital (TC=T1+T2)	4,956,443	4,981,895	
60	Total risk weighted assets	28,968,783	27,882,101	
	CAPITAL RATIOS AND BUFFERS			
61	Common Equity Tier 1 (as a percentage of risk exposure amount)	17.1%	17.9%	
62	Tier 1 (as a percentage of risk exposure amount)	17.1%	17.9%	
63	Total capital (as a percentage of risk exposure amount)	17.1%	17.9%	
	APPLICABLE CAPS ON THE INCLUSION OF PROVISIONS IN TIER 2			
72	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	36,804	24,690	36 (1) (h), 45, 46, 472 (10), 56 (c), 59, 60, 475 (4), 66 (c), 69, 70, 477(4)
73	Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	10,676	10,664	36 (1) (i), 45, 48, 470, 472 (11)
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)	208,220	175,903	36 (1) (c), 38, 48, 470, 472 (5)

Overview of RWAs

PLN '000			RWAs		Minimum capital requirements
CRR			**30.06.2018**	**31.12.2017**	**30.06.2018**
	1	**Credit risk (excluding CCR)**	**22,280,850**	**20,911,562**	**1,782,468**
Article 438 c) d)	2	Of which the standardized approach	22,280,850	20,911,562	1,782,468
Article 438 c) d)	3	Of which the foundation IRB (FIRB) approach	-	-	-
Article 438 c) d)	4	Of which the advanced IRB (AIRB) approach	-	-	-

Article 438 d)	5	Of which equity IRB under the simple risk-weighted approach or the IMA	-	-	-
Article 107 Article 438 c) d)	**6**	**CCR**	**1,299,688**	**1,335,653**	**103,975**
Article 438 c) d)	7	Of which mark to market	717,043	722,737	57,363
Article 438 c) d)	8	Of which original exposure	-	-	-
	9	Of which the standardized approach	-	-	-
	10	Of which internal model method (IMM)	-	-	-
Article 438 c) d)	11	Of which risk exposure amount for contributions to the default fund of a CCP	-	-	-
Article 438 c) d)	12	Of which CVA	582,645	612,916	46,612
Article 438 e)	**13**	**Settlement risk**	**-**	**1**	**-**
Article 449 o) i)	**14**	**Securitization exposures in the banking book (after the cap)**	**950,871**	**951,516**	**76,070**
	15	Of which IRB approach	-	-	-
	16	Of which IRB supervisory formula approach (SFA)	-	-	-
	17	Of which internal assessment approach (IAA)	-	-	-
	18	Of which standardized approach	950,871	951,516	76,070
Article 438 e)	**19**	**Market risk**	**880,834**	**1,030,143**	**70,467**
	20	Of which standardized approach	880,834	1,030,143	70,467
	21	Of which IMA	-	-	-
Article 438 e)	22	Large exposures	**50,083**	46,824	**4,007**
Article 438 f)	**23**	**Operational risk**	**3,506,465**	**3,606,401**	**280,517**
	24	Of which basic indicator approach	-	-	-
	25	Of which standardized approach	3,506,465	3,606,401	280,517
	26	Of which advanced measurement approach	-	-	-
Article 437 sec. 2), Article 48 Article 60	27	Amounts below the thresholds for deduction (subject to 250% risk weight)	547,240	466,417	43,779
Article 500	28	Floor adjustment	-	-	-
	29	**Total**	**28,968,791**	**27,882,100**	**2,317,504**

Standardized approach – credit risk

As at 30 June 2018

PLN '000	Risk weight											Total	Of which unrated
	0%	2%	4%	10%	20%	35%	50%	75%	100%	150%	250%		
Central governments or central banks	13,345,147	-	2,164,757	-	61,323	-	-	-	-	-	-	15,571,227	-
Regional governments or local authorities	-	-	-	-	173,313	-	-	-	-	-	-	173,313	173,313
Public sector entities		-	-	-	-	-	22,178	-	-	-	-	22,178	22,178
Multilateral development banks	310,244	-	-	-	-	-	-	-	-	-	-	310,244	-
International organizations	-	-	-	-	-	-	-	-	-	-	-	-	-
Institutions	-	-	-	-	218,570	-	419,505	-	13,213	-	-	651,288	224,498
Corporates	61,280	87,078	-	-	129,068	-	11,480	-	14,504,334	-	-	14,793,239	12,631,992
Retail	-	-	-	-	-	-	-	5,521,349	-	-	-	5,521,349	5,521,349
Secured by mortgages on immovable property	-	-	-	-	-	1,334,074	-		1,352,655	61,487	-	2,748,216	2,748,216
Exposures in default	-	-	-	-	-	-	-	-	145,386	79,309	-	224,695	224,695
Items associated with particularly high risk	-	-	-	-	-	-	-	-	-	48,013	-	48,013	19,222
Covered bonds	-	-	-	-	-	-	-	-	-	-	-	-	-
Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-	-	-	-	-
Collective investments undertakings	-	-	-	-	-	-	-	-	-	-	-	-	-
Equity exposures	-	-	-	-	-	-	-	-	1,239,	-	10,676	11,915	11,915
Other exposures	1,749,895	-	-	-	4,121	-	-	-	512,889	-	208,220	2,475,125	2,475,125
Total standardized approach	**15,466,566**	**87,078**	**2,164,757**	**-**	**586,395**	**1,334,074**	**453,163**	**5,521,349**	**16,529,716**	**188,809**	**218,896**	**42,550,803**	**24,052,503**

As at 31 December 2017

PLN '000	Risk weight									Total	Of which unrated
	0%	2%	20%	35%	50%	75%	100%	150%	250%		
Central governments or central banks	17,368,894	-	58,551	-	-	-	-	-	-	17,427,445	-
Regional governments or local authorities	-	-	35,252	-	-	-	-	-	-	35,252	35,233
Public sector entities	-	-	-	-	23,196	-	-	-	-	23,196	23,196
Multilateral development banks	90,738	-	-	-	-	-	-	-	-	90,738	-
International organizations	-	-	-	-	-	-	-	-	-	-	-
Institutions	-	-	503,462	-	358,973	-	11,623	-	-	874,058	615,731
Corporates	52,556	184,841	66,942	-	11,938	-	13,502,473	-	-	13,818,750	11,652,234
Retail	-	-	-	-	-	5,496,092	-	-	-	5,496,092	5,496,092
Secured by mortgages on immovable property	-	-	-	1,286,245	-	-	1,265,391	63,962	-	2,615,597	2,615,597
Exposures in default	-	-	-	-	-	-	167,608	53,663	-	221,271	221,271
Items associated with particularly high risk	-	-	-	-	-	-	-	25,184	-	25,184	2,122
Covered bonds	-	-	-	-	-	-	-	-	-	-	-
Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-	-	-
Collective investments undertakings	-	-	-	-	-	-	-	-	-	-	-
Equity exposures	-	-	-	-	-	-	1,316	-	10,664	11,980	11,979
Other exposures	1,783,988	-	3,495	-	-	-	511,616	-	175,903	2,475,002	2,475,001
Total standardized approach	**19,296,176**	**184,841**	**667,702**	**1,286,245**	**394,107**	**5,496,092**	**15,460,027**	**142,809**	**186,567**	**43,114,566**	**23,148,456**

Leverage ratio

Summary reconciliation of accounting assets and leverage ratio exposures

PLN '000		30.06.2018	31.12.2017
1	Total assets as per published financial statements	44,101,212	43,037,596
2	Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	0	0
3	(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 No. 575/2013 "CRR")	0	0
4	Adjustments for derivative financial instruments	862,645	1,207,699
5	Adjustments for securities financing transactions "SFTs"	60,074	9,272
6	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	4,662,805	4,389,798
6a	(Adjustment for intragroup exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (7) of Regulation No. 575/2013)	0	0
6b	(Adjustment for exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (14) of Regulation No. 575/2013)	0	0
7	Other adjustments	(21,359)	(40,992)
8	**Total leverage ratio exposure**	**49,665,378**	**48,603,373**

Leverage ratio common disclosure

PLN '000		30.06.2018	31.12.2017
	On-balance sheet exposures (excluding derivatives and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	42,498,413	41,743,709
2	(Asset amounts deducted in determining Tier 1 capital)	(1,395,226)	(1,393,405)
3	Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)	41,103,187	40,350,304
	Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	585,869	492,864
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	1,777,560	1,732,967
5a	Exposure determined under Original Exposure Method	-	-
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	-	-
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	-	-
8	(Exempted CCP leg of client-cleared trade exposures)	-	-
9	Adjusted effective Notional amount of written credit derivatives	-	-
10	(Adjusted effective Notional offsets and add-on deductions for written credit derivatives)	-	-
11	Total derivative exposures (sum of lines 4 to 10)	2,363,429	2,225,831
	Securities financing transaction exposures		
12	Gross SFT assets (with No. recognition of netting), after adjusting for sales accounting transactions	162,090	285,028
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	-	-
14	Counterparty credit risk exposure for SFT assets	-	-
14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Article 429b (4) and 222 of Regulation No. 575/2013	-	-
15	Agent transaction exposures	-	-
15a	(Exempted CCP leg of client-cleared SFT exposure)	-	-
16	Total securities financing transaction exposures (sum of lines 12 to 15a)	162,090	285,028
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross Notional amount	17,006,842	16,803,693
18	(Adjustments for conversion to credit equivalent amounts)	(12,344,037)	(12,413,896)
19	Other off-balance sheet exposures (sum of lines 17 to 18)	4,662,805	4,389,798
	Exempted exposures in accordance with CRR Article 429 (7) and (14) (on and off balance sheet)		
19a	(Exemption of intragroup exposures (solo basis) in accordance with Article 429(7) of Regulation No. 575/2013 (on and off balance sheet))	-	-
19b	Exposures exempted in accordance with Article 429 (14) of Regulation No. 575/2013 (on and off balance sheet))	-	-
	Capital and total exposures		
20	Tier 1 capital	4,956,443	4,981,895

21	Total leverage ratio exposures (sum of lines 3, 11, 16, 19, 19a and 19b)	48,291,510	47,250,960
	Leverage ratio		
22	Leverage ratio	10,3%	10,5%
	Choice on transitional arrangements and amount of derecognized fiduciary items		
23	Choice on transitional arrangements for the definition of the capital measure	Transitional	Transitional
24	Amount of derecognized fiduciary items in accordance with Article 429(11) of Regulation No. 575/2013	-	-

Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)

PLN '000		**30.06.2018**	**31.12.2017**
1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	42,498,413	42,010,380
2	Trading book exposures	2,291,789	1,161,793
3	Banking book exposures, of which:	40,206,624	40,848,587
4	Covered bonds	0	0
5	Exposures treated as sovereigns	15,570,913	17,427,215
6	Exposures to regional governments, MDB, international organizations and PSE not treated as sovereigns	370,770	137,130
7	Institutions	995,054	1,008,275
8	Secured by mortgages of immovable properties	2,634,333	2,475,463
9	Retail exposures	5,484,735	5,445,997
10	Corporate	11,190,660	10,433,486
11	Exposures in default	224,162	207,067
12	Other exposures (e.g. equity, securitizations, and other Non-credit obligation assets)	3,735,997	3,713,954

2.4 Earnings forecast for 2018

The Bank as the parent entity did not publish earnings forecast for 2018

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VI. Activities of the Capital Group of Bank Handlowy w Warszawie S.A. in the first half of 2018

1. Lending and other risk exposures

1.1 Lending

The Group's lending policy is consistent and covers the Bank as the parent company and its subsidiaries (DMBH, Handlowy-Leasing Sp. z o.o.), excluding special purpose vehicles (so-called SPVs), companies in liquidation or bankruptcy and entities that ceased their statutory operations. The policy is based on active portfolio management and precisely specified target markets, designed to facilitate exposure and credit risk analysis within a given industry of each client. Borrowers are continuously monitored so that any signs of deterioration in creditworthiness can be detected promptly and appropriate corrective measures can be taken as needed.

In the first half of 2018, the Group focused its credit risk management activities primarily on:

- continuing its efforts to optimize the lending process and to adjust its credit offering to customer needs and to the current market situation;
- supporting the growth of assets;
- maintaining the high quality of the loan portfolio;
- efficient allocation of capital;
- further improvement of management processes for the risk of the models used to measure credit risk

Gross receivables to customers

PLN'000	As at		Change	
	30 Jun 2018	31 Dec 2017*	PLN'000	%
Receivables in PLN	18,493,680	18,059,110	434,570	2.4%
Receivables in foreign currency	3,204,790	2,377,706	827,084	34.8%
Total	**21,698,470**	**20,436,816**	**1,261,654**	**6.2%**
Receivables from non-financial sector entities	19,559,170	18,424,326	1,134,844	6.2%
Receivables from financial sector entities	2,139,300	2,012,490	126,810	6.3%
Total	**21,698,470**	**20,436,816**	**1,261,654**	**6.2%**

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

As at 30 June 2018, the gross credit exposure to customers was PLN 21.7 billion, increasing by 6.2% in comparison to 31 December 2017.

The share of FX-loans which stood at 11.6% as in December 2017 went up to 14.8% as at 30 June 2018. It should be stressed that the Group does not grant foreign currency loans to individual clients but only to business entities who have foreign currency cash flows or to entities which, in the Group's opinion, are able to predict or absorb the foreign exchange risk without a significant threat to their financial position. The Group monitors the concentration of its credit exposures on a regular basis in order to avoid situations where its portfolio is dependent on a small number of customers.

