Powszechny Zakład Ubezpieczeń Spółka Akcyjna Group

Consolidated Financial Statements
for the year ended 31 December 2018
prepared in accordance with the
International Financial Reporting Standards

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(in millions of PLN)

Consolidated profit and loss account

Consolidated profit and loss account	Note	1 January – 31 December 2018	1 January – 31 December 2017 (restated) [1]
Gross written premiums	10	23,470	22,847
Reinsurers' share in gross written premium		(755)	(612)
Net written premiums		**22,715**	**22,235**
Movement in net provision for unearned premiums		(365)	(881)
Net earned premiums		**22,350**	**21,354**
Revenue from commissions and fees	11	3,374	2,319
Net investment income	12	11,679	9,051
Net result on realization of financial instruments and investments	13	(15)	247
Movement in allowances for expected credit losses and impairment losses on financial instruments	14	(1,804)	(1,207)
Net movement in fair value of assets and liabilities measured at fair value	15	770	380
Other operating income	16	1,693	1,178
Claims, benefits and movement in technical provisions		(14,980)	(15,376)
Reinsurers' share in claims, benefits and movement in technical provisions		417	435
Net insurance claims and benefits paid	**17**	**(14,563)**	**(14,941)**
Fee and commission expenses	18	(754)	(557)
Interest expenses	19	(2,046)	(1,350)
Acquisition expenses	20	(3,130)	(2,901)
Administrative expenses	21	(6,609)	(5,357)
Other operating expenses	23	(3,858)	(2,758)
Operating profit		**7,087**	**5,458**
Share of the net financial results of entities measured by the equity method		(1)	16
Profit before tax		**7,086**	**5,474**
Income tax	24	(1,718)	(1,289)
Net profit, including:		**5,368**	**4,185**
- profit attributable to the equity holders of the Parent Company		3,213	2,895
- profit attributable to holders of non-controlling interest		2,155	1,290
Weighted average basic and diluted number of common shares	25	863,347,220	863,519,608
Basic and diluted profit per common share (in PLN)	25	3.72	3.35

[1] Information on restatement of the 2017 data is presented in section 5.3.

Warsaw, 12 March 2019

The accompanying notes form an integral part of the consolidated financial statements.

(in millions of PLN)

Consolidated statement of comprehensive income

Consolidated statement of comprehensive income	Note	1 January – 31 December 2018	1 January – 31 December 2017 (restated) [1]
Net profit		5,368	4,185
Other comprehensive income	24	(98)	66
Subject to subsequent transfer to profit or loss		150	57
Valuation of debt instruments measured at fair value through other comprehensive income		15	n/a
Measurement of financial instruments available for sale		n/a	117
Foreign exchange translation differences		36	(71)
Cash flow hedging		99	11
Not to be reclassified to profit or loss in the future		(248)	9
Valuation of equity instruments measured at fair value through other comprehensive income		(247)	n/a
Reclassification of real property from property, plant and equipment to investment property		3	2
Actuarial gains and losses related to provisions for employee benefits		(4)	7
Total net comprehensive income		**5,270**	**4,251**
- comprehensive income attributable to equity holders of the Parent Company		3,027	2,882
- comprehensive income attributable to holders of non-controlling interest		2,243	1,369

[1] Information on restatement of the 2017 data is presented in section 5.3.

Warsaw, 12 March 2019

The accompanying notes form an integral part of the consolidated financial statements.

(in millions of PLN)

Consolidated statement of financial position

Assets	Note	31 December 2018	31 December 2017 (restated) 1)	1 January 2017 (restated) 1)
Goodwill	26	3,871	3,830	1,583
Intangible assets	27	3,180	3,443	1,463
Other assets	28	562	692	866
Deferred acquisition expenses	29	1,546	1,485	1,407
Reinsurers' share in technical provisions	41	1,512	1,250	990
Property, plant and equipment	30	3,184	3,287	1,467
Investment property	31	1,697	2,355	1,738
Entities measured by the equity method	32	17	20	37
Loan receivables from clients	33	182,054	169,457	44,998
Financial derivatives	34	2,487	2,351	953
Investment financial assets	35	101,665	110,046	59,335
Measured at amortized cost		45,234	n/a	n/a
Measured at fair value through other comprehensive income		38,737	n/a	n/a
Measured at fair value through profit or loss		17,694	n/a	n/a
Held to maturity		n/a	21,237	17,346
Available for sale		n/a	48,519	11,652
Measured at fair value through profit or loss		n/a	20,243	21,001
Loans		n/a	20,047	9,336
Deferred tax assets	44	2,234	1,590	641
Receivables	37	6,343	9,096	5,664
Cash and cash equivalents	38	17,055	8,239	2,973
Assets held for sale	39	1,147	317	1,189
Total assets		**328,554**	**317,458**	**125,304**

Warsaw, 12 March 2019

The accompanying notes form an integral part of the consolidated financial statements.

(in millions of PLN)

Consolidated statement of financial position (cont.)

Equity and liabilities	Note	31 December 2018	31 December 2017 (restated) [1)]	1 January 2017 (restated) [1)]
Equity				
Equity attributable to equity holders of the Parent		14,925	14,599	12,990
Share capital	40.1	86	86	86
Other capital	40.3	12,566	11,917	10,869
Retained earnings		2,273	2,596	2,035
Retained earnings		(940)	(299)	100
Net profit		3,213	2,895	1,935
Non-controlling interest		22,482	22,961	4,067
Total equity		**37,407**	**37,560**	**17,057**
Liabilities				
Technical provisions	41	45,839	44,558	42,194
Provisions for employee benefits	42	531	556	128
Other provisions	43	519	497	367
Deferred tax liability	44	486	638	469
Financial liabilities	45	236,316	224,550	60,045
Other liabilities	46	7,407	9,096	5,011
Liabilities related directly to assets classified as held for sale	39	49	3	33
Total liabilities		**291,147**	**279,898**	**108,247**
Total equity and liabilities		**328,554**	**317,458**	**125,304**

[1)] Information on restatement of data as at 1 January and 31 December 2017 is presented in section 5.3.

(in millions of PLN)

Consolidated statement of changes in equity

Consolidated statement of changes in equity	Note	Equity attributable to equity holders of the parent										Non-controlling interest	Total equity
		Share capital	Other capital						Retained earnings		Total		
			Treasury shares	Supplementary capital	Revaluation reserve	Other reserve capital	Actuarial gains and losses related to provisions for employee benefits	Foreign exchange translation differences	Retained earnings	Net profit			
Note		40.1		40.3	40.3		40.3	40.3				2.3	
As at 1 January 2018		**86**	**-**	**11,824**	**157**	**5**	**4**	**(73)**	**2,596**	**-**	**14,599**	**22,961**	**37,560**
Effect of the application of IFRS 9 and other changes		-	-	-	7	-	-	-	(519)	-	(512)	(1,146)	(1,658)
As at 1 January 2018 after the change of accounting policies		**86**	**-**	**11,824**	**164**	**5**	**4**	**(73)**	**2,077**	**-**	**14,087**	**21,815**	**35,902**
Valuation of equity instruments measured at fair value through other comprehensive income		-	-	-	(255)	-	-	-	-	-	(255)	8	(247)
Valuation of debt instruments measured at fair value through other comprehensive income		-	-	-	9	-	-	-	-	-	9	6	15
Cash flow hedging		-	-	-	24	-	-	-	-	-	24	75	99
Foreign exchange translation differences		-	-	-	-	-	-	37	-	-	37	(1)	36
Actuarial gains and losses related to provisions for employee benefits		-	-	-	-	-	(4)	-	-	-	(4)	-	(4)
Reclassification of real property from property, plant and equipment to investment property		-	-	-	3	-	-	-	-	-	3	-	3
Total net other comprehensive income		**-**	**-**	**-**	**(219)**	**-**	**(4)**	**37**	**-**	**-**	**(186)**	**88**	**(98)**
Net profit (loss)		-	-	-	-	-	-	-	-	3,213	3,213	2,155	5,368
Total comprehensive income		**-**	**-**	**-**	**(219)**	**-**	**(4)**	**37**	**-**	**3,213**	**3,027**	**2,243**	**5,270**
Other changes, including:		**-**	**(11)**	**836**	**(10)**	**13**	**-**	**-**	**(3,017)**	**-**	**(2,189)**	**(1,576)**	**(3,765)**
Distribution of financial result	40.2.1.1	-	-	848	-	14	-	-	(3,021)	-	(2,159)	(1,659)	(3,818)
Transactions on treasury shares		-	(11)	-	-	-	-	-	-	-	(11)	-	(11)
Transactions with non-controlling shareholders		-	-	(19)	-	-	-	-	-	-	(19)	83	64
Sale of revalued real estate and other		-	-	7	(10)	(1)	-	-	4	-	-	-	-
As at 31 December 2018		**86**	**(11)**	**12,660**	**(65)**	**18**	**-**	**(36)**	**(940)**	**3,213**	**14,925**	**22,482**	**37,407**

Warsaw, 12 March 2019

The accompanying notes form an integral part of the consolidated financial statements.

(in millions of PLN)

Consolidated statement of changes in equity (continued)

Consolidated statement of changes in equity (restated) [1]	Equity attributable to equity holders of the parent										Non-control-ling interest	Total equity
	Share capital	Other capital						Retained earnings		Total		
		Treasury shares	Supplementary capital	Revaluation reserve	Other reserve capital	Actuarial gains and losses related to provisions for employee benefits	Foreign exchange translation differences	Retained earnings	Net profit			
Note	40.1		40.3	40.3		40.3	40.3				2.3	
As at 1 January 2017	**86**	**(1)**	**10,758**	**106**	**5**	**3**	**(2)**	**2,043**	**-**	**12,998**	**4,086**	**17,084**
Adjustment of the opening balance	-	-	-	-	-	-	-	(8)	-	(8)	(19)	(27)
As at 1 January 2017 after adjustment	86	(1)	10,758	106	5	3	(2)	2,035	-	12,990	4,067	17,057
Measurement of financial instruments available for sale	-	-	-	53	-	-	-	-	-	53	64	117
Cash flow hedging	-	-	-	2	-	-	-	-	-	2	9	11
Foreign exchange translation differences	-	-	-	-	-	-	(71)	-	-	(71)	-	(71)
Actuarial gains and losses related to provisions for employee benefits	-	-	-	-	-	1	-	-	-	1	6	7
Reclassification of real property from property, plant and equipment to investment property	-	-	-	2	-	-	-	-	-	2	-	2
Total net other comprehensive income	**-**	**-**	**-**	**57**	**-**	**1**	**(71)**	**-**	**-**	**(13)**	**79**	**66**
Net profit (loss)	-	-	-	-	-	-	-	-	2,895	2,895	1,290	4,185
Total comprehensive income	**-**	**-**	**-**	**57**	**-**	**1**	**(71)**	**-**	**2,895**	**2,882**	**1,369**	**4,251**
Other changes, including:	**-**	**1**	**1,066**	**(6)**	**-**	**-**	**-**	**(2,334)**	**-**	**(1,273)**	**17,525**	**16,252**
Distribution of financial result	-	-	1,125	-	-	-	-	(2,334)	-	(1,209)	-	(1,209)
Acquisition of shares in Pekao	-	-	-	-	-	-	-	-	-	-	17,711	17,711
Transactions on treasury shares	-	1	-	-	-	-	-	-	-	1	-	1
Changes in the composition of the PZU Group and transactions with holders of non-controlling interests	-	-	(65)	-	-	-	-	-	-	(65)	(186)	(251)
Sale of revalued real estate	-	-	6	(6)	-	-	-	-	-	-	-	-
As at 31 December 2017	**86**	**-**	**11,824**	**157**	**5**	**4**	**(73)**	**(299)**	**2,895**	**14,599**	**22,961**	**37,560**

[1] Information on restatement of the 2017 data is presented in section 5.3.

Warsaw, 12 March 2019

The accompanying notes form an integral part of the consolidated financial statements.

(in millions of PLN)

Consolidated cash flow statement

Consolidated cash flow statement	Note	1 January – 31 December 2018	1 January – 31 December 2017 (restated) [1)]
Profit before tax		7,086	5,474
Adjustments		(6,683)	9,948
Movement in loan receivables from clients		(15,972)	(13,222)
Movement in liabilities under deposits		9,093	19,478
Movement in the valuation of assets measured at fair value		(770)	(411)
Interest income and expenses		(2,276)	(1,749)
Realized gains/losses from investing activities and impairment losses		1,664	960
Net foreign exchange differences		(184)	(589)
Movement in deferred acquisition expenses		(61)	(78)
Amortization of intangible assets and depreciation of property, plant and equipment		1,103	884
Movement in the reinsurers' share in technical provisions		(262)	(260)
Movement in technical provisions		1,281	2,364
Movement in receivables		(586)	(554)
Movement in liabilities		(871)	2,025
Cash flow on investment contracts		(21)	(89)
Acquisitions and redemptions of participation units and investment certificates of mutual funds		(126)	(228)
Income tax paid		(1,898)	(1,229)
Other adjustments		3,203	2,646
Net cash flows from operating activities		**403**	**15,422**
Cash flow from investing activities			
Proceeds		909,865	904,328
- sale of investment property		22	59
- proceeds from investment property		300	301
- sale of intangible assets and property, plant and equipment		51	13
- sale of ownership interests and shares		3,590	3,115
- realization of debt securities		204,645	200,893
- closing of buy-sell-back transactions		460,379	369,251
- closing of term deposits with credit institutions		208,469	235,593
- realization of other investments		30,645	88,276
- interest received		1,655	1,757
- dividends received		66	37
- increase in cash due to purchase of entities and change in the scope of consolidation		4	5,000
- other investment proceeds		39	33

Warsaw, 12 March 2019

The accompanying notes form an integral part of the consolidated financial statements.

(in millions of PLN)

Consolidated cash flow statement (continued)

Consolidated cash flow statement	Note	1 January – 31 December 2018	1 January – 31 December 2017 (restated) [1)]
Expenditures		(900,694)	(916,362)
- purchase of investment property		(106)	(56)
- expenditures for the maintenance of investment property		(105)	(179)
- purchase of intangible assets and property, plant and equipment		(824)	(578)
- purchase of ownership interests and shares		(3,378)	(1,817)
- purchase of ownership interests and shares in subsidiaries		(29)	(6,867)
- decrease in cash due to the sale of entities and change in the scope of consolidation		-	(54)
- purchase of debt securities		(192,342)	(214,622)
- opening of buy-sell-back transactions		(462,749)	(366,738)
- purchase of term deposits with credit institutions		(209,697)	(234,071)
- purchase of other investments		(31,436)	(91,372)
- other expenditures for investments		(28)	(8)
Net cash flows from investing activities		**9171**	**(12,034)**
Cash flows from financing activities			
Proceeds		202,272	228,417
- proceeds from the issue of shares by subsidiaries (in the part paid up by holders of non-controlling interests)		13	-
- proceeds from loans and borrowings	38	4,284	1,605
- proceeds on the issue of own debt securities	38	6396	5,829
- opening of repurchase transactions	38	191,579	220,983
Expenditures		(203,072)	(226,462)
- dividends paid to equity holders of the parent	40.2.1.1	(2,159)	(1,209)
- dividends to owners of non-controlling interests		(1,659)	(1,823)
- repayment of loans and borrowings	38	(3,373)	(1,530)
- redemption of own debt securities	38	(3,384)	(150)
- closing of repurchase transactions	38	(192,217)	(221,637)
- interest on loans and borrowings	38	(45)	(6)
- interest on outstanding debt securities	38	(235)	(107)
Net cash flows from financing activities		**(800)**	**1,955**
Total net cash flows		**8,774**	**5,343**
Cash and cash equivalents at the beginning of the period		8,239	2,973
Movement in cash due to foreign exchange differences		42	(77)
Cash and cash equivalents at the end of the period, including:	38	17,055	8,239
- restricted cash	38	25	41

[1)] Information on restatement of the 2017 data is presented in section 5.3.

Supplementary information and notes

1. Introduction

Compliance statement

These consolidated financial statements of the Powszechny Zakład Ubezpieczeń Spółka Akcyjna Group ("consolidated financial statements" and "PZU Group", respectively) have been prepared in line with the International Financial Reporting Standards as endorsed by the European Commission ("IFRS"), published and in force as at 31 December 2018.

Period covered by the statements

These consolidated financial statements cover the period of 12 months from 1 January to 31 December 2018.

Approval of the statements

These consolidated financial statements were signed and authorized for publication by the Management Board of Powszechny Zakład Ubezpieczeń Spółka Akcyjna ("PZU", "parent company") on 12 March 2019 and will be subject to approval by the shareholder meeting of Powszechny Zakład Ubezpieczeń Spółka Akcyjna.

Functional and presentation currency

PZU's functional and presentation currency is the Polish zloty. Unless noted otherwise, all amounts presented in these consolidated financial statements are stated in millions of Polish zloty.

The functional currency of the companies domiciled in Ukraine is the Ukrainian hryvnia, the euro is the functional currency of the companies domiciled in Lithuania, Latvia and Sweden and pound sterling – of the company domiciled in the United Kingdom.

Going concern assumption

These consolidated financial statements have been drawn up under the assumption that PZU Group companies remain a going concern in the foreseeable future, i.e. in the period of at least 12 months after the end of the reporting period. As at the date of signing these consolidated financial statements, there are no facts or circumstances that would indicate a threat to the ability of PZU Group companies to continue their activity in the period of 12 months after the end of the reporting period as a result of an intentional or an induced discontinuation or a material curtailment of their hitherto activity.

Discontinued operations

In 2018, the PZU Group companies did not discontinue any material type of activity.

Glossary

The most important terms, abbreviations and acronyms used in the consolidated financial statements are explained below.

Company names

AAS Balta – Apdrošināšanas Akciju Sabiedrība Balta.

Alior Bank – Alior Bank SA.

Bank BPH – Bank BPH SA.

Elvita – Przedsiębiorstwo Świadczeń Zdrowotnych i Promocji Zdrowia ELVITA – Jaworzno III sp. z o.o.

EMC – EMC Instytut Medyczny SA.

Alior Bank Group – Alior Bank with its subsidiaries: Alior Services sp. z o.o., Centrum Obrotu Wierzytelnościami sp. z o.o. in liquidation, Alior Leasing sp. z o.o., Meritum Services ICB SA, Alior TFI SA, New Commerce Services sp. z o.o., Absource sp. z o.o., Serwis Ubezpieczeniowy sp. z o.o.

Armatura Group – Armatura Kraków SA with its subsidiaries: Aquaform SA, Aquaform Badprodukte GmbH, Aquaform Ukraine TOW, Aquaform Romania SRL, Morehome.pl sp. z o.o. in liquidation.

Pekao Group – Pekao with its subsidiaries: Pekao Bank Hipoteczny SA, Centralny Dom Maklerski Pekao SA, Pekao Leasing sp. z o.o., Pekao Investment Banking SA, Pekao Faktoring sp. z o.o., Pekao PTE in liquidation, Pekao TFI, Centrum Kart SA, PFS, Centrum Bankowości Bezpośredniej sp. z o.o., Pekao Property SA, FPB – Media sp. z o.o., Pekao Fundusz Kapitałowy sp. z o.o. in liquidation, PIM, Xelion.

Link4 – Link4 Towarzystwo Ubezpieczeń SA.

NZOZ Trzebinia – Niepubliczny Zakład Opieki Zdrowotnej Trzebinia sp. z o.o.

Pekao – Bank Pekao SA.

Pekao DFE – Pekao Dobrowolny Fundusz Emerytalny.

Pekao OFE – Pekao Otwarty Fundusz Emerytalny.

Pekao PTE – Pekao Powszechne Towarzystwo Emerytalne SA in liquidation (formerly Pekao Pioneer Powszechne Towarzystwo Emerytalne SA).

Pekao TFI – Pekao Towarzystwo Funduszy Inwestycyjnych SA (formerly Pioneer Pekao Towarzystwo Funduszy Inwestycyjnych SA).

PFR – Polski Fundusz Rozwoju SA.

PFS – Pekao Financial Services sp. z o.o.

Bank BPH's Core Business – organized part of the business including all of Bank BPH's assets and equity and liabilities excluding the assets and equity and liabilities that remained in Bank BPH after the demerger and which constitute Bank BPH's mortgage business.

PIM – Pekao Investment Management SA (formerly Pioneer Pekao Investment Management SA).

PTE PZU – Powszechne Towarzystwo Emerytalne PZU SA.

PZU, parent company, parent – Powszechny Zakład Ubezpieczeń Spółka Akcyjna.

PZU CO – PZU Centrum Operacji SA.

PZU Ukraine – PrJSC IC PZU Ukraine.

PZU Ukraine Life – PrJSC IC PZU Ukraine Life Insurance.

PZU Życie – Powszechny Zakład Ubezpieczeń na Życie Spółka Akcyjna.

TFI PZU SA – Towarzystwo Funduszy Inwestycyjnych PZU SA.

TUW PZUW – Towarzystwo Ubezpieczeń Wzajemnych Polski Zakład Ubezpieczeń Wzajemnych.

Xelion – Dom Inwestycyjny Xelion sp. z o.o.

Other definitions

BFG – Bank Guarantee Fund.

CGU – cash generating unit.

Forbearance – tools used to restructure debt, most frequently taking the form of arrangements provided to the debtor by the creditor.

CODM – chief operating decision maker within the meaning of IFRS 8 Operating Segments.

WSE – Warsaw Stock Exchange.

IBNR – Incurred But Not Reported or 2nd provision – provision for losses and accidents incurred but not reported.

PZU standalone financial statements for 2018 – annual standalone financial statements of Powszechny Zakład Ubezpieczeń Spółka Akcyjna for 2018 prepared in accordance with PAS, signed by the PZU Management Board on 12 March 2019.

KNF – Polish Financial Supervision Authority.

Commercial Company Code – Act of 15 September 2000 entitled Commercial Company Code (consolidated text: Journal of Laws of 2017, Item 1577).

IFRS – International Financial Reporting Standards, as endorsed by the European Commission, published and in force as at 31 December 2018.

NBP – National Bank of Poland.

Tax Group – Tax Group established by the power of the agreement signed on 20 September 2017 between 13 PZU Group companies: PZU, PZU Życie, Link4, PZU CO, PZU Pomoc SA, Ogrodowa-Inwestycje, PZU Zdrowie SA, Tulare Investments Sp. z o.o., Battersby Investments SA, Ipsilon Sp. z o.o., PZU Finanse Sp. z o.o., PZU LAB SA (formerly Omicron SA), Omicron Bis SA. The Tax Group was established for a period of 3 years – from 1 January 2018 to 31 December 2020. PZU is the parent company representing the Tax Group.

PAS – Accounting Act of 29 September 1994 (consolidated text: Journal of Laws of 2018 Item 395) and regulations issued thereunder.

PLET – Polish Life Expectancy Tables published annually by the Central Statistical Office of Poland.

RBNP – Reported But Not Paid, or 1st provision – provision for losses reported but not handled and handled but not paid.

IASB – International Accounting Standards Board.

Capital Requirements Regulation, CRR – Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012.

Consolidated financial statements – consolidated financial statements of the PZU Group prepared in accordance with IFRS for the year ended 31 December 2018.

KNF Office – Office of the Polish Financial Supervision Authority.

Insurance Activity Act – Act of 11 September 2015 on Insurance and Reinsurance Activity (i.e. Journal of Laws of 2019 Item 381, as amended).

Supplementary Oversight Act – Act of 15 April 2005 on supplementary oversight over credit institutions and insurance undertaking, reinsurance undertakings and investment firms comprising a financial conglomerate (i.e. Journal of Laws of 2016, Item 1252, as amended).

ZUS – Social Insurance Institution.

OSM PZU – Ordinary Shareholder Meeting of Powszechny Zakład Ubezpieczeń Spółka Akcyjna.

2. Composition of PZU Group

2.1 PZU

The parent company in the PZU Group is PZU – a joint stock company with its registered office in Warsaw at Al. Jana Pawła II 24.

PZU has been entered in the National Court Register kept by the District Court for the Capital City of Warsaw in Warsaw, 12th Commercial Division of the National Court Register, under file number KRS 0000009831.

According to the Polish Classification of Business Activity and the Statistical Classification of Economic Activities in Europe, the core business of PZU consists of non-life insurance (65.12).

(in millions of PLN)

2.2 PZU Group companies and associates

No.	Name of the entity	Registered office	Date of obtaining control / significant influence	% of the share capital and % of votes held directly or indirectly by PZU		Line of business and website
				31 December 2018	31 December 2017	
Consolidated companies						
1	Powszechny Zakład Ubezpieczeń SA	Warsaw	n/a	n/a	n/a	Non-life insurance. https://www.pzu.pl/grupa-pzu/spolki/pzu-sa
2	Powszechny Zakład Ubezpieczeń na Życie SA	Warsaw	18.12.1991	100.00%	100.00%	Life insurance. https://www.pzu.pl/pl/grupa-pzu/spolki/pzu-zycie
3	Link4 Towarzystwo Ubezpieczeń SA	Warsaw	15.09.2014	100.00%	100.00%	Non-life insurance. https://www.link4.pl/
4	Towarzystwo Ubezpieczeń Wzajemnych Polski Zakład Ubezpieczeń Wzajemnych	Warsaw	20.11.2015	100.00%	100.00%	Non-life insurance. https://www.tuwpzuw.pl/
5	Lietuvos Draudimas AB	Vilnius (Lithuania)	31.10.2014	100.00%	100.00%	Non-life insurance. http://www.ld.lt/
6	Apdrošināšanas Akciju Sabiedrība Balta	Riga, Latvia	30.06.2014	99.99%	99.99%	Property insurance. http://www.balta.lv/
7	PrJSC IC PZU Ukraine	Kiev (Ukraine)	01.07.2005	100.00%	100.00%	Property insurance. http://www.pzu.com.ua/
8	PrJSC IC PZU Ukraine Life Insurance	Kiev (Ukraine)	01.07.2005	100.00%	100.00%	Life insurance. http://www.pzu.com.ua/
9	UAB PZU Lietuva Gyvybes Draudimas	Vilnius (Lithuania)	26.04.2002	99.34%	99.34%	Life insurance. https://pzugd.lt/
Consolidated companies – Pekao Group						
10	Bank Pekao SA	Warsaw	07.06.2017	20.03%	20.02%	Banking services. https://www.pekao.com.pl/
11	Pekao Bank Hipoteczny SA	Warsaw	07.06.2017	20.03%	20.02%	Banking services. http://www.pekaobh.pl/
12	Centralny Dom Maklerski Pekao SA	Warsaw	07.06.2017	20.03%	20.02%	Brokerage services. https://www.cdmpekao.com.pl/
13	Pekao Leasing sp. z o.o.	Warsaw	07.06.2017	20.03%	20.02%	Leasing services. http://www.pekaoleasing.com.pl/
14	Pekao Investment Banking SA	Warsaw	07.06.2017	20.03%	20.02%	Brokerage services. http://pekaoib.pl/
15	Pekao Faktoring sp. z o.o.	Lublin	07.06.2017	20.03%	20.02%	Factoring services. https://www.pekaofaktoring.pl/
16	Pekao Powszechne Towarzystwo Emerytalne SA in liquidation[1)]	Warsaw	07.06.2017	20.03%	20.02%	Management of pension funds.
17	Pekao TFI SA	Warsaw	11.12.2017	20.03%	20.02%	Creation, representing and management of mutual funds. https://www.pekaotfi.pl/tfi/welcome
18	Centrum Kart SA	Warsaw	07.06.2017	20.03%	20.02%	Auxiliary financial services. http://www.centrumkart.pl/

(in millions of PLN)

No.	Name of the entity	Registered office	Date of obtaining control / significant influence	% of the share capital and % of votes held directly or indirectly by PZU		Line of business and website
				31 December 2018	31 December 2017	
Consolidated companies – Pekao Group – continued						
19	Pekao Financial Services sp. z o.o.	Warsaw	07.06.2017	46.82% [2)]	20.02%	Transfer agent. http://www.pekao-fs.com.pl/pl/
20	Centrum Bankowości Bezpośredniej sp. z o.o.	Krakow	07.06.2017	20.03%	20.02%	Call-center services. http://www.cbb.pl/
21	Pekao Property SA	Warsaw	07.06.2017	20.03%	20.02%	Development activity.
22	FPB – Media sp. z o.o.	Warsaw	07.06.2017	20.03%	20.02%	Development activity.
23	Pekao Fundusz Kapitałowy sp. z o.o. in liquidation	Warsaw	07.06.2017	20.03%	20.02%	Business consulting.
24	Pekao Investment Management SA	Warsaw	11.12.2017	20.03%	20.02%	Asset management. https://www.pekaotfi.pl/tfi/welcome
25	Dom Inwestycyjny Xelion sp. z o.o.	Warsaw	11.12.2017	20.03%	20.02%	Financial intermediation. https://www.xelion.pl/
Consolidated companies – Alior Bank Group						
26	Alior Bank SA	Warsaw	18.12.2015	31.93%	32.23%	Banking services. https://www.aliorbank.pl/
27	Alior Services sp. z o.o.	Warsaw	18.12.2015	31.93%	32.23%	Other activity supporting financial services, excluding insurance and pension funds.
28	Centrum Obrotu Wierzytelnościami sp. z o.o. in liquidation	Krakow	18.12.2015	31.93%	32.23%	Trading in receivables.
29	Alior Leasing sp. z o.o.	Wroclaw	18.12.2015	31.93%	32.23%	Leasing services. https://www.aliorbank.pl/wlasna-dzialalnosc/alior-leasing.html
30	Meritum Services ICB SA	Gdańsk	18.12.2015	31.93%	32.23%	IT services.
31	Alior TFI SA (formerly Money Makers TFI SA) [3)]	Warsaw	18.12.2015	31.93%	19.39%	Asset management services and management of Alior SFIO subfunds. https://www.aliortfi.com/
32	New Commerce Services sp. z o.o.	Warsaw	18.12.2015	31.93%	32.23%	The company does not conduct any activity
33	Absource sp. z o.o.	Krakow	04.05.2016	31.93%	32.23%	Service activity in the area of IT.
34	Serwis Ubezpieczeniowy sp. z o.o.	Katowice	30.01.2017	31.93%	32.23%	Brokerage activity.

(in millions of PLN)

No.	Name of the entity	Registered office	Date of obtaining control / significant influence	% of the share capital and % of votes held directly or indirectly by PZU		Line of business and website
				31 December 2018	31 December 2017	
Consolidated companies – PZU Zdrowie Group						
35	PZU Zdrowie SA	Warsaw	02.09.2011	100.00%	100.00%	Medical services. https://www.pzu.pl/pl/grupa-pzu/spolki/pzu-zdrowie
36	Centrum Medyczne Medica sp. z o.o.	Płock	09.05.2014	100.00%	100.00%	Medical services. http://cmmedica.pl/
37	Specjalistyczna Przychodnia Przemysłowa Prof-Med sp. z o.o.	Włocławek	12.05.2014	100.00%	100.00%	Medical services. http://cmprofmed.pl/
38	Sanatorium Uzdrowiskowe "Krystynka" sp. z o.o.	Ciechocinek	09.05.2014	99.09%	99.09%	Hospital, physical therapy and spa services. http://www.sanatoriumkrystynka.pl/
39	Przedsiębiorstwo Świadczeń Zdrowotnych i Promocji Zdrowia ELVITA – Jaworzno III sp. z o.o. [4)]	Jaworzno	01.12.2014	100.00%	100.00%	Medical services. http://www.elvita.pl/
40	Przedsiębiorstwo Usług Medycznych PROELMED sp. z o.o.	Łaziska Górne	01.12.2014	57.00%	57.00%	Medical services. http://www.proelmed.pl/
41	Centrum Medyczne Gamma sp. z o.o.	Warsaw	08.09.2015	60.46%	60.46%	Medical services. http://www.cmgamma.pl/
42	Polmedic sp. z o.o.	Radom	30.11.2016	100.00%	100.00%	Medical services. http://www.polmedic.com.pl/
43	Artimed Niepubliczny Zakład Opieki Zdrowotnej sp. z o.o.	Kielce	21.12.2016	100.00%	100.00%	Medical services. http://artimed.pl/
44	Revimed sp. z o.o.	Gdańsk	31.05.2017	100.00%	100.00%	Medical services. http://www.revimed.pl/
45	Centrum Medyczne św. Łukasza sp. z o.o.	Częstochowa	09.01.2018	100.00%	n/a	Medical services. http://www.cmlukasza.pl/
46	Specjalistyczny Zakład Opieki Zdrowotnej Multimed sp. z o.o.	Oświęcim	31.12.2018	100.00%	n/a	Medical services. http://www.multimed.oswiecim.pl/
Consolidated companies – other companies						
47	Powszechne Towarzystwo Emerytalne PZU SA	Warsaw	08.12.1998	100.00%	100.00%	Management of pension funds. https://www.pzu.pl/pl/grupa-pzu/spolki/pte-pzu
48	PZU Centrum Operacji SA	Warsaw	30.11.2001	100.00%	100.00%	Auxiliary activity associated with insurance and pension funds.
49	Towarzystwo Funduszy Inwestycyjnych PZU SA	Warsaw	30.04.1999	100.00%	100.00%	Creation, representing and management of mutual funds. https://www.pzu.pl/pl/grupa-pzu/spolki/tfi-pzu
50	PZU Pomoc SA	Warsaw	18.03.2009	100.00%	100.00%	Provision of assistance services. https://www.pzu.pl/grupa-pzu/spolki/pzu-pomoc
51	PZU Finance AB (publ.)	Stockholm (Sweden)	02.06.2014	100.00%	100.00%	Financial services. https://www.pzu.pl/pl/grupa-pzu/spolki/pzu-finance

(in millions of PLN)

No.	Name of the entity	Registered office	Date of obtaining control / significant influence	% of the share capital and % of votes held directly or indirectly by PZU		Line of business and website
				31 December 2018	31 December 2017	
Consolidated companies – other companies – continued						
52	PZU Finanse Sp. z o.o.	Warsaw	08.11.2013	100.00%	100.00%	Financial and accounting services.
53	Tower Inwestycje Sp. z o.o.	Warsaw	27.08.1998	100.00%	100.00%	Development activity, operation and lease of properties. https://www.pzu.pl/pl/grupa-pzu/spolki/tower-inwestycje
54	Ogrodowa-Inwestycje sp. z o.o.	Warsaw	15.09.2004	100.00%	100.00%	Buying, operating, renting and selling real estate. http://www.ogrodowainwestycje.pl/
55	Arm Property sp. z o.o.	Krakow	26.11.2014	100.00%	100.00%	Purchase and sale of real estate.
56	Ipsilon sp. z o.o.	Warsaw	02.04.2009	100.00%	100.00%	Provision of assistance services and medical services.
57	PZU Corporate Member Limited	London (United Kingdom)	28.09.2017	100.00%	100.00%	Investment activity.
58	Ardea Alba SA in liquidation	Warsaw	12.07.2001	100.00%	100.00%	No business conducted.
59	PZU LAB SA	Warsaw	13.09.2011	100.00%	100.00%	Consulting and training services, development of technology innovation to support technical and procedural security processes and risk management. https://www.pzu.pl/pl/grupa-pzu/spolki/pzu-lab
60	Omicron BIS SA	Warsaw	28.08.2014	100.00%	100.00%	No business conducted.
61	Sigma BIS SA	Warsaw	12.12.2014	100.00%	100.00%	No business conducted.
62	LLC SOS Services Ukraine	Kiev (Ukraine)	01.07.2005	100.00%	100.00%	Assistance services.
63	Battersby Investments SA	Warsaw	15.09.2017	100.00%	100.00%	No business conducted.
64	Tulare Investments sp. z o.o.	Warsaw	15.09.2017	100.00%	100.00%	No business conducted.
Consolidated companies – Armatura Group						
65	Armatura Kraków SA	Krakow	07.10.1999	100.00%	100.00%	Production and sale of radiators and sanitary fittings and administration and management of the group. http://www.grupa-armatura.pl/
66	Aquaform SA	Środa Wlkp.	15.01.2015	100.00%	100.00%	Production and sale of bathroom accessories and fittings. http://www.aquaform.com.pl/
67	Aquaform Badprodukte GmbH	Anhausen (Germany)	15.01.2015	100.00%	100.00%	Wholesale trade.
68	Aquaform Ukraine TOW	Zhytomyr (Ukraine)	15.01.2015	100.00%	100.00%	Wholesale trade. http://aquaform.org.ua/
69	Aquaform Romania SRL	Prejmer (Romania)	15.01.2015	100.00%	100.00%	Wholesale trade.
Consolidated companies – Armatura Group – continued						
70	Morehome.pl sp. z o.o. in liquidation [5]	Środa Wlkp.	15.01.2015	100.00%	100.00%	No business conducted.

(in millions of PLN)

No.	Name of the entity	Registered office	Date of obtaining control / significant influence	% of the share capital and % of votes held directly or indirectly by PZU		Line of business and website
				31 December 2018	31 December 2017	
Consolidated companies – mutual funds						
71	PZU SFIO Universum	Warsaw	15.12.2009	n/a	n/a	Investment of funds collected from fund members.
72	PZU FIZ Dynamiczny	Warsaw	27.01.2010	n/a	n/a	as above
73	PZU FIZ Sektora Nieruchomości [6)]	Warsaw	01.07.2008	n/a	n/a	as above
74	PZU FIZ Sektora Nieruchomości 2 [6)]	Warsaw	21.11.2011	n/a	n/a	as above
75	PZU FIZ Aktywów Niepublicznych BIS 1	Warsaw	12.12.2012	n/a	n/a	as above
76	PZU FIZ Aktywów Niepublicznych BIS 2	Warsaw	19.11.2012	n/a	n/a	as above
77	PZU FIZ Surowcowy	Warsaw	03.09.2015	n/a	n/a	as above
78	PZU FIO Globalny Obligacji Korporacyjnych	Warsaw	30.05.2016	n/a	n/a	as above
79	PZU FIZ Forte	Warsaw	01.07.2016	n/a	n/a	as above
80	PZU Innowacyjnych Technologii (formerly: PZU Telekomunikacja Media Technologia)	Warsaw	07.09.2016	n/a	n/a	as above
81	PZU Dłużny Aktywny	Warsaw	26.10.2016	n/a	n/a	as above
82	PZU FIZ Akcji Combo	Warsaw	09.03.2017	n/a	n/a	as above
83	PZU Akcji Spółek Dywidendowych	Warsaw	31.12.2017	n/a	n/a	as above
84	PZU FIZ Akcji Focus	Warsaw	01.04.2018	n/a	n/a	as above
85	inPZU Inwestycji Ostrożnych	Warsaw	10.04.2018	n/a	n/a	as above
86	inPZU Obligacje Polskie	Warsaw	10.04.2018	n/a	n/a	as above
87	inPZU Akcje Polskie	Warsaw	10.05.2018	n/a	n/a	as above
88	inPZU Akcji Rynków Rozwiniętych	Warsaw	10.05.2018	n/a	n/a	as above
89	inPZU Obligacji Rynków Rozwiniętych	Warsaw	10.05.2018	n/a	n/a	as above
90	inPZU Obligacji Rynków Wschodzących	Warsaw	10.05.2018	n/a	n/a	as above

(in millions of PLN)

No.	Name of the entity	Registered office	Date of obtaining control / significant influence	% of the share capital and % of votes held directly or indirectly by PZU		Line of business and website
				31 December 2018	31 December 2017	
Associates						
91	GSU Pomoc Górniczy Klub Ubezpieczonych SA	Tychy	08.06.1999	30.00%	30.00%	Insurance administration. http://gsupomoc.pl/
92	EMC Instytut Medyczny SA	Wroclaw	18.06.2013	28.31% [7)]	28.31% [7)]	Human health activities, research and development in the area of medical sciences and pharmaceutical practice. http://www.emc-sa.pl/
93	CPF Management	Tortola, British Virgin Islands	07.06.2017	8.01% [8)]	8.01% [8)]	Consulting and business activity – no business conducted.
94	PayPo sp. z o.o.	Warsaw	15.11.2018	6.39% [9)]	n/a	Financial services.

[1)] On 1 June 2018, the shareholder meeting adopted a resolution to dissolve the company and open its liquidation process.

[2)] As a result of the transaction described in item 2.4.4, starting from 4 June 2018 PZU became the direct holder of 33.5% of PFS shares and Pekao's share fell to 66.5%.

[3)] Direct subsidiary of Alior Bank, in which Alior Bank holds a 100% stake (as at 31 December 2017: 60.16%). As a consequence, the PZU Management Board considers the PZU Group to be in control of the company.

[4)] On 6 September 2018, Elvity merged with NZOZ Trzebinia. The transaction had no effect on the consolidated financial statements.

[5)] On 7 January 2019, an application was filed with KRS on the liquidation of the company.

[6)] As at 31 December 2018, the funds PZU FIZ Sektora Nieruchomości and PZU FIZ Sektora Nieruchomości 2 conducted their investment activity through (consolidated) subsidiary companies established under commercial law as special-purpose vehicles whose number in the respective funds was: 18 and 18 (as at 31 December 2017: 15 and 20, respectively).

[7)] The percentage of votes held by PZU is different from the stake held in the share capital, and both as at 31 December 2018 and as at 31 December 2017 it was 25.44%. The difference between the percentage of votes and the stake in the share capital results from the fact that holders of non-controlling interests hold certain shares preferred as to the voting rights.

