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Other Risks

Market risk

Market risk encompasses current and prospective impact on earnings or capital, arising from changes in the value of the Group's portfolio due to adverse market movement. The framework of market risk management and its control are defined on a centralized basis with the use of the same concepts and metrics which are used in all the entities of the BCP Group.

The main measure used by the Group to evaluate market risks is the parametric VaR (Value at Risk) model – an expected loss that may arise on the portfolio over a specified period of time (holding period) with a required probability (confidence level) due to an adverse market movement. The market risk measurement is carried out daily, both on an individual basis for each of the areas responsible for risk taking and risk management, and also in consolidated terms considering the effect of the diversification that exists between the particular portfolios.

In parallel to VaR calculations, in order to estimate the potential economic loss resulting from the extreme changes in the market risk factors, a number of stress tests are conducted for the portfolios

that are subject to high market risk. Additionally, in the process of interest rate risk management, the Group also uses interest income sensitivity measure and analyzes repricing gaps.

In situations as the one faced in October 2014 (cut by the Monetary Policy Council the reference rate by 50 bps and of lombard credit rate by 100 bps) the Bank is subject to asymmetrical impacts on its Net Interest Income. This is due to the Polish legal system and the fact that the interest rate of consumer loans and credit cards cannot exceed four times the Lombard interest rate of the National Bank of Poland. The impact on net interest income in face of decrease of the interest rate depends among other factors on the percentage of the loan portfolio that is affected by the new maximum rate.

VaR ratios reflect total exposure to market risk in the Group. In 2014, open positions included just interest-rate instruments and FX risk instruments. The total market risk exposure in the Group was relatively low during 2014 and was on average equal to PLN 29.1 million compared to the end-of-year internal limit of PLN 277.8 million.

All eventual excesses of market risk limits are reported, documented and ratified at the proper competence level. In 2014, the market risk exposure was kept within limits in place (no excesses were detected).

More on market Risk in terms of VaR and management of interest rate risk in Banking Book- see point 8 in Annual Financial Statements of the Capital Group of Bank Millennium for 12 month period ended 31 Dec. 2014.

Liquidity risk

Liquidity risk reflects the possibility of incurring significant losses as a result of deteriorated financing conditions (financing risk) and/or of the sale of assets for less than their market value (market liquidity risk) to meet the funding needs arising from the Group's obligations.

The process of the Group's planning and budgeting covers the preparation of a Liquidity Plan in order to make sure that the growth of business will be supported by an appropriate liquidity financing structure and supervisory requirements in terms of quantitative liquidity measures will be met.

In 2014 , the Group's Loan-to-Deposit ratio was kept below 100% (as of end of December 2014 the ratio was equal to 92.0%). The liquidity surplus was still invested in the portfolio of liquid assets (Cash, balance with NBP, NBP Bills and Polish Government bonds).The share of polish government securities (including NBP Bills) in total securities portfolio in Banking Book (qualified as assets available for sale) amounted to 99% at the end of December 2014 that is 15% of total assets.

	31.12.2014	31.12.2013
Loans/Deposits ratio (%) *	92,00%	91.5%
High liquid assets portfolio (PLN million) (**)	11.862	11.546

(*) including bonds for individual Clients and sell-buy-backs with Clients

(**) without Trading activity

At the end of 2014 total Clients' deposits of the Group reached the level of PLN 47.6 billion. The growth of the deposits were driven mostly by funds of individuals, of which the share in total Client's deposits grow to approx. 62.6% at the end of December 2014 from 58.3% at the end of December 2013. Consequently, the large, diversified and stable funding from retail, corporate and public sector Clients remains the main source of financing of the Group. The source of medium-term funding remains also medium-term loans, subordinated debt and own bonds issue.

During 2014 the Bank continued to explore the possibility of raising additional funding from bond issue in order to diversify the source of funding. At the end of 2014, the value of bonds placed in institutional investors increased to PLN 1 408 million from PLN 353 million at the end of 2013. The growth was connected with the issue of the 3-year floating rate bonds in the total amount of PLN 500 million at the end of March 2014. Another PLN 501 million of that portfolio increased due to 3-month term bonds, issued partially as a replacement of deposits from financial institutions and as rollover of 3-months bonds issued already in 2Q and 3Q 2014. The new issues had a positive impact on the Group's liquidity.

The Group manages its FX liquidity through the use of FX-denominated bilateral loans as well as subordinated debt, FX swaps and cross-currency interest rate swaps transactions. The swaps portfolio is diversified in term of counterparties and maturity dates. For the majority of counterparties the Group has signed a Credit Support Annex to the master agreements.

The estimation of the Group's liquidity risk is carried out both with the use of the ratios defined by the supervisory authorities and own indicators, for which exposure limits were also established. In 2014 both internal as well as supervisory liquidity measures were kept well above the minimum limits in place.

Additionally, the Group employs an internal structural liquidity analysis based on cumulative liquidity gaps calculated on an actuarial basis (i.e. assuming a certain probability of cash flow occurrence). In 2014 all the liquidity gaps were maintained at the levels significantly above the minimum limits, both for normal as well as stress scenarios.

Liquidity stress tests are performed at least quarterly, in order to understand the Group's liquidity-risk profile and to ensure that the group is in a position to fulfil its obligations in the event of a liquidity crisis and to update the Liquidity Contingency Plan and management decisions.

The Group has emergency procedures for situations of increased liquidity risk – the Liquidity Contingency Plan. The Liquidity Contingency Plan establishes the concepts, priorities, responsibilities and specific measures to be taken in the event of a liquidity crisis. The Liquidity Contingency Plan is revised at least twice a year and it is tested once a year in order to ensure that it is operationally robust.

Operational risk

Operational risk management is based on the processes structure implemented in the Group and overlapping the traditional organisational structure. Current management of the specific processes,

including the management of the profile of process operational risk, is entrusted to Process Owners, who report to all other units participating in the risk management process and are supported by these units.

The Group has in its structure a special organizational unit to develop, implement and monitor the Group's policy for management of this risk in cooperation with other organisational units of the Group and in accordance with its internal regulations. The Fraud Risk Management Bureau is a centre of competence for the fraud prevention process.

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