Concentration of exposures – non-bank clients

PLN'000	30 Jun 2018			31 Dec 2017		
	Balance sheet exposure*	Granted financial and guarantee liabilities	Total exposure	Balance sheet exposure*	Granted financial and guarantee liabilities	Total exposure
CLIENT 1	1,000,000	-	1,000,000	1,000,000	-	1,000,000
CLIENT 2	803,202	183,707	986,909	828,101	115,658	943,759
GROUP 3	474,360	454,079	928,439	251,522	475,980	727,502
GROUP 4	44,854	798,289	843,143	261,317	574,317	835,634
CLIENT 5	191,400	558,600	750,000	191,400	558,600	750,000
GROUP 6	536,194	183,020	719,214	557,053	83,530	640,583
GROUP 7	109,053	523,580	632,633	18	618,348	618,366
CLIENT 8	396,005	204,680	600,685	396,000	205,185	601,185
CLIENT 9	600,000	-	600,000	600,000	-	600,000
GROUP 10	229,700	338,244	567,944	82,161	60,017	142,178
GROUP 11	-	-	-	74,439	495,376	569,815
Total	**4,384,768**	**3,244,199**	**7,628,967**	**4,242,011**	**3,187,011**	**7,429,022**

** Net of equity and other securities exposures*
**Group is understood as a capital group consisting of entities towards which Bank Handlowy w Warszawie S.A.Capital Group is exposed.*

Concentration of exposure in individual industries *

Sector of the economy according to the Polish Classification of Economic Activity (PKD)*	30 Jun 2018		31 Dec 2017	
	PLN'000	%	PLN'000	%
Wholesale trade, excluding trade in vehicles	4,770,469	18.1%	4,458,076	18.3%
Financial services, excluding insurance and pension funds	3,141,953	11.9%	3,039,423	12.5%
Manufacture and supply of electricity, gas, steam, hot water and air conditioning	2,564,550	9.7%	2,645,822	10.8%
Production of food and beverages	1,136,002	4.3%	1,071,761	4.4%
Manufacture of metal finished goods, excluding machinery and devices	1,089,935	4.1%	657,375	2.7%
Retail trade, excluding retail trade in vehicles	984,087	3.7%	825,311	3.4%
Mining of metal ores	928,439	3.5%	727,502	3.0%
Production and processing of coke and petroleum products	902,995	3.4%	884,023	3.6%
Manufacture of motor vehicles, trailers and semi-trailers, excluding motorcycles	825,197	3.1%	633,978	2.6%
Activity of head offices; consultancy for management	737,993	2.8%	592,730	2.4%
10 business sectors	**17,081,620**	**64.8%**	**15,536,001**	**63.7%**
Other sectors	**9,265,135**	**35.2%**	**8,855,908**	**36.3%**
Total	**26,346,755**	**100.0%**	**24,391,909**	**100.0%**

**Gross balance-sheet and off-balance-sheet exposure to institutional customers (including banks).*

1.2 Loan portfolio quality

The Group's exposures are classified into the relevant portfolio depending on impairment risk: non-impaired (basket 1 and basket 2) and impaired loan portfolios (basket 3).

Loans to customers by portfolio with/without recognized impairment

PLN'000	As of		Change	
	30 Jun 2018	31 Dec 2017*	PLN'000	%
Loans without recognized impairment (Stage 1), including:	**19,203,033**	**19,714,214**	**(511,181)**	**(2.6%)**
institutional entities	2,139,286	1,995,354	143,932	7.2%
non-financial sector entities	17,063,747	17,718,860	(655,113)	(3.7%)
institutional clients**	10,787,250	10,946,510	(159,260)	(1.5%)
individual customers	6,276,497	6,772,350	(495,853)	(7.3%)
Loans without recognized impairment (Stage 2), including:	**1,740,095**	**n/a**	**n/a**	**n/a**
institutional entities	14	n/a	n/a	n/a
non-financial sector entities	1,740,081	n/a	n/a	n/a
institutional clients**	1,085,025	n/a	n/a	n/a
individual customers	655,056	n/a	n/a	n/a
Loans with recognized impairment (Stage 3), including:	**698,352**	**660,094**	**38,258**	**5.8%**
institutional entities	-	17,136	(17,136)	(100.0%)
non-financial sector entities	698,352	642,958	55,394	8.6%
institutional clients**	321,351	322,643	(1,292)	(0.4%)
individual customers	377,001	320,315	56,686	17.7%
Amounts due from matured transactions in derivative instruments (Stage 3)	**56,990**	**62,508**	**(5,518)**	**(8.8%)**
Total gross loans to customers, including:	**21,698,470**	**20,436,816**	**1,261,654**	**6.2%**
non-financial sector entities	19,502,180	18,361,818	1,140,362	6.2%
institutional clients**	12,193,626	11,269,153	924,473	8.2%
individual customers	7,308,554	7,092,665	215,889	3.0%
Impairment, including:	**(668,590)**	**(587,783)**	**(80,807)**	**13.7%**
Amounts due from matured transactions in derivative instruments	(50,772)	(54,295)	3,523	(6.5%)
Total net amounts due from customers	**21,029,880**	**19,849,033**	**1,180,847**	**5.9%**
Impairment provisions coverage ratio* **	**88.5%**	**80.8%**		
institutional clients**	77.9%	68.3%		
individual customers	96.9%	92.3%		
Non-performing loans ratio (NPL)	**3.2%**	**3.2%**		

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

** Institutional *clients include enterprises, the public sector, state-owned and private companies, co-operatives, individual enterprises, non-commercial institutions acting for the benefit of households.*

**** In accordance with Transition Resource Group for Impairment of Financial Instruments the value of receivables in Stage 3 shall be presented increased by accrued contract interest in total amount of PLN 418,589 thousand. The result of this presentation of receivables is also the growth of loan provisions by the same amount. By this presentation non-performing loans ratio (NPL) will amount to 5.2%.*

In the first half of 2018, the coverage ratio (impairment losses to receivables with recognized impairment) increased by 7.7 p.p. compared to the end of 2017 and stood at 88.5%.

As compared to the end of 2017, the share of non-performing loans remained stable, accounting for 3.2% of the portfolio of gross amounts receivable from customers as at the end of June 2018.

As at 30 June 2018, portfolio impairment charges stood at PLN 668.6 million, which represented an increase by PLN 80.8 million (i.e. 13.7%) vs the end of December 2017. Impairment charges on loans collectively evaluated for impairment increased by PLN 37.1 m (i.e. 16.3%) as compared to the end of 2017.

Impairment of the customer loan portfolio

PLN'000	As of*		Change	
	30 Jun 2018	31 Dec 2017	PLN'000	%
Impairment of financial assets				
Impairment of financial assets - Stage 1	59,503	n/a	n/a	n/a
Impairment of financial assets – Stage 2	79,729	n/a	n/a	n/a
Impairment of financial assets – Stage 3	529,358	n/a	n/a	n/a
Total impairment	**668,590**	**587,783**	**80,807**	**13.7%**

PLN'000	As of*		Change	
	30 Jun 2018	31 Dec 2017	PLN'000	%
Impairment provision coverage ratio on total receivables	88.5%	80.8%		

*** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods. Not restated data for 2017 can be found in note 17 to Consolidated Financial Statement.*

The Management Board believes that the current level of impairment charges accurately reflects the observed growth in the balance of receivables and the expected portfolio impairment, considering the discounted projection of the cash flow associated with repayments.

1.3 Contingent liabilities

As at June 30, 2018, exposure from conditional commitments granted by the Group amounted to PLN 17 billion, up by PLN 0.2 billion (or 1.3%) compared to the end of 2017. Promised loan commitments still represent the largest share in total conditional commitments granted (i.e. 84%). Promised loan commitments consist of committed but currently unutilized credit lines and unutilized overdraft facilities.

Contingent off-balance sheet liabilities granted

PLN'000	As of		Change	
	30 Jun 2018	31 Dec 2017	PLN'000	%
Guarantees	2,476,441	2,312,023	164,418	7.1%
Import letters of credit issued	180,865	148,607	32,258	21.7%
Export letters of credit confirmed	-	19,376	(19,376)	(100.0%)
Credit commitments	14,337,696	14,292,534	45,162	0.3%
Other	45,362	43,942	1,420	3.2%
Total	**17,040,364**	**16,816,482**	**223,882**	**1.3%**
Provisions for contingent liabilities granted	33,522	12,789	20,733	162.1%
Provisions coverage ratio	0,20%	0,08%		

As at 30 June 2018, the total value of accounts or assets of the Bank's borrowers pledged as collateral stood at PLN 4,042 million, compared to PLN 3,762 million on 31 December 2017.

At the end of the first half of 2018, the total value of guarantees and sureties provided by the Bank or its subsidiary to a single entity or its subsidiary did not exceed 10% of the Group's equity.

2. External funding

As at the end of June 2018 the Group's total external funds obtained from banks totaled PLN 2.1 billion, up by PLN 0.5 billion (or 31.8%) compared to the end of December 2017. The increase was observed mainly in current accounts.

Total external funding from customers amounted to PLN 32.5 billion as at the end of H1, 2018, higher from the deposit base as at the end of 2017, mainly due to a higher balance of deposits of the financial sector entities (PLN 1.5 billion, or 31.6%) partially offset by a decline in non-financial sector deposits (public sector and corporate clients). On the other hand the uptrend in the individual customer deposit portfolio continued (an increase of PLN 0.7 billion, or 6.1% compared to the end of 2017).

Funding from banks

PLN'000	As of		Change	
	30 Jun 2018	31 Dec 2017	PLN'000	%
Current accounts	1,451,221	1,108,689	342,532	30.9%
Term deposits	310,318	248,373	61,945	24.9%
Loans and advances received	11,858	36,467	(24,609)	(67.5%)
Liabilities due to sold securities under repurchase agreements	29,820	9,085	20,735	228.2%
Other liabilities	264,533	165,762	98,771	59.6%
Total funding from banks	**2,067,750**	**1,568,376**	**499,374**	**31.8%**

Funding from customers

PLN'000	As of		Change	
	30 Jun 2018	31 Dec 2017	PLN'000	%
Deposits from financial sector entities				
Current accounts	581,794	531,361	50,433	9.5%
Term deposits	5,804,665	4,321,787	1,482,878	34.3%
	6,386,459	**4,853,148**	**1,533,311**	**31.6%**

PLN'000	As of		Change	
	30 Jun 2018	31 Dec 2017	PLN'000	%
Deposits from non-financial sector entities				
Current accounts, including:	20,144,130	22,129,625	(1,985,495)	(9.0%)
corporate customers	10,282,354	10,766,475	(484,121)	(4.5%)
individual customers	8,815,400	8,536,410	278,990	3.3%
public sector units	1,046,376	2,826,740	(1,780,364)	(63.0%)
Term deposits, including:	5,686,512	4,962,380	724,132	14.6%
corporate customers	2,930,484	3,053,104	(122,620)	(4.0%)
individual customers	2,185,910	1,812,310	373,600	20.6%
public sector units	570,118	96,966	473,152	488.0%
	25,830,642	**27,092,005**	**(1,261,363)**	**(4.7%)**
Total deposits	**32,217,101**	**31,945,153**	**271,948**	**0.9%**
Other liabilities				
Liabilities due to securities sold under repurchase agreements	29,049	-	29,049	100.0%
Other liabilities, including:	253,471	191,545	61,926	32.3%
Cash collateral	142,881	112,611	30,270	26.9%
Hedging deposits	63,008	40,671	22,337	54.9%
Other liabilities, total	**282,520**	**191,545**	**90,975**	**47.5%**
Total amounts due to customers	**32,499,621**	**32,136,698**	**362,923**	**1.1%**

3. Institutional Bank

3.1 Segment results summary

PLN'000	1st half of 2018	1st half of 2017*	Change	
			PLN'000	%
Net interest income	251,723	233,289	18,434	7.9%
Net fee and commission income	144,988	146,807	(1,819)	(1.2%)
Dividend income	1,032	1,228	(196)	(16.0%)
Net income on trading financial instruments and revaluation	178,677	137,230	41,447	30.2%
Net gain/(loss) on debt investment financial assets measured at fair value through other comprehensive income	79,193	15,861	63,332	399.3%
Net gain/(loss) on equity and other instruments measured at fair value through income statement	6,792	3,377	3,415	101.1%
Net gain/(loss) on hedge accounting	3,682	3,554	128	3.6%
Net other operating income	5,016	10,513	(5,497)	(52.3%)
Total income	**671,103**	**551,859**	**119,244**	**21.6%**
General administrative expenses and depreciation	(280,121)	(281,425)	1,304	(0.5%)
Profit on sale of other assets	(836)	30	(866)	-
Net impairment losses on financial assets and provisions for granted financial liabilities and guarantees	(7,254)	(11,759)	4,505	(38.3%)
Share in net profits/(losses) of entities valued at equity method	255	265	(10)	(3.8%)
Tax on some financial institutions	(30,925)	(29,349)	(1,576)	5.4%
Profit before tax	**352,222**	**229,621**	**122,601**	**53.4%**
Cost/Income	**42%**	**51%**		

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

The key highlights that impacted the gross profit of the Institutional Banking Segment in the first half of 2018 when compared to the corresponding period of 2017 were as follows:

- increase in net interest income by PLN 18.4 million YoY as a result of increased income from the customer business (PLN +12.1 million) due to an increase in volumes of amounts due from non-financial and financial sector entities. At the same time interest expenses decreased in the area of the customer business as a result of lower interest rates on deposits. On the other hand, net interest income on securities declined;
- decrease in net fee and commission income by PLN 1.8 million YoY, mainly in the area of brokerage activity, reflecting the weak investor sentiment on the stock exchange;

- increase in net income from trade financial instruments and revaluation by PLN 41.4 million YoY due to improved result on the Bank's proprietary management;
- net income on debt investment financial assets measured at fair value through other comprehensive income, which in the first half of 2018 amounted to PLN 79.2 million, up by PLN 63.3 million compared to the corresponding period of the previous year;
- a slight decline in operating costs by PLN 1.3 million YoY;
- decrease in net impairment losses (net impairment losses of PLN 7.3 million in the first half of 2018 compared to net impairment losses of PLN 11.8 million in the corresponding period of the previous year) mainly as a result of lower provisions for impaired loans and repayment of part of loan portfolio.

3.2 Institutional Bank and the Capital Markets

3.2.1 Institutional Bank

As regards corporate and commercial banking, the Bank provides comprehensive financial services to the largest Polish companies and strategic enterprises with a strong growth potential as well as to the largest financial institutions and public sector entities.