[8)] Pekao's associate, in which it holds a 40.00% stake. Consequently, the PZU Management Board recognizes that the PZU Group has significant influence over this company.

[9)] Alior Bank's associate, in which it holds a 20.00% stake. Consequently, the PZU Management Board recognizes that the PZU Group has significant influence over this company.

(in millions of PLN)

As at 31 December 2018, in addition to the companies listed in the table, the PZU Group held a 100% stake in Syta Development sp. z o.o. in liquidation, control over which is exercised by a liquidator independent of the PZU Group and for this reason the company was not consolidated. The value of these shares in the PZU Group's consolidated statement of financial position was zero.

2.3 Non-controlling interest

2.3.1. Accounting policy

Non-controlling interests constitute that part of capital in a subsidiary that is not directly or indirectly attributable to the parent company. As at the date of obtaining control, non-controlling interests are measured at the at the non-controlling interest's proportionate share in the fair value of the subsidiary's identifiable net assets. As at the subsequent balance sheet dates, the value of non-controlling interests is updated by the value of comprehensive income attributable to non-controlling interests.

2.3.2. Quantitative data

The table below presents subsidiaries with certain non-controlling interest (at present or in the past):

Name of the entity	31 December 2018	31 December 2017
Pekao [1]	79.97%	79.98%
Alior Bank [2]	68.07%	67.77%
Przedsiębiorstwo Usług Medycznych PROELMED sp. z o.o.	43.00%	43.00%
Centrum Medyczne Gamma sp. z o.o.	39.54%	39.54%
Sanatorium Uzdrowiskowe "Krystynka" sp. z o.o.	0.91%	0.91%
UAB PZU Lietuva Gyvybes Draudimas	0.66%	0.66%
AAS Balta	0.01%	0.01%
NZOZ Trzebinia	n/a [3]	0.25%

[1] As a result, PZU also holds non-controlling interests in Pekao's subsidiaries listed in the table in section 2.2.
[2] As a result, PZU also holds non-controlling interests in Alior Bank's subsidiaries listed in the table in section 2.2.
[3] Because of the merger between Elvita and NZOZ Trzebinia.

Carrying amount of non-controlling interests	31 December 2018	31 December 2017 (restated) [1]
Pekao Group	18,251	18,636
Alior Bank Group	4,225	4,319
Other	6	6
Total	**22,482**	**22,961**

[1] Information on restatement of data as at 31 December 2017 is presented in section 5.3.

(in millions of PLN)

Presented below is condensed financial information for the Pekao Group and the Alior Bank Group included in the consolidated financial statements.

Assets	Pekao Group		Alior Bank Group	
	31 December 2018	31 December 2017 (restated) [1)]	31 December 2018	31 December 2017 (restated) [1)]
Goodwill	692	692	-	-
Intangible assets	1,777	2,032	658	662
Other assets	45	95	35	36
Property, plant and equipment	1,682	1,731	461	476
Investment property	13	24	-	-
Loan receivables from clients	128,242	118,660	53,811	50,797
Financial derivatives	1,765	1,608	579	454
Entities measured by the equity method	-	-	4	-
Investment financial assets	40,356	52,555	13,636	14,020
Measured at amortized cost	12,262	n/a	6,307	n/a
Measured at fair value through other comprehensive income	27,266	n/a	7,280	n/a
Measured at fair value through profit or loss	828	n/a	49	n/a
Held to maturity	n/a	3,500	n/a	1,339
Available for sale	n/a	33,593	n/a	12,259
Measured at fair value through profit or loss	n/a	1,731	n/a	87
Loans	n/a	13,731	n/a	335
Deferred tax assets	1,112	915	1,076	641
Receivables	2,235	2,017	815	785
Cash and cash equivalents	13,219	5,282	2,069	1,338
Assets held for sale	4	64	-	-
Total assets	**191,142**	**185,675**	**73,144**	**69,209**

Equity and liabilities	Pekao Group		Alior Bank Group	
	31 December 2018	31 December 2017 (restated) [1)]	31 December 2018	31 December 2017 (restated) [1)]
Equity				
Equity attributable to equity holders of the Parent	22,824	23,304	6,207	6,374
Share capital	262	262	1,306	1,293
Other capital	20,721	20,562	5,609	5,019
Retained earnings	1,841	2,480	(708)	62
Non-controlling interest	11	-	-	1
Total equity	**22,835**	**23,304**	**6,207**	**6,375**
Liabilities				
Provisions for employee benefits	407	425	32	43
Other provisions	297	305	119	77
Deferred tax liability	33	38	-	-
Financial liabilities	164,636	157,903	65,373	60,905
Other liabilities	2,934	3,700	1,413	1,809
Total liabilities	**168,307**	**162,371**	**66,937**	**62,834**
Total equity and liabilities	**191,142**	**185,675**	**73,144**	**69,209**

[1)] Information on restatement of data as at 31 December 2017 is presented in section 5.3.

(in millions of PLN)

The table below presents consolidated data of the PZU Group with separated data of the Pekao Group and Alior Bank Group incorporating the effect of adjustments resulting from the measurement of assets and liabilities to fair value as at the date control was acquired and their subsequent amortization over time.

Consolidated profit and loss account for the period from 1 January to 31 December 2018	**PZU Group**	**Elimination of Pekao's data**	**Elimination of Alior Bank's data**	**Elimination of consolidation adjustments**	**PZU Group without Pekao and Alior Bank**
Gross written premiums	23,470	-	-	16	23,486
Reinsurers' share in gross written premium	(755)	-	-	-	(755)
Net written premiums	**22,715**	**-**	**-**	**16**	**22,731**
Movement in net provision for unearned premiums	(365)	-	-	(8)	(373)
Net earned premiums	**22,350**	**-**	**-**	**8**	**22,358**
Revenue from commissions and fees	3,374	(2,380)	(819)	58	233
Net investment income	11,679	(6,644)	(3,692)	23	1,366
Net result on realization of financial instruments and investments	(15)	(190)	(111)	-	(316)
Movement in allowances for expected credit losses and impairment losses on financial instruments	(1,804)	525	1,152	-	(127)
Net movement in fair value of assets and liabilities measured at fair value	770	(5)	(608)	(5)	152
Other operating income	1,693	(443)	(458)	27	819
Claims, benefits and movement in technical provisions	(14,980)	-	-	-	(14,980)
Reinsurers' share in claims, benefits and movement in technical provisions	417	-	-	-	417
Net insurance claims and benefits paid	**(14,563)**	**-**	**-**	**-**	**(14,563)**
Fee and commission expenses	(754)	392	360	-	(2)
Interest expenses	(2,046)	1,117	776	(16)	(169)
Acquisition expenses	(3,130)	-	-	(49)	(3,179)
Administrative expenses	(6,609)	3,398	1,574	(27)	(1,664)
Other operating expenses	(3,858)	1,479	788	(19)	(1,610)
Operating profit (loss)	**7,087**	**(2,751)**	**(1,038)**	**-**	**3,298**
Share of the net financial results of entities measured by the equity method	(1)	-	-	-	(1)
Profit (loss) before tax	**7,086**	**(2,751)**	**(1,038)**	**-**	**3,297**
Income tax	(1,718)	694	286	-	(738)
Net profit (loss)	**5,368**	**(2,057)**	**(752)**	**-**	**2,559**

(in millions of PLN)

Consolidated profit and loss account for the period from 1 January to 31 December 2017 [1)] (restated)	**PZU Group**	**Elimination of Pekao's data**	**Elimination of Alior Bank's data**	**Elimination of consolidation adjustments**	**PZU Group without Pekao and Alior Bank**
Gross written premiums	22,847	-	-	-	22,847
Reinsurers' share in gross written premium	(612)	-	-	-	(612)
Net written premiums	**22,235**	**-**	**-**	**-**	**22,235**
Movement in net provision for unearned premiums	(881)	-	-	-	(881)
Net earned premiums	**21,354**	**-**	**-**	**-**	**21,354**
Revenue from commissions and fees	2,319	(1,279)	(831)	15	224
Net investment income	9,051	(3,677)	(3,900)	13	1,487
Net result on realization of financial instruments and investments	247	(58)	(7)	-	182
Movement in allowances for expected credit losses and impairment losses on financial instruments	(1,207)	267	908	-	(32)
Net movement in fair value of assets and liabilities measured at fair value	380	(5)	(36)	-	339
Other operating income	1,178	(185)	(169)	-	824
Claims, benefits and movement in technical provisions	(15,376)	-	-	-	(15,376)
Reinsurers' share in claims, benefits and movement in technical provisions	435	-	-	-	435
Net insurance claims and benefits paid	**(14,941)**	**-**	**-**	**-**	**(14,941)**
Fee and commission expenses	(557)	196	343	-	(18)
Interest expenses	(1,350)	607	635	(13)	(121)
Acquisition expenses	(2,901)	-	-	(15)	(2,916)
Administrative expenses	(5,357)	1,915	1,795	-	(1,647)
Other operating expenses	(2,758)	721	500	-	(1,537)
Operating profit (loss)	**5,458**	**(1,498)**	**(762)**	**-**	**3,198**
Share of the net financial results of entities measured by the equity method	16	(22)	-	-	(6)
Profit (loss) before tax	**5,474**	**(1,520)**	**(762)**	**-**	**3,192**
Income tax	(1,289)	367	231	-	(691)
Net profit (loss)	**4,185**	**(1,153)**	**(531)**	**-**	**2,501**

[1)] Information on restatement of data for the period from 1 January to 31 December 2017 is presented in section 5.3.

Statement of comprehensive income	**Pekao Group**		**Alior Bank Group**	
	1 January – 31 December 2018	**1 June – 31 December 2017** (restated)[1)]	**1 January – 31 December 2018**	**1 January – 31 December 2017** (restated)[1)]
Net profit	2,057	1,153	752	531
Other comprehensive income	88	24	27	86
Valuation of debt instruments measured at fair value through other comprehensive income	13	n/a	(7)	n/a
Valuation of equity instruments measured at fair value through other comprehensive income	10	n/a	-	n/a
Measurement of financial instruments available for sale	n/a	6	-	86
Net cash flow hedges	65	11	34	-
Actuarial gains and losses related to employee provisions	-	7	-	-
Total net comprehensive income	**2,145**	**1,177**	**779**	**617**

[1)] Information on restatement of data for the period from 1 January to 31 December 2017 is presented in section 5.3.

(in millions of PLN)

Cash flow statement	Pekao Group		Alior Bank Group	
	1 January – 31 December 2018	1 June – 31 December 2017	1 January – 31 December 2018	1 January – 31 December 2017
Net cash flows from operating activities	(4,233)	10,233	2,067	3,067
Net cash flows from investing activities	10,745	(9,729)	(949)	(3,651)
Net cash flows from financing activities	1,387	(184)	(413)	869
Total net cash flows	**7,899**	**320**	**705**	**285**

Dividend-related information	Pekao Group		Alior Bank Group	
	1 January – 31 December 2018	1 June – 31 December 2017	1 January – 31 December 2018	1 January – 31 December 2017
Date of ratifying the dividend	21 June 2018	19 April 2017	-	-
Record date	6 July 2018	21 June 2017	-	-
Dividend payout date	20 July 2018	6 July 2017	-	-
Dividend per share (PLN)	7.90	8.68	-	-
Dividend due to the PZU Group	415	456	-	-
Dividend due to non-controlling shareholders	1,659	1,822	-	-

2.4 Changes in the scope of consolidation and structure of the PZU Group

The detailed accounting policy pertaining to settlement of acquisition transactions are presented in section 5.6.

The acquisition of entities providing medical services (in 2018 it was: Centrum Medyczne św. Łukasza sp. z o.o. and Specjalistyczny Zakład Opieki Zdrowotnej Multimed sp. z o.o.) is aimed at supplementing the insurance and health services offered by the PZU Group. Development of the medical service and health insurance offering is one of the core elements of the PZU Group strategy. Provision of some of the services in own centers will increase the PZU Group's competitiveness in this market. The goodwill recognized in the consolidated financial statements is the effect of the planned increase of the scale of this business and the volume of services generated by health insurance, combined with improvement of the profitability of these services thanks to retaining some of the margin in the PZU Group.

2.4.1. Acquisition of shares in Pekao

On 8 December 2016 PZU, acting in a consortium with PFR signed the Pekao share purchase agreement ("SPA") with UniCredit S.p.A. („Seller", „UniCredit").

On the closing date, i.e. on 7 June 2017, PZU directly acquired a stake in Pekao representing approximately 20% of the total number of votes and at the same time PFR directly acquired a stake in Pekao representing approximately 12.8% of the total number of votes.

As a result of this transaction PZU recognized that it acquired control over Pekao on 7 June 2017.

The price agreed by the Parties is PLN 123 per share, which entailed the total price of PLN 10,589 million for the whole stake to be acquired by PZU and PFR, of which the price for the stake to be acquired by PZU was PLN 6,457 million. The price also included payment for the acquired right to the dividend adopted by the Pekao Ordinary Shareholder Meeting held on 19 April 2017 in the amount of PLN 8.68 per share, i.e. PLN 456 million in total.

Final settlement of the Pekao acquisition

The settlement for the acquisition of the stake in Pekao on the date of obtaining control was made on the basis of the data prepared on 31 May 2017. No material differences in accounting data transpired between 31 May and 7 June 2017.

(in millions of PLN)

The consolidated financial statements contain the final fair value of the assets and liabilities acquired (in particular, of the loan portfolio). In the process of calculating goodwill:

- the goodwill carried in Pekao's financial statements was written down;
- intangible assets not carried thus far in Pekao's financial statements were recognized;
- the assets and liabilities in Pekao's financial statements were measured at fair value – the loan portfolio, the property portfolio (owner-occupied property, investment property and property for sale), financial assets held to maturity (measured by Pekao at amortized cost) and available for sale (measured by Pekao at historical cost);
- no contingent liabilities requiring recognition were identified;

no potential indemnification assets requiring recognition were identified.

The final settlement of the transaction is presented below on the basis of the fair value of the acquired assets and liabilities.

Assets	**Carrying amount**	**Adjustment to fair value** (preliminary settlement)	**Adjustment – final settlement**	**Fair value**	**Comments**
Goodwill	56	(56)	-	-	The goodwill recognized in Pekao's balance sheet was eliminated and it was recognized as part of the goodwill coming from the acquisition of shares in Pekao.
Intangible assets	544	1,450	-	1,994	New assets were identified: • trade mark – PLN 340 million; • core deposit intangibles (CDI) – PLN 1,000 million; • relations with clients holding a PEX cash loan – PLN 110 million.
Other assets	192	-	-	192	
Property, plant and equipment	1,403	253	51	1,707	The property measured by Pekao at historical cost less accumulated depreciation and impairment losses was measured at fair value.
Investment property	25	-	2	27	
Entities measured by the equity method	154	400	-	554	The stakes in associates (PIM and Xelion), which Pekao measured using the equity method, were measured at fair value.
Financial assets	157,634	(1,199)	-	156,435	
Held to maturity	4,507	22	-	4,529	The assets measured by Pekao at amortized cost were measured at fair value.
Available for sale	22,168	151	-	22,319	The equity instruments presented by Pekao at historical cost were measured at fair value and the measurement of some assets was done in a consistent manner in accordance with the models in operation in the PZU Group.
Measured at fair value through profit or loss	2,886	-	-	2,886	
Hedge derivatives	325	-	-	325	
Loans	127,748	(1,372)	-	126,376	The loan portfolio was measured at fair value.

(in millions of PLN)

Assets	Carrying amount	Adjustment to fair value (preliminary settlement)	Adjustment – final settlement	Fair value	Comments
Deferred tax assets	867	(67)	(10)	790	The deferred tax on the adjustments made to fair value was assessed.
Receivables	2,542	(16)	-	2,526	Receivables were measured at fair value.
Cash and cash equivalents	4,981	-	-	4,981	
Assets held for sale	48	(2)	-	46	Property held for sale was measured at fair value.
Total assets	**168,446**	**763**	**43**	**169,252**	

Liabilities	Carrying amount	Adjustment to fair value (preliminary settlement)	Adjustment – final settlement	Fair value	Comments
Provisions for employee benefits	381	40	-	421	The provision for employee holidays was measured at fair value.
Other provisions	249	46	-	295	A fair value measurement of provisions was made.
Deferred tax liability	5	-	-	5	
Financial liabilities	141,297	43	-	141,340	Liabilities measured at amortized cost were measured at fair value.
Other liabilities	4,990	66	-	5,056	
Total liabilities	**146,922**	**195**	**-**	**147,117**	

Net assets	Carrying amount	Adjustment to fair value (preliminary settlement)	Adjustment – final settlement	Fair value	Comments
Net assets attributable to the holders of Pekao	21,509	568	43	22,120	Impact exerted by the foregoing revaluations on the net asset value attributable to the holders of Pekao
Non-controlling interest	15	-	-	15	
Total net assets	**21,524**	**568**	**43**	**22,135**	

In the settlement of the acquisition, the PZU Group reduced the consideration transferred by PLN 456 million, which was the price for the right to receive a dividend payable from profits earned by Pekao before the date of acquisition; on the date of PZU's obtaining control that amount was presented as a receivable, and it was received on 6 July 2017.

Goodwill calculation	Preliminary settlement	Adjustment – final settlement	Final settlement
Consideration transferred	6,001	-	6,001
Cash transferred	6,457	-	6,457
Adjustment by an amount forming the price for the right to receive the dividend	(456)	-	(456)
Value of non-controlling interests (80.00% of the fair value of Pekao's net assets)	17,662	34	17,696
Fair value of the Pekao's identifiable net assets	(22,077)	(43)	(22,120)
Goodwill	**1,586**	**(9)**	**1,577**

Goodwill will not reduce taxable income.

2.4.2. Purchase of other companies

On 9 January 2018, PZU Zdrowie SA acquired 360 shares in Centrum Medyczne św. Łukasza sp. z o.o. representing 100% of the share capital and 100% of the votes at the shareholder meeting with a par value of PLN 600 each.

Since the date of obtaining control, i.e. 9 January 2018, Centrum Medyczne św. Łukasza sp. z o.o. has been consolidated.

(in millions of PLN)

On 31 December 2018, Elvita acquired 500 shares in Specjalistyczny Zakład Opieki Zdrowotnej Multimed sp. z o.o. representing 100% of the share capital and 100% of the votes at the shareholder meeting with a par value of PLN 1 thousand each.

Since the date of obtaining control, i.e. 31 December 2018, Specjalistyczny Zakład Opieki Zdrowotnej Multimed sp. z o.o. has been consolidated.

Settlement of the acquisition

Fair value of acquired assets as at the time of obtaining control	Preliminary settlement
Financial assets	7
Receivables	2
Other assets	2
Total assets	**11**
Liabilities	3
Fair value of acquired net assets	**8**
Fair value of the payment made – cash	33
Goodwill	**25**

Goodwill will not reduce taxable income.

Consolidated profit and loss account taking into account acquired entities

The table below presents the amounts of revenues and profits of the PZU Group, taking into account the financial data of acquired subsidiaries (Centrum Medyczne św. Łukasza sp. z o.o. and Specjalistyczny Zakład Opieki Zdrowotnej Multimed sp. z o.o.) calculated as if the beginning of the year was the acquisition date for all the combinations effected during the year.

Consolidated profit and loss account	1 January – 31 December 2018
Gross written premiums	23,470
Reinsurers' share in gross written premium	(755)
Net written premiums	**22,715**
Movement in net provision for unearned premiums	(365)
Net earned premiums	**22,350**
Revenue from commissions and fees	3,374
Net investment income	11,679
Net result on realization of financial instruments and investments	(15)
Movement in allowances for expected credit losses and impairment losses on financial instruments	(1,804)
Net movement in fair value of assets and liabilities measured at fair value	770
Other operating income	1,713
Claims, benefits and movement in technical provisions	(14,980)
Reinsurers' share in claims, benefits and movement in technical provisions	417
Net insurance claims and benefits paid	**(14,563)**
Fee and commission expenses	(754)
Interest expenses	(2,046)
Acquisition expenses	(3,130)
Administrative expenses	(6,609)
Other operating expenses	(3,873)
Operating profit	**7,092**
Share of the net financial results of entities measured by the equity method	(1)
Profit before tax	**7,091**
Income tax	(1,719)

(in millions of PLN)

Consolidated profit and loss account	1 January – 31 December 2018
Net profit, including:	**5,372**
- profit attributable to the equity holders of the Parent Company	3,217
- profit (loss) attributed to holders of non-controlling interest	2,155

2.4.3. Changes to consolidation of mutual funds

Since control was gained over the PZU FIZ Akcji Focus fund, it is consolidated as of 1 April 2018.

In addition, the following newly-created funds, namely inPZU Inwestycji Ostrożnych, inPZU Obligacje Polskie are consolidated (as of 10 April 2018) while the following funds, namely inPZU Akcje Polskie, inPZU Akcji Rynków Rozwiniętych, inPZU Obligacji Rynków Rozwiniętych, inPZU Obligacji Rynków Wschodzących are consolidated (as of 10 May 2018).

On 24 December 2018 the liquidation of the PZU FIZ Aktywów Niepublicznych Witelo Fund was completed. The fund was consolidated until its liquidation date.

2.4.4. Transactions under joint control

On 24 April 2018 PTE PZU received the KNF's decisions consenting to the acquisition of management of Pekao OFE and Pekao DFE. PZU PTE and Pekao PTE entered into a business transfer agreement on 18 May 2018 encompassing i.a. the operations of Pekao OFE and Pekao DFE, involving the management of Pekao OFE and Pekao DFE. The business was acquired effectively on 19 May 2018. According to KNF's decision the date for commencing the winding up of Pekao OFE is 1 August 2018, while this process will end and the assets of Pekao OFE were merged with the assets of OFE PZU "Złota Jesień" on 12 October 2018. The winding up of DFE Pekao was in progress since 19 May 2018 was completed on 28 September 2018.

On 4 June 2018 the National Court Register registered PFS's share capital increase in connection with the spin off (organizational, functional and financial) and the transfer of the branch of the PZU CO transfer agent (forming an organization part of a business) to PFS within the meaning of Article 530 § 2 of the Commercial Company Code. The transaction was executed on the basis of the agreement concluded on 16 March 2018 by and between PZU, Pekao, PFS and PZU CO and the spin off plan executed on 27 February 2018 by and between PZU CO (company being spun off) and PFS (acquiring company). PZU CO's net asset value transferred to PFS on the date of the spin off was PLN 7 million. From the spin off date the transfer agent services rendered thus far by PZU CO are rendered by PFS.

On 6 September 2018, Elvita merged with NZOZ Trzebinia.

The transactions did not affect the consolidated financial statements.

2.4.5. Acquisition of an associate

On 15 November 2018 Alior Bank acquired, for PLN 4 million, 2,510 shares with the total par value of PLN 125,500, representing 20% shares in GTR Finanse sp. z o.o. (currently PayPo sp. z o.o.).

(in millions of PLN)

3. Shareholder structure

PZU's shareholder structure, taking into consideration the shareholders with at least 5% of the votes at the PZU shareholder meeting is as follows:

As at 31 December 2018

Item	Shareholder's name	Number of shares and votes at the Shareholder Meeting	Percentage held in the share capital and in the total number of votes at the Shareholder Meeting
1	State Treasury	295,217,300 [1)]	34.1875%
2	Nationale-Nederlanden Otwarty Fundusz Emerytalny and Nationale Nederlanden Dobrowolny Fundusz Emerytalny	43,825,000	5.0751%
3	Other shareholders	524,480,700	60.7374%
Total		**863,523,000**	**100.00%**

1) According to the Current Report No. 21/2018 on the list of shareholders holding at least 5% of the number of votes at the PZU Ordinary Shareholder Meeting that took place on 28 June 2018.

As at 31 December 2017

Item	Shareholder's name	Number of shares and votes at the Shareholder Meeting	Percentage held in the share capital and in the total number of votes at the Shareholder Meeting
1	State Treasury	295,217,300 [1)]	34.1875%
2	Other shareholders	568,305,700	65.8125%
Total		**863,523,000**	**100.00%**

1) According to the Current Report No. 11/2018 on the list of shareholders holding at least 5% of votes at the PZU extraordinary shareholder meeting commenced on 27 February and ended on 9 March 2018.

Information on the number of shares taken into account in the calculation of earnings per share is presented in section 25.

Transactions pertaining to significant stakes in PZU

As a result of a transaction to buy PZU shares settled on 6 June 2018, Nationale-Nederlanden Otwarty Fundusz Emerytalny and Nationale Nederlanden Dobrowolny Fundusz Emerytalny increased their shareholding in PZU to 5.03% of PZU's share capital, constituting 5.03% of the total number of votes at PZU's Shareholder Meeting. On 28 June 2018, i.e. on the date of holding the PZU SA Ordinary Shareholder Meeting, Nationale-Nederlanden Otwarty Fundusz Emerytalny and Nationale Nederlanden Dobrowolny Fundusz Emerytalny held a total of 43,825,000 shares, representing 5.0751% of PZU's share capital and giving the right to 43,825,000 votes at the Shareholder Meeting.

4. Composition of the Management Board, Supervisory Board and PZU Group Directors

4.1 Composition of the parent company's Management Board

From 1 January 2018, the PZU Management Board consisted of the following persons:

- Paweł Surówka – President of the PZU Management Board;
- Roger Hodgkiss – Member of the PZU Management Board;
- Tomasz Kulik – Member of the PZU Management Board;
- Maciej Rapkiewicz – Member of the PZU Management Board;
- Małgorzata Sadurska – Member of the PZU Management Board.

No changes in the composition of the PZU Management Board have occurred by the date of signing the consolidated financial statements.

4.2 Composition of the parent company's Supervisory Board

From 1 January 2018, the PZU Supervisory Board consisted of the following persons:

- Katarzyna Lewandowska – Chairwoman of the Supervisory Board;
- Aneta Fałek – Deputy Chairwoman of the Supervisory Board;
- Alojzy Nowak – Supervisory Board Secretary;
- Bogusław Banaszak – Supervisory Board Member;
- Marcin Chludziński – Supervisory Board Member;
- Paweł Górecki – Supervisory Board Member;
- Agata Górnicka – Supervisory Board Member;
- Robert Śnitko – Supervisory Board Member;
- Maciej Zaborowski – Supervisory Board Member.

On 8 January 2018, Aneta Fałek tendered her resignation from being a PZU Supervisory Board Member as of 8 February 2018.

On 8 January 2018, the Prime Minister, acting on behalf of the State Treasury of the Republic of Poland, appointed Mr. Maciej Łopiński to be a PZU SA Supervisory Board Member.

On 9 January 2018, Bogusław Banaszak, who was a PZU SA Supervisory Board Member, died.

On 9 January 2018, Maciej Łopiński took over the function of Chairman of the PZU Supervisory Board and Paweł Górecki – Deputy Chairman of the PZU Supervisory Board.

On 9 March 2018 the Extraordinary Shareholder Meeting of PZU appointed Robert Jastrzębski to the PZU Supervisory Board.

From 9 March 2018 to the date of signing the consolidated financial statements, the PZU Supervisory Board consisted of the following persons:

- Maciej Łopiński – Supervisory Board Chairman;
- Paweł Górecki – Supervisory Board Deputy Chairman;
- Alojzy Nowak – Supervisory Board Secretary;
- Marcin Chludziński – Supervisory Board Member;
- Agata Górnicka – Supervisory Board Member;
- Robert Jastrzębski – Supervisory Board Member;
- Katarzyna Lewandowska – Supervisory Board Member;
- Robert Śnitko – Supervisory Board Member;
- Maciej Zaborowski – Supervisory Board Member.

4.3 PZU Group Directors

Apart from Management Board Members, key managers in the PZU Group also comprise PZU Group Directors who generally also sit on the Management Board of PZU Życie.

From 1 January 2018, the following persons were PZU Group Directors:

- Aleksandra Agatowska;
- Tomasz Karusewicz;
- Bartłomiej Litwińczuk;
- Dorota Macieja;
- Roman Pałac.

No changes in the composition of the PZU Group Directors have occurred by the date of signing the consolidated financial statements.

5. Key accounting policies, key estimates and judgments

The consolidated financial statements have been prepared in accordance with the historical cost concept, except for the update of the valuation of investment properties and certain financial instruments which are carried at fair value.

Preparation of the consolidated financial statements in accordance with IFRS requires that the PZU Management Board make professional judgment and estimates and assumptions, which impact the adopted accounting policies and the presented values of assets and liabilities, revenues and costs.

The estimates and the related assumptions are based on historical experience and other factors which are deemed reasonable in the given circumstances, and their results provide the basis for professional judgment regarding the carrying amount of the assets and liabilities which does not follow directly from other sources.

Making the judgments, estimates or assumptions the PZU Management Board may, in material issues, rely on the opinions of independent experts.

The actual value may differ from the estimate value. The judgments, estimates and related assumptions are subject to ongoing verification. Their changes are recognized in the manner described in section 5.1.

(in millions of PLN)

The key accounting policies and estimates and assessments used in preparation of the consolidated financial statements are described below and in individual notes, according to the table below.

Profit and loss account item	Note number	Statement of financial position item	Note number
Gross written premiums	10	Goodwill	26
Revenue from commissions and fees	11	Intangible assets	27
Net investment income	12	Deferred acquisition expenses	29
Net result on realization of financial instruments and investments	13	Property, plant and equipment	30
Movement in allowances for expected credit losses and impairment losses on financial instruments	36	Investment property	31
Claims, benefits and movement in technical provisions	17	Entities measured by the equity method	32
Interest expenses	19	Loan receivables from clients	33
Acquisition expenses	20	Financial derivatives	34
Administrative expenses	21	Investment financial assets	35
Income tax	24	Cash	38
		Assets held for sale	39
		Equity attributable to equity holders of the parent	40
		Non-controlling interest	2.3
		Technical provisions	41
		Provisions for employee benefits	42
		Other provisions	43
		Deferred tax	44
		Financial liabilities	45

5.1 Changes in accounting policies and estimates, errors from previous years

The accounting policies are changed only if the change:

- is required by an IFRS; or
- results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the PZU Group's financial position, financial performance or cash flows.

Changes in accounting policies associated with the initial application of an IFRS are accounted for in accordance with the specific transitional provisions contained in that IFRS. If a change in accounting policies is made in connection with initial application of IFRS which do not contain specific transitional provisions pertaining to such a change or the change is made voluntarily, the entity introduces such a change retrospectively. Retrospective introduction of a change in accounting policies is made through a correction in the statement of financial position of the opening balance of each equity item to which the change pertains for the earliest presented period and disclosure of other comparative data for each period, as if the changed accounting policies have been always applied.

The financial statements items determined on the basis of estimates are subject to verification, if the circumstances constituting the basis for the estimates change or as a result of obtaining new information or gathering more experience.

The effects of a change of an estimate value are prospective, which means that the values pertaining to the transactions, other events and conditions are adjusted as of the moment when the change was made (the change influences only the current statement of comprehensive income, or the results of the given period or future periods).

An assumption is made that errors are corrected already in the period in which they were made (not detected), hence material errors from previous periods are corrected retrospectively, and the difference is charged to equity.

(in millions of PLN)

5.2 Amendments to the applied IFRS

5.2.1. Standards, interpretations and amended standards effective from 1 January 2018

The following changes in standards were applied to the consolidated financial statements.

Standard/interpretation	Approving regulation	Comments
IFRS 9 – Financial Instruments	2067/2016	The effect of the application of IFRS 9 is described in section 5.2.2.
Amendment to IFRS 4 – Application of IFRS 9 'Financial Instruments' together with IFRS 4 'Insurance Contracts'	1988/2017	In accordance with the amendment to IFRS 4 issued by IASB on 12 September 2016, insurance undertakings may defer the implementation of IFRS 9 until the entry into force of IFRS 4 Phase II concerning insurance contracts, but by no later than 1 January 2021. The Commission of the European Union has also allowed financial conglomerates to defer application of IFRS 9 by insurance undertakings in the conglomerates, provided that no financial instruments are transferred between insurance and banking entities within the conglomerates. The report includes information on insurance undertakings that continue to apply IAS 39 and the disclosures required under IFRS 7 are provided separately for the insurance entities applying IAS 39 and for other entities applying IFRS 9. The PZU Group could not take advantage of this exemption due to the significant share of banking activity.
IFRS 15 – Revenue from Contracts with Customers	1905/2016	IFRS 15 specifies how and when to recognize revenues and requires the presentation of more detailed disclosures. The standard replaces IAS 18 "Revenue", IAS 11 "Construction Contracts" and a number of interpretations related to revenue recognition. The standard applies to almost all agreements with customers (the main exceptions concern lease agreements, financial instruments and insurance agreements). The fundamental principle of the new standard is to recognize revenues in a manner that reflects the transfer of goods or services to customers and in an amount that reflects the value of consideration (i.e. the payment) which the company expects to obtain a right to in exchange for the goods or services. The standard also provides guidelines for recognizing transactions that were not regulated in detail in previous standards (e.g. revenues from services or modification of agreements) and contains more comprehensive explanations on the recognition of agreements with multiple deliverables. The standard does not apply to insurance contracts, financing arrangements and secondary activity (e.g. sale of fixed assets). The PZU Group applied IFRS 15 in accordance with the approach described in section C3 b) – retrospectively, with joint effect for contracts in force as at 1 January 2018 (date of initial application) recognized once as at that date. The PZU Group has analyzed the impact the new standard will have on agreements signed by PZU Group companies and has not identified any agreements, for which application of IFRS 15 would have a material effect on the consolidated financial statements. This is because revenues covered by IFRS 15 are of secondary importance to the financial reporting of the PZU Group.
Clarifications to IFRS 15 – revenue from contracts with customers	1987/2017	The clarifications provide guidelines concerning the identification of the obligations to fulfill benefits (determining in which instances the promises set forth in a contract constitute "separate" goods or services that should be settled separately), accounting for intellectual property licenses (determining in which situations revenues from intellectual property licenses should be settled "over a certain period" and in which situations "at a given point in time") and the distinctions between a principal and an agent (stating more precisely that a principal under a given determination controls a good or service prior to turning it over to a client). Changes to the standard also include additional practical solutions facilitating the implementation of the new standard.
Amendment to IFRS 2 – Classification and valuation of share-based payment	289/2018	The amendment provides guidance harmonizing accounting requirements for share-based payments settled in cash which adopt the same approach as that applied in the case of share-based payments settled in equity instruments (an exception to IFRS 2) and clarification of situations where share-based payments settled in cash are changed to share-based payments settled in equity instruments due to changes in contractual provisions. The change did not affect the consolidated financial statements.

(in millions of PLN)

Standard/interpretation	Approving regulation	Comments
Amendment to IAS 40 – Transfers of Investment Property	400/2018	The amendment clarifies when the entity should transfer properties under construction to or from the investment property category in the event of change of the nature of the use of such property in situations other than listed in IAS 40. The change did not affect the PZU Group's consolidated financial statements.
Amendments to IFRS 2014-2016	182/2018	The amendments pertain to: 1. IFRS 1 – waiver of exemptions for first time adopters as regards certain disclosures; 2. IAS 28 – as regards the election by specified entities to measure at fair value through profit or loss interests in associates and joint ventures in accordance with IFRS 9. The amendments did not affect the PZU Group's consolidated financial statements.
IFRIC interpretation 22 – Foreign Currency Transactions and Advance Consideration	519/2018	The interpretation clarifies that the exchange rate should be applied in recognizing a transaction denominated in a foreign currency in accordance with IAS 21 if the client makes a non-refundable payment of an advance consideration for delivery of goods or services. The interpretation had no effect on the PZU Group's consolidated financial statements.

5.2.2. IFRS 9 – Financial Instruments

IFRS 9 *Financial Instruments*, published by the IASB in July 2014 and approved by the European Commission in November 2016, replaces IAS 39 *Financial Instruments: Recognition and Measurement.* IFRS 9 is effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted.

The PZU Group started applying IFRS 9 on 1 January 2018.

IFRS 9 sets out new requirements for the classification and measurement of financial instruments, impairment of financial assets and hedge accounting.

(in millions of PLN)

Effect of the application of the new standard

Classification under IAS 39	Classification under IFRS 9	Net carrying amount under IAS 39 as at 31 December 2017	Impact of changes in measurement caused by reclassification	Impact of impairment due to expected losses resulting from credit risk	Net carrying amount under IFRS 9 as at 1 January 2018
Loan receivables from clients	Financial assets at amortized cost	167,554	(108)	(1,749)	165,697
	Financial assets at fair value through other comprehensive income	1,597	(32)	(9)	1,556
	Financial assets at fair value through profit or loss	306	51	8	365
Financial derivatives	Financial derivatives	2,351	-	-	2,351
Held to maturity	Financial assets at amortized cost	19,003	(14)	(11)	18,978
	Financial assets at fair value through other comprehensive income	2,186	38	-	2,224
	Financial assets at fair value through profit or loss	48	1	-	49
Available for sale	Financial assets at amortized cost	5,060	1	(2)	5,059
	Financial assets at fair value through other comprehensive income	43,199	(1)	-	43,198
	Financial assets at fair value through profit or loss	260	-	-	260
Measured at fair value through profit or loss	Financial assets at amortized cost	25	(2)	-	23
	Financial assets at fair value through other comprehensive income	491	-	-	491
	Financial assets at fair value through profit or loss	19,727	-	-	19,727
Loans – debt securities	Financial assets at amortized cost	8,515	41	(19)	8,537
	Financial assets at fair value through other comprehensive income	5,108	(2)	(9)	5,097
Loans - other	Financial assets at amortized cost	6,424	-	(45)	6,379
Cash and cash equivalents		8,239	-	-	8,239
Other assets		25,775	-	4	25,779
Deferred tax assets		1,590	(2)	355	1,943
Total assets		**317,458**	**(29)**	**(1,477)**	**315,952**

(in millions of PLN)

Classification under IAS 39	Classification under IFRS 9	Net carrying amount under IAS 39 as at 31 December 2017	Impact of changes in measurement caused by reclassification	Impact of impairment due to expected losses resulting from credit risk	Net carrying amount under IFRS 9 as at 1 January 2018
Equity attributable to equity holders of the parent		**14,599**	**(5)**	**(507)**	**14,087**
Share capital		86	-	-	86
Revaluation reserve		157	-	7	164
Other capital		11,760	-	-	11,760
Retained earnings		2,596	(5)	(514)	2,077
Non-controlling interest		**22,961**	**(24)**	**(1,122)**	**21,815**
Total equity		**37,560**	**(29)**	**(1,629)**	**35,902**
Financial liabilities held for trading	Financial liabilities at fair value through profit or loss	4,956	-	-	4,956
Financial liabilities at amortized cost	Financial liabilities at amortized cost	219,594	-	-	219,594
Provisions		45,611	-	159	45,770
Deferred tax liability		638	-	(7)	631
Other liabilities		9,099	-	-	9,099
Total liabilities		**279,898**	**-**	**152**	**280,050**
Total equity and liabilities		**317,458**	**(29)**	**(1,477)**	**315,952**

Classification under IAS 39	Classification under IFRS 9	The amount of allowances under IAS 39 as at 31 December 2017	Impact of changes in measurement caused by reclassification	Impact of impairment due to expected losses resulting from credit risk	The amount of allowances under IFRS 9 as at 1 January 2018
Loan receivables from clients	Financial assets at amortized cost	8,826	2,811	378	12,015
	Financial assets at fair value through other comprehensive income	9	-	9	18
	Financial assets at fair value through profit or loss	4	4	(8)	-
Held to maturity	Financial assets at amortized cost	1	-	11	12
Available for sale	Financial assets at amortized cost	-	-	2	2
	Financial assets at fair value through other comprehensive income	-	13	2	15
Loans – debt securities	Financial assets at amortized cost	85	(32)	19	72
	Financial assets at fair value through other comprehensive income	13	-	9	22
Loans - other	Financial assets at amortized cost	18	3	47	68
Other assets		661	165	10	836
Provisions		237	-	159	396
Total allowances		**9,854**	**2,964**	**638**	**13,456**

(in millions of PLN)

Net impact (gross impact minus the tax effect) of application of IFRS 9 on equity items	Revaluation reserve	Retained earnings
As at 31 December 2017 under IAS 39	157	2,596
Reclassifications of debt securities / loans granted to clients:	1	5
- from measured at amortized cost to measured at fair value through profit or loss	-	9
- from measured at amortized cost to measured at fair value through other comprehensive income	3	-
- from available for sale to measured at amortized cost	(4)	(2)
- from available for sale to measured at fair value through profit or loss	(1)	1
- from measured at fair value through profit or loss to measured at fair value through other comprehensive income	3	(3)
Reclassification of equity instruments from measured at fair value through profit or loss to measured at fair value through other comprehensive income	(3)	3
Reclassification of participation units and mutual fund investment certificates from available for sale to measured at fair value through profit or loss	(10)	10
Revaluation of equity securities measured at fair value through other comprehensive income	4	(4)
Recognition of the allowance for expected credit losses (“ECL”) for financial assets measured at amortized cost (including off-balance sheet items)	-	(510)
Recognition of the allowance for expected credit losses (“ECL”) for debt securities / loans granted to clients measured at fair value through other comprehensive income	7	(4)
Other changes	8	(19)
As at 1 January 2018 under IFRS 9	**164**	**2,077**

Classification of financial assets upon first application of IFRS 9

Information on classification of financial assets upon first application of IFRS 9 is presented in section 35.1.2.1.

