IV. Capital requirements

IV.1 Approach to assessing the adequacy of internal capital (CRR Article 438.a)

The Group carries out the internal capital adequacy assessment process (ICAAP) in reliance on the internal models of economic capital.

The Group defines economic capital as the amount of capital which is needed to cover all the unexpected economic losses that may occur during a specified future period and that are estimated with specific probability, without jeopardizing interests of the Group's depositors/creditors. Internal capital calculations incorporate all the material risk types to which the Group is exposed and are based on a set of parameters developed on the basis of the individual features and characteristics of the Polish market. The models quantify the value of expected and unexpected losses on account of the risk types considered to be material, at the assumed confidence level and in a 1-year time horizon.

The Group has taken a conservative approach to the correlation between individual risk types (the fact that different risk types do not convert to losses simultaneously) and calculates the effect of diversification on the entire loss distribution.

In line with the recommendations issued by the banking supervision authority, individual risk types and the diversification effect are subject to stress tests. The total diversified internal capital is subject to economic assessment of capital adequacy, by a comparison with "risk bearing capacity" (available financial resources). The Group conservatively assumes that the available financial resources are equivalent to regulatory own funds which form the basis for calculating the solvency ratio.

The internal capital adequacy assessment process following the Group's approach is closely linked to the risk, capital and business management processes in place in the Group. It consists of the following stages:

1. Classification and assessment of materiality of risk types, to determine the method for incorporating them in the risk management process and in the ICAAP process,
2. Measurement (quantification) of risk,
3. Aggregation of internal capital to secure material risk of operations, while taking into account the effect of correlation between risk types,
4. Assessment of capital adequacy by comparing the Bank's economic risk (internal capital) to its capacity to cover the risk,
5. Allocation of internal capital to business lines/areas of operation,
6. Use of allocated internal capital to measure risk-based efficiency, set risk limits, reallocate capital while taking into account risk-weighted returns,
7. Control and monitoring of the risk level, available financial resources, capital limits and objectives.

Capital adequacy assessment carried out at the end of 2014 indicates a high level of this adequacy, which is shown in a significant surplus of capital resources (equivalent to regulatory own funds) as compared to economic risk (internal capital value) and risk calculated on the basis of supervisory regulations (the value of minimum capital requirements to cover risk. Internal capital at the end of 2014 is lower than the capital requirements in the 1st Pillar, both in the Standardized Approach and the IRB Approach (taking into account the following additional requirement resulting from a temporary supervisory restriction) for credit risk.

Both the Bank and the Group meet the statutory requirements regarding the level of own funds and the internal capital set forth in Article 128 of the Banking Law Act and in the CRR.

IV.2 Upon demand from the relevant competent authority, the result of the institution's internal capital adequacy assessment process including the composition of the additional own funds requirements (CRR Article 438.b)

Not applicable

IV.3 Amounts equal to 8% of risk-weighted exposure, calculated separately for each exposure class defined in Article 147 of CRR

The Group has obtained a permission from the Bank of Portugal and the Polish Financial Supervision Commission (hereinafter: Regulatory Authorities) to apply the Advanced Internal Ratings Based Approach to a part of the retail exposure portfolio. Detailed information on this matter is provided in item XVII.1.

The table below presents the amounts of capital requirements calculated according to the permission received from the Regulatory Authorities to apply the IRB approach.

Table no 5 Capital requirements as at 31 December 2014, the Group (in PLN thous.)

No	Exposure class	Capital requirements
1	Central banks and governments	0
2	Institutions	71 873
3	Corporates	783 587
4	Retail exposures, incl.:	876 554
4.1	*- Residential Real Estate exposures (RRE)*	*486 357*
4.2	*- Qualified Retail Revolving Exposures (QRRE)*	*82 010*
4.3	*- Other Retail exposures*	*308 187*

5	Trading Book	18 248
6	Specialised Lending, incl.:	65 656
6.1	*- category 1*	*0*
6.2	*- category 2*	*23 367*
6.3	*- category 3*	*0*
6.3	*- category 4*	*15 665*
6.4	*- category 5*	*26 624*
7	Equity exposures	950
8	Securitization	0
9	Other assets	69 572
10	CAPITAL REQUIREMENTS TO CREDIT RISK, COUNTERPARTY CREDIT RISK, SETTLEMENT / DELIVERY, LARGE EXPOSURES EXCEEDING LIMITS AND OTHER ASSETS	1 886 440
10.1	*- including counterparty credit risk*	*25 553*
12	Capital requirements to credit valuation adjustment	23 810
13	CAPITAL REQUIREMENTS TO MARKET RISK	24 804
14	CAPITAL REQUIREMENTS TO OPERATIONAL RISK	257 503
15	TOTAL CAPITAL REQUIREMENTS (without regulatory floors)	2 192 556
16	REGULATORY FLOOR	628 004
17	TOTAL CAPITAL REQUIREMENTS (with regulatory floor)	2 820 561

(*) Capital requirements calculated using the IRB Approach

(**) Additional requirement resulting from the temporary supervisory constraint explained in part xvii.1 of this Information

For equity exposure class, the risk-weighted exposure amounts are calculated using the simple risk-weight approach laid down in Article 150.2 of CRR. These requirements are an immaterial amount compared to the amount of the requirement for own funds for credit risk (PLN 950 thousand).

IV.4 Capital requirements for position risk, large exposures limits excess, currency, settlement and commodities risks

- Market risk

The Group uses standardized approaches to calculate its capital requirements for various types of market risk. The Group had requirements for own funds for specific risk of debt instruments and the general interest rate risk. The exposure to market risk was not material. Capital requirements for this risk represented about 1% of the total amount of capital requirements (without the regulatory floor) as at 31 December 2014.

- Settlement risk, delivery risk, large exposures limits excess

As at 31 December 2014, there were no capital requirements for these risks.

IV.5 Capital requirements for operational risks and losses borne by operational risk

The capital requirements for operational risk are calculated using the standardized approach (CRR Article 317-320). They represented about 12% of the total amount of capital requirements (without the regulatory floor) as at 31 December 2014.

Losses stemming from operational risk events

The below table presents operational risk events registered in the operational risk database in 2014.

Table no 6 Operational risk events, divided by events categories and loss amount

Event category	Amount of events	Net loss	Gross loss
	no	PLN mn	PLN mn
External fraud	95	1,8	2,6
Internal fraud	1	0,9	1,2
Clients, Products and Business practices	2	0,2	0,3
Damage to physical assets	22	0,1	0,2
Other	7	0,1	0,1
TOTAL	127	3,1	4,4

Operational risk management system requires identification of a causes of an events and implementation of decisions or actions to reduce frequency and financial impact of events. It is completed using change of processes, strengthening of internal controls, adjustments of documentation and procedures and dedicated trainings.

In 2014 Bank reported no material operational risk events, i.e. those for which gross loss exceeds 10% of capital requirements for operational risk.