At the end of the first half of 2018 there were 5,900 institutional customers (including strategic, global and corporate banking customers). Within the framework of commercial banking (small and medium-sized enterprises, large companies and the public sector), the Group served 3,400 clients at the end of the first half of 2018.

What institutional banking clients have in common is their demand for advanced financial products and advisory related to financial services. In that area, the Group provides coordination of the investment banking, treasury and cash management products offered, and prepares loan offers involving diverse forms of financing. The innovative, competitive and innovative financing structures offered by the Group rely on the combination of its expertise and experience as well as on collaboration within the global Citigroup structure.

The table below presents balances of assets and liabilities in the particular segments according to the management reporting format.

Assets

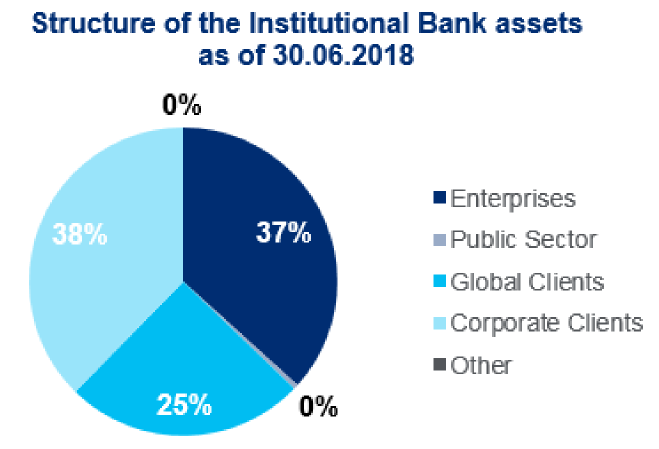
PLN million	30 Jun 2018	31 Dec 2017*	30 Jun 2017*	Change (1)/(2)		Change (1)/(3)	
	(1)	(2)	(3)	in PLN	%	in PLN	%
Enterprises, including:	4,965	4,494	4,841	471	10%	124	3%
SMEs	1,591	1,671	1,900	(80)	(5%)	(309)	(16%)
Large enterprises	3,374	2,823	2,941	551	20%	433	15%
Public Sector	68	66	116	2	3%	(48)	(42%)
Global Clients	3,400	3,271	3,046	129	4%	354	12%
Corporate Clients	5,092	4,819	4,762	273	6%	330	7%
Other**	-	2	29	(2)	(100%)	(29)	(100%)
Total Corporate Bank	**13,525**	**12,652**	**12,794**	**873**	**7%**	**731**	**6%**

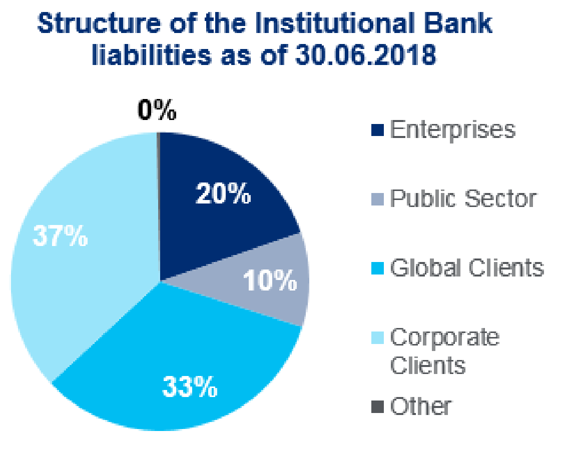
** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

Liabilities

PLN million	30 Jun 2018	31 Dec 2017	30 Jun 2017	Change (1)/(2)		Change (1)/(3)	
	(1)	(2)	(3)	in PLN	%	in PLN	%
Enterprises, including:	4,062	3,865	3,850	197	5%	212	6%
SMEs	2,081	2,129	2,250	(48)	(2%)	(169)	(7%)
Large enterprises	1,981	1,736	1,600	245	14%	381	24%
Public Sector	2,122	3,313	3,736	(1,191)	(36%)	(1,614)	(43%)
Global Clients	6,854	7,745	6,837	(891)	(12%)	17	0%
Corporate Clients	7,554	5,855	5,979	1,699	29%	1,575	26%
Other**	70	71	83	(1)	(1%)	(13)	(15%)
Total Corporate Bank	**20,662**	**20,850**	**20,485**	**(187)**	**(1%)**	**177**	**1%**

*** 'Other' includes, among others, clients under restructuring and clients of Handlowy Leasing Sp. z o.o. who are not clients of the Bank.*





Key transactions and successes of the Corporate and Commercial Bank in the first half of 2018:

- In the first half of 2018, developing its cooperation with strategic clients, the Bank successfully completed significant transactions related to financing, including signing of:
  - An annex to the syndicated loan agreement worth PLN 1,590 million, extending the period of financing by 2 years, with a chemical industry client. The Bank is the Agent, with total exposure of PLN 330 million;
  - An extension to the syndicated bond issue agreement worth PLN 5,820 million with an energy industry client. Citi Handlowy is the Agent, with total exposure of PLN 750 million;
  - An agreement concerning a supplier finance programme with a leading chemical industry company. This is the first programme pursued by that company and is intended to encompass to dozens key suppliers of that client.
- In addition, in the first half of 2018 the Bank – consistently pursuing its strategy of supporting its clients – also signed:
  - Eleven long-term loan agreements where the Bank's share amounted to PLN 530 million;
  - Twelve overdraft facility, revolving loan, letter of credit facility or multi-purpose facility agreements for the total amount of PLN 309 million;
  - Six promises worth PLN 121 million;
  - Three agreements of supplier or receivable financing, for the total amount of PLN 113 million;
  - Reverse factoring agreement and guarantee agreement, for the total amount of PLN 105 million.
- Owing to its strategy of winning new business and to the support it received from its global network as well as to a set of unique technological solutions, in the first half of 2018 the Bank initiated cooperation with seven customers for the comprehensive banking service or extended cooperation with the existing customers;
- Customer acquisition in the first half of 2018: in the Commercial Bank, 97 new customers were acquired in the first half of 2018, including 9 Large Enterprises, 84 Small and Medium-sized Enterprises, and 4 Public Sector Customers. The Bank acquired 11 client relationships in the Strategic Clients and Global Clients segment.

3.2.2 Achievements of the Sub-Sector Financial Markets

- In the first half of 2018, Citi Handlowy won the competition of the Ministry of Finance for Treasury Securities Dealers (TSDs) in 2018. The Bank's recorded another victory in this prestigious competition organized since 2002 which confirms its strong position in this market segment.
- During the wrap-up of the 2017 Stock Market Year in March 2018, Citi Handlowy was awarded the following prizes in two categories: "Treasury BondSpot Poland Market Making Leader" and "Treasury BondSpot Poland Spot Market Leader".
- The CitiFx Pulse platform, which has operated in the market since 2005, enjoys our clients' solid trust. This is reflected by the fact that the platform accounts for approximately 80% of all FX transactions. Using the platform, a client can effect transactions in the self-service model at any time, executing up to 300 transactions at once with a single click. The platform provides the Bank's clients with access to quotes 24 hours a day, providing constant access to market information, enabling currency exposures to be managed, convenient reports to be generated and online transactions to be confirmed. The tool is both innovative and functional and it offers automated FX solutions.
- In first half of 2017, the Bank was active in the market of debt securities, participating in the following transactions:
  - Syndicated issue of PLN 500 million worth of 3-year bonds for a domestic bank;
  - Syndicated issues of 7-year bonds for the European Investment Bank in two tranches: PLN 1.5 million and PLN 1 billion;
  - Extension of syndicated loan financing worth PLN 12.5 billion for a company from the telecommunications sector.
  - Granting syndicated loan financing worth EUR 400 million to a company from the metal industry.

3.2.3 Transaction services

Citi Handlowy is a leading provider of transactional banking services. For the fourth year in a row, the prestigious Euromoney magazine has named Citi Handlowy's transactional services the best in Poland. This distinction is awarded based on ratings from clients who have once again indicated that the Bank is the leader in the financial industry.

The current range of transactional products and services on offer includes:

- Electronic banking;
- Deposits and current accounts;
- Liquidity management products;
- Cross-border fund transfers;
- Card products;
- Payment and receivables processing: Direct Debit and SpeedCollect;
- Cash products;
- EU advisory; and
- Trade finance products.

Electronic banking

Given the development of state-of-the-art banking technologies as well as responding to the complex needs of clients who use electronic and mobile solutions, the CitiDirect BE system was streamlined. The primary focus was on simplifying the creation and authorization of payments, and a new mechanism for handling bulk payments was developed as well. The need to exchange traditional documentation was reduced owing to the introduction of the eWnioski [e-Application] electronic document exchange platform.

Deposits and current accounts

One of the most important elements of the Bank's strategy in practice is the focus on selling operating accounts to clients and on servicing such accounts. A current account enables clients to access the full range of Citi Handlowy services. The funds accumulated by a client in a current account which are not required to finance day-to-day operations may be invested in time deposits or be left in the current account with an increased interest rate. The Bank also sells, among others, negotiated, automatic and blocked deposits.

Liquidity management products

Liquidity management solutions can reduce the overall debt and its servicing costs while maintaining the entity's ability to meet its liabilities on a current basis. Liquidity management instruments optimize cash flows for a single client or within a group of companies. The Bank enables optimal management of cash surpluses at over-liquid companies and firms with increased demand for capital. Liquidity management products include:

- consolidated accounts,
- actual cash pooling; and
- net balance.

International fund transfers

The Bank boasts a comprehensive and very extensive settlement offering in more than 130 currencies throughout the world. Responding to client needs, the Bank has extended the functionality of its multicurrency account product, adding the ability to receive foreign payments in exotic currencies (such as Mongolian tögrögs or Belarusian rubles). This is a unique solution on the Polish market.

Cash products

The Bank completed the mass migration of clients to its new card handling system. Currently the offer of new functional solutions is developed regarding creation of personalized report from the application available to customers, e-mail notifications about the transactions and other solutions, previously unavailable to customers of the Bank. Therefore, the card portfolio management tools have become very attractive and make the Bank competitive in this product segment. At the same time, the Bank is finalizing implementation of contactless payments, to be followed by implementation of mobile payments.

To increase security and control over online transactions, the Bank has launched a new service, 3D Secure for Business Cards. It is an additional, free of charge, security protocol for transactions executed without the physical use of the card which assures strong authentication of the cardholder. The service consists in confirming online transactions with a unique password sent in a text message (SMS) to the number of the mobile phone belonging to the cardholder.

Payment and receivables processing: Direct Debit and SpeedCollect

The Bank offers convenient and efficient tools for handling payments and receivables to its clients. These modern solutions have been designed for companies and institutions with multiple recipients of their products and services.

- Direct Debit

This tool makes it possible to efficiently collect receivables from payers while reducing enforcement costs. Citi Handlowy is the market leader in servicing direct debits with the most transactions handled in the market; additionally, as the only bank in Poland, it offers the SMS alert option for payers (as part of the Direct Debit Comfort service).

- SpeedCollect

SpeedCollect is a service that allows automated booking of receivables for creditors who are recipients of bulk payments. The virtual account functionality allows information which is important for the creditor to be encoded in the account number such as e.g. the number of the counterparty or the number of its own sales unit that accounts for the revenue. The number of SpeedCollect transactions conducted by Citi Handlowy in this market segment remains very high.

Cash products

The Bank provides its clients with comprehensive cash management services. The sealed deposit service may be provided nationwide at more than 1,200 cash centers. Additionally, the Bank provides open deposit services at more than 4,500 locations thanks to its partnership with Poczta Polska S.A.

Trade finance products

The numerous trade service products offered by Citi Handlowy include letters of credit, bank guarantees, collection, trade credit, supplier and distributor finance as well as factoring. The Trade Finance Department recorded an increase in assets at 10% compared to the corresponding period of 2017.

In the first half of 2018 the Bank entered, among others, into the agreement of financing procurement and supplies to companies which are members of the Group active in the energy industry (the financing limit set at PLN 200 m). The customer appreciated the individual approach of the Bank to the transaction, and the limit was increased to PLN 300 m.

The Bank maintains its leading position in the supply chain financing area with a market share of over 20%. Since 1 July 2018, at the customer's request, the Bank has offered trade products (factoring/ supply chain financing) in the configuration customized to customer needs, using the split payment mechanism.

3.2.4 Custody services

The Bank provides custody services under Polish regulations and in compliance with international standards for custody services offered to investors and intermediaries active on international securities markets. The Bank is able to meet the requirements of the largest and most demanding institutional clients.

The Bank provides custody services to domestic and foreign institutional investors and depositary bank services to domestic pension and investment funds. Citi Handlowy has maintained its position of a market leader among depositary banks in Poland for many years.

As part of its statutory activities provided on the basis of a permit from the Securities and Exchange Commission (currently the Polish Financial Supervision Authority), the Bank operates securities accounts, clears securities trades, executes dividend and interest payments, performs asset portfolio valuations, provides individual reports, and arranges representation of clients at general shareholders' meetings of public companies. The Bank maintains omnibus accounts for authorized foreign entities. The Bank also provides the service of maintaining a registry of foreign securities, which includes mediation in clearing transactions of domestic clients in foreign markets.

The Bank also acts as the operator of accounts in the client's name with KDPW S.A. (National Depository for Securities), which involved the transfer of instructions received from the client to KDPW S.A. and vice versa – settlement confirmations and statements from the entity's accounts opened at KDPW S.A. for the Bank's client. The service is targeted at foreign financial institutions, including without limitation depository and settlement institutions (financial entities with the ICSD status), and includes the handling of securities accounts and omnibus accounts of such entities.

The Bank maintained a leading position in the market for the clearing of transactions in securities executed for remote members of Giełda Papierów Wartościowych w Warszawie S.A. (Warsaw Stock Exchange) and BondSpot S.A. In addition, the Bank remained the leader in the clearing of transactions made by foreign institutional clients on the electronic platform for trading in debt securities operating under the name of Treasury BondSpot Poland, organized by BondSpot S.A.