Classification of financial liabilities

Information on classification of financial liabilities upon first application of IFRS 9 is presented in section 45.1.

Impairment

Information on impairment under IFRS 9 is presented in section 36.1.1.

Hedge accounting

Upon first application of IFRS 9, the PZU Group has made a decision to continue to apply IAS 39 to hedge accounting instead of chapter 6 of IFRS 9. However, in respect to hedge accounting disclosures, IFRS 7 *Financial Instruments: Disclosures* amended by IFRS 9 is applied because the option to choose an accounting policy does not exempt from the application of the new disclosure requirements.

Disclosures

The implementation of IFRS 9 resulted in a significant change in the presentation disclosures pertaining to financial instruments. The PZU Group took advantage of the exemption not to restate the comparative data from prior periods in respect to the changes resulting from classification and measurement (including impairment). The differences in the carrying amount of financial assets and liabilities arising from the application of IFRS 9 are recognized in the “Revaluation reserve” and “Retained earnings” line items.

(in millions of PLN)

5.2.3. Standards, interpretations and amended standards not yet effective

- Approved by the regulation of the European Commission

Name of standard/ interpretation	Effective date	Approving regulation	Comments
IFRS 16 – Leases	1 January 2019	1986/2017	IFRS 16 replaces IAS 17 *Leases* and any interpretations related to this standard and introduces a full model of identification and settlement of leases in the lessors' and lessees' financial statements. The most important change pertains to lessees, for which the new standard eliminates the distinction between financial leases and operating leases. The recognition of current operating leases in the statement of financial position will result in the recognition of a new asset (the right to use the leased object) and a new liability (the liability of remitting lease payments). Recognition of leases on the lessor's side will in most cases remain unchanged due to the maintenance of the breakdown between operating leases and financial leases. The PZU Group has assessed these contracts in terms of their fulfillment of the definition of lease and estimating the lease period. Applying IFRS 16 the PZU Group made the following assumptions: • As at 1 January 2019 the PZU Group will apply the simplified approach in accordance with paragraph C5(b). Comparative data will not be restated and the total effect of the first application of IFRS16 will be recognized as adjustment of the opening balance of retained earnings on the first application date. • In the case of leases previously classified as operating leases in accordance with IAS 17 lease assets and liabilities will be carried at present value of the remaining lease payments, discounted by the lessee's marginal interest rate. • The lessee's marginal rate has been calculated as the sum of the risk-free rate and fixed risk spread. For all contracts ending on the same date and with a fixed amount of monthly payments (this group includes most lease contracts in the PZU Group) a fixed contract discount rate is calculated. • In accordance with section 5 the PZU Group will take advantage of the exemptions of short-term leases and for leases for which the underlying asset has a low value. Low value assets are assets with the value equal to or lower than PLN 20 thousand. Pursuant to item C10(c), for operating leases with the lease term ending within 12 months of the day of first application of IFRS 16, PZU Group shall apply rules concerning short-term leases. • Pursuant to item 4, PZU Group shall not apply IFRS 16 to intangible assets. • PZU Group shall recognize assets and liabilities in respect of lease at a net amount. The VAT amount shall be recognized in expenses of the current period. The recognition of assets and liabilities in respect of lease is based on a subjective evaluation of the Management Board, taking into account interpretations related to the application of IFRS 16. The subjective evaluation and the estimates concerning the results of the application of the new standard, presented below, are subject to change as a result of new interpretations of IFRS 16 or changes to the general practice of application of new accounting policies.

(in millions of PLN)

Name of standard/ interpretation	Effective date	Approving regulation	Comments
			In the consolidated profit and loss account for 2019, fees related to lease and rental will be replaced with the amortization of the right to use the lease object and with interest expenses on liabilities in respect of lease. This will generate greater costs at the initial stage of the lease (above all due to the financial element related to the discount settlement), even if the parties have agreed on fixed annual payments. As a result of the application of IFRS 16, PZU Group shall recognize new assets in respect of the right to use: • Property, plant and equipment – PLN 1,200 m; • Investment property – PLN 51 m; The value of the recognized liabilities in respect of lease will be PLN 1,251 m. Assets in respect of the right to use shall be recognized jointly with property, plant and equipment or investment property, respectively, while liabilities in respect of lease shall be disclosed within financial liabilities.
Amendment to IFRS 9 – prepayments with negative compensation	1 January 2019	498/2018	According to the current version of IFRS 9, certain options, which force a lender to accept reduced compensation for granting financing (in the case of negative compensation) do not pass the SPPI test; accordingly any instruments containing such options cannot be classified as measured at amortized cost or at fair value through other comprehensive income. According to the amendment, the positive or negative sign of the prepayment amount will not be important; this means that, depending on the interest rate in effect when the agreement is terminated, payment can be made to a party resulting in prepayment. This compensation must be calculated in the same manner for both a penalty for prepayment and also for a gain earned on prepayment. The change will not affect to a material extent the PZU Group’s consolidated financial statements.
IFRIC 23 interpretation – Uncertainty over Income Tax Treatments	1 January 2019	1595/2018	The interpretation is applied when there is uncertainty to the determination of taxable profit, tax losses, taxable income, outstanding tax losses, unused tax credits and tax rates under IAS 12. The interpretation will not affect the PZU Group’s consolidated financial statements.
Amendment to IAS 28 – Long-term interests in associates and joint ventures	1 January 2019	237/2019	According to the amended IAS 28, long-term interests in associates and joint ventures for which the company does not apply the equity method, the applicable standard is IFRS 9, also with regard to impairment. The amendment will not affect the PZU Group’s consolidated financial statements.

- Not approved by the European Commission:

Name of standard/ interpretation	Date of issue by IASB	Effective date (according to IASB)	Comments
IFRS 17 – Insurance contracts	18 May 2017	1 January 2022	The purpose of the standard is to establish the uniform accounting policy for all types of insurance contracts, including the reinsurance contracts held by the insurer. Introduction of this unified standard should ensure comparability of financial reports between different entities, states and capital markets. The new standard defines insurance contract as a contract under which one entity accepts significant insurance risk from the policyholder by agreeing to compensate the policyholder if a specified uncertain future event adversely affects the policyholder. The scope of the standard does not cover, among others, investment contracts, product warranties, loan guarantees, catastrophe bonds and so-called weather derivatives (contracts requiring payment based on the climatic, geological factor or another physical variable that is not specific to the party to the contract). The standard introduces a definition of contract boundary, defining its beginning as the beginning of coverage, the date when first premium becomes due, the moment when facts and circumstances indicate that the contract belongs to the group of onerous contracts - whichever is earliest. The end of the contract boundary occurs when the insurer has the right or practical ability to reassess the risk for a particular policyholder or a policy group, and the premium measurement does not cover the risk related to future periods. In accordance with IFRS 17, contracts will be measured by one of the following methods: • General Measurement Model, GMM – the basic measurement model, wherein the total value of the insurance liability is calculated as the sum of: ○ discounted value of the best estimate of future cash flows - expected (probability-weighted) cash flows from premiums, claims, benefits, acquisition expenses and costs, ○ risk adjustment, RA – individual estimate of the uncertainty related to the quantity and time of the future cash flows, and ○ contractual service margin (CSM) – representing an estimate of future profits recognized during the policy term. The CSM value is sensitive to changes in estimates of cash flows, resulting e.g. from changed non-economic assumptions. CSM cannot be a negative value – any losses on the contract shall be recognized immediately in the profit and loss account; • premium allocation approach, PAA – a simplified model which can be applied to measurement of insurance contracts with the coverage period below 1 year or where its application does not lead to significant changes in relation to GMM. In this model, liability for remaining coverage is analogous to the provision for unearned premiums mechanism, without separate presentation of RA and CSM, while the liability for incurred claims is measured using the GMM (without calculating CSM). • variable fee approach, VFA – model used for insurance contracts with direct profit sharing. The liability value is calculated in the same manner as in the GMM, the CSM value is additionally sensitive to changes in economic assumptions. IFRS 17 provides for separate recognition of reinsurance contracts from reinsured insurance contracts. The cedent shall measure reinsurance contracts by the modified GMM method or, if possible, by the PAA method. Modifications of the GMM method arise above all from the fact that reinsurance contracts are usually assets, not liabilities, and the cedent pays a remuneration to the reinsurer rather than deriving profits from the contract. Modifications are also supposed to reduce discrepancies arising from separate recognition of the reinsurance contract from reinsured insurance contracts.

(in millions of PLN)

Name of standard/ interpretation	Date of issue by IASB	Effective date (according to IASB)	Comments
			In the case of reinsurance contracts, both the profit and the loss calculated as at the contract recognition are recognized in the statement of financial position and settled through the reinsurance coverage period. The assumptions for reinsurance contract measurement shall be consistent with those used for reinsured insurance contract measurement. In addition, measurement shall take into account the risk that the reinsurer fails to fulfill its obligations. In mid 2018 PZU Group formally launched project work to implement a standard in all PZU Group insurance companies. As part of the project, PZU Group works, among others, on: • analyzing the gap in existing IT processes, tools and systems; • determining new components necessary to be implemented in processes and areas which will be significantly affected by the implementation of IFRS 17; • analyzing the current product offer in terms of segmentation and principles of measurement in accordance with IFRS 17. Despite publishing the content of IFRS 17, IASB continues the works on its final wording. For this reason, the standard version which will be finally approved by a European Commission Regulation will differ from the present text. The IFRS 17 implementation will have a fundamental impact both on the processes in insurance entities and on the financial reporting of PZU Group. At the present stage of the IFRS 17 implementation project and due to the potential changes in its content, it is not possible to estimate the effect of application of IFRS 17 on PZU Group's comprehensive income and equity.
Amendments to IAS 19 Employee Benefits – plan amendment, curtailment or settlement	7 February 2018	1 January 2019	The amendment contains clarifications for the guidelines in case of a plan amendment, curtailment or settlement during the reporting period. The amendments require entities, after such an event, to use updated actuarial assumptions to calculate current service cost and net interest for the remaining part of the reporting period. The amendments also clarify how requirements concerning the plan's amendment, curtailment or settlement affect asset threshold requirements. The IASB has decided that the scope of these amendments does not cover the settlement of "significant market fluctuation" (in euro). The amendments apply to plan amendments, curtailments or settlements that will take place on or after 1 January 2019, with the possibility of earlier application. The Group is currently analyzing the impact of these amendments on its consolidated financial statements.

(in millions of PLN)

Name of standard/ interpretation	Date of issue by IASB	Effective date (according to IASB)	Comments
Annual improvements to IFRS 2015-2017	12 December 2017	1 January 2019	The amendments pertain to: 1st IFRS 3 - the amendments clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business; 2nd IFRS 11 - the amendments clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business; 3rd IAS 12 - the amendments specify that any income tax consequences of dividends (i.e. profit distribution) should be recognized in the profit and loss account, regardless of how the tax arises; 4th IAS 23 - the amendments clarify that if any specific borrowings remain outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds which an entity generally borrows when calculating the capitalization rate on general borrowings. The amendments will have no significant influence on the PZU Group's consolidated financial statements.
Amendment to IFRS 3 – Business combinations	22 October 2018	1 January 2020	The amendments aim to state precisely the difference between the acquisition of a business and an asset acquisition. The amendments will not affect the PZU Group's consolidated financial statements.
Amendments to IAS 1 and IAS 8 – definition of materiality	31 October 2018	1 January 2020	According to the new definition, information is material if one may justifiably expect that if it is overlooked, distorted or concealed this may affect the decisions made by the main users of financial statements on the basis of these financial statements. The change will not affect to a material extent the PZU Group's consolidated financial statements.
Amendments to the framework	29 March 2018	1 January 2020	The amended conceptual assumptions contain several new concepts pertaining to measurement, they incorporate the updated definitions and criteria for recognizing assets and liabilities and the guidelines for reporting financial results. Additionally, they contain explanations pertaining to important areas such as the role of management, prudence and the uncertainty of measurement in financial statements. The amendments will have no significant influence on the PZU Group's consolidated financial statements.

In summary, in the opinion of the PZU Group, the introduction of the above standards and interpretations (except for IFRS 16, for which the estimated impact is presented earlier, and IFRS 17) will have no material effect on the accounting policies applied by the PZU Group.

5.3 Explanation of differences between the 2017 annual consolidated financial statements and these consolidated financial statements

5.3.1. Settlement of the Pekao acquisition

In connection with the final settlement of the acquisition of the shares in Pekao, a retroactive restatement of data as at 31 December 2017 has been performed. More information on this matter is presented in section 2.4.1.

5.3.2. Change in presentation of the consolidated statement of financial position and the consolidated profit and loss account

In order to propose a better presentation of the PZU Group's financial standing and financial results, the following presentation changes have been made:

- in the consolidated statement of financial position:
  - "loan receivables from clients" have been spun off to a different line item;
  - financial derivatives have been spun off to a different line item and merged with derivatives for hedging purposes, presenting their breakdown in the pertinent note;
- in the consolidated profit and loss account, the line item "Net result on realization and impairment losses on investments" has been broken down into the following two separate line items: "Net result on realization of financial instruments and investments" and "Movement in allowances for expected credit losses and impairment losses on financial instruments".

Comparative data have been restated accordingly.

5.3.3. Amendments to comparative data in Alior Bank

5.3.3.1. Correction of errors pertaining to Corporate Income Tax for 2012-2017

Alior Bank made a correction to the income tax settlement for 2012-2017 due to eliminating from tax accounts for those years the accrued interest that was not received on the date of writing off the uncollectible receivables, thereby causing an understatement of taxable income. At the same time, some of the interest on the receivables written down in the off-balance sheet records was incorrectly recognized as a taxable temporary difference and included in the basis of the deferred tax liability.

This adjustment lowered equity as at 31 December 2017 by PLN 17 million (PLN 5 million on the PZU Group's interest and PLN 12 million on non-controlling interests, respectively) and net profit for 2017 by PLN 3 million (PLN 1 million on the PZU Group's interest and PLN 2 million on non-controlling interests, respectively).

5.3.3.2. Correction of the recognition of the result on structured products

Alior Bank altered the method of measuring the fair value of the option embedded in the structured products (certificates of deposit) issued by the bank. Previously, the embedded options were measured using parameters not coming from an active market. Presently, parameters from the interbank market are used where the bank enters into opposite transactions, hedging the options embedded in structured products. Alior Bank also altered its method of settling costs and income related to the issue of certificates of deposit. Under its previous methodology, marginal costs were approximately close to the amount of the distribution fee and therefore the costs and the fee were recognized all at once at the time of entering into the transaction. Alior

(in millions of PLN)

Bank reviewed its marginal costs as a result of which their level was reduced. Accordingly, Alior Bank presently settles the income from the distribution fee and the marginal costs spread over time until the date of maturity of the certificates of deposit.

This adjustment lowered equity as at 31 December 2017 by PLN 35 million (PLN 11 million on the PZU Group's interest and PLN 24 million on non-controlling interests, respectively) and lowered net profit for 2017 by PLN 22 million (PLN 7 million on the PZU Group's interest and PLN 15 million on non-controlling interests, respectively).

5.3.3.3. Correction to the recognition of the cost for the Bank Guarantee Fund fee in respect to a portion of the contribution in the form of freezing securities in the last period

In conjunction with the amendment as of 2017 to the BFG Act and the regulation of 10 March 2017 issued by the Minister of Development and Finance on transferring in the form of payment obligations the contributions paid to BFG, availing itself of § 4 of this regulation Alior Bank makes the settlement (30% of the contribution due) with BFG in the form of a payment obligation in the form of a freeze on securities. After receipt on 2 March 2017 and 20 April 2017 of letters from BFG specifying the amounts of the contributions to the Deposit Guarantee Fund and the Forced Restructuring Fund, Alior Bank applied an incorrect method of keeping records by recognizing this portion of the contribution similarly as in the case of freezing securities for the Guaranteed Funds Protection Fund and accordingly it failed to recognize the cost of the payment obligation in its profit and loss account. According to IAS 37 and IFRIC 21 a payment obligation in the form of freezing securities, just as the remaining portion of the contribution to BFG should be recognized as a cost in the current period. Accordingly, Alior Bank made a retrospective adjustment by recognizing the payment obligation in the form of freezing securities for 2017 as a cost in 2017 and restating the comparative data.

This adjustment lowered equity as at 31 December 2017 and net profit for 2017 by PLN 19 million (PLN 6 million on the PZU Group's interest and PLN 13 million on non-controlling interests, respectively).

5.3.4. Impact exerted by the differences on the consolidated financial statements

The following tables present the impact of the aforementioned changes on the individual items of the consolidated financial statements.

Assets	31 December 2017 *(historical)*	Adjustment	31 December 2017 *(restated)*	1 January 2017 *(historical)*	Adjustment	1 January 2017 *(restated)*
Goodwill	3,839	(9) 1)	3,830	1,583	-	1,583
Property, plant and equipment	3,239	48 1)	3,287	1,467	-	1,467
Investment property	2,354	1 1)	2,355	1,738	-	1,738
Loan receivables from clients	n/a	169,457 2)	169,457	n/a	44,998 2)	44,998
Financial derivatives	n/a	2,351 2)	2,351	n/a	953 2)	953
Investment financial assets	281,854	(171,808) 2)	110,046	105,286	(45,951) 2)	59,335
Measured at fair value through profit or loss	22,247	(2,004) 2)	20,243	21,882	(881) 2)	21,001
Hedge derivatives	347	(347) 2)	n/a	72	(72) 2)	n/a
Loans	189,504	(169,457) 2)	20,047	54,334	(44,998) 2)	9,336
Deferred tax assets	1,577	(10) 1) 23 3)	1,590	633	8 3)	641
Total assets	**317,405**	**53**	**317,458**	**125,296**	**8**	**125,304**

(in millions of PLN)

Equity and liabilities	31 December 2017 *(historical)*	Adjustment	31 December 2017 *(restated)*	1 January 2017 *(historical)*	Adjustment	1 January 2017 *(restated)*
Equity						
Equity attributable to equity holders of the parent	14,622	(23)	14,599	12,998	(8)	12,990
Retained earnings	2,619	(1) [1] (22) [3]	2,596	2,043	(8) [3]	2,035
Non-controlling interest	22,979	31 [1] (49) [3]	22,961	4,086	(19) [3]	4,067
Total equity	**37,601**	**(41)**	**37,560**	**17,084**	**(27)**	**17,057**
Financial liabilities	224,507	43 [3]	224,550	60,030	15 [3]	60,045
Other liabilities	9,045	51 [3]	9,096	4,991	20 [3]	5,011
Total liabilities	**279,804**	**94**	**279,898**	**108,212**	**35**	**108,247**
Total equity and liabilities	**317,405**	**53**	**317,458**	**125,296**	**8**	**125,304**

[1] Change described in section 5.3.1.
[2] Change described in section 5.3.2.
[3] Change described in section 5.3.3.

Consolidated profit and loss account	1 January – 31 December 2017 *(historical)*	Adjustment	1 January – 31 December 2017 *(restated)*
Revenue from commissions and fees	2,341	(22) [3]	2,319
Net result on realization and impairment losses on investments	(960)	960 [2]	n/a
Net result on realization of financial instruments and investments	n/a	247 [2]	247
Movement in allowances for expected credit losses and impairment losses on financial instruments	n/a	(1,207) [2]	(1,207)
Net movement in fair value of assets and liabilities measured at fair value	411	(31) [3]	380
Interest expenses	(1,365)	15 [3]	(1,350)
Administrative expenses	(5,364)	(4) [1] 11 [3]	(5,357)
Other operating expenses	(2,737)	(21) [3]	(2,758)
Profit before tax	**5,526**	**(52)**	**5,474**
Income tax	(1,293)	4	(1,289)
Net profit	**4,233**	**(48)**	**4,185**

[1] Change described in section 5.3.1.
[2] Change described in section 5.3.2.
[3] Change described in section 5.3.3.

Consolidated statement of comprehensive income	1 January – 31 December 2017 *(historical)*	Adjustment	1 January – 31 December 2017 *(restated)*
Net profit	4,233	(48)	4,185
Other comprehensive income	66	-	66
Total net comprehensive income	**4,299**	**(48)**	**4,251**
- comprehensive income attributable to equity holders of the Parent Company	2,897	(15)	2,882
- comprehensive income attributable to holders of non-controlling interest	1,402	(33)	1,369

(in millions of PLN)

Consolidated cash flow statement	1 January – 31 December 2017 *(historical)*	Adjustment	1 January – 31 December 2017 *(restated)*
Profit before tax	5,526	(52)	5,474
Adjustments	9,896	52	9,948
Movement in liabilities	1,977	48	2,025
Other adjustments	2,642	4	2,646
Net cash flows from operating activities	**15,422**	**-**	**15,422**

1) Change described in section 5.3.1.
2) Change described in section 5.3.3.

5.4 Consolidation principles

These consolidated financial statements for the financial year ended on 31 December 2018 include financial data of the parent company and all its subsidiaries after elimination of intra-group transactions.

A subsidiary is an entity that is controlled by another entity. That means that the latter simultaneously has: power over the investee, exposure or rights to variable returns from its involvement with the investee and the ability to use its power over the investee to affect the amount of the investor's returns.

Consolidation involves the combination of similar items of assets, liabilities, equity, revenue, costs and cash flows of a parent company and its subsidiaries and then elimination of the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary. Also, assets and liabilities, revenue, costs and cash flows relating to intra-group transactions between PZU Group entities are eliminated in full.

The financial statements of the subsidiaries are prepared for the same reporting period as the financial statements of the parent company.

Subsidiaries are consolidated from the date of obtaining control until the date cessation of control.

The rules applicable to translation of assets, liabilities and comprehensive income of foreign subsidiaries denominated in foreign currencies are presented in section 5.5.

5.4.1. Judgments in exercising control

In order to determine whether PZU Group has rights that are sufficient to give it power, that is practical ability to direct the relevant activities unilaterally, the PZU Group analyzes among others:

- how many votes it holds at the shareholder meeting and whether it holds more votes than other investors (including potential voting rights and rights resulting from other contractual arrangements);
- how many entities would have to act together in order to outvote the PZU Group;
- distribution of votes at previous shareholder meetings;
- if the key personnel of the entity or members of the investee's governing body are related parties of the PZU Group;
- capacity to appoint members of management and supervisory bodies of the entity;
- commitments, if any, to ensure that an investee continues to operate as designed;
- capacity to obligate the entity to perform or prevent it from performing significant transactions;
- other prerequisites.

(in millions of PLN)

The analysis of prerequisites for exercising control over Pekao and Alior Bank as at 31 December 2018 is presented in the table below.

Criterion	Pekao	Alior Bank
Share in votes at the shareholder meeting	20.03%	31.93%
Other shareholders	Only two shareholders hold a stake of more than 5%. The remaining shareholders are dispersed and a significant number of entities would have to take concerted action to outvote PZU at the shareholder meeting.	Only three shareholders hold stakes between 5% and 8%. The remaining shareholders are dispersed and a significant number of entities would have to take concerted action to outvote PZU at the shareholder meeting.
Shareholder agreements	On 23 January 2017, PZU and PFR (holding 12.8% of Pekao's share capital) signed a Shareholder Agreement to build Pekao's long-term value, implement a policy aimed at ensuring Pekao's development, financial stability and effective and prudent management. It defines the rules of cooperation between PZU and PFR, in particular pertaining to joint exercise of voting rights from the shares held and the implementation of a common long-term policy for Pekao's business. The Shareholder Agreement provides for the possibility of having real influence on Pekao's operating policies. The Management Board of PZU does not have any information about any agreements that may have been concluded between Pekao's other shareholders.	The Management Board of PZU does not have any information about any agreements that may have been concluded between Alior Bank's other shareholders.
Potential voting rights	No potential voting rights have been identified.	No potential voting rights have been identified.
Capacity to adopt resolutions in line with PZU's intentions	The analysis of attendance at past shareholder meetings does not provide clear grounds for denying control.	During all the shareholder meetings that were held after control was obtained by PZU, all the resolutions were adopted in line with PZU's intentions.
PZU representatives in governing bodies	The key management personnel and the Supervisory Board members include persons that earlier fulfilled or are fulfilling key management functions at PZU.	The key management personnel and the Supervisory Board members include persons that earlier fulfilled or are fulfilling key management functions at PZU.
Investor commitments and exposure to variability of returns	In connection with bancassurance, assurbanking activities, joint initiatives in the cost areas, including IT and real property, between PZU and Pekao, PZU has access to financial results, activities and operations that are not available to other shareholders of Pekao.	The PZU Group has undertaken investor commitments towards Alior Bank and conducts operations together with Alior Bank. This which means that it has greater exposure to the variability of Alior Bank's financial results than it is implied by the stake it holds in Alior Bank's equity.

In the light of the above prerequisites, it has been determined that the PZU Group exercises control both over Pekao (since 7 June 2017) and over Alior Bank (since 18 December 2015) and over their subsidiaries and therefore they were consolidated.

5.4.2. Rules of consolidation of mutual funds

The PZU Group has assumed that it exercises control over a mutual fund if the following conditions are jointly met:

- PZU Group companies jointly have the capacity to exercise their authority over the fund to influence the value of the return on investment, with the prerequisites for this capacity being, among others, control exercised over the mutual fund company and a significant share in the total number of votes at the meeting of investors or board of investors;
- the total exposure of PZU Group companies to variable returns from their involvement in a mutual fund is significant, which means that the total share of PZU Group companies in the fund's net assets equals or exceeds 20% (whereas the fund's assets that are net assets of unit-linked contracts are not used to determine this total share). If the involvement is less than 20% of the fund's net assets then the exposure to fluctuations in the fund's financial results, considered together with decision-making powers, imply that such a fund is not controlled by the Group.

PZU Group accepts that a fund will remain consolidated (or unconsolidated, as the case may be) for a period of two quarters following a quarter that closed for the first time with a decline (or increase, as the case may be) of the share in the fund's net assets below 20% (or above 20%, as the case may be) if this decline (or increase, as the case may be) resulted from deposits (or withdrawals, as the case may be) made by participants from outside the PZU Group.

(in millions of PLN)

The mutual funds controlled by the PZU Group are consolidated. Their assets are presented in their full amount in the statement of financial position as financial assets by type and classified to the relevant portfolios, while the liability related to the fund's net assets owned by third-party investors is recognized in "Financial liabilities". If control over a mutual fund is lost then its consolidation ceases and the fund's assets and liabilities, as well as liabilities to its participants, if any, are excluded from the consolidated statement of financial position. Instead, the participation units or the investment certificates corresponding to the fair value of shares held by PZU Group companies in the fund's net assets are presented.

5.5 Measurement of transactions and balances denominated in foreign currencies and FX rates used

Transactions carried out in a currency other than Polish zloty are recognized at the exchange rate set by the National Bank of Poland (NBP) for the transaction date. At the end of the reporting period, cash items denominated in foreign currencies are translated using the average NBP exchange rate in effect on that date. Non-cash items measured at fair value and denominated in foreign currencies are measured using the average NBP exchange rate in effect on the date on which the fair value is determined. Gains and losses on currency translation are recognized directly in the profit and loss account.

Financial data of foreign subsidiaries are converted into Polish zloty as follows:

- assets and liabilities – at the average exchange rate set by the National Bank of Poland at the end of the reporting period;
- items of the profit and loss account, other comprehensive income and cash flows – at the arithmetic mean of average exchange rates set by the National Bank of Poland as at the dates ending each month of the reporting period.

Translation differences are recognized under "Foreign exchange translation differences" in equity.

The following FX rates have been used for these consolidated financial statements:

FX rates used for translation of financial data of foreign related parties	1 January – 31 December 2018	1 January – 31 December 2017	31 December 2018	31 December 2017
Euro	4.2669	4.2447	4.3000	4.1709
British pound	4.8142	4.7694	4.7895	4.7001
Ukrainian hryvnia	0.1330	0.1402	0.1357	0.1236

5.6 Purchase method

Acquisitions of subsidiaries by the PZU Group are recognized by the purchase method of accounting.

For each acquisition transaction, the acquirer is identified and the acquisition date is determined, which is the date on which the acquirer obtains control over the acquiree. As of the acquisition date, the acquirer recognizes, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree.

As at the date of acquisition, the identifiable assets acquired and the liabilities assumed are measured at fair value.

For each acquisition, any non-controlling interest in the acquiree are measured at the non-controlling interest's proportionate share in the fair value of the acquiree's identifiable net assets.

The fair value measurement of assets and liabilities is associated with significant uncertainty regarding estimates, as it requires the Management Board of PZU to develop professional judgments and make use of complex and subjective assumptions. Relatively small changes in key assumptions may have a significant impact on the results of the measurement. Key assumptions include, among others: discount rates, credit risk costs, prepayment rates for performing portfolios and the timing and amount of expected cash flows for non-performing portfolios.

Determination of goodwill or a gain from a bargain purchase

Goodwill is measured and recognized as at the date of obtaining control as the surplus of:

- the consideration transferred measured at fair value as at the date of obtaining control;
- the amount of any non-controlling interest in the acquiree measured as described above;
- fair value of the PZU Group's equity interest in the acquiree held before obtaining control over the acquiree;

over the obtaining control date net amount of the fair value of the identifiable assets acquired and the liabilities assumed.

If the net fair values of identifiable assets acquired and the liabilities assumed exceeds the fair value of payment received, increased by the value of all non-controlling interests in the acquiree and the fair value of the interest in the acquiree's equity and held before obtaining control, the gain from a bargain purchase is recognized in the consolidated profit and loss account. Before a gain from a bargain purchase is recognized, a reassessment is made whether all of the assets acquired and all of the liabilities assumed have been correctly identified and all additional assets or liabilities have been are recognized.

In the period of maximum 1 year from taking the control, PZU Group may retrospectively adjust the provisional fair values of assets and liabilities recognized as at the date of obtaining control to reflect new information obtained about facts and circumstances that existed as of the date of obtaining control and, if known, would have affected the measurement of these assets and liabilities. Such adjustments are charged directly to the recognized goodwill or gain from a bargain purchase.

Intangible assets

Intangible assets acquired in business combination transactions are recognized at fair value as at the date of obtaining control. The fair value of an intangible asset reflects expectations as to the probability that the entity achieves economic benefits from the asset in the future. The fair value of intangible assets is determined as follows:

- trademark – using the relief-from-royalty method, based on potential savings on the license fees that the company is not required to pay as the owner of the trademark (i.e. present value of future potential license fees). The market level of license fees is determined by analyzing license fee rates for using trademarks applied between unrelated parties in a comparable market segment. Then, hypothetical license payments are determined as the product of the assumed license fee rate and the amount of the estimated sales revenues. In order to calculate the net income from license, license payments should be reduced by the hypothetical amount of income tax. Then the calculated net cash flows are increased by the potential tax relief arising from the tax amortization benefit (TAB) of the trademark. Finally, the calculated cash flows are discounted using the discount rate reflecting, among others, risk typical for a given trademark;
- relations with brokers and relations with clients – using the multiperiod excess earnings method (MEEM), based on the present value of future profits generated by each relation. Fair value is then determined based on discounted future cash flows resulting from the excess income generated by a company in possession of the relevant intangible asset over revenues generated by a company without such an asset. The relations are identified and subsequently their life expectancy is determined (by applying the applicable attrition ratio using the Weibull curve) and revenues and costs associated with each relation are projected. The identified and calculated CAC (contributory asset charge), including maintenance of capital ratios at levels required by supervisory authorities, fixed assets, organized workforce, trademark and other intangible assets, is applied to cash flows after tax. If there are any tax structures in place that allow an average market participant to amortize a relation then its measurement should include TAB;
- IT systems – the gross value of purchased systems was assumed to be equal to the financial expenditure made to purchase them. For systems developed internally, their gross value is established at the amount of capitalized expenditures made to develop them. The amounts calculated using this method are then adjusted by the remaining operational life of the system, which is calculated as a percentage of the period of the system's useful life. The fair value of systems under development is adjusted to the amount of expenditures made on the functionalities for which the development work has not been completed or which have not been tested and thus are not ready for production acceptance;
- relations with customers holding savings and checking accounts (CDI, core deposit intangible) – as the present value of the difference between the cost of the CDI and the alternative borrowing costs (including interest and administrative expenses) that the bank would have to incur if it had no core deposit. The value of CDI is measured using the favorable source of funds

method derived from the expense and income methods. In this method, the account retention ratio is projected (using the Weibull curve), the average initial balance and the number of accounts to be included in the measurement are estimated and the net balance of deposits is calculated (adjusted by the retention ratio and the unstable part of the deposit base). Then the cost of acquired deposits is calculated as loan loss reserve requirements, interest and administration expenses less net commission income from the accounts. Next, interest rate benchmarks are used to estimate the alternative borrowing cost. In the next step, the difference between the alternative borrowing costs and the cost of acquired deposits is calculated, which is discounted using the required rate of return. The measurement of CDI does not include any tax amortization benefit (TAB).

The discount rate used for the measurement of intangible assets reflects the time value of money and risks related to expected future cash flows. It is calculated on the basis of the expected return from the best investment alternative to the investment being measured. This rate sets the lowest return from the measured asset that is required by an investor in such a manner that the rate of return achieved by the investor is at least equal to the best available investment alternative. The return on the alternative investment must be comparable in terms of value, time and certainty.

Cost of equity (CE) is estimated as at the date of obtaining control in accordance with the Capital Asset Pricing Model (CAPM): $CE = RF + ERP \times \beta + SP + SR$, where RF stands for risk-free rate, ERP – market risk premium, β – measure of systematical risk borne by the equity holders, including the operational and financial risks associated with the business, SP – small cap premium, SR – specific risk premiums.

Loans and advances to customers

The measurement of the loan portfolio to fair value was performed using the income method involving the discounting of future cash flows arising from the loan portfolio component being measured. For performing loans, fair value was estimated as the present value of cash flows defined as the sum of the contractual installments of principal and interest (in accordance with the contractual margin rates and outstanding principal), adjusted by prepayments where relevant. The following is used to discount cash flows:

- interest rate determined based on money market instruments and derivative transactions (standard curve) taking into account the term structure and currency of the loan;
- credit spread (credit spread curve) taking into account the term structure, broken down into the credit risk level of the client or the transaction;
- liquidity margin (liquidity curve) taking into account the term structure and currency of the loan;
- market margin, taking into account the cost of capital and profit margin, broken down into client segment, type and currency of the product.

For measurement purposes, the loan portfolio has been divided by currencies, product groups, risk level and client segments.

The standard curve was calculated on the basis of quotations for deposits for nodes up to 1 year and IRS transactions for nodes above 1 year.

The credit spread curve was calculated on the basis of estimated cumulative probability of default curves and expected average recovery rates for a given product group and client segment.

The liquidity curve for PLN was determined as the higher of zero or the difference between the PLN:BOND curve (zero-coupon curve based on Treasury bond prices) and the PLN:Std curve. For other currencies, the liquidity curve was increased by the cost of a swap converting PLN into the currency in question (calculated from FX Swap and Cross Currency Basis Swap quotations). When the cost was negative, the value of zero was assumed.

Market margin was calibrated for loans granted in the period of 3 months preceding the date of obtaining control, so that the fair value is equal to the gross carrying amount. If the market margin became negative following the calibration, it was assumed to be zero. For foreign currency mortgage loans, the margin was determined as the margin for PLN mortgage loans plus the difference in the average margin between mortgage loans granted in foreign currencies and the average margin of PLN mortgage loans.

For short-term working capital loans, the net carrying amount was taken as fair value.

Analyses have shown that the fair value of impaired loans did not differ materially from their carrying amount.

Property, plant and equipment

Property is measured using the income method, while other tangible assets – using market or replacement method.

Liabilities arising from unfavorable (liability-generating) lease agreements

In order to determine the fair value of liabilities arising from unfavorable (liability-generating) real property lease agreements, an analysis was carried out of the standard market lease rates in various locations at the time of determination of the fair value. Then these rates were compared to the amounts resulting from the lease agreements. Due to the large number of such agreements, the analysis was conducted on a sample of agreements concluded in different years. The differences obtained on the examined sample for a given year of execution were then extrapolated to the entire portfolio of agreements concluded in such a year. In the determination of the fair value, no renegotiation or termination of the lease agreements prior to the end date of the agreement was assumed (in particular for agreements where the contractual rate of rent differed from the estimated market rate). Based on the leased area, the location of the real property, the term of the lease and the difference between the market rate and the rate actually paid, cash flows were projected along with the dates of their occurrence in the projection period. These cash flows were then discounted as at the valuation date using a risk-free rate. The value of the discounted cash flows represents the fair value of the liability as at the valuation date.

5.7 Classification of insurance contracts in accordance with IFRS 4

The PZU Group Companies conducting insurance activity apply the guidelines set forth in IFRS 4 concerning the classification of their products as insurance contracts subject to IFRS 4 or as investment contracts. A contract meets the definition of an insurance contract only if an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (i.e. have no discernible effect on the economics of the transaction) and thus if a contract transfers considerable insurance risk.

The assessment whether a contract transfers considerable insurance risk requires analysis of the cash flows related to a product in various scenarios and estimating the probability of such scenarios. Such an assessment includes an element of subjective judgment, which has significant influence on the accounting policies applied. According to the assumptions made by the PZU Group, we are dealing with considerable insurance risk when the occurrence of an insured event results in disbursement of a benefit that is at least 10% higher than the benefit that would be paid had the event not occurred. Based on this criterion, concluded contracts are recognized either according to IFRS 4 or according to IAS 9.

5.7.1. Classification of non-life insurance contracts

Analysis has shown that all non-life insurance contracts transfer considerable insurance risk and accordingly they are governed by the requirements of IFRS 4.

Additionally, insurance contract accounting is still applied to financial guarantees that meet the definition of a financial instrument.

5.7.2. Classification of life insurance contracts

Analysis has shown that PZU Group’s offer contains products that do not transfer significant insurance risk (including certain products with guaranteed rate of return and some unit-linked products) and thus do not meet the definition of an insurance contract pursuant to IFRS 4. Therefore, these products have been classified in the consolidated financial statements as investment contracts measured in accordance with IFRS 9 at amortized cost or fair value (depending on the structure of each product).

Investment contracts include, among others: Pewny Zysk individual life and endowment insurance (recognized at amortized cost), unit-linked PZU IKZE insurance and Program Inwestycyjny Prestige [Prestige Investment Program] (recognized at fair value).

Both insurance contracts and investment contracts may include discretionary participation features (DPF). They entitle the insured to receive an additional benefit or a bonus in addition to the guaranteed claim. Such a benefit is constitutes a significant portion of the total contractual claim; its amount or term are contractual and they depend on the insurer's discretion, whereas their occurrence depends on:

- history of the specified set or type of contracts;
- whether or not profit is realized on specified assets;
- whether the insurer, a fund or another entity related to the agreement makes profit or incurs loss.

All contracts with discretionary participation features, unilaterally specified by the insurance company, are measured in accordance with IFRS 4.

Additionally, no life insurance contracts have been identified which would provide for a simultaneous transfer of insurance risk and financial risk and require unbundling of insurance and investment components. In the case of contracts where unbundling of embedded options is permitted but not required under IFRS 4 (such as the right to surrender a contract, convert it into a funded contract, guaranteed annuity for a pre-defined premium, indexation of the sum insured and premiums), the investment component is not unbundled.

6. Segment reporting

6.1 Reportable segments

6.1.1. Key classification criterion

Operating segments are components of an entity for which separate financial information is available and is subject to regular assessment by CODM (in practice this is the PZU Management Board), related to allocating resources and assessing operating results.

The main dividing line between segments in the PZU Group is based on the criteria of the nature of business, product groups, client groups and the regulatory environment. The characteristics of individual segments is provided in the table below.

Segment	Accounting standards	Segment description	Aggregation criteria
Corporate insurance (non-life insurance)	PAS	Broad scope of property insurance products, TPL and motor insurance customized to a customer's needs entailing individual underwriting offered to large economic entities by PZU, Link4, TUW PZUW.	Aggregation by similarity of products offered, similar client groups to which they are offered, distribution channels and operation in the same regulatory environment.
Mass insurance (non-life insurance)	PAS	Broad scope of property, accident, TPL and motor insurance products offered to individual clients and entities in the small and medium enterprise sector by PZU and Link4.	As above.

Segment	Accounting standards	Segment description	Aggregation criteria
Group and individually continued insurance (life insurance)	PAS	Group insurance addressed by PZU Życie to groups of employees and other formal groups (e.g. trade unions), under which persons under a legal relationship with the policyholder (e.g. employer, trade union) enroll in the insurance and individually continued insurance in which the policyholder acquired the right to individual continuation during the group phase. PZU Życie's offer covers a wide range of protection, investment (not investment contracts) and health insurance.	No aggregation.
Individual insurance (life insurance)	PAS	Insurance offered by PZU Życie to individual clients under which the insurance contract applies to a specific insured and this insured is subject to individual underwriting. PZU Życie's offer covers a wide range of protection, investment (not investment contracts) and health insurance.	No aggregation.
Investments	PAS	The segment includes: 1. investments of the PZU Group's own funds, understood as the surplus of investments over technical provisions in PZU, Link4 and PZU Życie plus the surplus of income earned over the risk-free rate on investments reflecting the value of technical provisions in insurance products, i.e. surplus of investment income allocated at transfer prices to insurance segments; 2. income from other free funds in the PZU Group (in particular consolidated mutual funds).	The aggregation was effected because of the similar surplus-based nature of the revenues.
Banking activity	IFRS	Broad range of banking products offered both to corporate and retail clients by the Pekao Group and the Alior Bank Group.	The aggregation was carried out due to similarity of products and services offered by the companies and the identical regulatory environment of their operations.
Pension insurance	PAS	2nd pillar pension insurance	No aggregation.
Baltic States	IFRS	Non-life and life insurance products offered by Lietuvos Draudimas AB and its branch in Estonia, AAS Balta and UAB PZU Lietuva Gyvybes Draudimas.	The aggregation was carried out due to similarity of products and services offered by the companies and similarity of the regulatory environment of their operations.
Ukraine	IFRS	Non-life and life insurance products offered by PZU Ukraine and PZU Ukraine Life Insurance.	The aggregation was carried out due to similarity of the regulatory environment of their operations.
Investment contracts	PAS	PZU Życie products that do not transfer significant insurance risk within the meaning of IFRS 4 and that do not meet the definition of an insurance contract (i.e. some products with a guaranteed rate of return and some unit-linked products).	No aggregation.
Other	PAS / IFRS	Other products and services not classified into any of the above segments.	