As at 30 June 2018, the Bank maintained over 9,300 securities accounts.

At the same time, the Bank served as depositary for three open-end pension funds (OFE): Aviva OFE Aviva BZ WBK, Nationale-Nederlanden OFE, Pekao OFE; three voluntary pension funds: Nationale-Nederlanden DFE, DFE Pekao and Generali DFE, and also for the Orange Polska Occupational Pension Fund.

The Bank was a depositary for investment funds managed by the following fund management companies (TFI): BZ WBK TFI S.A., PKO TFI S.A., ESALIENS TFI S.A., Aviva Investors Poland TFI S.A. and Templeton Asset Management (Poland) TFI S.A.

The Bank continued its activities aimed at improving the legal regulations concerning the securities market. A representative of the Bank was the Chair of the Bureau of the Council of Depositary Banks at the Polish Bank Association ("Council") for the sixth consecutive term of office. During the reporting period, the Council was involved in implementation of good practice for depositories arising from the amended Act on Investment Funds; these amendments have been related to the implementation of European Union directives (AIFMD and UCITS V) into Polish law.

The Council was actively involved in the evaluation of other draft legal acts related to operations of domestic depositary banks. Based on the Bank's resources, experience and competences, employees of the Bank in cooperation with the Polish Financial Supervision Authority, KDPW S.A. (National Depository for Securities), KDPW_CCP S.A. (National Depository for Securities – Central Counterparty) and the Warsaw Stock Exchange participated in consultations on the implementation of new solutions in the Polish capital market through working groups established at the Polish Bank Association and also through market working groups. Among other things, the Council actively participated in agreeing the plan for implementing in the market the projects related to adapting to the provisions of the Central Securities Depository Regulation (CSDR), and supported work of the KDPW S.A. over the new technology project based on the distributed ledger concept.

3.2.5 Brokerage activities

The Group pursues brokerage activity on the capital market via the Dom Maklerski Banku Handlowego S.A. brokerage house, which is wholly owned by the Bank.

In the first half of 2018, DMBH brokered session transactions representing 8.1% of equity turnover in the secondary market. The value of session transactions executed via DMBH in the equity market on the WSE amounted to PLN 6.9 billion.

At the end of the first half of 2018, DMBH was the Market Maker for the shares of 60 companies listed on the Warsaw Stock Exchange (including the 20 from the WIG20 index). That represented 12.7% of all shares traded on the WSE main market.

In the DMBH consumer segment, the strategy of intensive cooperation with the Bank was pursued further in the first half of 2018. The first half of 2018 also saw high activity by consumers using the CitiFX Stocks transactional platform, which enables trading in shares and ETF instruments listed on major foreign exchanges. Owing to advisory services, which are increasingly popular in the CPC (Citi Private Client) segment, revenues from fees in foreign markets supplemented the traditional revenue stream from client activity on the WSE to a significant extent. The domestic market witnessed a negative variance from the previous period due to a smaller volume of closed-end fund transactions.

DMBH maintained 14,000 investment accounts at the end of the first half of 2018, an increase of 4.9% compared to the corresponding period of 2017 and 1% compared to the end of the first quarter of 2018. The number of accounts continued to increase due to a steady growth in the number of brokerage service agreements concerning foreign market services performed via the CitiFX Stocks platform.

Summarized financial data as of June 30, 2018

Company	Headquarter	% of authorized capital held by the Bank	Total assets 30 Jun 2018	Total equity 30 Jun 2018	Net financial result for the period of 1 Jan – 30 Jun 2018
		%	PLN'000	PLN'000	PLN'000
Dom Maklerski Banku Handlowego S.A.	Warsaw	100.00	515,831	98,504	977

3.2.6 Leasing activities

Leasing products continue to be offered by the Bank and are made available as part of the "open architecture", i.e. the Bank's partnership with organizations from outside its Group.

Summary financial data as of June 30, 2018

Company	Headquarter	% of authorized capital held by the Bank	Total assets 30 Jun 2018	Total equity 30 Jun 2018	Net financial result for the period of 1 Jan – 30 Jun 2018
		%	PLN'000	PLN'000	PLN'000
Handlowy-Leasing Sp. z o.o.	Warsaw	100.00	22,360	22,197	(233)

4. Consumer Bank

4.1 Segment results summary

PLN'000	1st half of 2018	1st half of 2017*	Change	
			PLN'000	%
Net interest income	296,038	285,060	10,978	3.9
Net fee and commission income	135,424	142,859	(7,435)	(5.2)
Dividend income	7,918	7,720	198	2.6
Net income on trading financial instruments and revaluation	14,066	15,701	(1,635)	(10.4)
Net other operating income	3,883	(11,686)	15,569	-
Total income	**457,329**	**439,654**	**17,675**	**4.0**
General administrative expenses and depreciation	(346,210)	(351,496)	5,286	(1.5)

PLN'000	1st half of 2018	1st half of 2017*	Change	
			PLN'000	%
Net impairment on financial assets and provisions for off–balance sheet commitments	(25,270)	(30,947)	5,677	(18.3)
Tax on some financial institutions	(11,008)	(10,762)	(246)	2.3
Profit before tax	**74,841**	**46,449**	**28,392**	**61.1**
Cost/Income	**76%**	**80%**		

*** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

The key highlights that impacted the gross profit of the Consumer Bank in the first half of 2018 when compared to the corresponding period of 2017 were as follows:

- increase in net interest income by PLN 11.0 million YoY due to an increased asset products portfolio (+5.8% YoY);
- decrease in net fee and commission income by PLN 7.4 million YoY due to abolition by the Bank the charge for delay in payment of credit by clients, as well as lower commissions from insurance and investment products sale as a result of worse market sentiment;
- decrease in expenses by PLN 5.3 million YoY due to continuation of business model optimization and digitization process, while the saves were largely reinvented in marketing;
- decrease in net impairment losses by PLN 5,7 million YoY mainly due to implementation of changes that increased effectiveness of a recovery process, partially offset by rising volumes of unsecured loans.

4.2 Selected business data

'000	1st half of 2018	1st half of 2017	Change	
Number of individual customers	691.5	687.2	4.3	0.6%
Number of current accounts, including:	460.8	459.9	0.9	0.2%
number of operating accounts*	101.1	97.7	3.4	3.5%
Number of operating accounts acquired in the period*	15.5	27.2	(11.7)	(42.9%)
Number of savings accounts	141.8	146.7	(4.9)	(3.4%)
Number of credit cards, including:	691.7	702.4	(10.7)	(1.5%)
Number of debit cards, including:	247.4	248.9	(1.5)	(0.6%)

** Change in the methodology in terms of current accounts and operating accounts in Q1'2018. Prior period was adjusted.*

Receivables from individual clients – management view

PLN '000	30.06. 2018 (1)	31.12.2017* (2)	30.06.2017* (3)	Change YTD		Change YoY	
				PLN '000	%	PLN '000	%
Unsecured receivables, including:	5,413,507	5,323,199	5,213,381	90,308	1.7%	200,126	3.8%
Credit cards	2,660,007	2,535,457	2,443,963	124,550	4.9%	216,044	8.8%
Cash loans	2,696,365	2,735,544	2,714,364	(39,179)	(1.5%)	(17,999)	(0.7%)
Other unsecured receivables	57,135	52,198	55,054	4,937	9.5%	2,081	3.8%
Mortgage loans	1,529,614	1,473,927	1,350,997	55,687	3.7%	178,617	13.2%
Total net individual clients' receivables	**6,943,121**	**6,797,126**	**6,564,378**	**145,995**	**2.2%**	**378,743**	**5.8%**

** On 1st. January 2018 Group adopted IFRS 9 "Financial instruments" for the first time without restatement of comparative data for earlier periods.*

4.3 Business highlights

Bank accounts

Current accounts

Total balance in current accounts in the first half of 2018 increased by nearly 5% in relation to the end of 2017 and exceeded PLN 5.9 billion. The number of personal accounts as at the end of the first half of 2018 was 460,000. Of those, 262,000 were Polish zloty accounts, and 198,000 were foreign currency accounts.

Savings accounts

The number of savings accounts as at the end of the first half of 2018 decreased to 141,000. The total balance of funds accumulated in them also dropped to PLN 2.7 billion as against 144,000 savings accounts with a total balance of more than PLN 2.7 billion in the same period last year.

Changes to the range of products offered

In March 2018, the revised Table of Fees and Charges took effect. A monthly fee charged for access to CitiPhone telephone banking service was introduced for clients holding Citi Priority personal accounts. Clients may opt out of that service free of charge while keeping the ability to cancel the Debit Card and place a complaint with a CitiPhone Officer; they are also able to use the Interactive Voice Responder for free. The limits on ATM cash withdrawals and the limits on payment instructions made via Citibank Online were increased.

The changes introduced are consistent with the Bank's digitization strategy. The new model of fees and commissions and higher transaction limits encourage clients to use online banking where most services are offered free of charge.

In the first half of 2018, the Bank introduced a number of solutions that have made using its accounts more convenient. Among other things, the Bank made it possible for the clients to change their contact details or send documents to the Bank via the Citibank® Online banking solution. The Bank also launched a Google Pay phone payment service and the Express Elixir instant transfer orders.

As in the previous year, the Bank focused on winning new clients in the Citigold, Citigold Private Client and Citi Priority segments. This goal was pursued through promotions for new clients and through advertising in traditional and electronic media as well as acquisition activities via the telephone customer service channel (Tele Gold and Tele Priority). In the remaining months of 2018, the Bank plans to further implement its strategy consisting in increasing the client portfolio in these segments, stressing digital acquisition. The Bank also plans to develop its Citigold recommendation program by strengthening communications via the Citibank® Online banking service, via social media, and by educating Citi Handlowy employees.

In February 2018, the prestigious British financial magazine Euromoney awarded yet another distinction to Citi Handlowy. In the 15th edition of the annual private banking market survey, the Bank was honored in two categories – for the best private banking offer and for the best offer for global clients. These distinctions are testament to the effectiveness of the Bank's efforts in that area.

Credit cards

As at the end of the first half of 2018, the number of credit cards was 691,9. The cards portfolio dropped by 1.5% as compared to the end of 2017.

The credit card portfolio balance, as at the end of the first half of 2018, totaled PLN 2.7 billion, which means that the Bank consolidated its leading position in the credit card market in terms of the value of credit facilities extended in the form of credit cards, holding a market share of 25.6% according to the figures provided at the end of June 2018.

High activation levels and transaction volumes were maintained among newly acquired clients. The structure of credit cards sold in the first half of 2018 was dominated by the Citi Simplicity card with a share of 91%.

Credit products

Cash loans and hire purchase products associated with credit card accounts

The balance of cash products at the end of June 2018 amounted to PLN 2.7 billion and remained nearly unchanged on an annual basis; the Bank observed that some acquisitions and hire purchase product balances were moved against the credit card limits.

Total sales of cash products in the first half of 2018 reached PLN 0.6 billion. With the focus on new client acquisition, in the first half of 2018 the Bank recorded more than a double increase in the sale of cash products in that group of clients compared to the same period last year. The Bank will continue to focus on the sale of products via remote channels, notably on online sales and acquisition of new clients for cash loans.

Mortgage products

As at the end of the second quarter of 2018, the mortgage loan portfolio stood at PLN 1.55 billion, which represented an increase of 14% compared to the first half of 2017. Sales of mortgage products during the first two quarters of 2018 amounted to PLN 147 million.

Investment and insurance products

Investment products

At the end of the first half of 2018, the total value of investment products (including investment-type insurance products, net of bi-currency investments) purchased by retail customers via the Bank was 12% higher than at the end of the same period of 2017.

This increase was in the area of investment funds and structured bonds as well as the instruments accumulated on accounts maintained by Dom Maklerski Banku Handlowego S.A. (DMBH).

Within the scope of its cooperation with DMBH, the Bank granted its clients access to 16 issues of investment certificates of closed-end investment funds.

As regards structured products, by the end of the first half of 2018 the Bank offered 54 structured bond subscriptions denominated in PLN, USD, GBP and EUR.

As concerns open-end investment funds, in 2018 the Bank introduced four funds into its range of products on offer – two equity funds, one bond fund and one multi asset fund.

Insurance products

As part of strategic cooperation with WARTA S.A. life insurance company, in February 2018 the Bank added a new insurance to its offer called *WARTA Twoje Zdrowie Plus* as financial security in the event of frequent diseases of affluence. Proceeds paid out of the policy may facilitate Citi Handlowy's clients access to private medical care or modern treatment methods or allow the insured to buy necessary drugs. The product is available in the SMART branches located in the shopping malls.

As part of its offer for upscale clients, in the first half of 2018, the Bank simplified the process of entering into agreements concerning two key products – term life insurance and insurance with a savings component. Consequently, our clients are now able to buy insurance much faster and easier at our branches.

Furthermore, the Bank implemented a new distribution model with sales via an agent; the new model was incorporated in the telephone sales process.

In addition, the insurance products offered by the Bank were successfully adjusted to the changes under MiFID II and GDPR.

4.4 Development of distribution channels

4.4.1 Direct acquisition

In the first half of 2018, the Universal Bankers retail distribution channel continued to pursue its strategy of winning new clients by focusing on three basic products: credit cards, Citi Priority accounts and cash loans. As in previous years, the mobile sales force, which includes more than 80 Relationship Managers, operated nationwide from local offices in six cities.

The first half of 2018 saw further relocations of Smart Mini sales points between shopping malls in accordance with the assumption that sales potential had to be periodically refreshed while keeping the formula cost-effective and maintaining presence at both corporations and public administration bodies.

Universal Bankers also contributed to building the image of Citi Handlowy as an innovative institution that offers state-of-the-art solutions and that is oriented on client needs by their presence with the Mobile Smart Mini during social and cultural events, including shows and air shows, car shows and sports events.