6.1.2. Information relating to geographical areas

The PZU Group applies additional segmentation by geographic location, according to which the following geographic areas were identified:

- Poland;
- Baltic states;
- Ukraine.

6.2 Inter-segment settlements

The net result of investments (the difference between realized and unrealized revenues and costs) carried in corporate insurance (non-life), mass insurance (non-life), group and individually continued insurance (life), individual insurance (life) is determined on the basis of transfer prices using interest rates from the yield curves for treasuries. For unit-linked insurance products, guaranteed rate products and structured products the net result of investments covering the technical provisions corresponding to them is carried directly.

6.3 Segment's measure of profit

The PZU Group's fundamental measure of a segment's profit is as follows:

- in the case of corporate, mass, group, individually continued and individual insurance segments – insurance result, which is the financial result before tax and other operating income and expenses (including financial costs), however including investment income (corresponding to the value of technical provisions) determined using the risk-free rate. The insurance result is a measure approximately equivalent to the technical result defined in PAS, taking into account the difference in the recognition of the net result on investments as described in the previous sentence;
- in the case of the investment segment – the investment result of PZU Group companies minus the result allocated to insurance segments;
- in the case of investment contracts – the operating result, calculated in the manner approximately equivalent to the technical result in accordance with PAS;
- in the case of banking activity and foreign insurance activity – the operating result according to local accounting standards in the country of the company's registered offices or according to IFRS, which is the financial result before tax.

6.4 Accounting policies applied according to PAS

6.4.1. PZU

PAS and the differences between PAS and IFRS in respect of PZU's standalone financial reporting are presented in detail in the PZU's standalone financial statements for 2018.

PZU's 2018 standalone financial statements are available on the PZU website at www.pzu.pl in the "Investor Relations" tab.

6.4.2. PZU Życie

The accounting standards according to PAS applicable to PZU Życie are convergent with the PAS applicable to PZU.

What is unique to PZU Życie is the rules of accounting for insurance agreements and investment contracts according to IFRS.

The fundamental difference between PAS and IFRS in respect of accounting for insurance agreements and investment contracts at PZU Życie is the classification of contracts. There is no term "investment contract" in PAS, as a consequence of which all agreements are classified as insurance agreements. According to IFRS agreements are classified according to the guidelines set forth under IFRS 4 on the classification of products as insurance agreements (subject to IFRS 4) or investment contracts (measured according to IAS 9). In the case of the latter the written premium is not recognized. The classification of those contracts is described in section 5.7.

6.5 Simplifications in the segmental note

The segmental note has applied certain simplifications permitted by IFRS 8. The justification for their usage is portrayed below:

(in millions of PLN)

- withdrawing from presenting data related to the allocation of all assets and liabilities to various segments – resulting from not preparing and not presenting such tables to the PZU Management Board. The main information delivered to the PZU Management Board consists of data regarding the results of given segments and managerial decisions are made on this basis, including decisions on resource allocation. The analysis of the segmental allocation of assets and liabilities is limited to a large extent to monitoring the fulfillment of the regulatory requirements;
- presenting the net result on investments as a single amount as the difference between the realized and unrealized revenues and the costs of investments – stemming from the internal assessment of the segmental results based on such a combined measure of investment results;
- not allocating other revenues and costs to the segment called „investments" besides realized and unrealized revenues and costs of investments – stemming from the method of analyzing this segment's data and the impracticality of such an allocation.

6.6 Quantitative data

Corporate insurance (non-life insurance)	1 January 2018 - 31 December 2018	1 January 2017 - 31 December 2017
Gross written premium – external	3,059	2,673
Gross written premium – cross-segment	38	65
Gross written premiums	**3,097**	**2,738**
Movement in provision for unearned premiums and gross provision for unexpired risks	(322)	(361)
Gross earned premium	**2,775**	**2,377**
Reinsurers' share in gross written premium	(582)	(440)
Reinsurer's share in the movement in provision for unearned premiums and the gross provision for unexpired risk	133	68
Net earned premiums	**2,326**	**2,005**
Investment income, including:	113	85
external operations	113	85
intersegment operations	-	-
Other net technical income	50	59
Income	**2,489**	**2,149**
Net insurance claims and benefits	(1,591)	(1,323)
Movement in other net technical provisions	2	(10)
Acquisition expenses	(477)	(425)
Administrative expenses	(131)	(137)
Reinsurance commissions and profit participation	39	27
Other	(63)	(90)
Insurance result	**268**	**191**

(in millions of PLN)

Mass insurance (non-life insurance)	1 January 2018 - 31 December 2018	1 January 2017 - 31 December 2017
Gross written premium – external	10,325	10,029
Gross written premium – cross-segment	76	39
Gross written premiums	**10,401**	**10,068**
Movement in provision for unearned premiums and gross provision for unexpired risks	(106)	(465)
Gross earned premium	**10,295**	**9,603**
Reinsurers' share in gross written premium	(113)	(114)
Reinsurer's share in the movement in provision for unearned premiums and the gross provision for unexpired risk	(14)	24
Net earned premiums	**10,168**	**9,513**
Investment income, including:	526	482
external operations	526	482
intersegment operations	-	-
Other net technical income	114	148
Income	**10,808**	**10,143**
Net insurance claims and benefits	(6,171)	(6,069)
Movement in other net technical provisions	(44)	(44)
Acquisition expenses	(1,890)	(1,745)
Administrative expenses	(594)	(608)
Reinsurance commissions and profit participation	(6)	(9)
Other	(378)	(341)
Insurance result	**1,725**	**1,327**

Group and individually continued insurance (life insurance)	1 January 2018 - 31 December 2018	1 January 2017 - 31 December 2017
Gross written premium – external	6,891	6,855
Gross written premium – cross-segment	-	-
Gross written premiums	**6,891**	**6,855**
Movement in the provision for unearned premiums	-	-
Gross earned premium	**6,891**	**6,855**
Reinsurers' share in gross written premium	(1)	(1)
Reinsurer's share in the movement in provision for unearned premiums and the gross provision for unexpired risk	-	-
Net earned premiums	**6,890**	**6,854**
Investment income, including:	581	720
external operations	581	720
intersegment operations	-	-
Other net technical income	2	2
Income	**7,473**	**7,576**
Net insurance claims and benefits and movement in other net technical provisions	(4,931)	(5,142)
Acquisition expenses	(349)	(332)
Administrative expenses	(604)	(587)
Other	(46)	(65)
Insurance result	**1,543**	**1,450**

(in millions of PLN)

Individual insurance (life insurance)	1 January 2018 - 31 December 2018	1 January 2017 - 31 December 2017
Gross written premium – external	1,346	1,664
Gross written premium – cross-segment	-	-
Gross written premiums	**1,346**	**1,664**
Movement in the provision for unearned premiums	(2)	(2)
Gross earned premium	**1,344**	**1,662**
Reinsurers' share in gross written premium	-	-
Reinsurer's share in the movement in provision for unearned premiums and the gross provision for unexpired risk	-	-
Net earned premiums	**1,344**	**1,662**
Investment income, including:	59	419
external operations	59	419
intersegment operations	-	-
Other net technical income	-	-
Income	**1,403**	**2,081**
Net insurance claims and benefits and movement in other net technical provisions	(976)	(1,672)
Acquisition expenses	(126)	(135)
Administrative expenses	(69)	(61)
Other	(5)	(4)
Insurance result	**227**	**209**

Investments	1 January 2018 - 31 December 2018	1 January 2017 - 31 December 2017
Investment income, including:	1,388	1,696
- external operations	(447)	111
- intersegment operations	1,835	1,585
Operating result	**1,388**	**1,696**

Banking activity	1 January 2018 - 31 December 2018	1 January 2017 - 31 December 2017 (restated)
Revenue from commissions and fees	3,133	2,122
Investment income, including:	9,596	6,475
- external operations	9,596	6,475
- intersegment operations	-	-
Income	**12,729**	**8,597**
Fee and commission expenses	(753)	(539)
Interest expenses	(1,904)	(1,249)
Administrative expenses	(4,989)	(3,743)
Other	(1,047)	(627)
Operating result	**4,036**	**2,439**

(in millions of PLN)

Pension insurance	1 January 2018 - 31 December 2018	1 January 2017 - 31 December 2017
Investment income, including:	5	6
external operations	5	6
intersegment operations	-	-
Other income	149	128
Income	**154**	**134**
Administrative expenses	(40)	(44)
Other	(7)	(3)
Operating result	**107**	**87**

Insurance - Baltic States	1 January 2018 - 31 December 2018	1 January 2017 - 31 December 2017
Gross written premium – external	1,592	1,404
Gross written premium – cross-segment	-	-
Gross written premiums	**1,592**	**1,404**
Movement in provision for unearned premiums and gross provision for unexpired risks	(62)	(117)
Gross earned premium	**1,530**	**1,287**
Reinsurers’ share in gross written premium	(48)	(42)
Reinsurer’s share in the movement in provision for unearned premiums and the gross provision for unexpired risk	(2)	3
Net earned premiums	**1,480**	**1,248**
Investment income, including:	2	20
external operations	2	20
intersegment operations	-	-
Income	**1,482**	**1,268**
Net insurance claims and benefits paid	(905)	(773)
Acquisition expenses	(317)	(275)
Administrative expenses	(125)	(111)
Other	3	-
Insurance result	**138**	**109**

(in millions of PLN)

Insurance – Ukraine	1 January 2018 - 31 December 2018	1 January 2017 - 31 December 2017
Gross written premium – external	257	223
Gross written premium – cross-segment	-	-
Gross written premiums	**257**	**223**
Movement in provision for unearned premiums and gross provision for unexpired risks	(12)	(20)
Gross earned premium	**245**	**203**
Reinsurers' share in gross written premium	(96)	(88)
Reinsurer's share in the movement in provision for unearned premiums and the gross provision for unexpired risk	3	8
Net earned premiums	**152**	**123**
Investment income, including:	19	18
external operations	19	18
intersegment operations	-	-
Income	**171**	**141**
Net insurance claims and benefits paid	(59)	(56)
Acquisition expenses	(82)	(69)
Administrative expenses	(25)	(23)
Other	18	18
Insurance result	**23**	**11**

Investment contracts	1 January 2018 - 31 December 2018	1 January 2017 - 31 December 2017
Gross written premium	40	44
Movement in the provision for unearned premiums	-	-
Gross earned premium	**40**	**44**
Reinsurers' share in gross written premium	-	-
Reinsurer's share in the movement in the provision for unearned premiums	-	-
Net earned premiums	**40**	**44**
Investment income, including:	(14)	18
external operations	(14)	18
intersegment operations	-	-
Other income	-	-
Income	**26**	**62**
Net insurance claims and benefits and movement in other net technical provisions	(15)	(50)
Acquisition expenses	(1)	(1)
Administrative expenses	(5)	(7)
Other	(2)	-
Operating result	**3**	**4**

(in millions of PLN)

Other segments	1 January 2018 - 31 December 2018	1 January 2017 - 31 December 2017
Investment income, including:	6	5
- external operations	6	5
- intersegment operations	-	-
Other income	1,004	946
Income	**1,010**	**951**
Expenses	(1,081)	(1,038)
Other	33	33
Operating result	**(38)**	**(54)**

Reconciliations 1 January 2018 – 31 December 2018	Net earned premiums	Investment income	Net insurance claims and benefits	Acquisition expenses	Administrative expenses	Operating result
Corporate insurance	2,326	113	(1,591)	(477)	(131)	268
Mass insurance	10,168	526	(6,171)	(1,890)	(594)	1,725
Group and individually continued insurance	6,890	581	(4,931)	(349)	(604)	1,543
Individual insurance	1,344	59	(976)	(126)	(69)	227
Investments	-	1,388	-	-	-	1,388
Banking activity	-	9,596	-	-	(4,989)	4,036
Pension insurance	-	5	-	(6)	(40)	107
Insurance - Baltic States	1,480	2	(905)	(317)	(125)	138
Insurance – Ukraine	152	19	(59)	(82)	(25)	23
Investment contracts	40	(14)	(15)	(1)	(5)	3
Other segments	-	6	-	-	-	(38)
Total segments	**22,400**	**12,281**	(14,648)	(3,248)	(6,582)	**9,420**
Presentation of investment contracts	(40)	20	15	-	-	-
Estimated salvage and subrogation	-	-	(5)	-	-	(5)
Valuation of equity instruments	-	55	-	-	-	55
Measurement of properties	-	(27)	-	-	(5)	(45)
Elimination of the equalization provision and prevention fund	-	-	-	-	-	24
Allowances to the Company Social Benefit Fund and actuarial costs	-	-	-	-	(5)	(5)
Consolidation adjustments [1)]	(10)	(1,699)	75	118	(17)	(2,357)
Consolidated data	**22,350**	**10,630** [2)]	**(14,563)**	(3,130)	(6,609)	**7,087**

[1)] Consolidation adjustments ensue chiefly from the dividends paid between the various segments and the various accounting standards in which the specific reporting segments are reported (PAS and IFRS) and consolidated data (IFRS).

[2)] The sum of the following line items in the consolidated profit and loss account: “Net investment income”, “Net result on realization of financial instruments and investments”, “Movement in allowances for expected credit losses and impairment losses on financial instruments” and “Net movement in fair value of assets and liabilities measured at fair value”.

(in millions of PLN)

Reconciliations 1 January 2017 – 31 December 2017 (restated)	Net earned premiums	Investment income	Net insurance claims and benefits	Acquisition expenses	Administrative expenses	Operating result
Corporate insurance	2,005	85	(1,323)	(425)	(137)	191
Mass insurance	9,513	482	(6,069)	(1,745)	(608)	1,327
Group and individually continued insurance	6,854	720	(5,142)	(332)	(587)	1,450
Individual insurance	1,662	419	(1,672)	(135)	(61)	209
Investments	-	1,696	-	-	-	1,696
Banking activity	-	6,475	-	-	(3,743)	2,439
Pension insurance	-	6	-	(4)	(44)	87
Insurance - Baltic States	1,248	20	(773)	(275)	(111)	109
Insurance – Ukraine	123	18	(56)	(69)	(23)	11
Investment contracts	44	18	(50)	(1)	(7)	4
Other segments	-	5	-	-	-	(54)
Total segments	**21,449**	**9,944**	**(15,085)**	**(2,986)**	(5,321)	**7,469**
Presentation of investment contracts	(44)	(10)	50	-	-	-
Estimated salvage and subrogation	-	-	23	-	-	23
Valuation of equity instruments	-	(12)	-	-	-	(12)
Measurement of properties	-	(7)	-	-	(1)	(10)
Elimination of the equalization provision and prevention fund	-	-	55	-	-	60
Allowances to the Company Social Benefit Fund and actuarial costs	-	-	-	-	(20)	(20)
Consolidation adjustments [1]	(51)	(1,444)	16	85	(15)	(2,052)
Consolidated data	**21,354**	**8,471 [2]**	**(14,941)**	**(2,901)**	**(5,357)**	**5,458**

[1] Consolidation adjustments ensue chiefly from the dividends paid between the various segments and the various accounting standards in which the specific reporting segments are reported (PAS and IFRS) and consolidated data (IFRS).

[2] The sum of the following line items in the consolidated profit and loss account: "Net investment income", "Net result on realization of financial instruments and investments", "Movement in allowances for expected credit losses and impairment losses on financial instruments" and "Net movement in fair value of assets and liabilities measured at fair value".

Geographic breakdown 2018	Poland	Baltic States	Ukraine	Not allocated (consolidation eliminations and other)	Consolidated value
Gross written premium – external	21,621	1,592	257	-	23,470
Gross written premium – cross-segment	94	-	-	(94)	-
Revenue from commissions and fees	3,374	-	-	-	3,374
Investment income [1]	10,609	2	19	-	10,630
Non-current assets, other than financial assets [2]	6,122	238	4	-	6,364
Deferred tax assets	2,231	-	3	-	2,234
Assets	326,874	2,704	409	(1,433)	328,554

[1] The sum of the following line items in the consolidated profit and loss account: "Net investment income", "Net result on realization of financial instruments and investments", "Movement in allowances for expected credit losses and impairment losses on financial instruments" and "Net movement in fair value of assets and liabilities measured at fair value".

[2] Applies to intangible assets and property, plant and equipment.

(in millions of PLN)

Geographic breakdown 2017	Poland	Baltic States	Ukraine	Not allocated (consolidation eliminations and other)	Consolidated value
Gross written premium – external	21,220	1,404	223	-	22,847
Gross written premium – cross-segment	53	-	-	(53)	-
Revenue from commissions and fees	2,319	-	-	-	2,319
Investment income [1]	8,433	20	18	-	8,471
Non-current assets, other than financial assets [2]	6,486	240	4	-	6,730
Deferred tax assets	1,588	-	2	-	1,590
Assets	316,388	2,190	267	(1,387)	317,458

[1] The sum of the following line items in the consolidated profit and loss account: "Net investment income", "Net result on realization of financial instruments and investments", "Movement in allowances for expected credit losses and impairment losses on financial instruments" and "Net movement in fair value of assets and liabilities measured at fair value".

[2] Applies to intangible assets and property, plant and equipment.

6.7 Information on key customers

Due to the nature of operations undertaken by PZU Group companies, there are no customers that would provide 10% or more of total revenues of the PZU Group (defined as gross written premium).

7. Risk management

7.1 Introduction

Risk management has the following objectives:

- enhance the PZU Group's value through active and deliberate management of the extent of risk taken;
- prevent the acceptance of risk at a level that could pose a threat to the financial stability of the PZU Group or the financial conglomerate within the meaning of the supplementary oversight act.

Risk management in the PZU Group is based on risk analysis in all processes and units. Risk management is an integral part of the management system.

The main elements of PZU Group's risk management have been implemented to ensure sectoral consistency and the execution of the strategic plans of individual companies as well as the business objectives of the entire PZU Group. They include the following:

- systems of limits and limitations on the acceptable level of risk, including the level of risk appetite;
- processes involving the identification, measurement and assessment, monitoring and control, reporting and management measures pertaining to various risks;
- risk management organizational structure in which the management boards and supervisory boards of the entities and dedicated committees play a crucial role.

Entities from the financial sector are additionally obligated to apply the appropriate standards for a given sector. The adopted internal regulations specify among others:

- processes, methods and procedures facilitating risk measurement and management;
- split of duties in the risk management process;
- scope and conditions and the frequency of risk management reporting.

The risk management system in the PZU Group is based on the following:

- organizational structure – comprising a split of duties and tasks performed in the risk management process by statutory bodies, committees and individual organizational units and cells;
- risk management process, including risk identification, measurement and assessment, monitoring and control methods, risk reporting and undertaking management actions.

PZU exercises supervision over the PZU Group's risk management system on the basis of cooperation agreements entered into with Group entities. PZU manages the PZU Group risk from an aggregated perspective and on the basis of the information provided thereunder. The agreements entered into and the scope of information to be provided take into consideration the specific legal nature of each entity, including limitations arising from banking secrecy rules.

In order ensure effective risk management on PZU Group level, risk management rules applicable to subsidiaries have been adopted, containing a recommendation issued by PZU regarding the organization of the risk management system (in both insurance and banking sectors). Additionally, guidelines regulating the various risk management processes in the PZU Group entities are also issued from time to time.

The management boards of PZU Group entities are responsible for fulfilling their own duties in accordance with the generally applicable provisions of national and international law. In particular, they are responsible for the implementation of an adequate and effective risk management system.

Supervision over the risk management systems in the various financial sector unites is exercised by the supervisory boards to which PZU appoints its representatives.

7.2 Organizational structure

The organizational structure of the risk management system is consistent across the PZU Group and in the PZU Group's various financial sector entities consists of four competence levels.

The first three are:

- The Supervisory Board, which supervises the risk management process and assesses its adequacy and effectiveness as part of its decision-making powers defined in each company's Articles of Association and the Supervisory Board bylaws;
- The Management Board, which organizes the risk management system and ensures that it is operational, by adopting strategies and policies, setting the level of risk appetite, defining the risk profile and tolerance levels for individual categories of risk;
- committees, which make decisions to mitigate individual risks to a level determined by the risk appetite. The committees adopt the procedures and methodologies for mitigating individual risks and accept individual risk limits.

The fourth decision-making level pertains to operational measures and is divided into three lines of defense:

- the first line of defense includes ongoing risk management at the business unit and organizational unit level and decision-making as part of the risk management process;
- the second line of defense includes risk management by specialized cells responsible for risk identification, measurement, monitoring and reporting and controlling the limits;
- the third line of defense includes the internal audit division that conducts independent audits of individual components of the risk management system as well as of control activities embedded in the Group's operations.

In the risk management process in banks (Pekao and Alior Bank), an active role is played by Management Board, Supervisory Boards and special committees dealing with credit, financial and operating risk as well as asset and liability management.

Supervisory Boards oversee the risk management process and set out a relevant strategy each year. Management Boards are responsible, among others, for accepting policies and guidelines related to risk management and for setting detailed limits to mitigate bank risk and provide adequate control mechanisms.

Special committees exercise ongoing control over the bank's risk management, which includes decisions about the accepted level of credit risk for single transactions, recommendations of portfolio limits for credit risk to the Management Board, supervision of liquidity risk level, market risk limits and the allowed level of operational risk. In addition, they monitor the risk appetite and capital adequacy levels.

7.3 Risk appetite, risk profile and risk tolerance

A process of determining the risk appetite and risk limits for each risk category consistent with the Group's process has been implemented in the PZU Group insurance entities. The Management Board of each entity determines the risk appetite, risk profile and tolerance limits reflecting its financial plans, business strategy and the objectives of the entire PZU Group.

Risk appetite is defined as the level of risk that a company is prepared to accept in pursuit of its business objectives. The measure of risk appetite is the level of potential financial losses, the decline in asset value or the growth in the amount of liabilities within one year. The risk appetite level is defined as the minimum capital requirements coverage ratio. Risk appetite defines the maximum level of permissible risk while setting limits and restrictions for the various partial risks and the level above which remedial actions are taken to curtail further risk expansion.

The risk profile involves quantitative limits which offer a more precise definition of the risk appetite.

Tolerance limits are additional limits for individual risk types to limit potential risk exposure.

This approach ensures the adequacy and effectiveness of the risk management system in the PZU Group and prevents acceptance of risk levels that could jeopardize the financial stability of individual companies and the entire PZU Group. The Management Board is responsible for setting the appropriate level of risk in each entity, whereas a review of the risk appetite values is conducted once a year by the unit responsible for risk. All actions are coordinated at the PZU Group level.

Risk appetite is determined at least once a year in the PZU Group's banking sector entities. This process is carried out based on the applicable regulatory requirements (including those arising from remedial plans) and best practices. This process is tailored to both banks to reflect their business strategy and capital structure. Risk appetite in banking entities is a topic for consultation with the PZU Group's parent company and the subject matter of opinions issued by the PZU Group Risk Committee with a view to ensuring consistency between the activities carried out by the banks and the strategic plans and business objectives of the entire PZU Group while maintaining an acceptable level of risk at the PZU Group level. Once agreed, the level of risk appetite is then approved by the banking entities' supervisory boards.

7.4 Risk identification, measurement, assessment, monitoring and reporting methods

Identification, measurement and assessment, monitoring and control, and undertaken management activities ensure ongoing adequacy and effectiveness of the risk management system. In the PZU Group, the risk management process consists of the following stages:

- risk identification commences with a proposal to start developing an insurance product, buying a financial instrument, modifying an operating process, and also whenever some other event occurs that may potentially lead to the emergence of risk. The identification process continues until the expiration of liabilities, receivables or activities associated with the risk. Risk identification involves identification of actual and potential sources of risk, which are later analyzed in terms of significance;
- risk measurement and assessment are conducted depending on the nature of the individual risk type and its significance level. Risk measurement is carried out by specialized units. Risk units in each entity are responsible for the development of tools and the measurement of risk in terms of risk appetite, risk profile and tolerance limits;
- risk monitoring and control consists in the ongoing analysis of deviations from benchmarks (limits, threshold values, plans, figures from prior periods, recommendations and guidelines);
- reporting allows for effective communication on risk and supports risk management on various decision-making levels;
- management actions include, among others, risk avoidance, risk transfer, risk mitigation, determination of risk appetite, acceptance of risk level, as well as the use of supporting tools, such as limits, reinsurance programs or underwriting policy reviews.

Two levels are distinguished in the risk management process:

- the PZU Group level, ensuring that the PZU Group attains its business objectives in a safe manner appropriate to fit the scale of the risk involved. Monitored at this level are the limits and risks specific to the PZU Group such as: catastrophic risk, financial risk, counterparty risk and risk concentration. The PZU Group provides support for the implementation of a risk management system, including the introduction of compatible mechanisms, standards and organization of an efficient operation of the internal control system (with particular emphasis on the compliance function), the risk management system (in particular in the reinsurance area) and the security management system in the PZU Group, and monitors their ongoing application. While carrying out their tasks in the risk management system, authorized PZU Group personnel cooperates with the Management Boards of subsidiaries and the management of such areas as finance, risk, actuary, reinsurance, investments and compliance on the basis of appropriate cooperation agreements;
- the entity level, ensuring that the PZU Group entity attains its business objectives in a safe manner appropriate to the scale of the risk involved. Monitored at this level are the limits and risk categories specific to the company and, as part of the risk management system, mechanisms, standards and organization are implemented for the efficient operation of the internal control system (with particular emphasis on the compliance function), the risk management system (in particular in reinsurance area) and the security management system.

7.5 Risk profile

The main types of risk to which the PZU Group is exposed includes credit risk (in particular risk related to bank credit portfolio), actuarial risk, market risk (in particular interest rate risk, foreign exchange risk, and risk related to financial instruments and commodities), concentration risk, operational risk, compliance risk and models risk.

When managing each type of risk, the PZU Group identifies, measures and monitors risk concentration; for the banking sector, these processes occur on the entity level, according to requirements in the sector. To meet the regulatory obligations imposed on capital groups identified as financial conglomerates, intensive adjustment is pending to extend the current risk concentration management model.

7.5.1. Credit and concentration risk

Credit risk is the risk of a loss or adverse change in the financial situation resulting from fluctuations in the trustworthiness and creditworthiness of issuers of securities, counterparties and all debtors, materializing through a counterparty's default on a liability or an increase in credit spread. This definition also includes credit risk in financial insurance.

Credit risk in the PZU Group includes:

- *credit spread* risk, the possibility of incurring a loss due to a change in the value of assets, liabilities and financial instruments resulting from a change in the level of credit spreads as compared to the term structure of interest rates of debt securities issued by the State Treasury or fluctuations of their volatility;
- counterparty default risk, the possibility of incurring a loss as a result of unexpected default of counterparties and debtors or deterioration of their credit rating;
- credit risk in banking activity, credit risk resulting from activity in the banking sector, associated mainly with the possibility that a debtor or borrower defaults on their obligations;
- credit risk in financial insurance, credit risk resulting from activity in the financial insurance sector, related mainly to the possibility that a third party counterparty, or a debtor/borrower defaults on their obligations to a PZU Group client; this threat may result from failure to complete an undertaking or adverse influence of the business environment.

Concentration risk, a risk stemming from the failure to diversify an asset portfolio or from large exposure to the risk of default by a single issuer of securities or a group of related issuers.

Exposure to credit risk in the PZU Group arises directly from banking, investment activities, activity in the financial insurance and guarantee segment, reinsurance agreements, and *bancassurance* operations. The PZU Group distinguishes the following kinds of credit risk exposure:

- risk of a customer defaulting against the PZU Group under contracted credits or loans (in banking activity);
- the risk of bankruptcy of the issuer of financial instruments invested in or traded by the PZU Group, such as corporate bonds;
- the risk of counterparty default, for example in reinsurance or OTC derivative instruments and *bancassurance* activities;
- the risk of PZU Group customer defaulting against a third party, for example in insurance of cash receivables, insurance guarantees.

7.5.1.1. Concentration risk arising out of lending activity

This section presents information related to lending activity of PZU Group's banks.

To prevent adverse events that could result from excessive concentration, both Pekao and Alior Bank mitigate the concentration risk by setting limits and applying concentration standards arising from both external and internal regulations. They include the following:

- rules for identifying areas where concentration risk arises in credit activity;
- taking concentration into account when estimating internal capital;
- the process of setting and updating limit levels;
- the process of managing limits and defining actions taken if the permitted limit level is exceeded;
- concentration risk monitoring process, including reporting;
- oversight over the concentration risk management process.

In the process of setting and updating concentration limits, the following information is taken into account:

- information on the level of credit risk of limited portfolio segments and their impact on realization of assumptions related to risk appetite in terms of credit portfolio quality and capital position;
- sensitivity of limited portfolio segments to changes in the macroeconomic environment, assessed in regular stress tests;
- reliable economic and market information concerning each exposure concentration area, especially macroeconomic and industry ratios, information on economic trends, including the projections of interest rate levels, exchange rates, political risk analysis, ratings of governments and financial institutions;
- reliable information about the economic situation of companies, industries, branches, economic sectors, general economic information including news on the economic and political situation of countries, as well as other information needed to evaluate concentration risk;
- interactions between different kinds of risk, i.e. credit, market, liquidity and operational risk.

Risk analysis is performed using both an individual and a portfolio approach. Measures are undertaken to:

- minimize credit risk for an individual loan with the assumed level of return;
- reduce overall credit risk arising from a specific credit portfolio.

In order to minimize the risk level of a single exposure, the following is assessed every time when a loan or other credit product is granted:

- reliability and creditworthiness, including detailed analysis of the source of exposure repayment;
- collaterals, including review of their formal, legal and economic status, having regard to the *loan to value* (LTV) adequacy ratio.

In order to enhance control over the risk of individual exposures, customers are monitored regularly and appropriate measures are taken if increased risk factors are identified.

In order to minimize credit risk arising from a particular portfolio:

- concentration limits are set and tracked;
- early warning signs are monitored;
- the credit portfolio is monitored regularly, with particular supervision of material credit risk parameters;
- regular stress tests are carried out.

7.5.1.2. Credit risk arising out of lending activity

Risk assessment in credit process

The provision of credit products is accomplished in accordance with loan granting methodologies appropriate for a given client segment and type of product. The internal rating process in both banks constitutes a significant part of assessing credit risk of both the client and the transaction. It is an important step in the credit decision-making process for new loans and for changes of lending terms, and in monitoring loan portfolio quality. Each bank has developed its own models used in the client creditworthiness assessment process, which must be completed before a credit decision is made. The models are based on external information and on internal data. Credit products are granted in the banks in accordance with the operating procedures, whose purpose is to set out the proper steps that must be taken in the credit process, identify the units responsible for those activities and the tools to be applied.

Credit decisions are made in accordance with the existing credit decision system (with decision-making powers at specific levels matching the risk level of a particular client and transaction).

In order to conduct regular assessment of accepted credit risk and to mitigate potential losses on credit exposures, the client's standing is monitored during the lending period by identifying early warning signals and by conducting regular individual reviews of credit exposures.

To minimize credit risk, security interests are established in line with the level of exposure to credit risk and in accordance with the client's ability to provide the required collateral. The establishment of a security interest does not waive the requirement to examine the client's creditworthiness.

Collateral is taken to secure repayment of the loan amount with due interest and costs if the borrower fails to settle its due debt within the dates stipulated in a loan agreement and restructuring activities are not successful. Accepted forms of collateral include: guarantees, sureties, account freezes, registered pledges, transfers of title, assignments of receivables, assignment of credit insurance, promissory notes, mortgages, powers of attorney to bank accounts and security deposits (as special forms of collateral). The assets constituting collateral are reviewed in the credit process in terms of their legal capacity to establish effective security interest and also the recoverable amount in a possible enforcement procedure.

Scoring and credit rating

The rating scale differs by bank, client segment and transaction type. The following tables present the quality of credit portfolios for exposures covered by internal rating models. Because of the different rating models employed by Pekao and Alior Bank, the data are presented for each of the banks separately.

Permanent protection of credit portfolio quality is provided by continuous monitoring of timely service of loans and regular reviews of the financial and economic standing of clients and the value of accepted collateral. This process is applied to all credit exposures of individual and business clients.

(in millions of PLN)

Pekao

Individual client portfolio (unimpaired) covered by the rating model – gross carrying amount	31 December 2018
Mortgage-backed residential loans (1 - best class, 7 worst class)	**53,967**
Class 1 (0.00% <= PD < 0.06%)	10,447
Class 2 (0.06% <= PD < 0.19%)	5,308
Class 3 (0.19% <= PD < 0.35%)	24,380
Class 4 (0.35% <= PD < 0.73%)	10,309
Class 5 (0.73% <= PD < 3.50%)	2,233
Class 6 (3.50% <= PD < 14.00%)	621
Class 7 (14.00% <= PD < 100.00%)	669
Consumer cash loans (1 - best class, 8 worst class)	**11,174**
Class 1 (0.00% <= PD < 0.09%)	798
Class 2 (0.09% <= PD < 0.18%)	1,643
Class 3 (0.18% <= PD < 0.39%)	2,740
Class 4 (0.39% <= PD < 0.90%)	2,567
Class 5 (0.90% <= PD < 2.60%)	1,802
Class 6 (2.60% <= PD < 9.00%)	1,001
Class 7 (9.00% <= PD < 30.00%)	399
Class 8 (30.00% <= PD < 100.00%)	224
Renewable limits (1 - best class, 7 worst class)	**275**
Class 1 (0.00% <= PD < 0.02%)	8
Class 2 (0.02% <= PD < 0.11%)	55
Class 3 (0.11% <= PD < 0.35%)	78
Class 4 (0.35% <= PD < 0.89%)	61
Class 5 (0.89% <= PD < 2.00%)	36
Class 6 (2.00% <= PD < 4.80%)	24
Class 7 (4.80% <= PD < 100.00%)	13
Total individual client segment	**65,416**

Corporate segment portfolio (unimpaired) covered by the rating model – gross carrying amount	31 December 2018
Corporate client (1 – best class, 9 – worst class)	**23,336**
Class 1 (0.00% <= PD < 0.15%)	511
Class 2 (0.15% <= PD < 0.27%)	2,001
Class 3 (0.27% <= PD < 0.45%)	3,708
Class 4 (0.45% <= PD < 0.75%)	5,070
Class 5 (0.75% <= PD < 1.27%)	4,443
Class 6 (1.27% <= PD < 2.25%)	3,953
Class 7 (2.25% <= PD < 4.00%)	1,512
Class 8 (4.00% <= PD < 8.50%)	1,922
Class 9 (8.50% <= PD < 100.00%)	216
Small and medium-sized enterprises (SMEs) (1 – best class, 10 – worst class)	**4,230**
Class 1 (0.00% <= PD < 0.06%)	19
Class 2 (0.06% <= PD < 0.14%)	291
Class 3 (0.14% <= PD < 0.35%)	913
Class 4 (0.35% <= PD < 0.88%)	1,083
Class 5 (0.88% <= PD < 2.10%)	874
Class 6 (2.10% <= PD < 4.00%)	429
Class 7 (4.00% <= PD < 7.00%)	256
Class 8 (7.00% <= PD < 12.00%)	168
Class 9 (12.00% <= PD < 22.00%)	92
Class 10 (22.00% <= PD < 100.00%)	105
Total corporate segment	**27,566**

(in millions of PLN)

Local government units (unimpaired) covered by the rating model – gross carrying amount	31 December 2018
Class 1 (0.00% <= PD < 0.04%)	1
Class 2 (0.04% <= PD < 0.06%)	345
Class 3 (0.06% <= PD < 0.13%)	337
Class 4 (0.13% <= PD < 0.27%)	348
Class 5 (0.27% <= PD < 0.50%)	637
Class 6 (0.50% <= PD < 0.80%)	686
Class 7 (0.80% <= PD < 1.60%)	33
Class 8 (1.60% <= PD < 100.00%)	18
Total local government units	**2,405**

Portfolio of specialized lending exposures within the meaning of CRR Regulation – unimpaired – by supervisory classes – gross carrying amount	31 December 2018
High	1,405
Good	3,876
Satisfactory	797
Poor	14
Total	**6,092**

Pekao Portfolio – data as at 31 December 2018	Gross carrying amount	Write-off	Net carrying amount
Exposures without recognized impairment	127,375	(2,194)	125,181
Portfolio covered by the rating model for the individual client segment	65,416	(1,429)	63,987
Mortgage loans	53,967	(1,168)	52,799
Cash (consumer) loans	11,174	(248)	10,926
Renewable limits	275	(13)	262
Portfolio covered by the rating model for the corporate segment	27,566	(362)	27,204
Corporate clients	23,336	(268)	23,068
Small and medium-sized enterprises (SME)	4,230	(94)	4,136
Portfolio covered by the rating model for the local government unit segment	2,405	12	2,417
Specialized lending exposures	6,092	(99)	5,993
Exposures not covered by the rating model	25,896	(316)	25,580
Exposures with recognized impairment	7,836	(5,197)	2,639
Total receivables from clients on account of impaired loans [1)]	**135,211**	**(7,391)**	**127,820**

[1)] Loan receivables from clients are measured at amortized cost or at fair value through other comprehensive income.

(in millions of PLN)

Non past due financial assets	31 December 2017
Non past due receivables, without impairment	
Retail segment	**59,052**
Mortgage-backed residential loans (1 - best class, 7 worst class)	48,725
Class 1 (0.00% <= PD < 0.06%)	10,308
Class 2 (0.06% <= PD < 0.19%)	5,220
Class 3 (0.19% <= PD < 0.35%)	21,829
Class 4 (0.35% <= PD < 0.73%)	8,464
Class 5 (0.73% <= PD < 3.50%)	1,553
Class 6 (3.50% <= PD < 14.00%)	628
Class 7 (14.00% <= PD < 100.00%)	723
Cash loans (1 - best class, 8 worst class)	10,327
Class 1 (0.00% <= PD < 0.34%)	763
Class 2 (0.34% <= PD < 0.80%)	1,597
Class 3 (0.80% <= PD < 1.34%)	2,555
Class 4 (1.34% <= PD < 2.40%)	2,424
Class 5 (2.40% <= PD < 4.75%)	1,603
Class 6 (4.75% <= PD < 14.50%)	855
Class 7 (14.50% <= PD < 31.00%)	336
Class 8 (31.00% <= PD < 100.00%)	194
Corporate client segment (1 - best class, 9 worst class)	**20,434**
Class 1 (0.00% <= PD < 0.15%)	618
Class 2 (0.15% <= PD < 0.27%)	1,401
Class 3 (0.27% <= PD < 0.45%)	2,803
Class 4 (0.45% <= PD < 0.75%)	6,073
Class 5 (0.75% <= PD < 1.27%)	3,468
Class 6 (1.27% <= PD < 2.25%)	2,494
Class 7 (2.25% <= PD < 4.00%)	1,245
Class 8 (4.00% <= PD < 8.50%)	2,247
Class 9 (8.50% <= PD < 100.00%)	85
Total non past due receivables from clients, without impairment	**79,486**

Portfolio of specialized lending exposures within the meaning of CRR Regulation – unimpaired – by supervisory classes	31 December 2017
High	1,106
Good	4,863
Satisfactory	1,272
Poor	7
Total	**7,248**

(in millions of PLN)

The following table presents the breakdown of the portfolio of loans granted to Pekao clients (including finance lease receivables) into loans covered and not covered by internal rating models.