Modern technological solutions and consistently pursued goals have enabled high sales efficiency in this channel, which is focused on acquiring new clients.

4.4.2 Branch network

Construction of a Smart Bank Ecosystem

In the branch network of Citi Handlowy, the first half of 2018 was a period when the Bank's strategy was further implemented and consolidated around the Smart Bank Ecosystem. Currently we serve clients in 15 branches in the 10 largest cities where the Bank continues to see the greatest potential in the client segments on which it bases its consumer banking development strategy.

The Smart Mini sales outlets, which had been launched since 2016 and manned by Universal Bankers Relationship Managers, served as tools for building the Bank's image and the perception of its scale and also for supporting acquisition through handling markets whose sales potential does not justify investments in brick-and-mortar branches. In 2017, the Smart Mini format was supplemented by the first entirely mobile point designed for serving mass events and for the organization of other marketing and sales activities which were continued in the first half of 2018. The opening hours of Smart Mini outlets are the same as the opening hours of shopping malls or the duration of outdoor events.

At both Smart Branches and Smart Mini outlets, customer service involves the use of modern banking systems and the new sales application designed for tablets. A client who applies for credit products (a credit card or a cash loan) for the first time has access to a unified user interface irrespective of the point of contact, i.e. online, at a branch or on a tablet. The tool also makes it possible to safely interrupt the application process at any time and to resume it without losing data, also when the acquisition channel is changed. The solution adopted allows for the complete elimination of paper documents from the sales process, leveraging electronic signatures and text message and e-mail communication.

Number of branches and other points of sale / touch points at the end of the period

	30.06.2018 (1)	31.12.2017 (2)	30.06.2017 (3)	Change (1)/(2)	Change (1)/(3)
Number of branches*:	**26**	**26**	**26**	**-**	**-**
HUB Gold	8	8	8	-	-
Smart HUB Gold**	2	2	2	-	-
Investment Center	1	1	1	-	-
Smart branch	14	14	14	-	-
Corporate branch	1	1	1	-	-
Other PoS/touch points:					
Smart Mini	4	4	3	-	1

** Branches classified according to a type of provided services into: HUB Gold (branches with separate CitiGold customer service zones), Smart HUB Gold (a separate part of the Smart dedicated to serve customers primarily from the segment Citi Priority), Blue (branches without separate CitiGold zones), Investment Center and Smart.*

4.4.3 Internet and telephone banking

Internet Banking

The number of active Citibank Online users, i.e. those who logged in to the online or mobile banking service using their browser or used the Citi Mobile app at least once every 30 days, amounted to 348,000 in the first half of 2018, representing an increase of over 9,000 in relation to the same period of 2017. The share of active Citibank Online users in the total portfolio of the Bank's clients amounted to 51.0% in the first half of 2018.

In the first half of 2018, digital users (i.e. those who used Citibank Online or Citi Mobile services on various devices at least once a month) accounted for 73.5% of all clients who executed transactions, which constituted an increase of more than one percentage point compared to the same period of 2017.

The Bank added new functionalities at quarterly intervals and by the end of 2017, there were more than 300 of them, including full credit card and hire purchase product management, full transactional functionalities associated with personal accounts and comprehensive visibility of investment and insurance products. In the fourth quarter of 2018, the Bank is planning to implement the possibility of making transactions on investments funds using online banking. The clients will also be able to conduct full profiling, as well as the knowledge and experience assessment, on their own, in accordance with MiFID II. All those processes will be available from mobile devices.

The new Citibank Online platform has also been a success with respect to the sale of hire purchase products. Contextual offerings which addressed the clients' needs made it possible to increase the volume of credit product sales via this channel by 106% YoY.

Mobile Banking

In the first half of 2018, the number of financially active mobile banking users, i.e. those who accessed mobile banking at least once every 30 days via the app or Citibank Online using responsive technology, exceeded 146,500, an increase of more than 34% compared to June 2017. The share of active users of mobile banking in the group of clients who executed transactions stood at 28.8%, which represents an increase of 7 p.p. over the same period of 2017.

Social media

Citi Handlowy continued its efforts in the social media, which remained an important channel for contacting and interacting with its clients. In everyday communications, the Bank focused not just on providing information about current offerings or promotions, but also invited its fans to participate in unusual events and competitions; the posts shared by the Bank reached almost 1 million Facebook users each month. Citi Handlowy launched many innovations as part of its Facebook activity in 2018, including live webinars with experts from different areas, chats with an expert from the Bank, for example about cash loans or mortgage loans. In addition, Citi Handlowy added new themes on Facebook related to banking for upscale clients, posting Weekly Analyses or Market Alerts.

Facebook is among the key tools for handling client queries; all fan engagement indicators improved significantly and the average response time to inquiries was 7 minutes. The Bank has more than 144,000 fans. In 2018, Facebook also became one of the channels to acquire new clients – it is also used for publishing advertisements promoting the Bank's products and encouraging Facebook users to become the Bank's clients.

5. Changes in information technology

In the first half of 2018, the Bank's strategic goal in the IT area remained making the Bank ever more competitive by providing the highest-quality services and products with broad support for innovative solutions, digitization and automation while optimizing costs at the same time. In line with market trends, the Bank's technology is largely based on centralized services and outsourcing. Service centralization processes allow the Bank to achieve savings, improve quality and standardize processes as well as ensuring high control and information security levels.

IT processes at the Bank operate according to international standards, as recognized by the positive outcome of the ISO 20000 (IT service management), ISO 27001 (information security management) and ISO22301 (business continuity) recertification audits.

The most important modifications and improvements introduced in the first half of 2018 include:

- **in the Corporate and Commercial Bank area:**
  - **finalization of commercial card migration for institutional customers to the new platform implemented in 2017** to facilitate further development of the card product. As a result of this deployment, institutional clients gained additional opportunities to use chip cards and to access data via digital systems. As a result of the new platform having been launched, the Bank expects to increase client acquisition in the corporate card area;
  - **implementation of new solutions that increase digitalization of communication between the Bank and the customer –** as a result of the changes, more clients will be able to submit documents to the Bank and download them using digital channels (fewer non-digital documents when dealing with customers).
- **in the Consumer Bank area:**
  - **introduction of Google Pay for MasterCard debit and credit cards** - online banking and mobile banking are the two fastest growing areas of the cashless payment market. Poland is among the markets where mobile payments are the most widespread, have immense potential and the number of virtual cards is surging. This is facilitated by the fact that almost 100% of terminals already support contactless payments, and such transactions account for more

than 60% of the total. For this reason, the Bank decided to implement the modern Google Pay solution, which allows clients to make contactless payments via smartphones without using a physical card in a quick, easy and convenient manner;

  - **the introduction of instant KIR transfers for retail banking consumers** - the transfers are effected in less than 30 seconds while maintaining consistently high transaction security standards. The purpose is to improve customer experience as measured by the NPS and grow revenue as a result of the expected increase in the total number of transactions executed.

- **in the area of adapting the Bank's systems to ensure compliance with regulatory requirements –** the Bank has implemented regulatory changes to adapt the information systems to the requirements of Split Payment, General Data Protection Regulation (GDPR) and further requirements of the Directive on financial markets (MIFID 2).

Technology units proactively develop and improve their service portfolio to fully meet the Bank's current and future business needs. They propose and provide to their business partners optimal technological solutions which make it possible to achieve competitive advantage. Technology units actively support initiatives aimed at the broader use of information technologies that automate the Bank's processes and increase the digitization of services.

Information on pending (unfinished) initiatives and system modifications impacting the Bank's activity in the coming periods is presented below:

- **in the Corporate and Commercial Bank area:**
  - **the implementation of solutions which automate the Bank's operational processes** - the deployment of the business process automation platform is meant to drive the efficiency and automation of the back-office processes conducted at the Bank.
- **in the Consumer Bank area:**
  - **automating and digitizing sales processes (straight through processing) in the area of consumer banking products** – cards, loans, accounts;
  - introduction of the service that supports **automatic customer authentication** – to accelerate and increase acquisition of new customers;
  - **further enhancements to the online and mobile banking platform** (adding new functionalities and products) to increase customer satisfaction, increase revenues and security.
- **in the area of adapting the Bank's systems to ensure compliance with regulatory requirements:**
  - further adaptation of the Bank's IT systems to support a wider scope of monitoring of transactions as part of **money laundering prevention**;
  - adapting the Bank's IT systems to the requirements of the **PSD2** financial market regulations.

6. Equity investments of the Group

Equity investments of the Bank are divided into the strategic investment portfolio and the portfolio of investments intended for sale. In the first half of 2018, the Bank continued to pursue its earlier equity investment policy. The Bank managed the strategic investment portfolio in order to maximize profits in the long term, increase its market share, stimulate development of the Bank's relations and expand the Bank's offering; the Bank managed the divestment portfolio in order to optimize gains on equity transactions and minimize the risk inherent in such transactions.

6.1 Strategic investment portfolio

This portfolio includes companies running a business in the financial sector which contribute to the Bank's product offering, bring prestige to the Bank's operations and strengthen its competitive position in the Polish financial services market.

Strategic holdings also include infrastructure providers operating for the benefit of the financial sector. The Bank holds minority interest in such companies but they are of strategic importance to the Bank in view of their operations as well as their cooperation with the Bank.

The Bank intends to retain its strategic holdings in infrastructure providers and play an active role in defining the strategic directions of their development by exercising its right of vote. The overall aim of the Bank when exercising corporate governance over such companies is to maintain their development without affecting their business operations, which is taken advantage of by the Bank as well as other financial market participants.

6.2 Portfolio of investments intended for sale

Divestment holdings are entities in which the Bank's investment is not strategic. They include entities held directly and indirectly by the Bank, as well as special purpose vehicles used by the Bank to execute equity transactions. Some of these holdings are restructured exposures which originate from debt-to-equity conversion performed by the Bank.

The strategic aims for the Bank with regard to such companies is to gradually reduce the Group commitment. The assumption is that individual participations will be sold whenever market conditions are most favourable. The portfolio of companies intended for sale includes equity investments without a predetermined rate of return. The Bank is not planning any new equity investments which would be sold later. The portfolio of companies intended for sale might be increased with additional exposure taken over by the Bank as part of debt for capital swaps or acquired in the course of operating activities.

6.3 Special-purpose investment vehicles

As at 30 June 2017, the Group included two investment vehicles through which the Bank runs capital transactions. The activity of the companies was financed with the partner's returnable contributions to capital and with their net profits.

As the Bank continues to pursue a strategy of restricting the activity run through special-purpose investment vehicles, it is expected that further investment vehicles will be gradually sold or liquidated.

According to information available as at the date of preparation of the financial statements, the main financial data of the companies in question as at 30 June 2018 were as follows:

Company	Headquarter	% of authorized capital held by the Bank	Total assets 30 Jun 2018	Total equity 30 Jun 2018	Net financial result for the period of 1 Jan – 30 Jun 2018
		%	PLN '000	PLN '000	PLN '000
Handlowy - Inwestycje Sp. z o.o.	Warsaw	100.00	11,135	11,090	13
Handlowy Investments S.A.	Luxemburg	100.00	18,832	18,391	(263)

VII. Key risk factors relating to the operations of the Capital Group of Bank Handlowy w Warszawie S.A.

1. Regulatory risk

Legal acts	The essence of the regulated issue
Act of 24 November 2017 Amending Certain Acts to Counteract the Use of the Financial Sector for Fiscal Fraud	• The purpose of the regulation is to combat tax fraud, including without limitation VAT fraud. • Banks and credit unions have been obliged to provide certain details on clients and their transactions to the clearing house in order to establish risk indicators. The clearing house will provide information on risk indicators to the Head of the National Tax Administration, banks and credit unions. The Act establishes a system for exchanging information between banks and the tax administration. The information provided by banks will enable the administration to carry out financial analyses which allow the identification of flows characteristic of tax fraud.
The Act of 15 December 2017 Amending the VAT Act and Certain Other Acts	• The purpose of the regulation is to reduce VAT frauds. • The Act introduces a split payment mechanism, which means that taxpayers who have received an invoice with the tax amount stated may use the split payment mechanism when paying the amount due. • The taxpayers' freedom of using the funds in the VAT account will be limited. The client will be able to use this account to pay VAT to its counterparties (also to the VAT account) or to settle its VAT liabilities to the tax office. • Under the Act, banks are obliged to open one VAT account for each client free of charge. The solution assumes a change in the technology used in the interbank settlements system and affects the manner in which some products are made available. The regulation does not apply to consumers.
Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs)	• The aim is to strengthen the protection of individual investors who purchase these products. • The Regulation requires entities that create and sell PRIIPs (including the Bank and DMBH) to meet a number of new obligations, primarily with respect to the provision of certain information to investors.
Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive	• The regulatory measures are aimed at strengthening the protection of investors and/or clients through the introduction of organizational improvements in the protection of client assets and the area of product management (product governance), increasing the range of products covered by the regulation, changes in the classification of clients, further strengthening the existing regulations regarding incentives, management of conflicts of interest, and a

2002/92/EC and Directive 2011/61/EU – "MiFIDII Directive"; Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 – "MiFIR Regulation"; Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012; Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014	number of other measures to ensure compliance with the rules of fairness and professionalism in services in the financial market. • MiFID II introduces changes to the structure of the organization and regulation of markets by introducing, where it is considered appropriate, among others, organized trading facilities (OTF) and multilateral trading facilities (MTF), greatly expands the existing principle of transparency in financial market transactions, strengthens the existing powers of EU and local regulators (including but not limited to EBA, ESMA, PFSA), including the regulators' powers of intervention as to the prohibition and restriction of activities in the financial market.
The Act of 30 November 2016 amending the Act on Payment Services and certain other acts	• The purpose of the Act is to implement into the Polish legal framework Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features (OJ EU L 257 28.08.2014, p. 214). • The key changes consist in: – access to the basic account; – introduction of provisions on payment account switching; – development of websites comparing payment service provider offerings related to the maintenance of payment accounts; – fulfilment of information obligations concerning the fees charged by providers which maintain payment accounts.
Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) The Act of 10 May 2018 on Personal Data Protection	• The Regulation is binding on all entities which process personal data in connection with their business. • The Regulation introduces a number of changes and considerably extends the scope of responsibilities for both data controllers and data processors. Another purpose of the new provisions is to provide individuals and supervisory authorities with effective tools to respond to breaches of the Regulation. • The key changes consist in: – right for data subjects: "the right to be forgotten" (designed to help people who want their personal data to be erased); – restrictions on profiling, including the obligation to obtain consent for profiling before data collection commences, a strict obligation to inform about profiling and the obligation to accept any objection to profiling. – rules for obtaining consent for the processing of personal data from data subjects.
The Act on Trading in Financial Instruments (Journal of Laws 2018 item 685) ("Act") Regulation of the Minister of Finance on the procedure and conditions of operation of investment firms, banks referred to in Article 70(2) of the Act on Trading in Financial Instruments, and custodian banks (Journal of Laws of 2018 item 1112), Regulation of the Minister of Finance on the detailed technical and organizational conditions to be met by investment firms, banks referred to in Article 70(2) of the	• The purpose is harmonization with provisions of Directive 2014/65/EU of the European Parliament and of the Council, Regulation (EU) No 600/2014 of the European Parliament and the related delegated acts. • In accordance with the Act and Secondary Legislation, the Bank is obliged to harmonize its activities by 21 October 2018.