Exposure	31 December 2017
Loans with no recognized impairment	**129,764**
Loans to retail clients:	**62,073**
Covered by an internal rating model:	59,052
Mortgage loans	48,725
Cash loans	10,327
Other, not covered by an internal rating model	3,021
Loans to businesses:	**67,691**
Covered by an internal rating model	20,434
Portfolio of specialized lending exposures within the meaning of CRR Regulation	7,248
Debt securities not covered by an internal rating model	12,658
Other, not covered by an internal rating model	27,351
Loans with recognized impairment	**2,536**
Total loans and advances to customers [1)]	**132,300**

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	31 December 2018
Retail segment	**26,115**
PD < 0.18%	4,375
0.18% <= PD < 0.28%	2,672
0.28% <= PD < 0.44%	2,687
0.44% <= PD < 0.85%	2,643
0.85% <= PD < 1.33%	2,872
1.33% <= PD < 2.06%	3,106
2.06% <= PD < 3.94%	4,560
3.94% <= PD < 9.10%	1,737
PD => 9.1%	1,094
No scoring	369
Business segment	**19,462**
PD < 0.28%	20
0.28% <= PD < 0.44%	91
0.44% <= PD < 0.85%	1,035
0.85% <= PD < 1.33%	1,495
1.33% <= PD < 2.06%	3,479
2.06% <= PD < 3.94%	5,727
3.94% <= PD < 9.1%	4,267
PD => 9.1%	2,719
Unrated	629
Total non past due receivables, without impairment	**45,577**
Non past due receivables, with impairment	**853**
Retail segment	42
Business segment	811
Total non past due receivables from clients	**46,430**

(in millions of PLN)

Non past due financial assets	31 December 2017
Non past due receivables, without impairment	**45,048**
Retail segment	**25,318**
Mortgage loans, cash loans, credit cards, current account overdraft (1 - best class, 6 - worst class)	2,461
Class 1	507
Class 2	527
Class 3	648
Class 4	734
Class 5	42
Class 6	3
Loans, credit cards, current account overdraft – standard process (K1 - best class, K10 - worst class)	10,841
Class K1-K2	2,514
Class K3-K4	3,868
Class K5-K6	3,528
Class K7-K8	913
Class K9-K10	18
Mortgage loans (M1 - best class, M10 - worst class)	12,016
Class M1-M2	34
Class M3-M4	747
Class M5-M6	3,637
Class M7-M8	2,763
Class M9-M10	543
No scoring	4,292
Business segment	**19,730**
Long-term products, car financing loans, current account overdraft limits (1 - best class, 5 - worst class)	6
Class 1	1
Class 2	1
Class 3	3
Class 4	1
Class 5	-
Models for microbusinesses without full accounting Models for businesses with full accounting, car dealers and developers (Q01 - best class, Q25 - worst class)	19,724
Class Q01-Q05	239
Class Q06-Q10	4,607
Class Q11-Q15	7,830
Class Q16-Q20	4,304
Class Q21-Q25	772
Unrated	1,972
Non past due receivables, with recognized impairment	**988**
Retail segment	68
Business segment	920
Total non past due receivables from clients	**46,036**

7.5.1.3. Application of forbearance

Forbearance is used if a threat arises that a client may default on the terms of a contract because of the financial difficulties, including problems with the service of debt. In such a situation, the terms and conditions of the agreement can be modified to ensure that the borrower is capable of servicing debt. Changes in terms and conditions of contracts may include: reduction of interest rates, principal installment amounts, accrued interest, rescheduling of principal or interest payments.

Accounting policies for the assessment and determination of impairment losses for forborne exposures are broadly in line with the principles for determining impairment losses under IFRS 9.

The PZU Group identifies a significant increase in the credit risk of assets for which forbearance modifications have been applied for the purpose of assessing impairment in accordance with IFRS 9.

(in millions of PLN)

Forborne exposures in the PZU Group's portfolio	31 December 2018						31 December 2017
	Basket 1	Basket 2	Basket 3		Purchased or originated credit-impaired (POCI)	Total	Total
			Individual analysis	Group analysis			
Loan receivables from clients measured at amortized cost							
Gross forborne exposures	501	444	3,170	713	301	5,129	4,952
Impairment loss	(6)	(7)	(1,664)	(308)	(80)	(2,065)	(2,092)
Net forborne exposures	495	437	1,506	405	221	3,064	2,860
Loan receivables from clients measured at fair value through profit or loss	-	-	-	-	2	2	n/a
Total	**495**	**437**	**1,506**	**405**	**223**	**3,066**	**2,860**

Movement in net carrying amount of forborne exposures	31 December 2018	31 December 2017
Opening balance	2,860	800
Effect of implementing IFRS 9	(43)	n/a
Adjusted value of the opening balance	2,817	800
Value of exposures recognized in the period	1,105	974
Value of exposures excluded in the period	(334)	(569)
Movements in impairment losses	(204)	(28)
Change in the composition of the Group	-	2,051
Other changes	(318)	(368)
Total net receivables	**3,066**	**2,860**

7.5.1.4. Credit risk arising out of investing activity

The management principles for credit risk arising from investing activity in the PZU Group are governed by a number of documents approved by supervisory boards, management boards and dedicated committees.

Credit risk exposures to respective counterparties and issuers are subject to restrictions based on exposure limits. The limits are established by dedicated committees, based on the analyses of risks associated with a given exposure and taking into account the financial standing of entities or groups of related entities and the impact of such exposures on the occurrence of concentration risk. Qualitative restrictions on exposures established by individual committees in accordance with their powers form an additional factor mitigating the credit risk and concentration risk identified in investment activities.

The limits refer to exposure limits to a single entity or a group of affiliated entities (this applies to both credit limits and concentration limits). The use of credit risk and concentration risk limits is subject to monitoring and reporting. If the limit is exceeded, appropriate actions, as defined in internal regulations, are taken.

Credit risk assessment of an entity is based on internal credit ratings (the approach to rating differs by type of entity). Ratings are based on quantitative and qualitative analyses and form one of the key elements of the process of setting exposure limits. The credit quality of counterparties and issuers is regularly monitored. One of the basic elements of monitoring is a regular update of internal ratings.

Risk units identify, measure and monitor exposure to credit risk and concentration risk related to investment activity, in particular they give opinions on requests to set exposure limits referred to individual committees.

Information on the credit quality of assets related to investing activity is presented in section 36.

(in millions of PLN)

Exposure to credit risk

The following tables present the credit risk exposure of individual credit risk assets in respective Fitch rating categories (if a Fitch rating was missing, it was substituted by a Standard&Poor's or Moody's rating). Credit risk exposures arising from conditional transactions are presented as an exposure to the issuer of the underlying securities.

The tables do not include loan receivables from clients and receivables due under insurance contracts. This was because these asset portfolios are very dispersed and therefore contains a significant percentage of receivables from unrated entities and individuals.

Credit risk assets at 31 December 2018	AAA	AA	A	BBB	BB	B	Unrated	Assets at the client's risk	Total
Debt securities measured at fair value through other comprehensive income – carrying amount	970	671	23,563	1,304	362	-	11,345	-	38,215
- write-off for expected credit losses [1)]	-	-	(7)	(3)	(1)	-	(29)	-	(40)
Debt securities measured at fair value through profit or loss – carrying amount	49	7	10,080	463	188	-	178	1,211	12,176
Debt securities measured at amortized cost – carrying amount	-	83	27,529	1,652	-	-	5,388	-	34,652
- gross carrying amount	-	83	27,537	1,653	-	-	5,455	-	34,728
- write-off for expected credit losses	-	-	(8)	(1)	-	-	(67)	-	(76)
Term deposits with credit institutions and buy-sell-back transactions – carrying amount	-	-	951	4,151	62	-	793	90	6,047
- gross carrying amount	-	-	951	4,151	62	-	804	90	6,058
- write-off for expected credit losses	-	-	-	-	-	-	(11)	-	(11)
Loans – carrying amount	-	-	-	-	612	-	3,923	-	4,535
- gross carrying amount	-	-	-	-	613	-	3,982	-	4,595
- write-off for expected credit losses	-	-	-	-	(1)	-	(59)	-	(60)
Derivatives	821	405	222	295	-	2	714	28	2,487
Reinsurers' share in claims provisions	-	149	634	-	-	-	135	-	918
Reinsurance receivables	-	21	55	-	-	-	39	-	115
Total	**1,840**	**1,336**	**63,034**	**7,865**	**1,224**	**2**	**22,515**	**1,329**	**99,145**

[1)] The write-off is recognized in revaluation reserve and it does not lower the carrying amount of assets.

Credit risk assets as at 31 December 2017	AAA	AA	A	BBB	BB	Unrated	Assets at the client's risk	Total
Debt securities	560	725	65,897	2,712	598	24,612	1,290	96,394
- held to maturity	-	-	20,941	59	58	179	-	21,237
- available for sale	-	725	34,865	289	41	11,935	-	47,855
- at fair value through profit or loss	560	-	9,964	962	499	404	1,290	13,679
- loans	-	-	127	1,402	-	12,094	-	13,623
Term deposits with credit institutions and buy-sell-back transactions	-	8	960	903	8	759	88	2,726
Other loans	-	-	-	-	282	3,416	-	3,698
Derivatives	-	127	952	212	-	1,020	40	2,351
Reinsurers' share in claims provisions	-	156	452	-	-	167	-	775
Reinsurance receivables	-	9	25	8	-	26	-	68
Total	**560**	**1,025**	**68,286**	**3,835**	**888**	**30,000**	**1,418**	**106,012**

(in millions of PLN)

The table below presents credit risk coefficients used by the PZU Group to measure credit risk:

Standard&Poor's ratings	AAA	AA	A	BBB	BB	B	Unrated
2018 coefficient	0.71%	0.76%	1.34%	3.58%	12.77%	24.95%	24.95%
2017 coefficient	0.72%	0.77%	1.41%	3.76%	13.33%	25.43%	25.43%

The credit risk level attributable to the assets where the risk is carried by the PZU Group as at 31 December 2018 was PLN 6,924 million (as at 31 December 2017 it was PLN 8,866 million; if the coefficients of 31 December 2018 were used, the value would be PLN 8,662 million).

7.5.1.5. Reinsurer's credit risk in insurance activity

PZU Group enters into proportional and non-proportional reinsurance contracts aiming to reduce liabilities arising from its core business. Reinsurance is exposed to credit risk associated with the risk that a reinsurer default on its obligations.

Assessment of reinsurers' creditworthiness is conducted based on market data, information obtained from external sources, such as Standard&Poor's and also based on an internal model. The model divides reinsurers into several classes, depending on the estimated risk level. A reinsurer will not be accepted if its risk is higher than a pre-defined cut-off point. The acceptance is not automatic and the analysis is supplemented by assessments by reinsurance brokers. In the credit risk monitoring process, this assessment is updated on a quarterly basis.

The following tables present the credit risk of the reinsurers that cooperated with PZU Group companies.

Reinsurer	Reinsurers' share in technical provisions (net) as at 31 December 2018	Standard&Poor's rating as at 31 December 2018 [2]
Reinsurer 1	145	A+
Reinsurer 2	127	unrated
Reinsurer 3	108	AA-
Reinsurer 4	70	AA-
Reinsurer 5	66	AA-
Reinsurer 6	49	AA+
Reinsurer 7	47	A+
Reinsurer 8	41	A+
Reinsurer 9	40	AA-
Reinsurer 10	38	AA-
Others, including: [1]	781	
With investment-grade rating	669	BBB- or better
With sub-investment grade rating or unrated	112	BB+ or worse or unrated
Total	**1,512**	

[1] "Others" includes reinsurers' shares in technical provisions if their carrying amounts are lower than those presented above.

[2] A.M. Best ratings were used if Standard&Poor's rating was missing.

(in millions of PLN)

Reinsurer	Reinsurers' share in technical provisions (net) as at 31 December 2017	Standard&Poor's rating as at 31 December 2017 [2]
Reinsurer 1	139	unrated
Reinsurer 2	131	A+
Reinsurer 3	76	AA-
Reinsurer 4	58	AA-
Reinsurer 5	58	unrated
Reinsurer 6	50	AA-
Reinsurer 7	48	A-
Reinsurer 8	36	AA-
Reinsurer 9	30	A+
Reinsurer 10	29	A+
Others, including: [1]	595	
With investment-grade rating	555	BBB- or better
With sub-investment grade rating or unrated	40	BB+ or worse or unrated
Total	**1,250**	

[1] "Others" includes reinsurers' shares in technical provisions if their carrying amounts are lower than those presented above.
[2] A.M. Best ratings were used if Standard&Poor's rating was missing

Counterparty risk related to reinsurance is mitigated by the fact that the PZU Group cooperates with numerous reinsurers with reliable credit ratings.

7.5.1.6. Risk concentration in credit risk

The following table presents the concentration of PZU Group's balance-sheet and off-balance-sheet exposures using the sections of the Polish Classification of Business Activity (PKD):

- exposure to financial investments such as equity instruments, debt securities, loans granted buy-sell-back transactions, bank accounts and term deposits;
- amounts of extended insurance guarantees;
- value of loans (balance-sheet and off-balance-sheet exposure without interest, collected fees and impairment losses) less security deposits paid in cash;
- unauthorized overdrafts in current accounts;
- treasury limits less security deposits paid in cash, including debt securities issued by an entity from each section.

Industry segment	31 December 2018	31 December 2017
Public administration and defense	27.92%	30.28%
Financial and insurance activities	15.83%	14.46%
Manufacturing	12.34%	13.45%
Wholesale and retail trade; repair of motor vehicles	9.88%	9.38%
Real estate activities	8.06%	8.44%
Construction	5.47%	6.04%
Transportation and storage	3.93%	3.53%
Production and supply of electricity, gas, steam, hot water	3.46%	3.75%
Information and communication	2.88%	2.68%
Professional, scientific and technical activity	2.29%	1.99%
Mining and quarrying	1.24%	1.40%
Other sectors	6.70%	4.60%
Total	**100.00%**	**100.00%**

7.5.2. Actuarial risk (non-life and life insurance)

Actuarial risk is the possibility of loss or of adverse change in the value of liabilities under the executed insurance agreements and insurance guarantee agreements, due to inadequate premium pricing and technical provisioning assumptions. Actuarial risk includes:

	Non-life insurance	Life insurance
Longevity risk – the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend, or volatility of mortality rates, where a decrease in the mortality rate leads to an increase in the value of insurance liabilities.	X	X
Expense risk – the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend, or volatility of the expenses incurred in servicing insurance or reinsurance contracts.	X	X
Lapse risk – the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level or volatility of the rates of policy lapses, terminations, renewals and surrenders.	X	X
Catastrophe risk – the risk of loss, or of adverse change in the value of insurance liabilities, resulting from the significant uncertainty of pricing and technical provisioning assumptions related to extreme or irregular events.	X	X
Premium risk – risk of inadequate estimation of tariff rates and possible deviations of written premiums from the expected level, resulting from fluctuations in the timing, frequency and severity of insured events.	X	n/a
Provisioning risk – risk of inadequate estimation of technical provisioning levels and the possibility of fluctuations of actual losses around their statistical average because of the stochastic nature of future claims payments.	X	n/a
Revision risk – the risk of loss, or of adverse change in the value of insurance liabilities, resulting from fluctuations in the level, trend, or volatility of the revision rates applied to annuities, due to changes in the legal environment or health of the person insured.	X	n/a
Mortality risk – the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend, or volatility of mortality rates, where an increase in the mortality rate leads to an increase in the value of insurance liabilities.	n/a	X
Morbidity (disability) risk – the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend or volatility of disability, sickness and morbidity rates.	n/a	X

PZU Group manages its actuarial risk among others through:

- calculation and monitoring of adequacy of technical provisions;
- tariff strategy, monitoring of the current estimates and evaluation of premium adequacy;
- *underwriting;*
- reinsurance.

Calculation and monitoring of adequacy of technical provisions

PZU Group manages its technical provisioning adequacy risk by using appropriate calculation methodology and by controlling provision calculation processes. The provisioning policy is based on:

- prudent approach to the calculation of technical provisions;
- continuity principle, which entails making no changes in the technical provisioning methodology if no significant circumstances occur to justify such changes.

For non-life insurance, the level of technical provisions is evaluated once a month and in specific circumstances (when a payment is made or new information obtained from adjusters or lawyers) their amount is updated. The historical developments and payments of technical provisions over the years are used in the current analyses of technical provisions. This analysis provides an assessment of precision of the current actuarial methods.

For life insurance products, the main sources of data used to estimate the expected frequency of claims include public statistical data (life expectancy tables) published by specialized statistical institutions and analysis of historical insurance portfolio data. Periodic statistical analysis of claim incidence are made at the level of product groups, individual insurance portfolios and properly defined homogeneous risk groups. These analyses form the basis for measuring relative incidence of events compared to publicly available statistical data. The use of appropriate statistical methodologies allows the Group to determine the significance of the statistics and where required – define and apply appropriate safety margins in the determination of technical provisions and risk measurement.

(in millions of PLN)

Estimation of technical provisions in the PZU Group is supervised by chief actuaries.

Tariff strategy, monitoring of current estimates and evaluation of premium adequacy

The objective of the tariff policy is to guarantee adequate level of premium (sufficient to cover current and future liabilities under in-force policies and expenditures). Along with developing a premium tariff, simulations are conducted with regard to the projected insurance profit/loss in subsequent years. Additionally, regular premium adequacy and portfolio profitability studies are carried out for each insurance type based on, among others, evaluation of the technical result on a product for a given financial year. The frequency of analyses is adjusted to the materiality of the product and possible fluctuations of its result. If the insurance history is unfavorable then measures are taken to restore the specified profitability level, which involves adjustments to premium tariffs or to the insured risk profile, through amendments to general terms of insurance.

Underwriting

For corporate and SME customers, the underwriting process is separate from the sales function. The insurance sales process to corporate customers is preceded by analysis and assessment of risk carried out by dedicated underwriting teams. The underwriting process consists of a risk acceptance system based on the assigned decision-making powers and limits.

Reinsurance

The purpose of the PZU Group's reinsurance program in non-life insurance is to secure its core business by mitigating the risk of catastrophic events that may adversely affect the its financial position. This task is performed through obligatory reinsurance contracts supplemented by facultative reinsurance.

PZU Group limits its risk among others by way of:

- non-proportional excess of loss treaties, which protect the portfolios against catastrophic losses (e.g. flood, cyclone);
- non-proportional excess of loss treaties, which protect property, technical, marine, aviation, TPL (including motor TPL) portfolios against the effects of large single losses;
- a proportional treaty, which protects the financial insurance portfolio.

Optimization of the reinsurance program in terms of protection against catastrophic claims is based on the results of internal analyses and uses third-party models.

7.5.2.1. Exposure to actuarial risk – non-life and life insurance

Key cost ratios in non-life insurance	1 January – 31 December 2018	1 January – 31 December 2017
Expense ratio	24.89%	25.91%
Net loss ratio	61.61%	63.51%
Reinsurer's retention ratio	4.98%	4.29%
Combined ratio	86.50%	89.42%

The expense ratio is the ratio of total acquisition expenses, administrative expenses, reinsurance commissions and profit participation, to the net earned premiums.

The net loss ratio is the ratio of claims and the net movement in technical provisions, to the net earned premiums.

The reinsurer's retention ratio is the ratio of the reinsurer's share in gross written premiums, to the gross written premiums.

The combined ratio is the ratio of the sum of acquisition expenses, administrative expenses, reinsurance commissions and profit participation, claims and net movement in technical provisions to the net earned premiums.

(in millions of PLN)

The following tables present the development of technical provisions and payments in successive reporting years.

Claims development in direct non-life insurance, gross (by reporting year)	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Provision at the end of the reporting period	8,699	9,381	9,870	10,989	11,783	13,312	13,163	13,181	13,990	14,975
Provision and total claim payments (from the end of the first reporting period to the end of the current reporting period, excluding payments made before the end of the first reporting period):										
- calculated 1 year later	8,561	9,681	10,298	11,286	12,241	13,032	12,908	13,353	14,251	
- calculated 2 years later	8,856	10,192	10,753	11,958	12,180	12,719	12,922	13,500		
- calculated 3 years later	9,346	10,719	11,590	11,973	12,080	12,822	12,983			
- calculated 4 years later	9,874	11,574	11,738	11,910	12,172	13,089				
- calculated 5 years later	10,712	11,735	11,702	12,067	12,439					
- calculated 6 years later	10,875	11,795	11,871	12,340						
- calculated 7 years later	10,971	12,017	12,184							
- calculated 8 years later	11,201	12,309								
- calculated 9 years later	11,503									
Sum total of the provision and total claim payments (from the end of the first reporting period to the end of the current reporting period, excluding payments made before the end of the first reporting period)	11,503	12,309	12,184	12,340	12,439	13,089	12,983	13,500	14,251	
Total claim payments (from the end of the first reporting period to the end of the current reporting period, excluding payments made before the end of the first reporting period)	6,750	7,227	6,700	6,457	6,041	5,873	5,084	4,206	3,088	
Provision recognized in the statement of financial position	4,753	5,082	5,484	5,883	6,398	7,216	7,899	9,294	11,163	
Difference between the provision at the end of the first year and the provision estimated at the end of the reporting period *(run-off result)*	(2,804)	(2,928)	(2,314)	(1,351)	(656)	223	180	(319)	(261)	
The above difference as % of provision at the end of the first year	-32%	-31%	-23%	-12%	-6%	2%	1%	-2%	-2%	

(in millions of PLN)

Claims development in direct non-life insurance, net of reinsurance (by reporting year)	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Provision at the end of the reporting period	7,973	8,639	9,305	10,413	11,453	12,814	12,653	12,559	12,880	13,484
Provision and total claim payments (from the end of the first reporting period to the end of the current reporting period, excluding payments made before the end of the first reporting period):										
- calculated 1 year later	7,844	8,838	9,731	10,722	11,787	12,525	12,355	12,576	13,066	
- calculated 2 years later	8,092	9,345	10,185	11,282	11,704	12,201	12,278	12,664		
- calculated 3 years later	8,558	9,873	10,947	11,278	11,599	12,224	12,473			
- calculated 4 years later	9,106	10,672	11,071	11,215	11,642	12,481				
- calculated 5 years later	9,892	10,818	11,047	11,326	11,891					
- calculated 6 years later	10,037	10,884	11,167	11,581						
- calculated 7 years later	10,145	11,032	11,449							
- calculated 8 years later	10,311	11,321								
- calculated 9 years later	10,601									
Sum total of the provision and total claim payments (from the end of the first reporting period to the end of the current reporting period, excluding payments made before the end of the first reporting period)	10,601	11,321	11,449	11,581	11,891	12,481	12,473	12,664	13,066	
Total claim payments (from the end of the first reporting period to the end of the current reporting period, excluding payments made before the end of the first reporting period)	6,027	6,429	6,183	5,964	5,805	5,641	4,852	3,910	2,743	
Provision recognized in the statement of financial position	4,574	4,892	5,266	5,617	6,086	6,840	7,621	8,754	10,323	
Difference between the provision at the end of the first year and the provision estimated at the end of the reporting period *(run-off result)*	(2,628)	(2,682)	(2,144)	(1,168)	(438)	333	180	(105)	(186)	
The above difference as % of provision at the end of the first year	-33%	-31%	-23%	-11%	-4%	3%	1%	-1%	-1%	

(in millions of PLN)

Motor insurance – motor own damage (autocasco) and motor TPL – is the core component of the PZU Group's portfolio. Both types of insurance are generally concluded for one year, in which the loss must occur for the claim to be paid out. In the case of motor own damage, the time for reporting a loss is short and it is not the source of uncertainty. Motor TPL is a whole different situation – the period for reporting losses may be up to 30 years. The level of property losses is sensitive especially to the number of litigation claims reported and court rulings awarded in respective cases. In the case of TPL insurance contracts, new types of long-tail losses arise, which makes the process of estimating technical provisions much more complicated.

Risk concentration in non-life insurance

Within actuarial risk, the PZU Group identifies concentration risk with regard to possible losses caused by natural disasters, such as, in particular, floods and cyclones. The table below presents sums insured in the specified ranges, broken down by voivodeships (for operations conducted in Poland) and countries (for foreign operations). With regard to the exposure to the risk of floods and cyclones, the risk management system in the PZU Group allows to monitor it regularly and the reinsurance program in place reduces significantly the potential net catastrophic loss levels.

Exposure to catastrophic losses in property insurance	Sum insured (PLN million) 31 December 2018							Sum insured (PLN million) 31 December 2017						
	0-0.2	0.2 - 0.5	0.5 - 2	2 – 10	10 - 50	over 50	Sum	0-0.2	0.2 - 0.5	0.5 - 2	2 – 10	10 - 50	over 50	Sum
Dolnośląskie	1.1%	1.5%	1.3%	0.6%	0.4%	2.3%	**7.2%**	1.1%	1.5%	1.2%	1.0%	0.7%	2.8%	**8.3%**
Kujawsko-Pomorskie	0.6%	0.7%	0.5%	0.3%	0.3%	2.1%	**4.5%**	0.6%	0.7%	0.5%	0.4%	0.4%	1.2%	**3.8%**
Lubelskie	0.6%	0.6%	0.3%	0.2%	0.2%	1.5%	**3.4%**	0.7%	0.6%	0.3%	0.2%	0.2%	2.1%	**4.1%**
Lubuskie	0.3%	0.3%	0.2%	0.2%	0.1%	0.3%	**1.4%**	0.3%	0.3%	0.2%	0.2%	0.2%	0.3%	**1.5%**
Łódzkie	0.7%	1.1%	0.7%	0.3%	0.3%	4.6%	**7.7%**	0.8%	1.1%	0.8%	0.4%	0.4%	5.6%	**9.1%**
Małopolskie	0.8%	1.6%	0.8%	0.5%	0.4%	1.5%	**5.6%**	0.9%	1.6%	0.8%	0.5%	0.5%	1.6%	**5.9%**
Mazowieckie	1.7%	2.7%	2.1%	0.9%	0.9%	12.2%	**20.5%**	1.7%	2.8%	2.1%	1.0%	1.4%	8.8%	**17.8%**
Opolskie	0.3%	0.4%	0.3%	0.1%	0.1%	1.0%	**2.2%**	0.3%	0.4%	0.3%	0.2%	0.1%	0.9%	**2.2%**
Podkarpackie	0.6%	0.8%	0.3%	0.2%	0.2%	0.7%	**2.8%**	0.7%	0.8%	0.3%	0.2%	0.2%	0.5%	**2.7%**
Podlaskie	0.3%	0.4%	0.3%	0.2%	0.1%	0.1%	**1.4%**	0.4%	0.5%	0.3%	0.2%	0.2%	0.3%	**1.9%**
Pomorskie	0.6%	1.0%	0.8%	0.5%	0.5%	3.7%	**7.1%**	0.7%	1.0%	0.8%	0.5%	0.7%	3.5%	**7.2%**
Śląskie	1.2%	1.4%	0.9%	0.5%	0.3%	2.6%	**6.9%**	1.2%	1.5%	0.9%	0.6%	0.4%	1.9%	**6.5%**
Świętokrzyskie	0.4%	0.5%	0.2%	0.1%	0.1%	0.6%	**1.9%**	0.4%	0.5%	0.2%	0.1%	0.1%	0.6%	**1.9%**
Warmińsko-Mazurskie	0.4%	0.4%	0.3%	0.2%	0.2%	0.5%	**2.0%**	0.4%	0.4%	0.3%	0.3%	0.2%	0.5%	**2.1%**
Wielkopolskie	1.2%	1.7%	1.3%	0.7%	0.5%	2.2%	**7.6%**	1.2%	1.7%	1.3%	0.7%	0.6%	2.1%	**7.6%**
zachodniopomorskie	0.3%	0.4%	0.4%	0.4%	0.4%	2.4%	**4.3%**	0.4%	0.4%	0.4%	0.5%	0.5%	3.5%	**5.7%**
Lithuania and Estonia	0.7%	1.7%	2.5%	0.9%	1.2%	2.3%	**9.3%**	0.7%	1.7%	2.6%	1.0%	0.6%	0.8%	**7.4%**
Latvia	0.2%	0.6%	0.7%	0.4%	0.5%	1.0%	**3.4%**	0.2%	0.7%	0.7%	0.5%	0.6%	0.9%	**3.6%**
Ukraine	0.1%	0.0%	0.0%	0.1%	0.1%	0.5%	**0.8%**	0.1%	0.0%	0.1%	0.2%	0.2%	0.1%	**0.7%**
Total	**12.1%**	**17.8%**	**13.9%**	**7.3%**	**6.8%**	**42.1%**	**100.0%**	**12.8%**	**18.2%**	**14.1%**	**8.7%**	**8.2%**	**38.0%**	**100.0%**

(in millions of PLN)

Capitalized annuities

The following results do not take into account the impact of changes in valuation of investments included in provision calculations.

Impact of the change in assumptions regarding the provision for the capitalized value of annuities in non-life insurance on the net financial result and equity	31 December 2018		31 December 2017	
	gross	net	gross	net
Technical rate - increase by 0.5 p.p.	445	426	424	407
Technical rate - decrease by 1.0 p.p.	(1,155)	(1,105)	(1,094)	(1,051)
Mortality at 110% of the assumed rate	132	127	131	127
Mortality at 90% of the assumed rate	(148)	(142)	(146)	(141)

7.5.2.2. Exposure to insurance risk – life insurance

The PZU Group has not disclosed information on the development of claims in life insurance, since uncertainty about the amount and timing of claims payments is typically resolved within one year.

Risk concentration is associated with the concentration of insurance contracts or sums insured. For traditional individual insurance products, where concentration risk is related to the possibility that an insurable event occurs or is related to the potential level of payouts arising from a single event, the risk is assessed on a case-by-case basis. The assessment includes medical risk and – in justified cases – also financial risk. Consequently, risk selection occurs (a person concluding an insurance agreement is evaluated) and the maximum acceptable risk level is defined.

In group insurance, concentration risk is mitigated by the sheer size of the contract portfolio. This significantly reduces the level of disturbances caused by the random nature of insurance history. Additionally, the collective form of a contract, under which all the persons insured have the same sum insured and coverage is an important risk-mitigating factor. Therefore, some risks within the contract portfolio are not concentrated.

In the case of group insurance contracts in which insurance cover may be adjusted at the level of individual group contracts, a simplified underwriting process is used. It is based on information about the industry in which the work establishment operates, assuming appropriate ratios of the insureds to employees in the work establishment. The insurance premiums used in such cases and appropriate mark-ups result from statistical analyses conducted by PZU Life on incidence of claims at the level of defined homogeneous risk groups, including relative frequency of events compared to public statistical data.

It should be noted that for most contracts, the claim amount is strictly defined in the insurance contract. Therefore, compared to typical non-life insurance contract, concentration risk is reduced, since single events with high claims payments are relatively rare.

Annuity products in life insurance

Impact of the change in assumptions in annuity life insurance on the net financial result and equity	31 December 2018	31 December 2017
Technical rate - decrease by 1.0 p.p.	(25)	(27)
Mortality at 90% of the assumed rate	(11)	(11)

Life insurance products excluding annuity products

Impact of the change in assumptions in life insurance, excluding provisions in annuity products, on the net financial result and equity	31 December 2018	31 December 2017
Technical rate - decrease by 1.0 p.p.	(2,062)	(2,092)
Mortality at 110% of the assumed rate	(869)	(881)
Morbidity and accident rate – 110% of the assumed rate	(143)	(148)

(in millions of PLN)

Effects of lapses in life insurance

Calculation of mathematical technical provisions for life insurance does not include the risk of lapses (resignations). The effects of hypothetical lapses 10% of all life insurance customers are presented below.

Item in financial statements	31 December 2018	31 December 2017
Movement in technical provisions	2,142	2,167
Claims and benefits paid	(803)	(843)
Movement in deferred acquisition expenses	(8)	(8)
Profit/loss before tax	1,331	1,316
Net profit/loss	1,078	1,066
Equity	1,078	1,066

7.5.3. Market risk

Market risk means the risk of loss or of adverse change in the financial situation resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of assets, credit spread, value of liabilities and financial instruments.

Market risk types in the PZU Group include:

- equity risk – the possibility of incurring loss as a result of changes in the values of assets, liabilities and financial instruments caused by changes in the level or in the volatility of market prices of equities;
- unquoted equity risk – the possibility of incurring loss as a result of changes in the valuation of unquoted shares;
- property risk – the possibility of incurring loss as a result of changes in the values of assets, liabilities and financial instruments caused by changes in the level or in the volatility of market prices of real estate;
- commodity price risk – the possibility of incurring loss as a result of changes in the values of assets, liabilities and financial instruments caused by changes in the level or in the volatility of market prices of commodities;
- inflation risk – the possibility of incurring loss associated with the level of information, especially inflation of prices of goods and services as well as expectations as to the future inflation level, which affect the valuation of assets and liabilities;
- liquidity risk – the risk of being unable to realize investments and other assets without affecting their market prices in order to settle financial liabilities when they fall due;
- interest rate risk – the possibility of incurring a loss as a result of changes in the value of financial instruments or other assets and a change in the present value of projected cash flows from liabilities, caused by changes in the term structure of market rates or in the volatility of risk-free market interest rates;
- basis risk – the possibility of incurring a loss as a result of changes in the value of financial instruments or assets and a change in the present value of projected cash flows from liabilities, caused by changes in the term structure of spreads between market interest rates and risk-free rates or in the volatility of such spreads, excluding credit spreads;
- foreign exchange risk – the possibility of incurring loss as a result of changes in the value of assets, liabilities and financial instruments, caused by changes in the level or in the volatility of currency exchange rates;
- credit spread risk – the possibility of incurring loss as a result of changes in the value of assets, liabilities and financial instruments, caused by changes in the level or in the volatility of credit spreads over the term structure of the interest rates on debt securities issued by the State Treasury;
- concentration risk – the possibility of incurring loss stemming either from lack of diversification in the asset portfolio or from large exposure to default risk by a single issuer of securities or a group of related issuers.

Concentration risk and credit spread risk are regarded as an integral part of market risk when measuring risk for the purposes of risk profile, risk tolerance, and market risk ratio reporting. The risk management process has, however, a different set of traits from the process of managing the other sub-categories of market risk and has been described in section 7.5.1.1 along with the process for managing counterparty insolvency risk.

(in millions of PLN)

The market risk in the PZU Group originates from three major sources:

- operations associated with asset and liability matching (ALM portfolio);
- operations associated with active allocation, i.e. designating the optimum medium-term asset structure (AA portfolios);
- banking operations in Pekao Alior Bank – generating material exposure to interest rate risk.

A number of documents approved by supervisory boards, management boards and dedicated committees govern investment activity in the PZU Group's companies.

Risk units take part in the risk identification process, measure, monitor and report on the risks. Market risk is measured using the model of calculating economic capital of market risk based on the value at risk method (VaR) or the standard formula in accordance with the principles defined by the Solvency II Directive. In order to effectively manage market risk, risk limits are adopted in a form of a capital amount allocated to each market risk and limits for individual market risk factors.

In Pekao, the market risk management system forms the structural, organizational and methodological framework, which aims to maintain the balance sheet and off-balance sheet structure in line with the accepted strategic objectives. The market risk management process and the governing procedures include the separation into the banking and trading books.

In managing its trading book's market risk, Pekao strives to optimize the financial performance and ensure the highest possible quality of service of the bank's clients in respect to market-making, while remaining within the limits approved by the management board and the supervisory board.

When managing interest rate risk in its banking book, Pekao endeavors to secure the economic value of equity and to achieve its intended net interest income target within the accepted limits.

In Alior Bank, the exposure to market and liquidity risk is restricted by the system of periodically updated limits introduced by the resolution of the supervisory board or the management board that include all risk measures. In Alior Bank, there are three types of limits that differ in respect to their functioning - basic, supplementary and stress-test limits. Market risk management focuses on limiting potential adverse changes in economic value of equity and optimizing the financial result.

Exposure to market risk

Carrying amount as at 31 December 2018	Note	Assets at Group's risk		Assets at the client's risk	Total
			Including banks' assets		
Financial assets and cash exposed to interest rate risk		**295,402**	**252,859**	**1,303**	**296,705**
Fixed-income debt securities	35	52,534	24,169	1,134	53,668
Variable-income debt securities	35	31,298	28,333	77	31,375
Loan receivables from clients	33	182,054	182,054	-	182,054
Term deposits with credit institutions	35	2,679	976	90	2,769
Loans	35	4,535	-	-	4,535
Cash	38	17,053	15,288	2	17,055
Buy-sell-back transactions	35	3,278	158	-	3,278
Derivatives	34	1,971	1,881	-	1,971
Financial assets exposed to other price risk		**2,347**	**816**	**4,209**	**6,556**
Equity instruments	35	1,859	356	4,181	6,040
Derivatives	34	488	460	28	516
Total		**297,749**	**253,675**	**5,512**	**303,261**

(in millions of PLN)

Carrying amount as at 31 December 2017 (restated)	Note	Assets at Group's risk		Assets at the client's risk	Total
			Including banks' assets		
Financial assets and cash exposed to interest rate risk		**280,829**	**243,736**	**1,384**	**282,213**
Fixed-income debt securities	35	66,973	39,278	1,270	68,243
Variable-income debt securities	35	28,128	25,449	23	28,151
Loan receivables from clients	33	169,457	169,457	-	169,457
Term deposits with credit institutions	35	1,751	851	90	1,841
Loans	35	3,698	-	-	3,698
Cash	38	8,238	6,620	1	8,239
Buy-sell-back transactions	35	885	553	-	885
Derivatives	34	1,699	1,528	-	1,699
Financial assets exposed to other price risk		**3,377**	**898**	**4,503**	**7,880**
Equity instruments	35	2,725	363	4,503	7,228
Derivatives	34	652	535	-	652
Total		**284,206**	**244,634**	**5,887**	**290,093**

The following table presents financial assets of banks and at client's risk, by the item in which they are classified in the consolidated financial statements:

Financial assets of banks and financial assets at client's risk	Note	31 December 2018		31 December 2017 (restated)	
		Pekao and Alior Bank	Financial assets at client's risk	Pekao and Alior Bank	Financial assets at client's risk
Loan receivables from clients	33	**182,054**	**-**	**169,457**	**-**
Financial derivatives		**2,341**	**28**	**2,063**	**-**
Investment financial assets		**53,992**	**5,482**	**66,494**	**5,886**
Measured at amortized cost		18,569	90	n/a	n/a
Debt securities		17,435	-	n/a	n/a
Government securities		11,395	-	n/a	n/a
Domestic		11,395	-	n/a	n/a
Fixed rate		8,491	-	n/a	n/a
Floating rate		2,904	-	n/a	n/a
Other		6,040	-	n/a	n/a
Quoted on a regulated market		738	-	n/a	n/a
Fixed rate		430	-	n/a	n/a
Floating rate		308	-	n/a	n/a
Not quoted on a regulated market		5,302	-	n/a	n/a
Fixed rate		801	-	n/a	n/a
Floating rate		4,501	-	n/a	n/a
Buy-sell-back transactions		158	-	n/a	n/a
Term deposits with credit institutions		976	90	n/a	n/a
Measured at fair value through other comprehensive income		34,546	-	n/a	n/a
Equity instruments		256	-	n/a	n/a
Quoted on a regulated market		44	-	n/a	n/a
Not quoted on a regulated market		212	-	n/a	n/a
Debt securities		34,290	-	n/a	n/a
Government securities		22,509	-	n/a	n/a
Domestic		21,556	-	n/a	n/a
Fixed rate		8,955	-	n/a	n/a
Floating rate		12,601	-	n/a	n/a
Foreign		953	-	n/a	n/a
Fixed rate		953	-	n/a	n/a

(in millions of PLN)

Financial assets of banks and financial assets at client's risk	Note	31 December 2018		31 December 2017 (restated)	
		Pekao and Alior Bank	Financial assets at client's risk	Pekao and Alior Bank	Financial assets at client's risk
Other		11,781	-	n/a	n/a
Quoted on a regulated market		4,121	-	n/a	n/a
Fixed rate		1,248	-	n/a	n/a
Floating rate		2,873	-	n/a	n/a
Not quoted on a regulated market		7,660	-	n/a	n/a
Fixed rate		2,985	-	n/a	n/a
Floating rate		4,675	-	n/a	n/a
Measured at fair value through profit or loss		877	5,392	n/a	n/a
Equity instruments		95	358	n/a	n/a
Quoted on a regulated market		68	358	n/a	n/a
Not quoted on a regulated market		27	-	n/a	n/a
Participation units and investment certificates		5	3,823	n/a	n/a
Quoted on a regulated market		5	61	n/a	n/a
Not quoted on a regulated market		-	3,762	n/a	n/a
Debt securities		777	1,211	n/a	n/a
Government securities		643	1,211	n/a	n/a
Domestic		643	1,207	n/a	n/a
Fixed rate		299	1,130	n/a	n/a
Floating rate		344	77	n/a	n/a
Foreign		-	4	n/a	n/a
Fixed rate		-	4	n/a	n/a
Other		134	-	n/a	n/a
Quoted on a regulated market		9	-	n/a	n/a
Fixed rate		4	-	n/a	n/a
Floating rate		5	-	n/a	n/a
Not quoted on a regulated market		125	-	n/a	n/a
Fixed rate		3	-	n/a	n/a
Floating rate		122	-	n/a	n/a
Financial instruments held to maturity		n/a	n/a	4,839	-
Debt securities		n/a	n/a	4,839	-
Government securities		n/a	n/a	4,808	-
Domestic		n/a	n/a	4,808	-
Fixed rate		n/a	n/a	3,839	-
Floating rate		n/a	n/a	969	-
Other		n/a	n/a	31	-
Not quoted on a regulated market		n/a	n/a	31	-
Fixed rate		n/a	n/a	31	-
Financial instruments available for sale		n/a	n/a	45,772	-
Equity instruments		n/a	n/a	358	-
Quoted on a regulated market		n/a	n/a	117	-
Not quoted on a regulated market		n/a	n/a	241	-
Debt instruments		n/a	n/a	45,414	-
Government securities		n/a	n/a	31,484	-
Domestic		n/a	n/a	30,762	-
Fixed rate		n/a	n/a	19,060	-
Floating rate		n/a	n/a	11,702	-
Foreign		n/a	n/a	722	-
Fixed rate		n/a	n/a	722	-

(in millions of PLN)

Financial assets of banks and financial assets at client's risk	Note	31 December 2018		31 December 2017 (restated)	
		Pekao and Alior Bank	Financial assets at client's risk	Pekao and Alior Bank	Financial assets at client's risk
Other		n/a	n/a	13,930	-
Quoted on a regulated market		n/a	n/a	652	-
Fixed rate		n/a	n/a	652	-
Not quoted on a regulated market		n/a	n/a	13,278	-
Fixed rate		n/a	n/a	13,077	-
Floating rate		n/a	n/a	201	-
Financial instruments measured at fair value through profit or loss – classified as such upon first recognition		n/a	n/a	-	68
Equity instruments		n/a	n/a	-	65
Quoted on a regulated market		n/a	n/a	-	61
Not quoted on a regulated market		n/a	n/a	-	4
Debt instruments		n/a	n/a	-	3
Government securities		n/a	n/a	-	3
Foreign		n/a	n/a	-	3
Fixed rate		n/a	n/a	-	3
Financial instruments measured at fair value through profit or loss – held for trading		n/a	n/a	1,817	5,728
Equity instruments		n/a	n/a	5	4,438
Quoted on a regulated market		n/a	n/a	5	383
Not quoted on a regulated market		n/a	n/a	-	4,055
Debt instruments		n/a	n/a	1,812	1,290
Government securities		n/a	n/a	1,732	1,267
Domestic		n/a	n/a	1,732	1,267
Fixed rate		n/a	n/a	435	1,267
Floating rate		n/a	n/a	1,297	-
Other		n/a	n/a	80	23
Not quoted on a regulated market		n/a	n/a	80	23
Floating rate		n/a	n/a	80	23
Loans		n/a	n/a	14,066	90
Debt securities		n/a	n/a	12,662	-
Other		n/a	n/a	12,662	-
Quoted on a regulated market		n/a	n/a	977	-
Fixed rate		n/a	n/a	281	-
Floating rate		n/a	n/a	696	-
Not quoted on a regulated market		n/a	n/a	11,685	-
Fixed rate		n/a	n/a	1,181	-
Floating rate		n/a	n/a	10,504	-
Buy-sell-back transactions		n/a	n/a	553	-
Term deposits with credit institutions		n/a	n/a	851	90
Cash		**15,288**	**2**	**6,620**	**1**
Total financial assets of banks and financial assets at client's risk		**253,675**	**5,512**	**244,634**	**5,887**

In its investing activities, the PZU Group uses derivatives as a tool to mitigate risk (with or without hedge accounting) and to facilitate efficient management of the investment portfolio.

The PZU Group's exposure to derivatives is presented in section 34.

(in millions of PLN)

Exposure to debt securities issued by governments other than the Polish government

Carrying amount of debt securities issued by governments other than the Polish government	31 December 2018	31 December 2017
United States	957	833
Lithuania	638	431
Ireland	233	7
Spain	232	10
Portugal	226	-
Romania	157	106
Croatia	152	98
Hungary	117	195
Latvia	90	64
Ukraine	90	62
Bulgaria	75	55
Greece	72	-
Indonesia	71	199
Russia	69	46
Brazil	57	105
Turkey	55	150
Argentina	53	101
Other	749 [1)]	1,316 [2)]
Total	**4,093**	**3,778**

[1)] The Other line item states the countries with respect to which the balance sheet exposure does not exceed the equivalent of PLN 50 million: Albania, Armenia, Australia, Azerbaijan, Belarus, Belgium, Bolivia, Cameroon, Chile, Columbia, Costa Rica, Denmark, Dominican Republic, Egypt, Ethiopia, France, Germany, Ghana, Guatemala, Honduras, India, Italy, Ivory Coast (Côte d'Ivoire), Jamaica, Jordan, Kazakhstan, Kenya, Morocco, Mexico, Mongolia, Namibia, the Netherlands, Nigeria, Oman, Panama, Paraguay, Peru, Philippines, South Africa, Senegal, Serbia, Slovenia, Sri Lanka, Sweden, Trinidad and Tobago, United Kingdom, Uruguay, Vietnam.

[2)] The Other line item shows: Azerbaijan, Chile, Dominican Republic, Ecuador, Philippines, Guatemala, Jamaica, Jordan, Kazakhstan, Kenya, Columbia, Costa Rica, Morocco, Mexico, Germany, Nigeria, Oman, Pakistan, Panama, Paraguay, Peru, South Africa, Senegal, Serbia, Slovakia, Slovenia, Sri Lanka, Trinidad and Tobago, Uruguay, United Kingdom, Italy, Ivory Coast, Zambia.

Exposure to debt securities issued by corporations and local government units

Carrying amount of debt securities issued by corporations and local government units	31 December 2018	31 December 2017
Domestic local governments	5,710	6,092
Foreign banks	3,495	61
National Bank of Poland	2,999	13,097
Transportation and storage	1,232	1,904
Companies from the WIG-Energy Index	1,183	1,886
Manufacturing	978	1,159
Public utility services	759	611
Companies from the WIG-Fuels Index	748	666
Companies from the WIG-Banks Index	452	563
Companies from the energy and fuel sector	312	447
Mining and quarrying (including companies included in the WIG-Mining index)	130	644
Other	1,391	1,245
Total	**19,389**	**28,375**

(in millions of PLN)

7.5.3.1. Interest rate

The following table presents the sensitivity test of the portfolio of financial instruments for which the PZU Group bears the risk (except for loan receivables from clients and deposit liabilities).

Change in portfolio value caused by a +/-100 bp shift in the yield curve, by currency of the instrument	31 December 2018		31 December 2017	
	decrease	increase	decrease	increase
Polish zloty	1,237	(1,174)	1,118	(1,060)
Euro	42	(40)	10	(6)
US dollar	169	(153)	164	(143)
other	2	(2)	42	(41)
Total	**1,450**	**(1,369)**	**1,334**	**(1,250)**

The above sensitivity tests do not include the effects of changes in interest rates for technical provisions and liabilities under investment contracts. An analysis of effect of a change in technical rate on measurement of insurance contracts is presented in sections 7.5.2.1 and 7.5.2.2.

Interest rate risk in Pekao

The VaR model is the main tool for measuring interest rate risk of the trading book. This value reflects the level of ten-day loss that may be exceeded with a probability of no more than 1%. VaR is determined through historical simulation, based on a 2-year history of observation of the evolution of risk factors. The set of factors taken into account in the calculation of VaR includes all the relevant market factors that are taken into account in the valuation of financial instruments. The impact of changes in market factors on the current portfolio value is estimated using full revaluation (as a difference between the value of the portfolio after the change in market parameters, by the historically observed changes in those factors, and the present value of the portfolio). In the event of specific credit risk of an issuer, a simplified approach is applied based on an estimated variability of CDS benchmark index. For such a set of probable changes in the portfolio's value (distribution function), VaR is determined as the 1% quantile.

The following table presents VaR for the interest rate risk in Pekao's trading book.

	31 December 2018	for January-December 2018			31 December 2017	for January-December 2017		
		Minimum	Medium	Maximum		Minimum	Medium	Maximum
Trading book – VaR interest rate risk (in thous. PLN)	3,650	1,492	3,425	5,481	2,501	1,568	3,203	6,087

When managing interest rate risk in its banking book, Pekao endeavors to secure the economic value of equity and to achieve its intended net interest income target within the accepted limits. The financial position in view of the changing interest rates is monitored by using interest rate gap (revaluation gap), duration analysis, sensitivity analysis, stress testing and VaR.

The table below presents the contractual level of sensitivity of net interest income (NII) to a 100 bp decline in interest rates and sensitivity of Pekao's economic value of equity (EVE) to a 200 bps decline in interest rates. EVE is defined as the present value of future cash flows that will be generated by the entity's assets, less the present value of the future cash flows necessary to pay the entity's liabilities. Both analyses assume an immediate change in market rates. The interest rate on bank products changes according to the contractual provisions, whereas in the case of contractual NII, for deposits from retail customers, the declines in interest rates are limited to the zero interest rate level, but not down to negative figures. In the case of EVE sensitivity for PLN-denominated current deposits, a model that ensures realistic revaluation is used.

Sensitivity in %	31 December 2018	31 December 2017
NII	-8.64%	-8.14%
EVE	-0.95%	0.79%

(in millions of PLN)

Interest rate risk in Alior Bank

The interest rate risk related to Alior Bank's open positions is linked, first of all, to:

- revaluation date mismatch risk;
- basis risk, or the impact of non-parallel change in reference indexes with a similar revaluation date on the financial result;
- yield curve risk;
- client option risk.

One of the method of estimating exposure to interest rate risk is to calculate BPV, which provides information on the estimated change in the valuation of a transaction/item after a parallel shift in the yield curve by 1 basis point.

BPV estimation for Alior Bank (data in PLN thousand)

Currency	31 December 2018						31 December 2017					
	Up to 6 months	6 months to 1 year	1 year - 3 years	3-5 years	5 to 10 years	Total	Up to 6 months	6 months to 1 year	1 year - 3 years	3-5 years	5 to 10 years	Total
PLN	(33)	285	445	1,003	(122)	**1,578**	3	193	196	95	(90)	**397**
EUR	(40)	42	258	359	15	**634**	-	(8)	61	90	(5)	**138**
USD	16	22	4	-	(2)	**40**	1	8	(2)	-	(1)	**6**
CHF	(2)	-	-	-	-	**(2)**	(1)	-	(1)	-	-	**(2)**
GBP	(1)	2	-	-	-	**1**	(4)	2	-	-	-	**(2)**
Other	-	-	-	-	-	**-**	(1)	2	(1)	-	-	**-**
Total	**(60)**	**351**	**707**	**1,362**	**(109)**	**2,251**	**(2)**	**197**	**253**	**185**	**(96)**	**537**

For the interest rate risk management purposes, Alior Bank distinguishes trading activity involving securities and derivatives concluded for trading purposes and banking activity involving other securities, own issues, loans, deposits, credits and derivative transactions used to hedge the risk of the banking book. Alior Bank uses the Value at Risk (VaR) model to estimate the level of interest rate risk. The following table presents the economic capital to cover interest rate risk measured using this method at the end of 2018 and 2017 (99% VaR with a 10-day horizon).

Book	for January-December 2018			for January-December 2017		
	Minimum	Medium	Maximum	Minimum	Medium	Maximum
Banking book	7	22	40	6	18	31
Trading book	1	3	5	1	2	4
Total	**8**	**25**	**45**	**7**	**20**	**35**

Alior Bank conducts scenario analysis that includes, among others, the impact of changes in interest rates on the future net interest income and economic value of equity. Within these scenarios internal limits are maintained, whose utilization is measured daily. Utilization of the limit of change in economic value of equity after a parallel shift of the percentage curve by +/- 200 bps and non-parallel shifts in the +/- 100/400 bps scenarios (for 1M/10Y tenors, the shift between them follows a linear interpolation) is presented in the following table:

(1M/10Y) scenario	Change in the economic value of equity	
	31 December 2018	31 December 2017
+400 / +100	385	189
+100 / -400	307	68
+200 / +200	281	103
- 200 / - 200	(204)	(85)
- 100 / - 400	(204)	(43)
- 400 / - 100	(219)	(95)

(in millions of PLN)

7.5.3.2. Currency

Exposure to FX risk

Assets by currency	31 December 2018				
	PLN	EUR	USD	Other	Total
Loan receivables from clients	153,035	23,458	1,903	3,658 [1)]	182,054
Financial derivatives	1,818	417	198	54	2,487
Investment financial assets	88,455	7,796	5,174	240	101,665
Measured at amortized cost	42,162	2,580	333	159	45,234
Debt securities	33,592	983	1	76	34,652
Government securities	27,338	86	1	76	27,501
Other	6,254	897	-	-	7,151
Buy-sell-back transactions	3,278	-	-	-	3,278
Term deposits with credit institutions	1,286	1,250	150	83	2,769
Loans	4,006	347	182	-	4,535
Measured at fair value through other comprehensive income	30,788	3,674	4,272	3	38,737
Equity instruments	509	13	-	-	522
Debt securities	30,279	3,661	4,272	3	38,215
Government securities	19,424	3,597	3,143	3	26,167
Other	10,855	64	1,129	-	12,048
Measured at fair value through profit or loss	15,505	1,542	569	78	17,694
Equity instruments	1,057	35	113	15	1,220
Participation units and investment certificates	3,556	550	178	14	4,298
Debt securities	10,892	957	278	49	12,176
Government securities	10,763	918	256	49	11,986
Other	129	39	22	-	190
Receivables	4,537	1,611	124	71	6,343
Cash and cash equivalents	11,741	3,815	778	721 [2)]	17,055
Total assets	**259,586**	**37,097**	**8,177**	**4,744**	**309,604**

[1)] Of which PLN 2,999 million in Swiss francs and PLN 409 million in British pounds.

[2)] Of which PLN 261 million in British pounds, PLN 157 million in Swiss francs, PLN 69 million in Swedish kronor, PLN 67 million in Norwegian kroner and PLN 52 million in Danish kroner.

(in millions of PLN)

Assets by currency	**31 December 2017 (restated)**				
	PLN	**EUR**	**USD**	**Other**	**Total**
Loan receivables from clients	143,417	19,602	2,603	3,835 [1)]	169,457
Financial derivatives	1,690	354	180	127	2,351
Investment financial assets	99,690	6,080	3,912	364	110,046
Held to maturity	20,724	464	13	36	21,237
Debt securities – government	20,589	368	13	36	21,006
Debt securities – other	135	96	-	-	231
Available for sale	43,731	3,058	1,725	5	48,519
Equity instruments	439	203	21	1	664
Debt securities	43,292	2,855	1,704	4	47,855
Government securities	29,113	2,828	1,704	4	33,649
Other	14,179	27	-	-	14,206
Measured at fair value – classified as such upon first recognition	5,967	324	252	107	6,650
Equity instruments	1,616	239	47	45	1,947
Debt securities	4,351	85	205	62	4,703
Government securities	4,326	75	201	62	4,664
Other	25	10	4	-	39
Held for trading	10,904	982	1,608	99	13,593
Equity instruments	4,288	185	133	11	4,617
Debt securities	6,616	797	1,475	88	8,976
Government securities	6,514	794	1,303	88	8,699
Other	102	3	172	-	277
Loans	18,364	1,252	314	117	20,047
Debt securities	12,452	1,059	111	1	13,623
Government securities	-	-	-	1	1
Other	12,452	1,059	111	-	13,622
Other, including:	5,912	193	203	116	6,424
- buy-sell-back transactions	885	-	-	-	885
- term deposits with credit institutions	1,606	58	61	116	1,841
- loans	3,421	135	142	-	3,698
Receivables	7,012	1,741	289	54	9,096
Cash and cash equivalents	4,877	1,959	492	911 [2)]	8,239
Total assets	**256,686**	**29,736**	**7,476**	**5,291**	**299,189**

[1)] Of which PLN 3,152 million in Swiss francs and PLN 121 million in Norwegian kroner.

[2)] Of which PLN 289 million in Czech korunas, PLN 193 million in British pounds, PLN 108 million in Swiss francs, PLN 83 million in Norwegian kroner and PLN 55 million in Swedish kronor.

(in millions of PLN)

Liabilities by currency	31 December 2018					31 December 2017 (restated)				
	PLN	EUR	USD	Other	Total	PLN	EUR	USD	Other	Total
Financial liabilities measured at fair value	3,445	374	157	41	4,017	4,199	385	223	149	4,956
Derivatives held for trading	1,982	277	150	41	2,450	2,038	285	134	149	2,606
Cash flow hedge derivatives	768	3	-	-	771	682	-	-		682
Fair value hedge derivatives	43	94	7	-	144	75	100	11		186
Liabilities on borrowed securities (short sale)	120	-	-	-	120	672	-	78		750
Investment contracts for the client's account and risk (unit-linked)	266	-	-	-	266	312	-	-		312
Liabilities to members of consolidated mutual funds	266	-	-	-	266	420	-	-		420
Financial liabilities measured at amortized cost	188,918	28,534	11,528	3,319	232,299	177,591	27,346	10,790	3,867	219,594
Liabilities to banks	2,234	3,474	60	276 [1]	6,044	2,067	2,559	95	602 [3]	5,323
Liabilities to clients under deposits	172,162	20,962	11,468	3,043 [2]	207,635	163,350	20,853	10,695	3,265 [4]	198,163
Liabilities on the issue of own debt securities	7,998	4,011	-	-	12,009	5,761	3,849	-		9,610
Subordinated liabilities	5,974	87	-	-	6,061	5,234	85	-		5,319
Liabilities on account of repurchase transactions	540	-	-	-	540	1,167	-	-		1,167
Investment contracts with guaranteed and fixed terms and conditions	-	-	-	-	-	1	-	-		1
Finance lease liabilities	10	-	-	-	10	11	-	-		11
Other liabilities	6,654	511	107	135	7,407	7,678	954	257	207	9,096
Total liabilities by currency	**199,017**	**29,419**	**11,792**	**3,495**	**243,723**	**189,468**	**28,685**	**11,270**	**4,223**	**233,646**

[1] Of which PLN 226 million in Swiss francs.
[2] Of which PLN 1,627 million in British pounds, PLN 584 million in Swiss francs, PLN 174 million in Norwegian kroner, PLN 112 million in Swedish kronor, PLN 89 million in Canadian dollars and PLN 81 million in Czech korunas.
[3] Of which PLN 591 million in Swiss francs.
[4] Of which PLN 597 million in Czech korunas, PLN 534 million in Swiss francs, PLN 153 million in Norwegian kroner and PLN 129 million in Swedish kronor.

To manage its FX risk, the PZU Group uses also derivatives which allows it to take a selected market exposure in a more efficient manner than by using cash instruments.

The following table presents the sensitivity test of the portfolio of PZU Group's financial instruments (except for loan receivables from clients and deposit liabilities) in respect to financial instruments for which the PZU Group bears the risk.

Financial assets exposed to exchange risk include investment (deposit) financial assets of the PZU Group and derivative financial assets denominated in foreign currencies.

Change in portfolio value caused by a +/-20% change of the exchange rate	31 December 2018		31 December 2017	
	decrease	increase	decrease	increase
EUR	189	(171)	343	(277)
USD	(27)	48	(33)	43
GBP	(4)	4	(3)	3
Other	(9)	9	(12)	12
Total	**149**	**(110)**	**295**	**(219)**

Both Pekao and Alior Bank use the VaR model to measure currency risk. It allows them to calculate potential loss on currency positions kept by the Bank caused by changes in exchange rates, while maintaining the assumed confidence level (99%) and the period in which the position is kept. The following table presents VaR determined for the trading book FX risk in both banks:

(in millions of PLN)

10-day VaR – fx risk – trading book (PLN thousand)	**31 December 2018**	**31 December 2017**
Pekao	370	2,337
Alior Bank	154	157

7.5.3.3. Equity

Level of risk exposure

The value of the portfolio of equity financial instruments is presented in item 35.2.

Sensitivity analysis

The following table presents the sensitivity test of PZU Group's portfolio of quoted equity instruments for which the PZU Group bears the risk.

Impact of a change in the measurement of quoted equity instruments on equity	**31 December 2018**	**31 December 2017**
increase in measurement of quoted equity instruments by 20%	190	350
decrease in measurement of quoted equity instruments by 20%	(190)	(350)

7.5.3.4. Liquidity risk

Insurance activity

Financial liquidity risk of the PZU Group may result from three types of events:

- shortage of liquid cash compared to current needs;
- illiquidity of financial instruments held;
- structural maturity mismatch between assets and liabilities.

In the liquidity risk management process, liquidity is controlled in the short, medium and long term, i.e.:

- short-term liquidity – the balance of funds in the liquidity portfolio is maintained at no more than the limit specified for them. Conditional sell-buy-back transactions are also used to manage liquidity;
- medium-term liquidity – investment portfolios with appropriate liquidity are maintained;
- long-term liquidity and risk of structural mismatch between the maturity of assets and liabilities – Asset Liability Management (ALM) involves matching the structure of financial investments, which provide coverage for technical provisions, to the character of such provisions.

Another objective of the ALM process is to ensure the capability to pay claims and benefits, also in unfavorable economic conditions. The level of liquidity risk is measured by estimating the shortages of cash required to pay liabilities. The estimate is made using a set of analyzes, including among others a liquidity gap analysis (a mismatch of net cash flows) and an analysis of the distribution of expenditures relating to operating activity.

Pekao

The objective of liquidity risk management is to:

- ensure and maintain the ability to meet both current and future liabilities, taking into account the costs of raising liquidity and return on equity;
- prevent a crisis situation, and
- identify the arrangements for overcoming a crisis when and if it occurs.

(in millions of PLN)

Pekao has a centralized liquidity risk management system in place, which includes regular liquidity management and first level control exercised by responsible units, second level control exercised by a dedicated unit responsible for risk management and independent audit.

Liquidity management in the Pekao Group is planned within the following time horizons:

- intraday – applicable to intra-day flows;
- short-term – including a liquidity measurement system within a one-year horizon;
- long-term – covering a period of more than one year.

Due to the specific nature of the liquidity risk management tools and techniques used, the Pekao Group manages its current and medium-term liquidity together with short-term liquidity.

Alior Bank

The liquidity risk management policy at Alior Bank consists in maintaining liquidity positions so that it is possible to satisfy payment obligations at all times using the available cash in hand, proceeds from transactions with specified maturity dates or through the sale of transferable assets, while minimizing the costs of maintaining liquidity.

Alior Bank manages its liquidity by using ratios and related limits of the following types of liquidity:

- payment liquidity – capacity to finance assets and pay liabilities on a timely basis in the ordinary course of business or in other foreseeable circumstances, without a need to incur loss. In payment liquidity management, special emphasis is placed on the analysis of immediate and current liquidity (up to 7 days);
- short-term liquidity – ability to settle all the cash liabilities by the payment deadline falling within the period of 30 successive days;
- medium-term liquidity – capacity to pay all liabilities with maturity dates from 1 to 12 months;
- long-term liquidity – monitoring the capacity to pay all cash liabilities as they become due, in the period of more than 12 months.

Risk exposure

Carrying amount of debt instruments, by maturity, as at 31 December 2018	up to 1 year	1 – 2 years	2 – 3 years	3 – 4 years	4 – 5 years	Over 5 years	Total
Loan receivables from clients	53,823	18,022	13,302	14,537	12,512	69,858	182,054
Investment (deposit) debt instruments	16,429	8,028	11,300	15,091	9,231	35,546	95,625
Measured at amortized cost	9,485	2,497	2,717	5,005	5,540	19,990	45,234
Debt securities	3,629	2,253	2,663	3,803	4,411	17,893	34,652
Government securities	2,032	1,765	2,218	3,245	3,429	14,812	27,501
Other	1,597	488	445	558	982	3,081	7,151
Buy-sell-back transactions	3,278	-	-	-	-	-	3,278
Term deposits with credit institutions	2,532	170	54	-	-	13	2,769
Loans	46	74	-	1,202	1,129	2,084	4,535
Measured at fair value through other comprehensive income	5,923	4,600	5,952	7,791	2,471	11,478	38,215
Government securities	1,413	4,002	2,581	7,006	1,666	9,499	26,167
Other	4,510	598	3,371	785	805	1,979	12,048
Measured at fair value through profit or loss	1,021	931	2,631	2,295	1,220	4,078	12,176
Government securities	944	887	2,619	2,275	1,215	4,046	11,986
Other	77	44	12	20	5	32	190
Total	**70,252**	**26,050**	**24,602**	**29,628**	**21,743**	**105,404**	**277,679**

(in millions of PLN)

Carrying amount of debt instruments, by maturity, as at 31 December 2017	up to 1 year	1 – 2 years	2 – 3 years	3 – 4 years	4 – 5 years	Over 5 years	Total
Loan receivables from clients	47,531	18,362	13,640	11,036	12,321	66,567	169,457
Investment (deposit) debt instruments	24,465	9,336	8,330	9,583	12,830	38,274	102,818
Held to maturity	229	1,350	1,087	1,243	4,604	12,724	21,237
Government securities	139	1,271	1,081	1,200	4,600	12,715	21,006
Other	90	79	6	43	4	9	231
Available for sale	19,457	5,260	2,632	3,756	4,803	11,947	47,855
Government securities	6,269	5,010	2,519	3,424	4,571	11,856	33,649
Other	13,188	250	113	332	232	91	14,206
Measured at fair value – classified as such upon first recognition	22	272	771	1,554	444	1,640	4,703
Government securities	20	272	770	1,549	417	1,636	4,664
Other	2	-	1	5	27	4	39
Held for trading	263	780	1,587	1,917	1,110	3,319	8,976
Government securities	240	764	1,482	1,903	1,094	3,216	8,699
Other	23	16	105	14	16	103	277
Loans	4,494	1,674	2,253	1,113	1,869	8,644	20,047
Debt securities	1,882	1,601	1,389	982	1,563	6,206	13,623
Government securities	-	1	-	-	-	-	1
Other	1,882	1,600	1,389	982	1,563	6,206	13,622
Other, including:	2,612	73	864	131	306	2,438	6,424
- buy-sell-back transactions	885	-	-	-	-	-	885
- term deposits with credit institutions	1,625	23	76	110	-	7	1,841
- loans	102	50	788	21	306	2,431	3,698
Total	**71,996**	**27,698**	**21,970**	**20,619**	**25,151**	**104,841**	**272,275**

The following table presents future undiscounted cash flow from assets and liabilities as at 31 December 2018.

Liquidity risk	Up to 1 year	1 – 2 years	2 – 3 years	3 – 4 years	4 – 5 years	5 to 10 years	Over 10 years	Total
Assets	**103,494**	**31,994**	**27,926**	**28,309**	**22,599**	**58,494**	**59,863**	**332,679**
Cash and cash equivalents	13,195	142	103	85	74	274	3,258	17,131
Receivables	4,955	1,192	26	7	29	1	180	6,390
Loan receivables from clients	47,576	23,979	19,287	16,650	13,761	36,998	42,209	200,460
Debt securities	31,560	6,184	8,115	9,997	7,069	19,079	14,056	96,060
Loans	298	331	254	1,510	1,562	2,093	160	6,208
Buy-sell-back transactions	3,278	-	-	-	-	-	-	3,278
Term deposits with credit institutions	2,632	166	141	60	104	49	-	3,152
Liabilities	**(106,726)**	**(13,218)**	**(7,707)**	**(4,824)**	**(3,664)**	**(17,013)**	**(117,603)**	**(270,755)**
Technical provisions	(7,122)	(1,806)	(1,316)	(1,081)	(905)	(2,501)	(21,225)	(35,956)
Financial liabilities	(95,013)	(11,138)	(6,378)	(3,732)	(2,740)	(14,476)	(95,724)	(229,201)
Other liabilities	(4,591)	(274)	(13)	(11)	(19)	(36)	(654)	(5,598)
Gap	**(3,232)**	**18,776**	**20,219**	**23,485**	**18,935**	**41,481**	**(57,740)**	**61,924**

The following table presents future undiscounted cash flows from banks' off-balance sheet liabilities (by contractual terms)

Off-balance sheet liabilities granted	up to 1 month	1 -3 months	3 months to 1 year	1 – 5 years	over 5 years	Total
Financing	48,769	-	-	-	-	**48,769**
Guarantees	7,702	-	-	-	-	**7,702**
Total	**56,471**	**-**	**-**	**-**	**-**	**56,471**

7.5.4. Operational risk

Operational risk is the possibility of suffering loss resulting from improper or erroneous internal processes, human activities, system failures or external events.

Operational risk management has the purpose of optimizing the level of operational risk and operating efficiency in the PZU Group's operations, leading to a reduction of losses and costs arising from such risks and ensuring adequate and effective control mechanisms. Information on operational risk levels is regularly reported to relevant internal authorities.

Operational risk is identified in particular by:

- accumulation and analysis of information on operational risk incidents;
- self-assessment of operational risk;
- scenario analyses.

Operational risk is assessed and measured by:

- calculating the effects of the occurrence of operational risk incidents;
- estimating the effects of possible occurrence of operational risk incidents.

Monitoring and control of operational risk is performed mainly through an established system of operational risk indicators enabling assessment of changes in the level of operational risk over time and assessment of factors that affect the level of this risk in the business.

Reporting involves communicating the level of operational risk, the effects of monitoring and control to various decision-making levels. The frequency of each report and the scope of information provided therein are tailored to the information needs at each decision-making level.

Management actions involving reactions to any identified and assessed operational risks involve, in particular:

- taking actions aimed at minimizing risks, for instance by strengthening the internal control system;
- risk transfer – in particular, by entering into insurance agreements;
- risk avoidance by refraining from undertaking or withdrawing from a particular type of business in cases where too high a level of operational risk is ascertained and where the costs involved in risk mitigation are unreasonable;
- risk acceptance – approval of consequences of a possible realization of operational risk unless they threaten to exceed the operational risk tolerance level.

7.5.5. Compliance risk

Compliance risk is the risk of legal sanctions, financial losses or loss of reputation or credibility arising from a failure of PZU Group companies, their employees or entities acting on their behalf to comply with the law, internal regulations or standards of conduct, including ethical standards.

The demarcation of responsibilities with respect to systemic and ongoing compliance risk management is based on internal regulations.

Systemic management entails in particular: developing solutions for implementing compliance risk management principles, monitoring the compliance risk management process and promoting and monitoring compliance with internal regulations and standards of conduct in respect to compliance.

Ongoing compliance risk management entails: identifying, assessing and measuring and adaptation to regulatory requirements.

7.5.6. Model risk

Model risk is the risk of incurring financial losses, incorrectly estimating data reported to the regulatory authority, taking incorrect decision or losing reputation as a result of errors in the development, implementation or application of models. In 2018, model risk was classified as material risk and the formal process of its identification and measurement was started.

At present, the process is implemented at PZU and PZU Życie and aims to ensure high quality of risk management practices applied to this risk.

Model risk is very important for banking sector entities and therefore management of this risk has already been implemented in the course of adaptation to the requirements of Recommendation W issued by the KNF. Both banks have defined standards for the model risk management process, including the rules for developing models and evaluating the quality of their operation and have ensured appropriate corporate governance solutions.

8. Equity management

On 3 October 2016 PZU Supervisory Board adopted a resolution to approve the PZU Group's capital and dividend policy for 2016-2020 ("Policy").

In accordance with the Policy, the PZU Group endeavors to do the following:

- manage capital effectively by optimizing the usage of capital from the PZU Group's perspective;
- maximize the rate of return on equity for the parent company's shareholders, in particular by maintaining the level of security and retaining capital resources for strategic growth objectives through acquisitions;
- ensure sufficient financial means to cover the PZU Group's liabilities to its clients.

The capital management policy rests on the following principles:

- the PZU Group's capital management (including excess capital) is conducted at the level of PZU as the parent company;
- sustain target solvency ratios at the level of 200% for the PZU Group, PZU and PZU Życie (according to Solvency II);
- maintain the PZU Group's financial leverage ratio at a level no higher than 0.35;
- ensure funds for growth and acquisitions in the coming years;
- PZU will not issue any new shares for the duration of this Policy.

The PZU Group and PZU dividend policy assumes that:

- the dividend amount proposed by the PZU Management Board for the financial year is determined on the basis of the PZU Group's consolidated financial result attributable to the parent company, where:
  - no more than 20% will be earmarked as retained earnings (supplementary capital) for goals associated with organic growth and innovations as well as execution of growth initiatives;
  - no less than 50% is subject to payment as an annual dividend;
  - the remaining part will be paid in the form of annual dividend or will increase retained earnings (supplementary capital) if in the given year significant expenditures are incurred in connection with execution of the PZU Group Strategy, including in particular, mergers and acquisitions;

subject to the items below;

- according to the PZU Management Board's plans and risk and solvency self-assessment of the parent company, the own funds of the parent company and the PZU Group following the declaration or payment of a dividend will remain at a level that will ensure fulfillment of the conditions specified in the capital policy;
- when determining the dividend the regulatory authority's recommendations concerning dividends will be taken into consideration.

External capital requirements

According to the Insurance Activity Act, the calculation of the capital requirement is based on market, actuarial (insurance), counterparty insolvency, catastrophic and operational risks. Assets, liabilities and as a consequence own funds covering the capital requirement are measured at fair value. The capital requirement is calculated in accordance with the standard formula at the level of the entire PZU Group.

Pursuant to art. 412 section 1 of the Insurance Activity Act, the PZU Group is obligated to prepare and disclose an annual solvency and financial condition report at the group level drafted in accordance with the principles of Solvency II. The 2017 report published on 14 June 2018 is available online at https://www.pzu.pl/relacje-inwestorskie/informacje-finansowe. For the 2018 report, the publication deadline is no later than 22 weeks after the year end, i.e. in practice until 3 June 2019. Pursuant to art. 290 section 1 of the Insurance Activity Act, a solvency and financial condition report of an insurance undertaking is audited by an audit firm.

Irrespective of the foregoing, some PZU Group companies are required to comply with their own capital requirements imposed by the relevant legal regulations.

The PZU Group's solvency ratio as at 31 December 2017, published in the PZU Group's 2017 solvency and financial condition report, was 207.52%. In 2018, the solvency ratio (both standalone and consolidated) reported to the KNF and not subject to verification by an audit firm as at the end of each quarter remained over the level of 200% (as at the end of Q3, the ratio for the PZU Group was 244.73%). As at the date of signing the consolidated financial statements, the calculation of the solvency ratio as at 31 December 2018 has not yet been available.

Estimated data as at 31 December 2018, available as at the date of consolidated financial statements being signed and not verified by an audit firm, show that the PZU Group fulfills the capital requirements imposed on it and holds a considerable surplus of own funds over the capital requirement.

The maintained levels of solvency ratio comply with those assumed in the capital policy of the PZU Group.

9. Fair value

9.1 Description of valuation techniques

9.1.1. Debt securities and loans

Fair values of debt securities are determined on the basis of quotations publicly available on an active market or valuations published by an authorized information service, and if there are no such quotations – using valuation models containing references to published price quotations of the underlying financial instruments, interest rates and stock exchange indices.

The PZU Group conducts an internal review of the valuations published by the authorized information service comparing them to the valuations available from other sources based on data which can be observed on the market.

The fair value of loans and debt securities for which an active market does not exist is measured using the discounted cash flow method. Discount rates are determined on the basis of the yield curve for government bonds adjusted by the credit spread. It is calculated as at the newest issue date based on the issue price and leads to parallel shifting of the yield curve for government bonds by a fixed amount along its whole length or as the difference between the yield of quoted debt securities of issuers with a similar rating operating in similar industries and the yield of government bonds (German government bonds for bonds denominated in EUR) multiplied by a ratio determined as at the issue date, taking into account issuer-specific risk in the discount curve.

9.1.2. Equity-based financial assets

Fair values of equity-based financial assets are determined on the basis of quotations publicly available on an active market.

Fair values of participation units and investment certificates of mutual funds are measured using the value of the participation units and investment certificates published by the mutual fund companies. Such valuation reflects the PZU Group's share in net assets of these funds.

9.1.3. Derivatives

For derivatives quoted on an active market, the fair value is considered to be the closing price as at the balance sheet date.

The fair value of derivatives not quoted on an active market, including forward contracts and interest rate swaps is measured using the discounted future cash flow method. The rates from OIS curves (overnight indexed swaps), taking into account the currency of the security deposit provided for the instrument, are used to discount cash flows.

The fair value of options related to structured deposits is measured based on valuations provided by the issuers of such options, taking into account a verification of these valuations performed by the PZU Group, based on its own valuation models.

9.1.4. Loan receivables from clients

In order to determine a change in the fair value of receivables from clients (excluding current account overdraft), the margins earned on newly granted loans (in the month preceding the date as at which the consolidated financial statements are prepared) are compared with the margins in the whole loan portfolio. If the margins earned on newly granted loans are higher than the margins in the existing portfolio the fair value of the loan portfolio is lower than its carrying amount.

Loan receivables from clients are classified in full to level 3 of the fair value hierarchy due to the use of a valuation model with significant non-observable input data, i.e. current margins generated on newly granted loans.

9.1.5. Property measured at fair value

Depending on the nature of the real property, its fair value is measured using the comparative method, the income method or the residual method.

The comparative method is used for measuring free land for development and certain smaller and less valuable buildings (such as residential units, garages, etc.). The comparative method assumes the determination of the fair value by reference to observable market prices, taking into account weighting coefficients. Weighting coefficients include, for instance, factors such as the passage of time and the trend of changes in market prices, the location, exposure, intended use in the zoning plan, accessibility for transportation purposes and access roads, surface, neighborhood (including the proximity to attractive objects), investment opportunities, physical conditions, form of exercising control, etc.

The income method assumes estimation of the fair value of the real property based on the discounted value of cash flows. The calculation takes into account such variables as the capitalization rate, the level of rents, the level of operating expenses, the provision for vacancy, losses resulting from rent free periods, rent arrears, etc. The values of the variables described above vary depending on the nature and the intended use of the measured real property (office space, retail space, logistics and warehousing space), its modernity and location (access roads, distance from an urban center, accessibility, exposure, etc.) as well as parameters specific to the relevant local market (such as capitalization rates, the level of rents, operating expenses, etc.).

The residual method is used to measure the market value if the real property is to be subjected to construction works. The fair value of such a real property is calculated as the difference in the value of the property after the construction works and the average value of the cost of these works, taking into account any gains earned in the market on similar properties.

Property measured at fair value is valuated by licensed appraisers. The acceptance of each such measurement is additionally preceded by a review conducted by PZU Group companies' employees in order to eliminate any potential errors or inconsistencies. Any emerging doubts are clarified on an ongoing basis.

Investment property is measured in accordance with the following rules:

- real properties held by mutual funds controlled by PZU – measured every 6 months – on days ending each financial half-year and financial year;
- investment properties held by PZU Group companies – the most valuable items are measured in the event of ascertainment of a possible significant change in the value (usually on an annual basis). Regardless of the value, each investment property is measured not less frequently than once every 5 years;

- real properties held for sale – measured before the commencement of their active exposure to the market in accordance with the requirements of IFRS 5.

9.1.6. Financial liabilities

9.1.6.1. Liabilities under deposits

Due to the fact that deposits are accepted under current operations on a daily basis, hence their terms are similar to the current market terms for identical transactions, and the time to maturity for such loans is short, it is deemed that for liabilities to clients with maturities up to 1 year the fair value does not significantly deviate from the carrying amount.

9.1.6.2. Liabilities on the issue of own debt securities and subordinated liabilities

The fair value of liabilities on the issue of own debt securities, including subordinated liabilities, is calculated as the present value of expected payments based on the current interest rate curves and the current credit spread.

9.1.6.3. Liabilities under investment contracts for the client's account and risk

Liabilities under investment contracts for the client's account and risk are measured at the fair value of assets covering the liabilities of the unit-linked fund associated with the relevant investment contract.

9.1.6.4. Liabilities to members of consolidated mutual funds

Liabilities to members in the consolidated mutual funds are measured at the fair value of assets of the relevant mutual fund (according to the share in the mutual fund's net assets).

9.1.6.5. Liabilities on borrowed securities

Liabilities on securities borrowed to make a short sale are measured at the fair value of borrowed securities.

9.2 Fair value hierarchy

On the basis of the input data for fair value measurement, the individual assets and liabilities for which fair value has been presented have been classified to the following levels:

- Level I – assets and liabilities measured based on quoted prices (unadjusted) from active markets for identical assets and liabilities. This level includes:
  - liquid quoted debt securities;
  - shares and investment certificates quoted on exchanges;
  - derivatives quoted on exchanges;
- Level II – assets and liabilities whose measurement is based on input data other than quoted prices included within level I, which can be observed on the market, either directly (as prices) or indirectly (derived from prices). This level includes:
  - quoted debt securities carried on the basis of the valuations published by an authorized information service;
  - derivatives – among others FX Swap, FX Forward, IRS, CIRS, FRA;
  - participation units in mutual fund;

- investment properties or properties held for sale measured using the comparative method, including free land free land for development and certain smaller and less valuable buildings (such as residential units, garages, etc.);
- liabilities to members of consolidated mutual funds;
- investment contracts for the client's account and risk.

- Level III – assets measured based on input data unobserved on the existing markets (unobservable input data). This level includes:
  - unquoted debt securities and non-liquid quoted debt securities (including non-treasury debt securities issued by other financial entities, local government and non-financial entities), measured using models based on discounted cash flows;
  - investment properties or properties held for sale measured using the income method or the residual method;
  - loan receivables from clients and liabilities to clients under deposits;
  - options embedded in certificates of deposit issued by PZU Group companies and options concluded in the interbank market to hedge embedded option positions.

In a situation in which the measurement of an asset or liability is based on input data classified in different levels of the fair value hierarchy, the measured asset is assigned to the lowest level from which the input data are taken, provided that they have a significant impact on the overall measurement.

The value of the measurement of components of assets or liabilities qualified in level III is affected to significant extent by unobservable input data.