Act on Trading in Financial Instruments, and custodian banks (Journal of Laws of 2018 item 1111) ("Secondary Legislation")	
Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 ("BMR Regulation")	• The regulation specifies, among others, the principles of management and control exercised by the administrators who develop benchmarks in financial instruments and financial contracts, requirements for the conduct of contributors, as well as requirements for the entities using benchmarks in specific types of financial contracts and financial instruments. The Bank is a supervised contributor of input data to benchmarks as well as a benchmark user for the purposes of certain contracts.
Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, with delegated and secondary legislation ("EMIR Regulation")	• The EMIR imposes on entrepreneurs who are both financial and non-financial counterparties obligations related to the execution of derivative transactions, including without limitation transactions executed outside the OTC market. • Obligations under the EMIR relate in particular to transaction reporting, central settlement of transactions, transaction confirmation, reconciliation, compression and collateral for transactions.
EBA Guidelines on remuneration policies and practices related to the provision and sale of retail banking products and services	• The Guidelines are designed to protect consumers against undesirable adverse effects of remuneration policies for sales staff. • EBA Guidelines set forth requirements for the development and implementation of remuneration policies and practices related to the offering or distribution of banking products and services to consumers.
EBA and ESMA Guidelines to assess the suitability of members of management bodies and key function holders	• EBA and ESMA Guidelines to establish a suitability assessment process as well as a number of requirements for assessing the suitability of both individuals (Supervisory Board members, Management Board members and key function holders) and entire bodies (collective assessment).
EBA guidelines on internal management	• The EBA guidelines regulate the main principles of internal governance in banks, including mutual relations of management and supervisory bodies, organizational structure, risk management system and internal control system.

The following factors, among others, will affect the financial and organizational situation of the BHW Group in the second half of 2018:

- **The Act of 1 March 2018 on Prevention of Money Laundering and Terrorism Financing:** the changes mainly concern the rules of reporting to the General Inspector of Financial Information, the scope of the data collected about clients and actual beneficiaries, and the modification of certain definitions;
- **The Act of 10 March 2018 amending the Payment Services Act and Certain Other Acts:** the new provisions are to ensure greater transparency and legal coherence in the area of payment services. They will also be the basis for the opening of the EU payments market for new payment services - the payment initiation service and the account access service;
- **Commission Delegated Regulation (EU) 2018/389 of 27 November 2017 supplementing Directive (EU) 2015/2366 of the European Parliament and of the Council with regard to regulatory technical standards for strong customer authentication and common and secure open standards of communication:** the regulation specifies the rules for the use of strong customer authentication and communication rules between account servicing payment service providers and payment initiation service providers and the account access service;
- **The Act of 13 April 2018 amending the Act on the Civil Code and Certain Other Acts:** provisions are designed to shorten the basic statutory limitation period (from ten years to six years) and to introduce a separate regulation concerning the effect of claims against consumers becoming time-barred – the limitation makes it impossible to pursue claims;
- **Act of 15 December 2017 on Insurance Distribution:** The Act sets forth the rules for performing activities related to the distribution of personal, property and casualty insurance and the distribution of reinsurance. The Act comes into force on 1 October 2018, subject to provisions on insurance with an investment element, which came into force on 3 January 2018;
- **Regulation of the Council of Ministers concerning the method of creation, fixing, transferring, storing and securing documents related to banking transactions, prepared on electronic information carriers:** the

published draft Regulation of 29 June 2018 is intended to considerably reduce to scope of possible technological and organizational solutions which can be applied by the Banks to create documents in the electronic form, as laid down in Art. 7 of the Banking Law and equivalent written form. If the current wording of the draft Regulation is preserved, it will be no longer possible to create a document pursuant to Art. 7 of the Banking Law using an ordinary electronic signature or identifying data in accordance with the agreement between the parties or internal regulations of the bank;

- **Recommendation B on mitigation of the risk of banks investments:** The purpose of the revised Recommendation B is to indicate to banks good practice in the scope of limiting the investment risk, the value of which is determined by price parameters. The draft prescribes that the effective date should occur by 31 December 2018.

2. Risk management principles

The Group manages its risk by introducing consistent rules, control mechanisms and tools that account for supervisory requirements and best market practices.

The risk management system implemented by the Group, which is based on the concept of joint responsibility, includes three independent tiers ("three lines of defense"):

- Tier 1, i.e. organizational units responsible for the business operations which result in risk-taking and responsible for risk management in the Bank's entire operational activity as well as for identifying and reporting risk to 2nd line units;
- Tier 2, i.e. risk management at organizational units irrespective of first-line risk management and compliance function activities – organizational units of the Risk Management Sector, Compliance, Finance, Legal, HR;
- Tier 3, i.e. Audit units which provide independent assessment of risk management processes and of the internal control system.

When structuring its risk management processes, the Group takes into account its risk profile, strategic and business objectives, available capital and liquidity resources, the macroeconomic environment and regulatory requirements which constitute the framework of the risk control and management system.

Risk management processes are implemented on the basis of written policies and rules concerning the identification, measurement, mitigation, control, monitoring and reporting of the risk to which the Bank is exposed, which policies and rules are approved by the Management Board, persons authorized pursuant to the rules of issuing internal Bank regulations or duly appointed Committees, including:

- the Assets and Liabilities Committee (ALCO);
- the Risk and Capital Management Committee, which includes the Model Commission and the Retail Banking Risk Commission;
- the Business Risk Control and Compliance Committee;
- the New Products Committee.

The risk inherent in the Group's operations is mitigated by a system of limits which arise from risk appetite, and the Bank's management information system enables risk level monitoring through the systematic provision of portfolio information to the management.

The Group manages all material risks resulting from the pursuit of its adopted business strategy. Within the framework of identification of significant risks, for 2018 the Bank's Management Board considered the following risks to be important from the point of view of risk management and the process of estimating and maintaining internal capital:

- credit risk;
- counterparty credit risk;
- market risk in the trading book;
- interest rate risk in the banking book;
- liquidity risk;
- operational risk;
- compliance risk;
- risk of information security (including cyberspace risk);
- outsourcing risk;
- models risk.

Main changes in the risk management area

The Group implemented, as part of its Key Project, the work related to the implementation of IFRS 9 "Financial Instruments". The entire implementation process, in line with the expectations of the European Securities and Markets Authority and of the Office of the PFSA, was supervised by the Audit Committee of the Bank's Supervisory Board, which regularly received information on project status and on the issues relevant to individual implementation stages.

The Group also enhanced its internal control system, including through the introduction of vertical monitoring, which is carried out by the second line of defense in the case of control mechanisms implemented by first line of defense units (by implementing provisions of Recommendation H in effect since 1 January 2018).

Liquidity risk

Definition	• Liquidity risk is the risk of being unable to meet a financial commitment to a client, creditor or investor when due as a result of a cash flow mismatch.
Management Strategy	• The objective of liquidity risk management is to ensure that the Bank and Group entities have access to liquidity in order to meet all their financial obligations when due, including under extreme but probable stress conditions. • Liquidity risk management is based on: – applicable laws, including without limitation the Banking Act; – requirements of Polish regulatory institutions, and especially resolutions of the Polish Financial Supervision Authority; – rules of prudent and stable management of risk within the Group as well as general risk levels approved by the Bank's Supervisory Board; – taking into account best market practice. • The Group analyses and manages liquidity risk in several time horizons while distinguishing current, short-, mid- and long-term liquidity, to which appropriate risk measurement methods and limits apply. The purpose of the measures and limits adopted is to limit excessive concentration within the adopted structure of the balance sheet or of funding sources. • Long-term liquidity management is the responsibility of the Assets and Liabilities Committee and as such it is reflected in the Bank's strategy. It is based on the monitoring of balance sheet structural ratios and on long-term regulatory liquidity measures and includes the analysis of liquidity gaps, the ability to acquire in the future sufficient funding sources as well as funding costs in the light of the overall business profitability. • Mid-term liquidity management, in the one-year time horizon, is the responsibility of the Assets and Liabilities Committee and is based on the process of the Annual Funding and Liquidity Plan defining the size of internal limits taking into account the business plans for asset and liability changes prepared by business units of the Bank as part of financial plans for the next budget year. • Short-term liquidity management, in the three-month time horizon, is the responsibility of the Financial Markets Sub-Sector and is performed based on short-term regulatory liquidity measures as well as internal limits. In addition, the Bank analyses liquidity under stress scenarios, assuming the lack of liquidity gaps in all tenors up to three months as a necessary condition. • Current liquidity management is the responsibility of the Financial Markets Sub-Sector and comprises the management of the balances on the Bank's nostro accounts and especially the mandatory reserve account with NBP while applying available money market products and central bank facilities.
Risk Measurement	• Liquidity risk measurement is conducted using external supervisory measures (the M1-M4 and LCR/NSFR measures) as well as additional measures which were developed in-house: – gap analysis – MAR/S2; – stress scenarios; – structural liquidity ratios; – market triggers; – significant funding sources; – contingency Funding Plan.
Monitoring	• Liquidity risk monitoring and management are performed using the supervisory liquidity risk limits set by the Office of the Polish Financial Supervision Authority, and also the internal limits and prudential thresholds for liquidity risk set by the Asset and Liability Committee: – limits for the S2 Report – for pre-defined currencies and time periods; – alert thresholds for structural liquidity ratios; – the alert threshold for stress tests. • The Market Risk Department and a dedicated reporting unit within the Risk Management Sector regularly submit to competent management liquidity position reports, results of stress tests related to liquidity risk and information on the allocation of capital requirements for liquidity risk. • Additionally, liquidity analysis results are systematically presented during meetings of committees such as: the Assets and Liabilities Committee, the Risk and Capital Management Committee and the Risk and Capital Committee of the Supervisory Board.

Market risk

Definition	• Market risk is the risk of negative impact on the Bank's earnings and equity resulting from changes in: – market interest rates; – foreign exchange rates; – equity prices;

	– commodity prices; – and all volatilities of these rates and prices.
Management Strategy	• The objective of market risk management is to ensure that the extent of risk accepted within the Group corresponds to the level acceptable to the shareholders and banking supervision authorities and to ensure that all exposures to market risk are properly reflected in the calculated risk measures, communicated to relevant persons and bodies responsible for the management of the Group. • The purpose of the market risk measures and limits adopted is preventing excessive concentration of exposure to a single risk factor or a group of related risk factors as well as determining the overall maximum level of risk assumed in the trading book or banking book. • Market risk management at the Bank is based on the requirements of Polish regulatory institutions, including without limitation resolutions of the Polish Financial Supervision Authority, rules of prudent and stable management of risk within the Group as well as general risk levels approved by the Supervisory Board of the Bank, taking best market practices into account. • Market risk management applies to all portfolios generating income exposed to the negative impact of market factors including interest rates, foreign exchange rates, equity prices, commodity prices and the parameters of their volatility. Two types of books have been defined for the purpose of market risk management: the trading book and the banking book. • Trading books include transactions in financial instruments (balance-sheet and off-balance-sheet instruments) expected to generate income owing to change in market parameters over a short period. Trading books include balance-sheet items such as debt securities held-for-trading, i.e., debt securities acquired to be further traded and meeting pre-defined liquidity criteria, as well as all derivative instrument positions broken down into portfolios acquired purely for trading and transactions executed in order to provide an economic hedge for banking book positions. The trading books are valued directly at market prices or using market pricing-based valuation models. Trading book operations are performed by the Interbank Market Trading Division in the Financial Markets Sub-Sector in respect of interest rate risk portfolios and FX risk portfolios. The trading book also includes options, manly options for foreign exchange transactions, interest rate options and option structures which reflect the economic nature of the products offered to the Bank's clients and the risk resulting from them. In this area, the Bank concludes transactions in a way which ensures concurrent conclusion of an opposite transaction with the same parameters and, in consequence, the option portfolio does not generate an open exposure to market risk. The only item related to the conclusion of option transactions which is reflected in market risk measurement, and in particular in foreign exchange risk, is the premium paid/received in a foreign currency.
Risk Measurement	• The following risk measurement methods apply to trade portfolios: the Factor Sensitivity/DV01 method, the value at risk (VaR) method and stress tests. • Factor Sensitivity measures the change in the value of positions in an underlying instrument in the case of a specific change in a market risk factor (e.g., change of the interest rate by 1 basis point at a given point on the interest rate curve, change of the currency exchange rate or share price by 1%). – In the case of interest rates, the sensitivity measure is DV01; – In the case of foreign exchange (FX) risk, the Factor Sensitivity value is equal to the value of the FX position in a given currency; – In the case of positions held in equities, the Factor Sensitivity value is equal to the net value of the positions held in the respective instruments (shares, indices, participation units). • Value at Risk (VaR) is the integrated measure of the market risk of trading books which combines the impact of positions in respective risk factors and accounts for the effect of correlation between the fluctuations of different factors. VaR is applied for the purpose of measuring the potential decrease in the value of a position or portfolio under normal market conditions, at a specific confidence level and within a specific time period. In the case of positions opened in the Bank's trading book, VaR is calculated at a 99% confidence level and for a one-day holding period. • DV01 as well as VaR for the trading book are calculated net of the economic hedge of the portfolio of securities available-for-sale, i.e., net of derivative instruments intended to hedge the fair value of the portfolio. The exposures to the risk of such transactions are mitigated through the application of relevant risk measurement methods and by the banking book risk limits. • Each day, the Bank runs stress tests on the assumption that the risk factors change by more than expected in the Value at Risk scenario and ignoring the historical correlations of these factors.
Monitoring	• The Market Risk Department and a dedicated reporting unit within the Risk Management Sector regularly submit to competent management reports concerning portfolio sensitivity, value at risk (VaR), the size of the securities position, results of market risk stress tests, information on the allocation of capital requirements against market risk and reports on the use of limits.

	• Additionally, market risk analysis results are systematically presented during meetings of committees such as: the Assets and Liabilities Committee, the Risk and Capital Management Committee and the Risk and Capital Committee of the Supervisory Board.

Interest rate risk in the banking book

Definition	• Interest rate risk in the banking book is the risk of the negative impact of changes in interest rates on the Group's interest income and capital. • Interest rate risk may occur where assets and liabilities (including equity and derivatives which meet hedge accounting requirements) are mismatched: they have different maturities, their interest rates change at different dates, their interest is tied to different market interest rate curves (basis risk) and they include options.
Management Strategy	• The purpose of interest rate risk management is to minimize the risk related to the possibility of adverse changes in market interest rates and the negative impact of these changes on the Group's net interest income and consequently on its earnings. • Market risk management at the Bank is based on the requirements of Polish and European regulatory institutions, including without limitation Polish Financial Supervision Authority and EBA resolutions; rules of prudent and stable management of risk within the Group as well as general risk levels approved by the Supervisory Board of the Bank, taking best market practices into account. • Interest rate risk is managed at the strategic and operational levels. The division into risk management levels depends on the nature and type of the decisions which are made by individual decision-making bodies at the Bank which affect the interest rate risk profile and level. – The Bank's Assets and Liabilities Committee (ALCO) is responsible for determining the risk management strategy. ALCO manages interest rate risk by setting risk limits for banking books and conducting monthly reviews of the exposure amount and of the profit or loss realized as a result of managing these books. – Operational interest rate risk management is conducted by the Asset and Liability Management Department, which is authorized to open risk positions within the limits adopted.
Risk Measurement	• The following risk measurement methods apply to banking books: interest rate gap analysis, the Value-at-Close/Total Return method, the Interest Rate Exposure (IRE) method and stress tests. • Interest rate gap analysis uses the schedule of maturities or revaluations of balance-sheet positions and of derivative instruments used in hedge accounting or qualified as economic hedge for the purpose of establishing the differences between positions whose maturity or interest rate revaluation fall within a given time range. • The general rule in the interest rate gap analysis is that of classifying transactions to respective banking book position revaluation bands according to contracted or assumed transaction interest rate revaluation dates. • The Value-at-Close method is an estimation of the economic or "fair" value of positions, equivalent to the market valuation of the trading book. Total return on a portfolio is the sum total of the changes in the value of closing the interest rate gap, accrued interest and gains/losses on sale of assets or cancelling of obligations. • The Interest Rate Exposure (IRE) method is used for estimation of potential impact of a specific parallel shift in the interest rate curves on interest income from the banking book before tax which can be earned in a specific period of time. It is a prospective measure. An assumption is made that under standard conditions interest rate shifts are identical for every currency and stand at 100 basis points upwards. IRE measures are calculated separately for positions in each currency in the time horizon of 10 years; however, for the purpose of current monitoring and limiting of interest rate risk positions in banking books, the Bank normally applies IRE measures with one-year and five-year time horizons. • Stress tests measure the potential impact of material changes in the level or directionality of interest rate curves on open interest positions in the banking book. • The Bank runs stress tests of predefined interest rate movement scenarios, which represent combinations of market factor movements defined as large moves and stress moves occurring both in Poland and abroad. Values of the assumed market factor movements are revised at least once a year and adjusted as appropriate to changes in the market conditions of the Bank's operation. • Activities relating to securities available for sale are the responsibility of the Assets and Liabilities Management Department within the Interbank Market Trading Division. There are three basic operating goals within the portfolio of securities available for sale: financial liquidity management, hedging against the risk assumed by the Interbank Market Trading Division from other organizational units of the Bank, the opening of own interest rate risk positions in the Bank's books by the Interbank Market Trading Division. • In order to avoid excessive fluctuations in the value of the Bank's capital caused by the revaluation of assets held for sale, maximum limits for the DV01 (Dollar Value of 1 basis point) position are set, which determines the potential change in the value of risk positions on a given interest rate curve, caused by a shift in the market interest rate by 1 basis point upwards

	for the type of portfolio in question. The limits also apply to positions in derivative instruments (e.g. interest rate swaps) which have been opened to hedge the fair value of the portfolio.
Monitoring	• The Market Risk Department and a dedicated reporting unit within the Risk Management Sector regularly submit to competent management reports concerning portfolio sensitivity, the size of the securities position and results of banking book interest rate risk stress tests. • Additionally, market risk analysis results are systematically presented during meetings of committees such as: the Assets and Liabilities Committee, the Risk and Capital Management Committee and the Risk and Capital Committee of the Supervisory Board.

Credit risk and counterparty risk

Definition	• Risk of a client's default. • The risk of a counterparty defaulting on its obligation arising from the transaction before or at the date of its final settlement.
Management Strategy	• The main purpose of credit risk management is to support the long-term plan for stable loan portfolio development while maintaining the adequate quality of this portfolio. The credit process is based on a range of fundamental policies, including: – Joint business and independent risk management responsibility for the quality of the loan portfolio and credit process as well as for credit loss; – Adherence to portfolio composition guidelines to ensure diversification and maintain risk/capital alignment; – Introducing a credit competence system, under which special authorizations for making credit decisions can only be granted to properly trained and experienced risk management unit employees, taking into account their previous professional experience as well as risk assessment skills and abilities; – Dependence of approval level on the risk taken – exposures with a higher risk (including size and risk assessment) require approval at a higher decision-making level; – Diverse risk rating standards, adequate to every obligor and exposure, including remedial actions; – A consistent rating process based on, *inter alia*, rating or scoring model results; – Regular monitoring of clients' business results and identification of negative changes in their standing which require immediate reclassification of exposure or remedial actions; – Monitoring the external environment in order to identify at an early stage any economic threats which could have a negative impact on the Bank's portfolio; – Observing credit policy and in special cases the requirement to approve exceptions to the Credit Policy at higher levels within the organization to ensure control over risk policy implementation while complying with the internal regulations in force at the Bank and with applicable laws and regulations issued by competent regulatory authorities.
Risk Measurement	• Risk measurement is conducted using rating and scoring models and scorecards at the individual client level as well as using provision models for portfolio risk assessment and the integrated ICAAP process, both at the aggregated level and for individual business lines.
Monitoring	• Credit risk exposure is monitored and managed at two levels: at the client level and at the portfolio level. The tools used to monitor the obligor's current creditworthiness include: – annual comprehensive reviews of limits, exposures, financial standing and of cooperation with obligors, – reports generated under the Early Warning process; – periodic financial reviews concerning the obligor, – periodic reviews of adversely classified credit exposures, – periodic visits to clients, – reports concerning current contacts between business unit staff/bank Relationship Managers and clients, – the analysis and assessment of external information (rating reports, analysts' reports, press, industry sources, etc.); – an internal classification system. • Portfolio-level monitoring – monitoring the utilization of risk concentration limits in the loan portfolio on the basis of relevant reports, – regular loan portfolio reviews, – *ad hoc* portfolio reviews caused by unexpected important external information, – monitoring of the indicators established for the retail exposure portfolio. • The monitoring of portfolio performance and identification of portfolio trends include regular management reports and control reports, including the analysis of rate of changes in the size and segmentation (industries) of the loan portfolio, client risk (rating), the quality of security for credit exposures and for defaulted exposures, deviations from the applicable risk acceptance rules and the limit utilization level. • The MIS report package for each portfolio is drawn up cyclically and distributed among the Bank's management, including to the managers responsible for the client segment in question, the Risk and Capital Management Committee and the Bank's Management Board.

Operational risk	
Definition	• Operational risk is defined as the risk of loss resulting either from inadequate or failing internal processes, people or technology systems or from external events. – The definition of the operational risk covers compliance risk, technological risk, outsourcing, fraud, money laundering, information security, business continuity, tax and accounting, product, legal, models, personnel, concentration and conduct risks as well as the reputation risk related to operational risk events and to business and market practices, and also the operational risk inherent in other risks (e.g. credit, counterparty, liquidity, compliance risks); – Operational risk does not include strategic risk or the risk of potential loss caused by decisions to accept credit risk, market risk, liquidity risk or insurance business risk.
Management Strategy	• The strategic objective of operational risk management is to ensure a coherent and effective system of operational risk identification, assessment, mitigation, control, monitoring and reporting and to ensure effective reduction of exposure to operational risk and, consequently, to reduce the number and severity of operational risk events. – Another objective of operational risk management is to fully integrate operational risk management processes and business decision making processes. – When structuring its operational risk management processes, the Group takes into account its business strategy, risk profile, the macroeconomic environment, available capital and liquidity resources and regulatory requirements which constitute the framework of the Group's risk control and management system.
Risk Measurement	• In the risk assessment process, the Group combines different approaches to risk measurement or estimation. – Risk assessment consists in determining the probability of losses arising from operational risk and their potential magnitude. To this end, both quantitative and qualitative measures are used (e.g. risk appetite, capital requirements, target risk profile, KRIs, data on operational risk losses and events, control issues and corrective actions, self-assessment process, risk map, key projects, risk concentration areas and areas where risk level is increasing, scenario analysis, stress tests, changes to processes and products, operational risk attestations, information from internal and external inspections and audits, information reported to the Commissions and Committees). – When assessing risks, both internal and external threats are analysed. Proper operational risk assessment enables the Bank to appropriately define the risk profile and correctly manage the risk.
Monitoring	• The Risk and Capital Management Committee, supported by Commissions, is responsible for ongoing monitoring of operational risk. – The quality of operational risk management (including self-assessment process) in respective organizational units of the Group is subject to inspections and evaluations carried out by the internal audit function. – Within the consolidated oversight over the Bank and subsidiaries, operational risk data are presented to Commissions and Committees supporting the Management Board and the Supervisory Board of the Bank in the operational risk management process. – The Supervisory Board exercises oversight over the operational risk management system and assesses its adequacy and effectiveness. The Supervisory Board is supported by Committees of the Supervisory Board: the Audit Committee, the Risk and Capital Committee and the Remuneration Committee. – On the basis of summary reports, which define the scale and types of operational risk to which the Group is exposed, risk concentration areas, operational risk management methods, the probability of materialization of operational risk, an assessment of the potential adverse impact of the operational risk management method, and the outcome of monitoring of the operational risk profile and operational risk appetite, the Supervisory Board, assisted by the Audit Committee and the Risk and Capital Committee, evaluates the Management Board's implementation of the assumptions underlying the strategy (including in relation to operational risk management policies) and, if necessary, commissions its review.

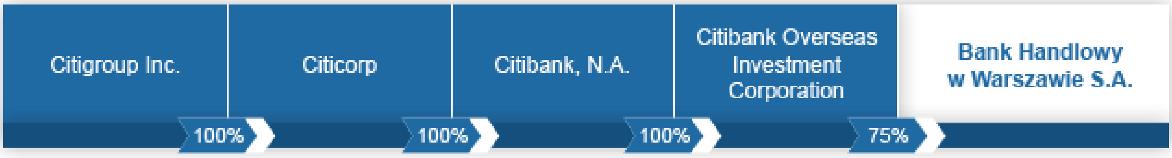
VIII. Investor information

1. The Bank's shareholding structure and performance of its shares on the WSE

1.1 Shareholders

The only shareholder of the Bank that holds at least 5% of share capital and of total voting rights at the General Meeting of Shareholders is Citibank Overseas Investment Corporation (COIC), a company belonging to the Citi Group and focused on its foreign investments. COIC is at the same time the strategic majority shareholder of the Bank. In the first half of 2016, the number of shares held by COIC as well as its stake in share capital and in total voting rights at the General Meeting of Shareholders remained unchanged and amounted to 97,994,700 and 75%, respectively.

The position of Bank Handlowy w Warszawie S.A. within the Citi Group structure is shown in the diagram below:

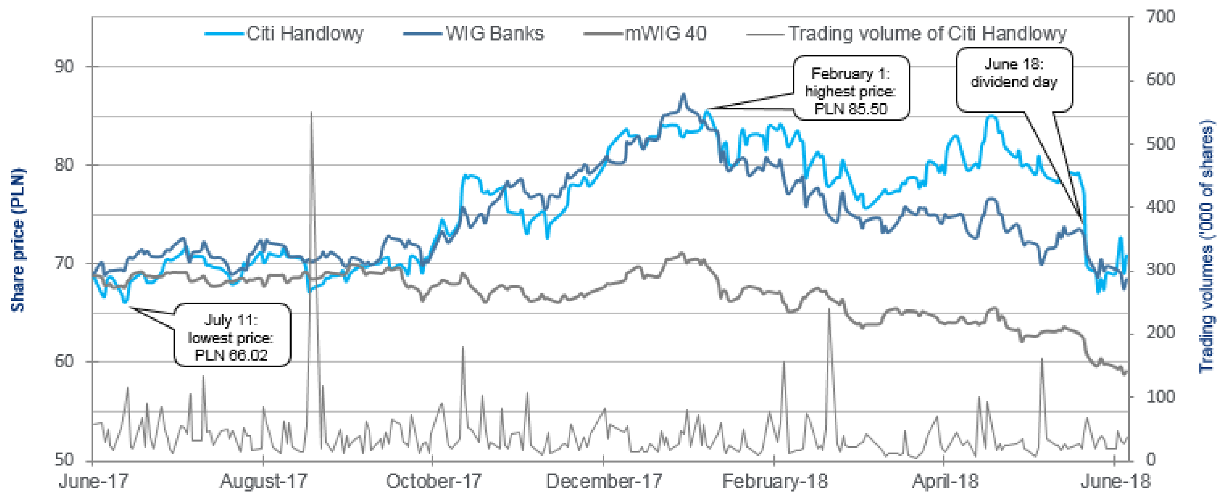


The remaining shares (32,664,900 shares representing 25% of the share capital) are free floating, which means that they are publicly traded and listed on the Warsaw Stock Exchange (WSE).