Measured assets	Unobservable data	Description	Impact on measurement
Loan receivables from clients	Liquidity margin and current margin from the sale of the product group	Fair values are estimated using valuation techniques, with an assumption that when the loan is granted, the fair value is equal to the carrying amount. The fair value of loans without recognized impairment is equal to the sum of future expected cash flows discounted at the balance sheet date less expected credit loss. The cash flow discounting rate is the appropriate risk-free market rate plus the liquidity margin and current sales margin for the loan's product group. The margin is determined by product group and by maturity. For the purpose of estimating the fair value of foreign currency loans, the liquidity margin for PLN loans is used, adjusted by quotations of FX swap and basis-swap transactions. The fair value of loans with recognized impairment is equal to the sum of future expected salvage discounted using the effective interest rate, since the average expected recoveries fully reflect the credit risk component. For loans that do not have a repayment schedule (current account loans, overdrafts and credit cards), the fair value is assumed to be equal to the carrying amount.	Negative correlation.
Liabilities to clients under deposits	Sales margin	Fair values are estimated using valuation techniques, with an assumption that when the deposit is accepted, the fair value is equal to the carrying amount. The fair value of term deposits is equal to the sum of future expected cash flows discounted at the balance sheet date. The cash flow discounting rate is the appropriate risk-free market rate plus the current sales margin. The margin is determined on the basis of deposits accepted in the last quarter, by product group and by maturity. For short-term deposits (current deposits, overnight deposits and savings accounts), the carrying amount is taken as fair value.	Negative correlation.
Options embedded in certificates of deposit issued by PZU Group companies and options concluded in the interbank market to hedge embedded option positions.	Model parameters	Embedded instruments are plain vanilla options and exotic options for individual shares, indices, commodities and other market indicators, including interest rate indices and exchange rates and their baskets. All separated options are offset on an ongoing basis on the interbank market. Currency options are measured based on the Garman-Kohlhagen option pricing model (and in the case of barrier and Asian options based on the so-called extended Garman-Kohlhagen model). Exotic options embedded in deposit agreements and their offsets are measured using the Monte-Carlo technique, assuming a geometric Brownian motion model for risk factors.	

Measured assets	Unobservable data	Description	Impact on measurement
Non-liquid bonds and loans	Credit spreads	Spreads are observed on all bonds (their series) or loans of the same issuer or a similar issuer. These spreads are observed on the dates of issue of new bond series, dates of conclusion of new loan agreements and dates of market transactions on the receivables following from such bonds and loans.	Negative correlation.
Investment property and property held for sale	Capitalization rate	Capitalization rate is determined through analysis of rates of return obtained in transactions for similar properties.	Negative correlation.
	Construction costs	Construction costs are determined based on market construction costs less costs incurred as at the date of measurement.	Positive correlation.
	Monthly rental rate per 1 m^2 of relevant space or per parking space	Rental rates are observed for similar properties of similar quality, in similar locations and with a similar size of leased space.	Positive correlation.
Derivatives	Model parameters	Currency options are measured based on the Garman-Kohlhagen option pricing model (and in the case of barrier and Asian options based on the so-called extended Garman-Kohlhagen model). Exotic options embedded in deposit agreements and their offsets are measured using the Monte-Carlo technique, assuming a geometric Brownian motion model for risk factors.	
Own issues and subordinated loans	Issue spread above the market curve	If historical issue spread above the market curve is used, these issues are classified at level III of the fair value hierarchy.	Negative correlation.
Equity instruments not quoted on an active market		Quotations of financial services	

(in millions of PLN)

9.2.1. Assets and liabilities measured at fair value

Assets and liabilities measured at fair value	31 December 2018				31 December 2017 (restated data)			
	Level I	Level II	Level III	Total	Level I	Level II	Level III	Total
Assets								
Investment financial assets measured at fair value through other comprehensive income	22,200	9,329	7,208	38,737	n/a	n/a	n/a	n/a
Equity instruments	309	1	212	522	n/a	n/a	n/a	n/a
Debt securities	21,891	9,328	6,996	38,215	n/a	n/a	n/a	n/a
Investment financial assets measured at fair value through profit or loss	12,758	4,684	252	17,694	n/a	n/a	n/a	n/a
Equity instruments	1,105	-	115	1,220	n/a	n/a	n/a	n/a
Participation units and investment certificates	102	4,182	14	4,298	n/a	n/a	n/a	n/a
Debt securities	11,551	502	123	12,176	n/a	n/a	n/a	n/a
Loan receivables from clients	-	-	1,814	1,814	n/a	n/a	n/a	n/a
Measured at fair value through other comprehensive income	-	-	1,511	1,511	n/a	n/a	n/a	n/a
Measured at fair value through profit or loss	-	-	303	303	n/a	n/a	n/a	n/a
Financial derivatives	35	2,384	68	2,487	29	2,222	100	2,351
Financial assets available for sale	n/a	n/a	n/a	n/a	30,027	17,081	1,411	48,519
Equity instruments	n/a	n/a	n/a	n/a	210	156	298	664
Debt securities	n/a	n/a	n/a	n/a	29,817	16,925	1,113	47,855
Financial instruments measured at fair value through profit or loss – classified as such upon first recognition	n/a	n/a	n/a	n/a	6,143	464	43	6,650
Equity instruments	n/a	n/a	n/a	n/a	1,802	127	18	1,947
Debt securities	n/a	n/a	n/a	n/a	4,341	337	25	4,703
Financial instruments measured at fair value through profit or loss – held for trading	n/a	n/a	n/a	n/a	7,363	6,133	97	13,593
Equity instruments	n/a	n/a	n/a	n/a	526	4,091	-	4,617
Debt securities	n/a	n/a	n/a	n/a	6,837	2,042	97	8,976
Investment property	-	141	1,556	1,697	-	151	2,204	2,355
Liabilities								
Derivatives	34	3,295	36	3,365	22	3,400	52	3,474
Liabilities to members of consolidated mutual funds	-	266	-	266	-	420	-	420
Investment contracts for the client's account and risk *(unit-linked)*	-	266	-	266	-	312	-	312
Liabilities on borrowed securities (short sale)	120	-	-	120	737	13	-	750

(in millions of PLN)

Movement in assets and liabilities classified as Level III of the fair value hierarchy in the year ended 31 December 2018	Investment financial assets measured at fair value through other comprehensive income		Investment financial assets measured at fair value through profit or loss			Derivatives – assets	Derivatives – liabilities	Loan receivables from clients measured at fair value		Investment property
	Equity	Debt	Equity	Investment certificates	Debt			through other comprehensive income	through profit or loss	
Balance at the beginning of the period – classification at the time of applying IFRS 9	**221**	**4,855**	**95**	**-**	**163**	**100**	**52**	**1,556**	**365**	**2,204**
Purchase/opening of the position	-	3,034	-	14	727	16	10	409	3	139
Reclassification from Level I	-	-	2	-	-	-	-	-	-	-
Reclassification from Level II	-	190 [1]	-	-	-	-	-	-	-	3
Reclassification from own properties	-	-	-	-	-	-	-	-	-	4
Profit or loss recognized in the profit and loss account as:	-	49	14	-	3	(30)	(9)	29	3	48
- net investment income	-	49	-	-	-	-	-	29	-	-
- net result on realization of financial instruments and properties	-	-	(2)	-	-	(3)	-	-	-	-
- net movement in fair value of assets and liabilities measured at fair value	-	-	16	-	3	(27)	(9)	-	3	48
Profits or losses recognized in other comprehensive income	(9)	(12)	-	-	-	-	-	31	-	-
Sale and settlements	-	(1,056)	-	-	(756)	(18)	(17)	(514)	(68)	(11)
Reclassification to assets held for sale	-	-	-	-	-	-	-	-	-	(831)
Reclassification to Level II	-	(64)	-	-	(14)	-	-	-	-	-
Foreign exchange differences	-	-	4	-	-	-	-	-	-	-
Balance at the end of the period	**212**	**6,996**	**115**	**14**	**123**	**68**	**36**	**1,511**	**303**	**1,556**

[1] Corporate and local government bonds were reclassified to level III; for those bonds, a parameter implied from historical data (credit spread) used in the valuation model exerts a significant influence on measurement.

(in millions of PLN)

Movement in assets and liabilities classified as Level III of the fair value hierarchy in the year ended 31 December 2017	Investment financial assets available for sale		Investment financial assets measured at fair value through profit or loss – classified as such upon first recognition		Investment financial assets measured at fair value through profit or loss – held for trading – Debt	Derivatives – assets	Derivatives – liabilities	Investment properties
	Equity	Debt	Equity	Debt				
Balance at the beginning of the period	38	614	17	25	135	53	26	1,589
Purchase/opening of the position	6	-	21	-	290	32	23	63
Reclassification from Level II	-	662 [1)]	-	-	4	-	-	-
Reclassification from own properties and properties held for sale	-	-	-	-	-	-	-	830
Profit or loss recognized in the profit and loss account as:	-	31	2	2	3	37	19	(102)
- net investment income	-	31	5	-	-	(1)	-	-
- net movement in fair value of assets and liabilities measured at fair value	-	-	(3)	2	3	38	19	(102)
Profits or losses recognized in other comprehensive income	9	(26)	-	-	-	-	-	-
Sale and settlements	-	(437)	(22)	(2)	(380)	(22)	(16)	(4)
Reclassification to own properties and properties held for sale	-	-	-	-	-	-	-	(196)
Foreign exchange translation differences	(1)	-	-	-	-	-	-	
Change in the composition of the Group	246	252	-	-	45	-	-	24
Other	-	17	-	-	-	-	-	-
Balance at the end of the period	**298**	**1,113**	**18**	**25**	**97**	**100**	**52**	**2,204**

[1)] Municipal bonds were reclassified to level III; for those bonds, a parameter implied from historical data (credit spread) used in the valuation model exerts a significant influence on measurement.

(in millions of PLN)

9.2.1.1. Change in the fair value measurement methodology for financial instruments measured at fair value

Both in 2018 and in 2017, no changes were made in the fair value measurement method for financial instruments measured at fair value that would be of material significance for the consolidated financial statements.

9.2.1.2. Investment property classified as Level III fair value

Investment property classified as Level III	Type of space	31 December 2018			31 December 2017 (restated)		
		Carrying amount	Rental fees included in the measurement	Capitalization rates included in the measurement	Carrying amount	Rental fees included in the measurement	Capitalization rates included in the measurement
Office properties	Office Parking lot	651	EUR 12.00 – 14.25 EUR 40.00 – 73.00	5.95% – 7.75%	710	EUR 8.00 – 19.18 EUR 35.00 – 119.88	6.60% – 7.55%
Commercial properties	Commercial	-	-	-	102	depending on size of leased space	7.40% – 8.70%
Warehousing properties	Office Warehouse	889	EUR 6.48 – 9.15 EUR 3.00 – 4.04	6.00% – 6.90%	1,365	EUR 6.50 – 9.00 EUR 2.40 – 3.60	6.00% – 7.80%
Other		16			27		
Total		**1,556**			**2,204**		

9.2.2. Assets and liabilities not measured at fair value

Fair value of assets and liabilities for which it is only disclosed	31 December 2018				31 December 2017 (restated)			
	Level I	Level II	Level III	Total	Level I	Level II	Level III	Total
Assets								
Entities measured by the equity method – EMC	-	-	14	14	-	-	20	20
Loan receivables from clients measured at amortized cost	-	-	180,507	180,507	-	-	169,393	169,393
Investment financial assets	24,251	2,301	21,541	48,093	17,632	9,849	16,164	43,645
Measured at amortized cost	24,251	2,301	21,541	48,093	n/a	n/a	n/a	n/a
Debt securities	24,251	1,239	11,900	37,390	n/a	n/a	n/a	n/a
Buy-sell-back transactions	-	126	3,153	3,279	n/a	n/a	n/a	n/a
Term deposits with credit institutions	-	936	1,830	2,766	n/a	n/a	n/a	n/a
Loans	-	-	4,658	4,658	n/a	n/a	n/a	n/a
Held to maturity	n/a	n/a	n/a	n/a	17,631	305	5,582	23,518
Loans	n/a	n/a	n/a	n/a	1	9,544	10,582	20,127
Debt securities classified in the loans portfolio	n/a	n/a	n/a	n/a	1	8,153	5,500	13,654
Buy-sell-back transactions	n/a	n/a	n/a	n/a	-	553	333	886
Term deposits with credit institutions	n/a	n/a	n/a	n/a	-	838	1,005	1,843
Loans	n/a	n/a	n/a	n/a	-	-	3,744	3,744

(in millions of PLN)

Fair value of assets and liabilities for which it is only disclosed	31 December 2018				31 December 2017			
	Level I	Level II	Level III	Total	Level I	Level II	Level III	Total
Liabilities								
Liabilities to banks	-	781	5,280	6,061	-	1,161	4,092	5,253
Liabilities to clients under deposits	-	-	207,668	207,668	-	-	201,605	201,605
Liabilities on the issue of own debt securities [1]	-	5,295	6,800	12,095	-	2,808	6,627	9,435
Subordinated liabilities [1]	-	2,013	4,043	6,056	-	1,257	4,108	5,365
Liabilities on account of repurchase transactions	-	540	-	540	-	1,167	-	1,167

[1] The liabilities classified to level II are those whose measurement was not affected by unobservable parameters. They are primarily liabilities on account of bonds issued by Pekao.

9.3 Reclassification between fair value hierarchy levels

If the method of measurement of assets or liabilities changes because of e.g. losing (or obtaining) access to quotations observed on an active market, such assets or liabilities are reclassified between Levels I and II.

Assets or liabilities are reclassified between Levels II and III (or accordingly between Levels III and II) when:

- there is a change in the measurement model resulting from the application of new unobservable factors (or accordingly observable ones); or
- previously used factors that had a significant impact on the measurement are no longer observable (or accordingly become observable) on the active market.

Reclassifications between different levels of the fair value hierarchy are effected on the date ending each quarter according to the value as at that date.

In 2018, the following transfers of assets between fair value levels were made:

- treasury bonds for which active market quotations were available were reclassified from Level II to Level I;
- reclassification from level III to level II was applied to municipal and corporate bonds measured using market information about prices of comparable financial instruments, corporate bonds for which the estimated credit parameters had no significant impact on their measurement, treasury bonds denominated in Polish zloty for which the estimated spread to benchmark bond had no significant impact on their measurement and a derivative equity market transaction because the unobservable factor (correlation) had no significant impact on their measurement;
- corporate and municipal bonds for which the impact of the estimated parameter (correlation) exerted a significant impact on their measurement were reclassified from Level II to Level III.

In 2017, PLN-denominated treasury bonds, for which active market quotations were available, were reclassified from Level II to Level I.

10. Gross written premiums

10.1 Accounting policy

Premium written under insurance contracts and inward reinsurance contracts is recognized on the date of concluding an insurance contract.

(in millions of PLN)

10.1.1. Non-life insurance

Gross written premiums include amounts, regardless of whether these amounts have been paid.

- due for the entire liability period, regardless of its length, on account of the insurance contracts concluded in the reporting period – if the duration of the liability period is specified;
- due in the reporting period – if the duration of the liability period is not specified.

These premiums are adjusted by the change in the provision for unearned premiums in the reporting period and reduced by premiums due to reinsurers.

10.1.2. Life insurance

Gross written premiums include the amounts due during the reporting period for the concluded insurance contracts, regardless of whether these amounts have been paid and whether they relate to the whole or part of the reporting period. These premiums are adjusted by the change in the provision for unearned premiums in the reporting period and reduced by premiums due to reinsurers.

10.2 Quantitative data

Gross written premiums	1 January – 31 December 2018	1 January – 31 December 2017
Gross written premiums in non-life insurance	15,113	14,228
In direct insurance	15,071	14,253
In indirect insurance	42	(25)
Gross written premiums in life insurance	8,357	8,619
Individual insurance premiums	1,464	1,762
Individually continued insurance premiums	2,004	1,977
Group insurance premiums	4,889	4,880
Total gross written premiums	**23,470**	**22,847**

In 2018 and in 2017, PZU Group companies did not conclude inward reinsurance contracts in life insurance.

Gross written premium in non-life insurance (by accounting classes prescribed by section II of the attachment to the Insurance Activity Act)	1 January – 31 December 2018	1 January – 31 December 2017
Accident and sickness insurance (group 1 and 2)	644	592
Motor third party liability insurance (group 10)	5,989	5,777
Other motor insurance (group 3)	3,901	3,714
Marine, aviation and transport insurance (groups 4, 5, 6, 7)	100	74
Insurance against fire and other property damage (groups 8 and 9)	2,969	2,718
TPL insurance (groups 11, 12, 13)	817	773
Credit and suretyship (groups 14, 15)	94	100
Assistance (group 18)	468	434
Legal protection (group 17)	10	10
Other (group 16)	121	36
Total	**15,113**	**14,228**

(in millions of PLN)

11. Revenue from commissions and fees

11.1 Accounting policy

Revenue from commissions and fees is generally recognized when the service is provided. Fees and commissions directly related to the origination of financial assets or liabilities (both income and costs) that are not an integral part of the effective interest rate are accounted for using the straight-line method. Other fees and commissions (that are not an integral part of the effective interest rate and are not accounted for by the straight-line method) related to financial services (e.g. cash management services, brokerage services, investment advisory services, financial planning, investment banking services and asset management services) are recognized in the profit and loss account when the service is provided.

Revenue from management of open-end pension funds and revenue and fees received from funds and mutual fund companies are recognized on an accrual basis.

11.2 Quantitative data

Revenue from commissions and fees	1 January – 31 December 2018	1 January – 31 December 2017 (restated)
Banking activity	2,678	1,899
Brokerage fees	160	171
Fiduciary activity	69	49
Payment card and credit card services	851	567
Fees on account of insurance intermediacy activities	90	107
Credits and loans	454	275
Bank account-related services	430	316
Transfers	309	201
Cash operations	103	80
Receivables purchased	42	28
Guarantees, letters of credit, collections, promises	79	48
Other commission	91	57
Revenue and payments received from funds and mutual fund companies	562	277
Pension insurance	129	138
Other	5	5
Total revenue from commissions and fees	**3,374**	**2,319**

12. Net investment income

12.1 Accounting policy

Dividends are recognized as income when the right to dividend is acquired.

Interest income is recognized on an accrual basis based on the effective interest rate.

12.1.1. Rules applicable as of 1 January 2018

Interest income comprises interest on financial instruments measured at amortized cost, at fair value through other comprehensive income and hedging derivatives.

The effective interest rate is the rate that discounts estimated future cash flows to the gross carrying amount of the financial asset.

(in millions of PLN)

Interest income is calculated on the gross carrying amount, except for credit-impaired assets and purchased or originated credit-impaired (POCI) financial assets. For such assets, interest income is calculated on the gross carrying amount less allowances for expected credit losses.

12.1.2. Rules applicable until 31 December 2017

Interest income comprises interest on financial instruments measured at amortized cost, available for sale and hedging derivatives. Interest income also includes fees and commissions directly related to the creation of a financial instrument constituting an integral part of the effective interest rate.

The effective interest rate is the rate that discounts estimated future cash flows to the net carrying amount of the financial asset or financial liability.

12.2 Quantitative data

Net investment income	1 January – 31 December 2018	1 January – 31 December 2017 (restated)
Interest income, including:	11,265	8,265
Loan receivables from clients	8,442	6,183
Debt securities measured at fair value through other comprehensive income	824	n/a
Debt securities measured at amortized cost	1,216	n/a
Buy-sell-back transactions	76	23
Term deposits with credit institutions	133	74
Financial assets available for sale	n/a	551
Financial assets held to maturity	n/a	921
Debt securities classified in the loans portfolio	n/a	65
Loans	231	233
Receivables purchased	107	83
Hedge derivatives	190	91
Receivables	3	9
Cash and cash equivalents	43	32
Dividend income, including:	68	40
Investment financial assets measured at fair value through profit or loss	38	n/a
Investment financial assets measured at fair value through other comprehensive income	30	n/a
Financial assets measured at fair value through profit or loss – classified as such upon first recognition	n/a	31
Financial assets held for trading	n/a	6
Financial assets available for sale	n/a	3
Foreign exchange differences	184	589
Income on investment property	256	262
Investment property maintenance expenses	(104)	(104)
Investment activity expenses	(23)	(28)
Other	33	27
Net investment income, total	**11,679**	**9,051**

(in millions of PLN)

13. Net result on realization of financial instruments and investments

13.1 Accounting policy

Net result on realization contains gains and losses arising from the sale of financial instruments.

13.2 Quantitative data

Net result on realization of financial instruments and investments	**1 January – 31 December 2018**	**1 January – 31 December 2017** (restated)
Investment financial assets	134	245
Debt instruments measured at fair value through other comprehensive income	232	n/a
Financial instruments measured at fair value through profit or loss	(77)	n/a
Equity instruments	(106)	n/a
Participation units and investment certificates	(42)	n/a
Debt instruments	71	n/a
Instruments measured at amortized cost	(21)	n/a
Financial assets available for sale, including:	n/a	27
Equity instruments	n/a	(8)
Debt securities	n/a	35
Financial assets measured at fair value through profit or loss – classified as such upon first recognition, including:	n/a	101
Equity instruments	n/a	81
Debt securities	n/a	20
Financial assets held for trading, including:	n/a	87
Equity instruments	n/a	113
Debt securities	n/a	(26)
Loans	n/a	30
Loan receivables from clients measured at amortized cost	33	n/a
Derivatives	(119)	174
Short sale	-	(115)
Receivables	(63)	(68)
Investment property	(1)	10
Other	1	1
Net result on realization of financial instruments and investments, total	**(15)**	**247**

14. Movement in allowances for expected credit losses and impairment losses on financial instruments

14.1 Accounting policy

Impairment losses contain the balance of impairment losses recognized and reversed in accordance with the rules described in section 36.1.

(in millions of PLN)

14.2 Quantitative data

Movement in allowances for expected credit losses and impairment losses on financial instruments	1 January – 31 December 2018	1 January – 31 December 2017 (restated)
Investment financial assets	(9)	56
Debt instruments measured at fair value through other comprehensive income	(3)	n/a
Instruments measured at amortized cost	(6)	49
- debt instruments	9	n/a
- term deposits with credit institutions	(1)	-
- loans	(14)	49
Debt instruments available for sale	n/a	7
Loan receivables from clients	(1,673)	(1,187)
Measured at amortized cost	(1,677)	(1,187)
Measured at fair value through other comprehensive income	4	n/a
Receivables	(116)	(64)
Associates [1)]	(6)	(12)
Movement in allowances for expected credit losses and impairment losses on financial instruments, total	**(1,804)**	**(1,207)**

[1)] Additional information on the measurement of EMC and the impairment test is presented in item 32.

15. Net movement in fair value of assets and liabilities measured at fair value

15.1 Accounting policy

Information on the method used to determine fair value of assets and liabilities is presented in section 9.

15.2 Quantitative data

Net movement in fair value of assets and liabilities measured at fair value	1 January – 31 December 2018	1 January – 31 December 2017 (restated)
Investment financial instruments	165	480
Measured at fair value through profit or loss	165	n/a
Equity instruments	(162)	n/a
Debt securities	495	n/a
Participation units and investment certificates	(168)	n/a
Measured at fair value through profit or loss – classified as such upon first recognition	n/a	219
Equity instruments	n/a	178
Debt securities	n/a	41
Held for trading	n/a	261
Equity instruments	n/a	115
Debt securities	n/a	146
Derivatives	537	128
Measurement of liabilities to members of consolidated mutual funds	15	(32)
Investment contracts for the client's account and risk (unit-linked)	20	(11)
Investment property	30	(185)
Loan receivables from clients	3	n/a
Total net movement in fair value of assets and liabilities measured at fair value	**770**	**380**

(in millions of PLN)

16. Other operating income

Other operating income	1 January – 31 December 2018	1 January – 31 December 2017
Revenues on the sales of products, merchandise and services by non-insurance companies	589	514
Revenues from direct claims handling on behalf of other insurance companies	199	211
Reversal of provisions	540 [1)]	81
Reimbursement of the costs of pursuit of claims	41	34
Reinsurance commissions and profit participation	44	25
Reversal of impairment losses for non-financial assets	24	29
Indemnity received	15	17
Interest for late payment of amounts due under direct insurance and outward reinsurance	27	19
Gain from sale of property, plant and equipment	51	-
Written off liabilities on account of premium refunds and payment surpluses	4	57
Other	159	191
Other operating income, total	**1,693**	**1,178**

[1)] Including PLN 477 million of the banks' reversal of provisions for guarantees and sureties given.

17. Claims, benefits and movement in technical provisions

17.1 Accounting policy

The expenses of the reporting period include all the costs of claims and benefits paid under the concluded insurance contracts with direct and indirect claims handling expenses and movement in provision for outstanding claims and benefits.

17.1.1. Non-life insurance

In non-life insurance costs of claims and benefits are reduced by all the salvage and subrogation received and by the movement in estimated salvage and subrogation.

17.1.2. Life insurance

Benefits paid include all payments and deductions made during the reporting period for benefits incurred during the reporting period and previous periods (including annuities and surrenders) and all direct and indirect, external and internal claim handling expenses. Claims handling expenses also include expenses related to disputes.

The value of benefits is recognized at the amount actually paid out, after deducting returns and refunds (except for outward reinsurance refunds), plus the movement in the provision for unpaid claims, less the reinsurers' share in claims paid and in provisions.

(in millions of PLN)

17.2 Quantitative data

Claims, benefits and movement in technical provisions	1 January – 31 December 2018	1 January – 31 December 2017
Claims, benefits and movement in technical provisions	**14,980**	**15,376**
In non-life insurance	9,042	8,525
- claims and benefits	7,263	7,074
- movement in technical provisions	992	685
- claims handling expenses	787	766
In life insurance	5,938	6,851
- claims and benefits	6,049	5,945
- movement in technical provisions	(242)	772
- claims handling expenses	131	134
Reinsurers' share in claims, benefits and movement in technical provisions	**(417)**	**(435)**
In non-life insurance	(417)	(435)
Total net insurance claims and benefits	**14,563**	**14,941**

Claims and benefits handling expenses by type	1 January – 31 December 2018	1 January – 31 December 2017
Consumption of materials and energy	15	14
Third party services	259	239
Taxes and charges	31	32
Employee expenses	400	384
Depreciation of property, plant and equipment	15	14
Amortization of intangible assets	22	31
Other, including:	176	186
- awarded costs, interest and fines in indemnity cases	165	173
- other	11	13
Total claims and benefits handling expenses	**918**	**900**

18. Fee and commission expenses

Fee and commission expenses	1 January – 31 December 2018	1 January – 31 December 2017
Costs of card and ATM transactions, including card issue costs	440	286
Commissions on acquisition of banking clients	87	43
Fees for the provision of ATMs	46	38
Costs of awards to banking clients	16	20
Costs of bank transfers and remittances	36	30
Additional services attached to banking products	27	26
Brokerage fees	16	11
Costs of administration of bank accounts	5	3
Costs of banknote operations	14	10
Fiduciary activity expenses	19	12
Other commission	48	78
Total fee and commission expenses	**754**	**557**

(in millions of PLN)

19. Interest expenses

19.1 Accounting policy

Interest expenses are recognized in the profit and loss account using the effective interest rate.

19.2 Quantitative data

Interest expenses	1 January – 31 December 2018	1 January – 31 December 2017 (restated)
Term deposits	1,054	750
Current deposits	445	249
Outstanding own debt securities	396	242
Hedge derivatives	29	18
Loans	21	5
Repurchase transactions	59	52
Bank loans contracted by PZU Group companies	12	8
Other	30	26
Total interest expense	**2,046**	**1,350**

20. Acquisition expenses

20.1 Accounting policy

Acquisition expenses include expenses related to the conclusion and extension of insurance agreements. Direct acquisition expenses include, among others, cost of commission for insurance intermediaries, employee remuneration costs associated with the conclusion of insurance agreements, cost of attestations, expert opinions and studies related to the accepted risk. Indirect acquisition expenses include costs of advertising and promoting insurance products and costs associated with the examination of applications and issuing policies.

According to the accrual accounting principle, some of the acquisition expenses are amortized over time, in accordance with the principles described in sections 29.1.1 and 29.1.2.

20.2 Quantitative data

Acquisition expenses by type	1 January – 31 December 2018	1 January – 31 December 2017
Consumption of materials and energy	28	27
Third party services	91	83
Taxes and charges	6	5
Employee expenses	573	549
Depreciation of property, plant and equipment	25	23
Amortization of intangible assets	39	34
Other, including:	2,425	2,266
- commissions in insurance activities	2,345	2,200
- advertising	74	59
- other	6	7
Movement in deferred acquisition expenses	(57)	(86)
Total acquisition expenses	**3,130**	**2,901**

(in millions of PLN)

21. Administrative expenses

21.1 Accounting policy

Administrative expenses include, among others:

- In insurance activity – insurance activity expenses not classified as acquisition expenses, related to premium collection, expenses related to management of the insurance contracts portfolio, reinsurance contracts portfolio and to overall management of PZU Group's insurance companies;
- In banking activity – bank's operating expenses, including employee, material costs, depreciation, taxes and charges.

21.2 Quantitative data

Administrative expenses by type	**1 January – 31 December 2018**	**1 January – 31 December 2017** (restated)
Consumption of materials and energy	245	226
Third party services	1,380	1,186
Taxes and charges	82	61
Employee expenses	3,742	2,922
Depreciation of property, plant and equipment	348	270
Amortization of intangible assets	293	210
Compensation of group insurance administrators in work establishments	205	212
Other, including:	314	270
- advertising	230	171
- other	84	99
Total administrative expenses	**6,609**	**5,357**

22. Employee expenses

Employee expenses	**1 January – 31 December 2018**	**1 January – 31 December 2017** (restated)
Payroll	4,127	3,459
Defined contribution plans, including:	743	636
- charges on salary	673	569
- 3rd pillar pension insurance, including costs of Employee Pension Plan contributions incurred in the period	70	67
Other	239	163
Total employee expenses	**5,109**	**4,258**

In 2017-2018, PZU, PZU Życie and PZU CO had third pillar pension plans for their employees, which were defined contribution plans. The employer additionally paid 7% of the gross salary amount as a contribution to these plans.

Employee expenses are recognized under "Claims and movement in technical provisions", "Acquisition expenses", "Administrative expenses" and "Other operating expenses" in the consolidated profit and loss account.

(in millions of PLN)

23. Other operating expenses

Other operating expenses	1 January – 31 December 2018	1 January – 31 December 2017 (restated)
Levy on financial institutions	1,092	822
Expenses of the core business of non-insurance and non-banking companies	692	642
Direct claims handling expenses on behalf of other insurance undertakings	207	220
Compulsory payments to insurance market institutions and banking market institutions	111	86
Bank Guarantee Fund	372	121
Insurance Indemnity Fund	70	69
Fee to the National Fire Brigade Headquarters and Association of Voluntary Fire Brigades	29	28
Expenditures for prevention activity	72	34
Establishment of provisions	503 [1)]	179
Amortization of intangible assets purchased in company acquisition transactions	331	278
Recognition of impairment losses for non-financial assets	41	81
Donations	25	15
Late interest, penalties, indemnities	67	38
Costs of pursuit of claims	73	41
Other	173	104
Other operating expenses, total	**3,858**	**2,758**

[1)] Including PLN 441 million of the banks' recognition of provisions for guarantees and sureties given.

24. Income tax

24.1 Accounting policy

Income tax shown in the profit and loss account includes the current and deferred parts.

The deferred part is the difference between the balance of deferred tax liabilities and assets at the end and at the beginning of the reporting period, except that changes in deferred tax liabilities and assets related to operations charged to equity are also charged to equity.

(in millions of PLN)

24.2 Quantitative data

Income tax	1 January – 31 December 2018	1 January – 31 December 2017 (restated)
Profit before tax (consolidated)	7,086	5,474
CIT rate (or range of CIT rates) for the country of the parent company's seat (%)	19%	19%
Income tax which would be calculated as the product of gross accounting profit of the entities and the CIT rate in the country of the parent company's seat	1,346	1,040
Differences between the income tax calculated above and the income tax shown in the profit and loss account:	372	249
- levy on financial institutions	207	156
- provisions for credit receivables in the part not covered by deferred tax	19	14
- measurement of financial assets	6	55
- recognition/reversal of impairment losses for receivables, not classified as tax-deductible expenses	56	39
- recognition/reversal of other provisions and impairment losses for assets, not classified as tax-deductible expenses	(21)	28
- prudence fee payable to BFG	71	23
- change of tax law in Latvia	-	(9)
- differences due to different tax rates	(4)	(3)
- taxation of insurance activities in Ukraine	5	6
- tax losses	12	6
- charges to PFRON	4	4
- dividends	-	(2)
- depreciation and amortization	2	2
- other tax increases, waivers, exemptions, deductions and reductions	15	(70)
Income tax shown in the profit and loss account	**1,718**	**1,289**

Total amount of current and deferred tax	1 January – 31 December 2018	1 January – 31 December 2017 (restated)
1. Recognized in the profit and loss account, including:	**1,718**	**1,289**
- current tax	2,098	1,363
- deferred tax	(380)	(74)
2. Recognized in other comprehensive income, including:	**(31)**	**31**
- deferred tax	(31)	31

Income tax on other comprehensive income items	1 January – 31 December 2018	1 January – 31 December 2017 (restated)
Gross other comprehensive income	(129)	97
Income tax	31	(31)
Valuation of equity instruments measured at fair value through other comprehensive income	58	n/a
Valuation of debt instruments	(28)	n/a
Valuation of debt instruments reclassified to profit or loss	24	n/a
Transactions to hedge cash flows	(23)	n/a
Measurement of financial instruments available for sale	n/a	(28)
Other	-	(3)
Net other comprehensive income	**(98)**	**66**

The PZU Group is comprised of units operating in different countries and subject to different tax regulations. Regulations governing value added tax, corporate income tax, personal income tax or contributions to social security undergo frequent changes. The regulations in effect in the countries where the PZU Group operates also contain confusing provisions, which result in differences of opinion concerning their legal interpretation between various state authorities and enterprises. Tax and other settlements (e.g. regarding customs or foreign currencies) may be inspected by authorities (in Poland – for a period of five years), which may levy high fines and any additional liabilities assessed during the inspection bear interest. These phenomena generate tax risk, as a result of which the amounts reported in the consolidated financial statements may change at a later date after the final amounts are determined by tax authorities.

(in millions of PLN)

25. Earnings per share

25.1 Accounting policy

Basic earnings per share are calculated by dividing profit or loss attributable to ordinary equity holders of PZU by the weighted average number of common shares outstanding during the period.

The weighted average number of common shares outstanding during the period is the number of ordinary shares outstanding at the beginning of the period, adjusted by the number of ordinary shares bought back or issued during the period, weighted by the ratio reflecting the period (in days) to the total number of shares in the period.

25.2 Quantitative data

Earnings per share	1 January – 31 December 2018	1 January – 31 December 2017 (restated)
Net profit attributable to the equity holders of the parent company	3,213	2,895
Weighted average basic and diluted number of common shares	863,347,220	863,519,608
Number of outstanding shares	863,523,000	863,523,000
Average weighted number of treasury shares (held by consolidated entities)	175,780	3,392
Basic and diluted earnings per common share (in PLN)	3.72	3.35

In the 2018 and in 2017, there were no transactions or events resulting in the dilution of earnings per share.

26. Goodwill

26.1 Accounting policy

Goodwill, whose initial value has been determined in a manner described in section 5.6 is not amortized, but at the end of each financial year and any time there are any indications of impairment, it is tested for impairment. The goodwill impairment test involves assessing the recoverable amount of the individual cash-generating units to which goodwill has been allocated and comparing it with their carrying amount (including the allocated goodwill). If the recoverable amount is lower than the impairment loss applies first to the goodwill allocated to the cash-generating unit. The cash-generating unit, for which the test is performed may not be larger than an operating segment.

(in millions of PLN)

26.2 Quantitative data

Goodwill	31 December 2018	31 December 2017 (restated)
Pekao [1]	2,269	2,269
Alior Bank	746	746
Lietuvos Draudimas AB [2]	476	462
Mass insurance segment in non-life insurance (Link4)	221	221
AAS Balta	39	37
Medical companies	115	90
Other	5	5
Total goodwill	**3,871**	**3,830**

[1] Includes goodwill on acquisition of PIM.
[2] Includes goodwill on acquisition of the Lietuvos Draudimas branch in Estonia.

Movement in goodwill	1 January – 31 December 2018	1 January – 31 December 2017 (restated)
Gross goodwill at the beginning of the period	3,844	1,598
Changes in the period:	41	2,246
- acquisition of Pekao and PIM	-	2,269
- acquisition of medical companies	25	8
- foreign exchange differences	16	(31)
Gross goodwill at the end of the period	3,885	3,844
Impairment losses at the beginning of the period	(14)	(15)
Changes in the period (foreign exchange differences)	-	1
Impairment losses – at the end of the period	(14)	(14)
Net goodwill at the end of the period	**3,871**	**3,830**

26.3 Testing for impairment

Impairment tests for goodwill were performed as at 31 December 2018 for all the CGUs, to which goodwill was allocated. As a result of the tests, no need has been found to recognize impairment losses.

The goodwill impairment test involves a comparison of carrying amounts (including the allocated goodwill) and recoverable amounts of the CGUs to which goodwill has been allocated. An impairment loss for a CGU should be recognized in the profit and loss account if CGU's recoverable amount is less than its carrying amount.

Cash-generating units (CGUs)

Goodwill is allocated to the individual companies (constituting CGUs for the purposes of the impairment test) and is monitored at this level. During the final purchase price allocation, the goodwill arising from the acquisition of Link4 was fully allocated to the mass insurance segment in non-life insurance, which – due to the scale of integration of Link4's business with PZU under the 'two brands' strategy that assumed synergies resulting from the management of the mass client portfolio and sale of additional insurance products – is the smallest CGU to which goodwill can be allocated. Goodwill on the acquisition of PIM was fully allocated to Pekao, since that was the lowest level at which goodwill is monitored at the Group level.

Carrying amount

For the purposes of the test, the net carrying amount of the mass insurance segment was determined on the basis of allocation of the PZU Group's net assets. The assets were allocated in the proportion corresponding to the ratio of the hypothetical solvency capital requirement, which may be allocated to the mass insurance segment, to the total solvency capital requirement. The Euler method was used to allocate the solvency capital requirement. This method allocates to a segment the risk measures, which are based on Solvency II regulations and take into account diversification effects.

(in millions of PLN)

The carrying amount of the remaining entities includes CGU's net assets and goodwill. For the entities, in which non-controlling interests exist, the carrying amount for the purposes of the test is increased by the portion of goodwill allocated to non-controlling interests (it is not presented in the consolidated statement of financial position).

Recoverable amount

As at the balance sheet date, recoverable amount was based on value in use. As at 31 December 2017, recoverable amount was based on value in use, except for Alior Bank and Pekao, for which recoverable amount was calculated based on fair value less cost to sell. The fair value was calculated based on the stock price of Alior Bank and Pekao as quoted on the WSE on the balance sheet date plus control premium of, respectively, 10% and 5%. The costs of disposal were considered to be insignificant.

The recoverable amount of individual CGUs was determined based on value in use of the entities, using the discounted cash flow method based on the most current financial projections, for a period not exceeding 5 years, which are presented in the table below. The discount rates used for testing of the insurance companies were set at the cost of equity level. In the case of medical companies, the weighted average cost of capital (WACC) was used. The cost of equity was set in accordance with the CAPM model. Also, size premiums were applied in justified cases. Risk-free rates were determined based on the average yield of 10-year government bonds offered by the country where the CGU is domiciled and the betas were based on measures of similar listed entities. Market premiums were 5.5% (5.5% in 2017). For regulated entities (banks and insurance companies, financial institutions), the projected cash flows incorporate the requirement to maintain an adequate level of own funds (economic capital). Cash flows of the mass insurance segment were calculated based on the amount of hypothetical dividends that the segment could have paid if it had operated as a separate insurance company. The amount of dividends depends on the projected technical results of that segment, net of income tax and levy on financial institutions and capital surpluses allocated to that segment as at the balance sheet date and in subsequent periods. The growth ratios after the projection period were determined while taking into account the long term growth prospects for the market on which the entity conducts its business. In the case of insurance companies operating in the Baltic states, an adjustment was made for the expected increase in the insurance penetration rate (insurance premiums expressed as % of GDP) at 0.2-0.3 pp. In all the other cases, growth rates do not exceed the long-term GDP growth forecasts of the country in nominal terms.

Cash generating unit	31 December 2018			31 December 2017		
	Discount rate	Growth rate after the projection period	Timeframe of financial projections	Discount rate	Growth rate after the projection period	Timeframe of financial projections
Pekao	9.4%	3.5%	2 years	n/a	n/a	n/a
Alior Bank	9.4%	3.5%	2 years	n/a	n/a	n/a
Lietuvos Draudimas AB	6.0%	3.7%	4 years	5.4%	3.7%	5 years
Mass insurance segment	8.3%	2.5%	2 years	8.2%	2.5%	3 years
AAS Balta	6.5%	3.8%	4 years	6.2%	3.8%	5 years
Medical companies	6.7-7.6%	2.0-3.0%	2-5 years	7.1%	2.0-3.0%	3-5 years

Sensitivity analysis

The table on the next page presents the surplus of recoverable amounts over carrying amounts and the maximum discount rates and minimum marginal growth rates after the projection period, at which the carrying amounts and recoverable amounts of the individual CGUs. The surplus amount was stated as PZU's share.

(in millions of PLN)

Cash generating unit	31 December 2018			31 December 2017		
	Surplus (in PLN m)	Marginal value of the discount rate	Marginal value of the growth rate after the projection period	Surplus (in PLN m)	Marginal value of the discount rate	Marginal value of the growth rate after the projection period
Pekao	1,502	10.9%	1.5%	n/a	n/a	n/a
Alior Bank	1,615	12.3%	(0.1%)	n/a	n/a	n/a
Lietuvos Draudimas AB	660 [1)]	7.2%	0.1%	1,283	7.3%	0.9%
AAS Balta	585	12.0%	(3.3%)	439	11.2%	(3.2%)
Mass insurance segment	8,004	36.2%	n/a [2)]	8,204	37.5%	n/a [2)]
Medical companies	102	8.1-32.9%	(6.3%)-3,0%	75	7.6-17.4%	(24.2%)-2,5%

1) Reduction of the surplus resulted mainly from an increase in the discount rate.