1.2 Performance of the Bank's shares on the WSE

The Bank's share price was PLN 70.80 at the end of the first half of 2018, an decrease of 2.9% within the last 12 months (i.e. compared to the closing price of PLN 71.70 as at 30 June 2017), thus the WIG-Banks industry index and the mWIG40 mid-cap index dropped 0.6% and 14.0% YoY, respectively.

The Bank's share price and trading volume vs. WIG-Banks and mWIG40 indices from the end of the first half of 2017 (29/06/2018 = PLN 70.80)



The Bank's highest share price since the end of the first half of 2017 was reached on 1 February 2018 at PLN 85.50. The average share price of the Bank in the last 12 months was PLN 75.78 and the average daily turnover in the Bank's shares was approximately 41,000 shares.

As at the end of June 2018, the Bank's capitalization was PLN 9.3 billion (compared to PLN 10.7 billion as at 30 December 2017 and PLN 9 billion as at end of the first half of 2017). As at the end of June 2018, stock exchange ratios were as follows: P/E (price/earnings) – 14.1 (compared to 20.0 as at 30 December 2017 and 22.4 as at the end of the first half of the previous year), P/B (price/book) – 1.4 (compared to 1.5 as at 30 December 2017 and 1.4 as at the end of June 2017).

The current consensus on the expected results of the Group is available on the Citi Handlowy's website at: http://www.citibank.pl/poland/homepage/polish/konsensus-wynikow.htm.

2. Dividend

On 8 June 2018, the Annual General Meeting of the Bank decided to allocate 99.98% of 2017 standalone net profit to dividend payout, which means that the dividend per share was PLN 4.11.

The table below presents the history of dividend payments since 1997 when the Bank was floated on the Warsaw Stock Exchange.

Financial year	Dividend (PLN)	Earnings per share (PLN)	Dividend per share (PLN)	Dividend payout ratio
1997	130,000,000	6.21	1.40	22.5%
1998	93,000,000	3.24	1.00	30.8%
1999	186,000,000	5.08	2.00	39.4%
2000	130,659,600	1.57	1.00	63.8%
2001	163,324,500	1.25	1.25	99.8%
2002	241,720,260	1.86	1.85	99.6%

Financial year	Dividend (PLN)	Earnings per share (PLN)	Dividend per share (PLN)	Dividend payout ratio
2003	241,720,260	1.86	1.85	99.7%
2004	1,563,995,412	3.17	11.97	*)
2005	470,374,560	4.51	3.60	79.8%
2006	535,704,360	4.75	4.10	86.4%
2007	620,633,100	6.19	4.75	76.8%
2008**	-	4.94	-	-
2009	492,586,692	4.02	3.77	94.0%
2010	747,372,912	5.72	5.72	99.9%
2011	360,620,496	5.52	2.76	50.0%
2012	756,519,084	7.72	5.79	75.0%
2013	934,216,140	7.15	7.15	99.9%
2014	970,800,828	7.43	7.43	99.9%
2015	611,486,928	4.75	4.68	98.6%
2016	591,887,988	4.62	4.53	98.0%
2017	537,010,956	4,11	4,11	100,0%

** Dividend-pay-out ratio for 2004 - 100% plus prior year profits.*
*** On June 18, 2009, the Bank's Ordinary General Meeting decided to pay no dividend for 2008 following the recommendation of the Polish Financial Supervision Authority (KNF) for the whole banking sector.*

3. Rating

As at 30 June 2018, the Bank was fully rated by an international rating agency: Fitch Ratings ("Fitch") and the Bank had the following ratings awarded by Fitch:

Long-term entity ranking *Long-term rating outlook*	A- *stable*
Short-term entity ranking	F1
Viability rating*	a-
Support rating	1
National long-term rating	AA+ (pol)
National short-term rating	F1+ (pol)

** The viability rating represents Fitch's view as to the intrinsic creditworthiness of an issuer excluding any impact of external factors.*

4. Investor relations

Investor relations, which ensure information to existing and prospective investors, capital market analysts and rating agencies, are an integral element of the Bank's information policy, the purpose of which is to cater for information needs of all persons and institutions interested in corporate information. In terms of investor relations, the main information policy tools are:

- regular contacts with investors and analysts in the form of conference calls and meetings, also at the Bank's premises, attended by members of the Bank's Management Board;
- support of the Press Office during quarterly press conferences for the media held after the publication of interim reports;
- publishing on the website current information on the Bank and its projects, and all current and interim reports. The website also enables contacts with the Investor Relations Office which has a broad knowledge of the Bank and its Group of Companies.

IX. Corporate governance rules in the Group

1. Best practice at the Bank

Corporate Governance Principles applied in the Group of the Bank are described in the Report of the Management Board on the activities in 2017.

2. Governing bodies of the Bank

2.1 Changes in the composition of the Management Board and Supervisory Board during the first half of 2018

3.1.1 Changes in the composition of the Management Board during the first half of 2018

In the first half of 2018, the Bank's Management Board consisted of:

Sławomir S. Sikora — President of the Bank's Management Board

Natalia Bożek	Vice-President of the Bank's Management Board from 21 March 2018
Maciej Kropidłowski	Vice-President of the Bank's Management Board
David Mouille	Vice-President of the Bank's Management Board
Barbara Sobala	Vice-President of the Bank's Management Board
Witold Zieliński	Vice-President of the Bank's Management Board until 18 February 2018
Katarzyna Majewska	Member of the Bank's Management Board
Czesław Piasek	Member of the Bank's Management Board until 31 march 2018

3.1.2 Changes in the composition of the Supervisory Board during the first half of 2018

During the first half of 2018 the Supervisory Board of the Bank consisted of:

Andrzej Olechowski	Chair of the Supervisory Board
Frank Mannion	Deputy Chair of the Supervisory Board
Shirish Apte	Member of the Supervisory Board
Marek Belka	Member of the Supervisory Board
Grzegorz Bielecki	Member of the Supervisory Board
Igor Chalupec	Member of the Supervisory Board
Jenny Grey	Member of the Supervisory Board
Marek Kapuściński	Member of the Supervisory Board
Marc Luet	Member of the Supervisory Board
Anand Selvakesari	Member of the Supervisory Board
Stanisław Sołtysiński	Member of the Supervisory Board
Stephen Volk	Member of the Supervisory Board

2.2 Rules of appointing and dismissing members of the Management Board

The Management Board consists of five to nine members. Each member of the Bank's Management Board is appointed by the Supervisory Board for an individual term of office of three years. At least half of the members of the Management Board should be of Polish nationality. The term of appointment of a Management Board member expires:

- on the day of the General Meeting of Shareholders approving the Management Report on the activities of the Bank and financial report for the full past year of the term of office of the Management Board member;
- upon death of the Management Board member;
- upon dismissal of the Management Board member;
- upon resignation of the Management Board member, submitted in writing to the Chair of the Supervisory Board.

2.3 Rights of the Management Board members

The Management Board makes decisions in matters concerning the Bank by way of resolutions, provided that decisions in such matters are not reserved for other governing bodies of the Bank by law or the Articles of Association.

By way of resolutions, the Management Board:

1) defines the Bank's strategy;
2) establishes and abolishes the committees supporting the work of the Bank and defines their mandates;
3) decides the Management Board's bylaws and submits them to the Supervisory Board for approval;
4) decides the rules of handling special purpose funds created from net profit and submits them to the Supervisory Board for approval;
5) decides on the date of payment of dividend within the time limits defined by the General Meeting of Shareholders;
6) appoints holders of general commercial power of attorney, attorneys and attorneys with powers of substitution;
7) decides in matters defined in Management Board bylaws;
8) makes decisions on matters brought by the President, Vice-President or Member of the Management Board;
9) independently decides on purchase or sale of real property, or on perpetual usufruct of, or share in, real property;
10) passes a resolution on the Bank's annual financial plan, accepts investment plans and reports of implementation of such plans;
11) accepts reports on the Bank's operations and financial reports;
12) formulates decisions regarding distribution of profit or coverage of losses;
13) approves the Bank's human resources policy, credit policy and legal principles of its operations;
14) approves the rules of the Bank's equity management;
15) approves the employment structure;
16) establishes the basic structure of the Bank's organization, appoints and dismisses Heads of Sectors, appoints and dismisses Heads of Divisions, and makes decisions on their competences;

17) establishes the audit plan at the Bank and accepts audit reports;
18) resolves other issues which, according to the Articles of Association, are submitted to the Supervisory Board or the General Meeting of Shareholders;
19) makes decisions on contracting liabilities or disposing of assets, when the total value of such liabilities or assets in relation to a single entity exceeds 5% of the Bank's own funds, or appoints authorized persons to make such decisions; however, in matters within the powers of Committees appointed by the Bank the decisions are made after consulting the relevant Committee.

The Bank's Management Board designs, implements, and ensures the operation of, the Bank's management system as well as designs, implements and updates written strategies and procedures, and undertakes actions relating to the system of risk management, internal controls and internal capital assessment as well as reviews of the internal capital assessment and maintenance processes.

3. Other principles

3.1 Information on owners of securities with special control rights towards the Bank

All shares issued by the Bank are common bearer shares and have no special control rights related to them.

3.2 Limitations regarding transfer of ownership of the Bank's shares or exercising the voting rights relating to the Bank's shares

Beside limitations stipulated by the Banking Law (Article 25 et seq.), the Bank's Articles of Association put no limitations with regard to transfer of Bank's shares.

X. Other information on the Bank's governing bodies and management principles

1. Information on the total number of the shares of the Bank held by Management Board or Supervisory Board members

According to the information available to the Bank as the parent company, the Bank's shares are held by the following members of the Management Board and Supervisory Board of the Bank:

Name	Function	Number of shares as at the day of submitting this consolidated semi-annual report for the first half of 2018	Number of shares as at the day of submitting the previous quarterly interim report for Q1 of 2018
Andrzej Olechowski	Chairman of the Supervisory Board	2,200	2,200
Total		**2,200**	**2,200**

Members of the Management Board and Supervisory Board of the Bank do not have any Bank share options.

2. Information on any agreements between the Bank and the Management Board members that provide for compensation in case of resignation or dismissal of such members without a valid reason, or when such dismissal is a result of a merger or acquisition of the Bank

Among all employment contracts between the Bank and the members of the Management Board of the Bank, there is only one contract with a member of the Management Board that provides for financial compensation in the case of termination with prior notice.

Each member of the Management Board of the Bank has signed a separate non-competition agreement with the Bank. In accordance with this agreement, if the employment relationship with the Bank is terminated, the member of the Management Board is obliged to refrain from undertaking any competitive activities in a period of 12 months (or 6 months in the case of one of the Management Board members). On account of this restriction, the Bank will be obliged to pay compensation to a terminated member of the Management Board.

3. Management policy

During the first half of 2018, no changes in the management principles were made. The management principles are outlined in the Note to the Interim Condensed Consolidated Financial Statements of the Capital Group of Bank.

XI. Statement of the Bank's Management Board

Accuracy and fairness of the statements presented

To the best knowledge of the Management Board of the Bank, composed as at the date of preparation of the financial statements of: Mr. Sławomir S. Sikora – President, Ms. Natalia Bożek – Vice President, Mr. Maciej Kropidłowski – Vice President, Mr. David Mouillé - Vice President, Ms. Barbara Sobala – Vice President and Mrs. Katarzyna Majewska – Member, the semi-annual financial data and comparative data presented in the "Interim Condensed Stand-alone Financial Statements of Bank Handlowy w Warszawie S.A. for the six-month period ended 30 June 2018" and the "Interim Condensed Consolidated Financial Statements of the Capital Group of Bank Handlowy w Warszawie S.A. for the six-month period ended 30 June 2018" were prepared in accordance with the applicable accounting principles and give a true, fair and clear picture of the assets and the financial standing of the Bank and the Group as well as the financial result of the Bank and the Group. The "Report on activities of the Capital Group of Bank Handlowy w Warszawie S.A. in the first half of 2018", contained in the semi-annual consolidated report, gives a true picture of developments, achievements and situation (and describes major risk) of the Group in the first half of 2018.

Other information required by the Regulation of the Minister of Finance of 29 March 2018 on current and periodic information published by issuers of securities and on the conditions under which such information may be recognized as equivalent to information required by the law of a non-Member State (Journal of Laws [Dz. U.] of 2018 item 757, as amended) was provided in the Condensed Interim Consolidated Financial Statements of the Bank's Group of Companies.

Members of Management Board signatures

Date	Name	Position/Function	Signature
22.08.2018	Sławomir S. Sikora	The President of Management Board	
22.08.2018	Natalia Bożek	Vice-president of Management Board	
22.08.2018	Maciej Kropidłowski	Vice-president of Management Board	
22.08.2018	David Mouillé	Vice-president of Management Board	
22.08.2018	Barbara Sobala	Vice-president of Management Board	
22.08.2018	Katarzyna Majewska	Member of Management Board	