2) The amount of discounted cash flows in the projection period is higher than the carrying amount attributed to the mass insurance segment and therefore no marginal growth rate was presented after the projection period.

27. Intangible assets

27.1 Accounting policy

Intangible assets are recognized if they are identifiable, controlled and it is likely that future economic benefits will be achieved, which can be ascribed to a specific assets and the purchase price or production cost of the asset can be measured reliably.

Intangible assets are measured at purchase prices or production costs less amortization charges and impairment losses.

The method used to measure the fair value of an intangible asset acquired in a business combination is presented in section 5.6.

Intangible assets include in particular: computer software, economic copyrights, licenses and concessions, as well as assets acquired in business combinations: trademarks, customer relations (including core deposit intangibles), relations with brokers, future profit from the purchased portfolio of insurance contracts, etc.

Intangible assets are amortized over their estimated economic life:

- assets other than intangible assets acquired in a business combination – using a straight-line method for the period of two to five years. In justified cases, after a case-by-case analysis, a different amortization rate may be used corresponding to the expected useful life of the intangible asset. Since a decision was made that the planned useful life of the Platforma Everest product system in PZU would be 10 years, the annual amortization rate of 10% was adopted for the system.
- intangible assets acquired in a business combination (except for the acquired trademarks) – for the period of one to fifteen years, based on the value of profits generated in the respective years;
- trademarks acquired in a business combination, as intangible assets with a useful period determined as indefinite are not amortized, but at the end of each financial year and any time there are any indications of impairment, they are tested for impairment.

Impairment

At the end of the reporting period, assets are reviewed to determine whether there are any indications of impairment.

Impairment loss on an intangible asset is deemed to have occurred if the expected economic benefits associated with an intangible asset or a property, plant and equipment item decrease as a result of technological changes, decommissioning, withdrawal from use or occurrence of other indications that the usefulness of the asset is reduced.

If such indications are identified, the asset is tested for impairment in order to determine its recoverable amount. The impairment test for future profit from the purchased portfolio of insurance contracts is performed in conjunction with the provision adequacy test, as described in section 41. Where necessary, an impairment loss is recognized reducing the portfolio value its the recoverable amount. In the situation when an asset does not generate cash flows that would be largely independent from cash flows generated by other assets, the analysis is carried out for the smallest identifiable group of assets generating independent cash flows, to which the asset belongs. The possible impairment losses are recognized as cost in the consolidated profit and loss account under "Other operating expenses".

(in millions of PLN)

If there is any indication that an impairment loss recognized in prior periods for an asset other than goodwill may no longer exist or may have decreased then the recoverable amount of such an asset is estimated. The impairment loss recognized in previous periods is reversed to the recoverable amount that does not exceed its carrying amount that would have been determined (net of amortization) had the impairment loss not previously been recognized. Reversal of an impairment loss is recognized as revenue in the in the consolidated profit and loss account under "Other operating income".

27.2 Quantitative data

Movement in intangible assets (by type groups) in the year ended 31 December 2018	Software, licenses and similar assets	Trademarks	Client relations	Intangible assets under development	Other intangible assets	Total intangible assets
Gross value at the beginning of the period	2,312	607	1,891	259	75	5,144
Changes (by virtue of):	251	4	9	106	5	375
- purchases and in-house production	90	-	-	341	2	433
- transfers	201	-	-	(203)	2	-
- sale and liquidation	(69)	-	-	-	(2)	(71)
- foreign exchange differences and other	29	4	9	(32)	3	13
Gross value at the end of the period	**2,563**	**611**	**1,900**	**365**	**80**	**5,519**
Accumulated amortization at the beginning of the period	(1,017)	-	(609)	-	(53)	(1,679)
Changes (by virtue of):	(282)	-	(338)	-	(11)	(631)
- amortization for the period	(348)	-	(331)	-	(9)	(688)
- sale and liquidation	66	-	-	-	1	67
- foreign exchange differences and other	-	-	(7)	-	(3)	(10)
Accumulated amortization at the end of the period	**(1,299)**	**-**	**(947)**	**-**	**(64)**	**(2,310)**
Impairment losses at the beginning of the period	(13)	-	-	(8)	(1)	(22)
Changes charged to other operating expenses	(1)	-	-	(3)	-	(4)
Other changes	-	-	-	-	(3)	(3)
Impairment losses – at the end of the period	**(14)**	**-**	**-**	**(11)**	**(4)**	**(29)**
Net value of intangible assets at the end of the period	**1,250**	**611**	**953**	**354**	**12**	**3,180**

(in millions of PLN)

Movement in intangible assets (by type groups) in the year ended 31 December 2017	Software, licenses and similar assets	Trademarks	Client relations	Intangible assets under development	Other intangible assets	Total intangible assets
Gross value at the beginning of the period	1,509	274	623	177	68	2,651
Changes (by virtue of):	803	333	1,268	82	7	2,493
- purchases and in-house production	122	-	-	247	2	371
- change in composition of the group	472	340	1,285	64	10	2,171
- transfers	240	-	-	(241)	1	-
- sale and liquidation	(22)	-	-	-	(4)	(26)
- foreign exchange differences and other	(9)	(7)	(17)	12	(2)	(23)
Gross value at the end of the period	**2,312**	**607**	**1,891**	**259**	**75**	**5,144**
Accumulated amortization at the beginning of the period	(772)	-	(345)	-	(49)	(1,166)
Changes (by virtue of):	(245)	-	(264)	-	(4)	(513)
- amortization for the period	(269)	-	(278)	-	(9)	(556)
- sale and liquidation	22	-	-	-	4	26
- foreign exchange differences and other	2	-	14	-	1	17
Accumulated amortization at the end of the period	**(1,017)**	**-**	**(609)**	**-**	**(53)**	**(1,679)**
Impairment losses at the beginning of the period	(16)	-	-	-	(6)	(22)
Changes charged to other operating expenses	-	-	-	(11)	5	(6)
Other changes	3	-	-	3	-	6
Impairment losses – at the end of the period	**(13)**	**-**	**-**	**(8)**	**(1)**	**(22)**
Net value of intangible assets at the end of the period	**1,282**	**607**	**1,282**	**251**	**21**	**3,443**

Trademarks, which are intangible assets with an indefinite period of useful life, were subject to an impairment test together with the CGUs to which they belong. The tests have shown no need to recognize impairment losses. Additional information about the tests is presented in section 26.3.

Amortization of intangible assets, by their presentation in consolidated profit and loss account	1 January – 31 December 2018	1 January – 31 December 2017
Claims, benefits and movement in technical provisions	22	31
Acquisition expenses	39	34
Administrative expenses	293	210
Other operating expenses [1)]	334	281
Total amortization	**688**	**556**

[1)] Including the amortization of intangible assets purchased in company acquisition transactions in the amount of PLN 331 million (PLN 278 million in 2017).

(in millions of PLN)

28. Other assets

Other assets	31 December 2018	31 December 2017
Reinsurance settlements	105	157
Estimated salvage and subrogation	183	192
Deferred IT expenses	72	63
Accrued direct claims handling receivables	56	60
Inventories	51	73
Accruals under insurance contracts (outside of the PZU Group)	3	58
Other assets	92	89
Total other assets	**562**	**692**

Other assets	31 December 2018	31 December 2017
Short-term	447	591
Long-term	115	101
Total other assets	**562**	**692**

29. Deferred acquisition expenses

29.1 Accounting policy

Deferred acquisition expenses are tested for impairment since that they are included in the calculation of adequacy of technical provisions.

29.1.1. Non-life insurance

Acquisition expenses in non-life insurance are deferred in line with the principles applicable to the determination of the provision for unearned premiums by amortizing them through the profit and loss account during the indemnity period (recognized under “Acquisition expenses”).

Deferrals apply to acquisition commissions and a portion of indirect acquisition expenses related to the signing and renewals of insurance policies, in particular costs related directly to sales processes, which cannot be classified as direct acquisition expenses, in particular costs of activities related to: agreement origination processes and underwriting processes in sales units (separated by using working time questionnaires), automatic and manual entry of policies into production systems (registration of sales) and contact center operations related to the sales of policies.

29.1.2. Life insurance

In life insurance, for traditional profit-sharing products (life and endowment insurance or birth assurance), acquisition expenses are amortized over time using the Zillmer method.

(in millions of PLN)

29.2 Quantitative data

Deferred acquisition expenses	31 December 2018	31 December 2017
Short-term	1,440	1,392
Long-term	106	93
Total deferred acquisition expenses	**1,546**	**1,485**

Movement in deferred acquisition expenses	1 January – 31 December 2018	1 January – 31 December 2017
Net value at the beginning of the period	1,485	1,407
Non-life insurance	1,394	1,323
Life insurance	91	84
Acquisition expenses pertaining to future periods	1,690	1,597
Amortization for the period recognized in financial result	(1,633)	(1,510)
Foreign exchange differences	4	(9)
Net value at the end of the period	**1,546**	**1,485**
Non-life insurance	1,445	1,394
Life insurance	101	91

30. Property, plant and equipment

30.1 Accounting policy

Property, plant and equipment components are measured at purchase price or production cost less accumulated depreciation and impairment losses.

All property, plant and equipment components and their important components are depreciated, with the exception of land and property, plant and equipment in construction. Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the intended manner.

Annual depreciation rates for material assets are presented below:

Asset category	Rate
Cooperative ownership rights to apartments, cooperative rights to commercial premises	2.5%
Buildings and structures	1.5% - 10%
Machinery and technical equipment	10% - 40%
Means of transport	14% - 33%
IT hardware	20% - 40%
Other non-current assets	7% - 20%

Assets held under a finance lease contract are depreciated over their useful life, provided that there is rational certainty that they would be purchased or ownership transferred. Otherwise, they are depreciated for a period no longer than the term of the lease.

The principles for recognizing impairment losses are the same as those applicable to intangible assets that are described in section 27.1.

(in millions of PLN)

30.2 Quantitative data

Movement in property, plant and equipment (by type groups) in the year ended 31 December 2018	Plant and machinery	Means of transport	Property, plant and equipment under construction	Real estate	Other property, plant and equipment	Total property, plant and equipment
Gross value at the beginning of the period	1,014	204	181	2,766	443	4,608
Changes (by virtue of):	95	22	17	14	42	190
- purchases and in-house production	64	26	237	51	30	408
- change in composition of the group	-	-	-	-	2	2
- sale and liquidation	(64)	(37)	(6)	(79)	(42)	(228)
- transfers to categories held for sale under IFRS 5	-	-	-	31	-	31
- transfers to/from investment property	-	-	-	(24)	-	(24)
- transfers	78	27	(167)	30	32	-
- foreign exchange differences and other	17	6	(47)	5	20	1
Gross value at the end of the period	**1,109**	**226**	**198**	**2,780**	**485**	**4,798**
Accumulated depreciation at the beginning of the period	(449)	(77)	-	(471)	(217)	(1,214)
Changes (by virtue of):	(127)	(11)	-	(146)	(16)	(300)
- depreciation for the period	(179)	(33)	-	(157)	(46)	(415)
- sale and liquidation	52	22	-	8	30	112
- foreign exchange differences and other	-	-	-	3	-	3
Accumulated depreciation at the end of the period	**(576)**	**(88)**	**-**	**(617)**	**(233)**	**(1,514)**
Impairment losses at the beginning of the period	(10)	-	(5)	(80)	(12)	(107)
Movements recognized in:	(1)	-	-	(20)	-	(21)
- other operating expenses	(1)	-	-	(36)	-	(37)
- other operating income	-	-	-	16	-	16
Other changes	7	-	5	15	1	28
Impairment losses – at the end of the period	**(4)**	**-**	**-**	**(85)**	**(11)**	**(100)**
Net value of property, plant and equipment – at the end of the period	**529**	**138**	**198**	**2,078**	**241**	**3,184**

(in millions of PLN)

Movement in property, plant and equipment (by type groups) in the year ended 31 December 2017 (restated)	**Plant and machinery**	**Means of transport**	**Property, plant and equipment under construction**	**Real estate**	**Other property, plant and equipment**	**Total property, plant and equipment**
Gross value at the beginning of the period	688	153	65	1,295	379	2,580
Changes (by virtue of):	326	51	116	1,471	64	2,028
- purchases and in-house production	65	12	200	10	39	326
- change in composition of the group	268	42	65	1,293	40	1,708
- sale and liquidation	(83)	(26)	-	(29)	(17)	(155)
- transfers to categories held for sale under IFRS 5	-	-	-	(4)	-	(4)
- transfers to/from investment property	-	-	-	157	-	157
- transfers	57	4	(118)	40	17	-
- foreign exchange differences and other	19	19	(31)	4	(15)	(4)
Gross value at the end of the period	**1,014**	**204**	**181**	**2,766**	**443**	**4,608**
Accumulated depreciation at the beginning of the period	(378)	(65)	-	(399)	(169)	(1,011)
Changes (by virtue of):	(71)	(12)	-	(72)	(48)	(203)
- depreciation for the period	(151)	(29)	-	(85)	(66)	(331)
- sale and liquidation	78	18	-	11	11	118
- foreign exchange differences and other	2	(1)	-	2	7	10
Accumulated depreciation at the end of the period	**(449)**	**(77)**	**-**	**(471)**	**(217)**	**(1,214)**
Impairment losses at the beginning of the period	(1)	-	(5)	(95)	(1)	(102)
Movements recognized in:	(10)	-	-	10	(11)	(11)
- other operating expenses	(11)	-	-	(2)	(11)	(24)
- other operating income	1	-	-	12	-	13
Other changes	1	-	-	5	-	6
Impairment losses – at the end of the period	**(10)**	**-**	**(5)**	**(80)**	**(12)**	**(107)**
Net value of property, plant and equipment – at the end of the period	**555**	**127**	**176**	**2,215**	**214**	**3,287**

"Transfers to and from investment property" items include amounts corresponding to those explained in section 31.

31. Investment property

31.1 Accounting policy

Investment property is held to earn rental income or obtain benefits from increases in value, or both. Investment property is not used in operating activities.

Investment property is initially recognized at purchase price or production cost, plus transaction costs. After initial recognition it is measured at fair value, in accordance with the rules described in section 9.1.5. Gains and losses resulting from the change of fair value of investment property are recognized in the consolidated profit and loss account under "Net movement in fair value of assets and liabilities measured at fair value" item in the period in which they occurred.

If owner-occupied property becomes investment property, depreciation is charged up to the date of reclassification and impairment losses, if any, are recognized and then:

- if the carrying amount determined as at that date is higher than the fair value, the difference is recognized in the consolidated profit and loss account under "Other operating expenses".
- if the existing carrying amount is lower than the fair value then the difference is first recognized in the consolidated profit and loss account under "Other operating income" as a reversal of the impairment loss (up to the amount of the impairment loss previously recognized, whereby the amount recognized in the consolidated profit and loss account may not exceed the amount of the impairment loss that would have been determined after deducting the accumulated

(in millions of PLN)

depreciation had no impairment loss been recognized), and the remaining part of the difference - in other comprehensive income under “Reclassification of real property from property, plant and equipment to investment property”.

On subsequent disposal of the investment property, revaluation reserve may be transferred to supplementary capital.

31.2 Quantitative data

Movement in investment property	1 January – 31 December 2018	1 January – 31 December 2017 (restated)
Net carrying amount at the beginning of the period	2,355	1,738
Additions (by virtue of):	154	920
- purchase	139	63
- change in composition of the Group	-	27
- transfers from owner-occupied property	15	-
- transfers from held for sale categories under IFRS 5	-	830
Reductions (by virtue of):	(842)	(201)
- sale and liquidation	(2)	(5)
- transfers to owner-occupied property	-	(157)
- transfers to held for sale categories under IFRS 5	(831)	(39)
- other	(9)	-
Gain (loss) on remeasurement to fair value	30	(101)
- through profit or loss	26	(101)
- through other comprehensive income	4	-
Foreign exchange differences	-	(1)
Net carrying amount at the end of the period, including	**1,697**	**2,355**
- buildings and structures	1,571	2,199
- own land	122	152
- perpetual usufruct right to land and cooperative ownership right to premises	4	4

The item “Perpetual usufruct of land” contains the right to use land for up to 99 years. This right may be traded.

The item “transfers from owner-occupied property” contains the value of properties at their carrying amounts (historical cost less accumulated depreciation and impairment losses) as at the date of transfer, which is the date of the change of use.

The fair value of investment property results from valuations by independent appraisers conducted mainly in 2018.

32. Entities measured by the equity method

32.1 Accounting policy

Associates are entities on which significant influence is exerted, or the power to participate in the financial and operating policy decisions of the investee but is not control or joint control.

A joint venture is a contractual arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

Associates and joint ventures are measured by the equity method, in which on initial recognition the investment is recognized at cost, and the carrying amount is increased or decreased to recognize the investor’s share of the profit or loss of the associate or joint venture. The share of the PZU Group in the financial result of the associates and joint ventures is recognized in the consolidated profit and loss account under “Share of the net profit of entities measured by the equity method”, while share in movement in other comprehensive income under other comprehensive income.

(in millions of PLN)

32.2 Quantitative data

Associates	31 December 2018	31 December 2017
EMC Instytut Medyczny SA	12	20
PayPo sp. z o.o.	4	-
GSU Pomoc Górniczy Klub Ubezpieczonych SA	1	-
Associates, total	**17**	**20**

Reconciliation of measurement of EMC	1 January – 31 December 2018	1 January – 31 December 2017
Net assets of EMC	119	123
Non-controlling interest in EMC's accounts	(7)	(8)
Goodwill in EMC's accounts at the moment significant influence was obtained	(1)	(1)
Net assets of EMC accepted for measurement by the equity method	111	114
PZU Group's share in EMC's capital	31	33
Goodwill	29	29
Impairment loss	(48)	(42)
Carrying amount	**12**	**20**

PZU Group's associates are not strategic entities. Information on interests held in the capital and votes of the respective associates is presented in section 2.2. There are no restrictions (e.g. resulting from any findings regarding borrowings, regulatory requirements or agreements) as to the ability of transferring funds by the associates in the form of cash dividends.

32.3 Testing for impairment

At the end of each financial year and any time there are any indications of impairment, shares in associates and joint ventures are tested for impairment. The test involves assessing the recoverable amount of the individual entities and comparing it to the carrying amount (including goodwill). If the recoverable amount is lower then the impairment loss applies first to goodwill.

The impairment test performed as at 31 December 2018 showed the need to recognize an impairment loss for EMC shares in the amount of PLN 6 million. The recoverable amount was determined on the basis of value in use.

33. Loan receivables from clients

33.1 Accounting policy

33.1.1. Rules applicable as of 1 January 2018

Loan receivables from clients are measured at the end of the reporting period as follows:

- at fair value through other comprehensive income – if classified in a business model whose objective is achieved by both collecting contractual cash flows and selling the asset;
- at fair value through profit or loss – assets that do not pass the SPPI test because of the contractual financial leverage element that increases volatility of cash flows (this applies among others to student loans, loans with subsidies from the Agency for Restructuring and Modernization of Agriculture and some corporate exposures);
- at amortized cost – for other assets.

Interest on loan receivables from clients measured at amortized cost or at fair value through other comprehensive income, accrued using the effective interest rate, are recognized in the profit and loss account, in the "Net investment income" item.

(in millions of PLN)

The change in the fair value of loan receivables from clients is recognized:

- for those measured at fair value through other comprehensive income – in revaluation reserve;
- for those measured at fair value through profit or loss – in the profit and loss account in the "Net movement in fair value of assets and liabilities measured at fair value" item.

Modification of financial assets

If terms and conditions of a financial asset agreement change, the modified and original cash flows are compared. If the identified difference is material then the original financial asset is removed from the balance sheet, while the modified financial asset is recognized in the ledgers at fair value.

Otherwise, the modification does not result in removing the financial asset from the balance sheet; just the new gross carrying amount is calculated.

The assessment whether the modification of financial assets is material or immaterial is conditional upon satisfaction of certain qualitative and quantitative criteria.

The following criteria are used to assess the materiality of modifications:

- qualitative – change of currency (unless it results from existing contractual provisions or requirements of the applicable legal regulations), change (replacement) of debtor (except for addition/resignation of a joint debtor or inheritance of a loan), consolidation of several exposures into a single one under an annex or an arrangement/ restructuring agreement, change of terms of contract causing a change in the outcome of the SPPI test;
- quantitative – among others % thresholds of margin change, increase of the financing amount and changes in the residual financing period.

Occurrence of at least one of these criteria results in a material modification.

33.1.2. Rules applicable until 31 December 2017

Loan receivables from clients are measured at the end of the reporting period at amortized cost and interest income is recognized in the profit and loss account, in the "Net investment income" item.

33.2 Quantitative data

Loan receivables from clients	31 December 2018	31 December 2017
Measured at amortized cost	180,240	169,457
Measured at fair value through other comprehensive income	1,511	n/a
Measured at fair value through profit or loss	303	n/a
Total loan receivables from clients	**182,054**	**169,457**

(in millions of PLN)

Loan receivables from clients	31 December 2018	31 December 2017
Retail segment	**97,567**	**89,407**
Operating loans	251	278
Consumer finance	27,380	26,185
Consumer finance loans	2,563	2,129
Loan to purchase securities	69	109
Overdrafts in credit card accounts	1,124	1,297
Loans for residential real estate	65,092	58,456
Other mortgage loans	830	832
Other receivables	258	121
Business segment	**84,487**	**80,050**
Operating loans	34,371	33,879
Car financing loans	35	80
Investment loans	26,166	26,108
Receivables purchased (factoring)	9,225	4,576
Overdrafts in credit card accounts	131	179
Loans for residential real estate	128	24
Other mortgage loans	8,560	8,465
Finance leases	5,327	5,086
Other receivables	544	1,653
Total loan receivables from clients	**182,054**	**169,457**

34. Financial derivatives

34.1 Accounting policy

Derivatives include financial instruments held for trading as well as financial instruments constituting a hedge of fair value or cash flows.

Derivative financial instruments held for trading are recognized at fair value on the transaction date and subsequently measured at fair value in accordance with the rules described in section 9.1.3.

Derivatives are recognized as financial assets if their fair value is positive or as financial liabilities if it is negative.

Changes of fair value of derivatives that are not hedges are recognized under “Net movement in fair value of assets and liabilities measured at fair value”.

As at 31 December 2018, PZU Group companies were not parties to agreements including embedded derivatives whose character and related risks were not closely linked to the base agreement.

The PZU Group took advantage of the option available in IFRS 9 and continues to apply hedge accounting in accordance with IAS 39.

Hedge accounting recognizes is used to recognize the offsetting effects on profit or loss of changes in the fair values of the hedging instrument and the hedged item. Hedge accounting is applied if the following conditions are fulfilled:

- at the inception of the hedge there is formal designation and documentation of the hedging relationship and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the entity will assess the hedging instrument’s effectiveness;
- the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows, consistently with the originally documented risk management strategy for that particular hedging relationship;
- in the case of cash flows it is highly probable that a hedged transaction occurs that is exposed to changes in cash flows affecting the profit and loss account;
- the effectiveness of the hedge can be reliably measured, i.e. the cash flows of the hedged item and the fair value of the hedging instrument can be reliably measured;

(in millions of PLN)

- The hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.

34.2 Types of hedging strategies

34.2.1. Fair value hedges

Changes in the fair value measurement of financial instruments designated as hedged items are recognized, in the part related to the hedged risk, in the profit and loss account. The remaining part of changes in the carrying amount are recognized in accordance with the general rules applicable to a given class of financial instruments.

Changes in the fair value measurement of derivatives designated as hedges in hedge accounting are recognized in full in profit and loss, in the same line item where the effect of changes in the measurement of the hedged item are recognized.

The PZU Group ceases to apply hedge accounting if the hedging instrument expires or is sold, terminated or exercised (for this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the hedging strategy), if the hedge no longer meets the hedge accounting criteria or the hedging designation is revoked.

Adjustment for hedged risk on the hedged interest item is amortized to profit and loss no later than at the moment when hedge accounting is discontinued.

Fair value hedge of fixed-coupon debt securities denominated in PLN, EUR and USD

Pekao hedges some of its interest rate risk arising from changes in the fair value of the hedged item caused by volatility of market interest rates through IRS transactions.

The table presents nominal values and interest rate of hedging instruments

	Curr-ency	31 December 2018 Maturity					31 December 2017 Maturity				
		Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total	Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total
Par value	PLN	-	-	280	200	480	115	-	511	200	826
Average interest rate of the fixed-rate part		-	-	1.8	1.8	1.8	1.8	-	1.8	1.8	1.8
Par value	EUR	262	-	884	836	1,982	-	-	1,028	895	1,923
Average interest rate of the fixed-rate part		0.2	-	0.9	0.1	0.5	-	-	0.6	0.2	0.4
Par value	USD	-	128	244	499	871	-	-	205	601	806
Average interest rate of the fixed-rate part		-	6.9	4.9	3.7	4.5	-	-	5.6	2.7	3.4
Total		**262**	**128**	**1,408**	**1,535**	**3,333**	**115**	**-**	**1,744**	**1,696**	**3,555**

(in millions of PLN)

Impact of the hedge relationship on the statement of financial position and the financial result	31 December 2018 Hedges of securities measured at amortized cost	31 December 2018 Hedges of securities measured at fair value	31 December 2018 Total	31 December 2017 Hedges of securities measured at amortized cost	31 December 2017 Hedges of securities measured at fair value	31 December 2017 Total
Hedging instruments						
Par value	200	3,133	3,333	255	3,300	3,555
Carrying amount – assets	-	21	21	-	16	16
Carrying amount – liabilities	10	134	144	2	184	186
Change in the fair value of the hedging instrument, on the basis of which hedge inefficiency is estimated	(8)	49	41	-	67	67
Hedge inefficiency amount recognized in the profit and loss account	-	3	3	-	5	5
Hedged items						
Carrying amount – assets	208	3,336	3,544	257	3,607	3,864
Accumulated adjustment to fair value of the hedged item included in the carrying amount of the hedged item recognized in the balance sheet – assets	9	125	134	1	221	222
Change in value of the hedged item used as the basis for estimating hedge inefficiency	8	(46)	(38)	-	(63)	(63)
Accumulated adjustment to fair value of a hedged item remaining in the balance sheet, for those hedged items for which the balance sheet item is no longer adjusted to fair value						

34.2.2. Cash flow hedges

Cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognized asset or liability or a highly probable planned transaction and could affect profit or loss.

The result of measurement of the effective part of cash flow hedges is recognized in other comprehensive income. The ineffective part of the hedge is recognized in profit or loss.

Where the interest rate risk and currency risk are hedged in's credit and deposit portfolios, the approach to managing these portfolios allows new transactions to be added to the hedge relationship or transactions to be removed following repayment or transfer to non-performing items. As a result, the exposure of these portfolios to interest rate risk and currency risk changes constantly. Since the age structure of the portfolios changes frequently, the hedged items are designated dynamically and the hedging items are allowed to adjust to these changes.

In cash flow hedge relationships, the main identified potential sources of inefficiencies include:

- the impact of counterparty credit risk and own credit risk on the fair value of hedging instruments, i.e. interest rate swaps (IRSs), basis swaps and FX swaps, which is not reflected in the fair value of the hedged item,
- differences between the frequencies of restatement of hedging instruments and hedged loans and deposits.

34.2.2.1. Hedging of the portfolio of loan receivables from clients and variable-interest securities denominated in PLN

Pekao hedges its interest rate risks associated with the volatility of market reference rates (WIBOR) generated by the portfolio of loan receivables from clients and variable-interest securities denominated in PLN, by using interest rate swaps (IRS).

(in millions of PLN)

31 December 2018	Currency	31 December 2018 Maturity					31 December 2017 Maturity				
		Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total	Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total
Par value	PLN	1,400	200	2,800	4,200	8,600	-	-	3,600	-	3,600
Average interest rate of the fixed-rate part	PLN	3.7	3.5	3.4	2.6	3.0	-	-	3.7	-	3.7

Impact of the hedge relationship on the statement of financial position and the financial result	31 December 2018	31 December 2017
Hedging instruments		
Par value	8,600	3,600
Carrying amount – assets	262	200
Carrying amount – liabilities	-	-
Change in the fair value of the hedging instrument, on the basis of which hedge inefficiency is estimated	(102)	(59)
Profit or loss arising out of net position hedge, captured in a separate line item of other comprehensive income	-	-
Hedge inefficiency amount recognized in the profit and loss account	-	-
Amount transferred from cash flow hedge accounting capital to the profit and loss account as reclassification adjustment	-	-
Hedged items		
Amount equal to the change in the fair value of a hypothetical derivative representing the hedged item, which forms the basis for estimating hedge inefficiency in the period	102	59
Balance of the hedge accounting capital item for relations, for which hedge accounting will be continued after the end of the reporting period	150	102
Balance remaining in the hedge accounting capital item for those relations, to which hedge accounting is no longer applied	-	-

34.2.2.2. Hedging of the deposit portfolio in the Polish zloty and in the Euro

Pekao hedges its interest rate risk associated with the volatility of market reference rates (WIBOR, EURIBOR) generated by the portfolios of deposits denominated in the Polish zloty and the Euro, which are economically equivalent to a long-term liability with variable interest rate, by using interest rate swaps (IRS).

(in millions of PLN)

	Currency	31 December 2018 Maturity: Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total	31 December 2017 Maturity: Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total
Par value	PLN	-	-	242	207	449	-	15	-	197	212
Average interest rate of the fixed-rate part	PLN	-	-	1.8	1.8	1.8	-	1.8	-	1.8	1.8
Par value	EUR	-	-	659	-	659	-	-	364	-	364
Average interest rate of the fixed-rate part	EUR	-	-	(0.3)	-	(0.3)	-	-	(0.3)	-	(0.3)

Impact of the hedge relationship on the statement of financial position and the financial result	31 December 2018	31 December 2017
Hedging instruments		
Par value	1,108	576
Carrying amount – assets	-	1
Carrying amount – liabilities	16	2
Change in the fair value of the hedging instrument, on the basis of which hedge inefficiency is estimated	(11)	1
Profit or loss arising out of net position hedge, captured in a separate line item of other comprehensive income	-	-
Hedge inefficiency amount recognized in the profit and loss account	-	-
Amount transferred from cash flow hedge accounting capital to the profit and loss account as reclassification adjustment	-	-
Hedged items		
Amount equal to the change in the fair value of a hypothetical derivative representing the hedged item, which forms the basis for estimating hedge inefficiency in the period	11	(1)
Balance of the hedge accounting capital item for relations, for which hedge accounting will be continued after the end of the reporting period	(12)	1
Balance remaining in the hedge accounting capital item for those relations, to which hedge accounting is no longer applied	-	-

34.2.2.3. Hedging for a variable interest rate loan portfolio in Swiss francs and a deposit portfolio in Polish zloty

Pekao hedges its exposure to interest rate risk associated with the volatility of market reference rates (WIBOR, LIBOR CHF) and its exposure to currency risk generated by portfolios of variable interest rate loans denominated in Swiss francs and deposits in Polish zloty, which are economically equivalent to long-term variable interest rate liabilities, by using cross currency basis swaps. CIRS transactions are decomposed into a component hedging the asset portfolio and a component hedging the liability portfolio.

	Currency	31 December 2018 Maturity: Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total	31 December 2017 Maturity: Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total
Par value	CHF/ PLN	-	3,759	916	1,691	6,366	-	888	4,191	1,759	6,838

(in millions of PLN)

Impact of the hedge relationship on the statement of financial position and the financial result	31 December 2018	31 December 2017
Hedging instruments		
Par value	6,366	6,838
Carrying amount – assets	-	-
Carrying amount – liabilities	745	675
Change in the fair value of the hedging instrument, on the basis of which hedge inefficiency is estimated	9	23
Profit or loss arising out of net position hedge, captured in a separate line item of other comprehensive income	-	-
Hedge inefficiency amount recognized in the profit and loss account	-	-
Amount transferred from cash flow hedge accounting capital to the profit and loss account as reclassification adjustment	-	-
Hedged items		
Amount equal to the change in the fair value of a hypothetical derivative representing the hedged item, which forms the basis for estimating hedge inefficiency in the period	(13)	(44)
Balance of the hedge accounting capital item for relations, for which hedge accounting will be continued after the end of the reporting period	(86)	(96)
Balance remaining in the hedge accounting capital item for those relations, to which hedge accounting is no longer applied	-	-

34.2.2.4. Hedging of a portfolio of variable interest rate loans in EUR and term and negotiated deposits in USD

Pekao hedges its exposure to interest rate risk associated with the volatility of market reference rates (EURIBOR) and its exposure to currency risk generated by portfolios of variable interest rate loans denominated in the Euro and term and negotiated deposits in the American dollar, which are economically equivalent to long-term variable interest rate liabilities, by using FX swaps.

	Curr-ency	31 December 2018 Maturity					31 December 2017 Maturity				
		Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total	Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total
Par value	EUR/ PLN	1,634	688	-	-	2,322	480	501	-	-	981
Average rate		4.3	4.4	-	-	4.4	4.4	4.4	-	-	4.4
Par value	EUR/ USD	804	-	-	-	804	-	-	-	-	-
Average rate		1.2	-	-	-	1.2	-	-	-	-	-

Impact of the hedge relationship on the statement of financial position and the financial result	31 December 2018	31 December 2017
Hedging instruments		
Par value	3,126	981
Carrying amount – assets	31	42
Carrying amount – liabilities	1	-
Change in the fair value of the hedging instrument, on the basis of which hedge inefficiency is estimated	-	2
Profit or loss arising out of net position hedge, captured in a separate line item of other comprehensive income	-	-
Hedge inefficiency amount recognized in the profit and loss account	-	-
Amount transferred from cash flow hedge accounting capital to the profit and loss account as reclassification adjustment	-	-

Impact of the hedge relationship on the statement of financial position and the financial result	31 December 2018	31 December 2017
Hedged items		
Amount equal to the change in the fair value of a hypothetical derivative representing the hedged item, which forms the basis for estimating hedge inefficiency in the period	-	(2)
Balance of the hedge accounting capital item for relations, for which hedge accounting will be continued after the end of the reporting period	-	-
Balance remaining in the hedge accounting capital item for those relations, to which hedge accounting is no longer applied	-	-

34.2.2.5. Hedging of a portfolio of variable interest rate loans and subordinated bonds

Alior Bank hedges its interest rate risk associated with the volatility of market reference rates (WIBOR) generated by the portfolio of loans and subordinated bonds denominated in the Polish zloty, by using interest rate swaps (IRS).

	Curr-ency	31 December 2018 Maturity					31 December 2017 Maturity				
		Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total	Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total
Par value	PLN	1,750	275	5,719	225	7,969	2,950	750	4,694	225	8,619
Average interest rate of the fixed-rate part		1.80	2.74	2.13	2.84	2.10	1.76	2.69	1.96	2.84	1.98

Impact of the hedge relationship on the statement of financial position and the financial result	31 December 2018	31 December 2017
Hedging instruments		
Par value	7,969	8,619
Carrying amount – assets	112	88
Carrying amount – liabilities	9	5
Change in the fair value of the hedging instrument, on the basis of which hedge inefficiency is estimated	28	(1)
Profit or loss arising out of net position hedge, captured in a separate line item of other comprehensive income	27	-
Hedge inefficiency amount recognized in the profit and loss account	1	(1)
Amount transferred from cash flow hedge accounting capital to the profit and loss account as reclassification adjustment	15	7
Hedged items		
Amount equal to the change in the fair value of a hypothetical derivative representing the hedged item, which forms the basis for estimating hedge inefficiency in the period	(50)	(2)
Balance of the hedge accounting capital item for relations, for which hedge accounting will be continued after the end of the reporting period	31	(11)
Balance remaining in the hedge accounting capital item for those relations, to which hedge accounting is no longer applied	-	-

(in millions of PLN)

34.3 Quantitative data

Derivatives as at 31 December 2018	Base amount by maturities					Assets	Liabilities
	Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total		
Related to interest rates	**21,889**	**70,485**	**111,548**	**32,426**	**236,348**	**1,971**	**2,933**
Instruments designated as fair value hedges – unquoted instruments, including:	262	128	1,408	1,535	3,333	21	144
- SWAP transactions	262	128	1,408	1,535	3,333	21	144
Instruments designated as cash flow hedges – unquoted instruments, including:	3,150	4,234	10,336	6,323	24,043	374	770
- SWAP transactions	3,150	4,234	10,336	6,323	24,043	374	770
Instruments carried as held for trading, including:	18,477	66,123	99,804	24,568	208,972	1,576	2,019
Unquoted instruments, including:	18,477	66,123	99,804	24,568	208,972	1,576	2,019
- FRA transactions	7,609	7,100	300	-	15,009	2	2
- SWAP transactions	10,208	56,405	94,891	24,486	185,990	1,564	2,012
- call options (purchase)	330	1,719	2,883	54	4,986	6	2
- put options (sale)	330	899	1,730	28	2,987	4	3
Related to exchange rates	**40,041**	**17,290**	**4,803**	**43**	**62,177**	**302**	**250**
Instruments designated as cash flow hedges – unquoted instruments, including:	2,438	688	-	-	3,126	31	1
- SWAP transactions	2,438	688	-	-	3,126	31	1
Instruments carried as held for trading, including:	37,603	16,602	4,803	43	59,051	271	249
Instruments quoted on a regulated market, including:	570	4,397	-	-	4,967	4	3
- forward contracts	570	4,397	-	-	4,967	4	3
Unquoted instruments, including:	37,033	12,205	4,803	43	54,084	267	246
- forward contracts	9,689	5,140	1,661	-	16,490	88	128
- SWAP transactions	24,792	2,351	952	43	28,138	115	54
- call options (purchase)	1,201	2,230	1,107	-	4,538	46	22
- put options (sale)	1,351	2,484	1,083	-	4,918	18	42
Related to prices of securities	**2,108**	**1,186**	**2,149**	**-**	**5,443**	**78**	**49**
Instruments quoted on a regulated market, including:	326	219	243	-	788	11	13
- forward contracts	326	211	243	-	780	10	13
- put options (sale)	-	8	-	-	8	1	-
Unquoted instruments, including:	1,782	967	1,906	-	4,655	67	36
- call options (purchase)	353	590	1,906	-	2,849	66	2
- put options (sale)	1,429	377	-	-	1,806	1	34
Related to commodity prices	**1,752**	**2,295**	**620**	**-**	**4,667**	**136**	**133**
Instruments quoted on a regulated market, including:	460	9	-	-	469	19	17
- forward contracts	460	9	-	-	469	19	17
Unquoted instruments, including:	1,292	2,286	620	-	4,198	117	116
- forward contracts	435	9	-	-	444	16	17
- SWAP transactions	529	372	72	-	973	46	45
- call options (purchase)	205	1,084	324	-	1,613	21	5
- put options (sale)	123	821	224	-	1,168	34	49
Total	**65,790**	**91,256**	**119,120**	**32,469**	**308,635**	**2,487**	**3,365**

(in millions of PLN)

Derivatives as at 31 December 2017	Base amount by maturities					Assets	Liabilities
	Up to 3 months	Over 3 months up to 1 year	Over 1 year to 5 years	Over 5 years	Total		
Related to interest rates	**20,461**	**33,068**	**116,218**	**26,450**	**196,197**	**1,699**	**2,797**
Instruments designated as fair value hedges – unquoted instruments, including:	115	-	1,744	1,696	3,555	16	186
- SWAP transactions	115	-	1,744	1,696	3,555	16	186
Instruments designated as cash flow hedges – unquoted instruments, including:	2,950	1,653	12,849	2,181	19,633	289	682
- SWAP transactions	2,950	1,653	12,849	2,181	19,633	289	682
Instruments carried as held for trading, including:	17,396	31,415	101,625	22,573	173,009	1,394	1,929
Unquoted instruments, including:	17,396	31,415	101,625	22,573	173,009	1,394	1,929
- FRA transactions	1,285	450	-	-	1,735	1	-
- SWAP transactions	14,932	27,813	96,648	22,468	161,861	1,381	1,921
- call options (purchase)	411	1,363	3,854	11	5,639	10	2
- put options (sale)	768	1,789	1,123	94	3,774	2	6
Related to exchange rates	**37,435**	**11,455**	**2,060**	**42**	**50,992**	**444**	**517**
Instruments designated as cash flow hedges – unquoted instruments, including:	480	501	-	-	981	42	-
- SWAP transactions	480	501	-	-	981	42	-
Instruments carried as held for trading, including:	36,955	10,954	2,060	42	50,011	402	517
Instruments quoted on a regulated market, including:	456	-	-	-	456	19	1
- forward contracts	456	-	-	-	456	19	1
Unquoted instruments, including:	36,499	10,954	2,060	42	49,555	383	516
- forward contracts	11,684	4,300	945	-	16,929	175	221
- SWAP transactions	22,650	2,851	462	42	26,005	164	256
- call options (purchase)	1,005	1,323	71	-	2,399	27	8
- put options (sale)	1,160	2,480	582	-	4,222	17	31
Related to prices of securities	**485**	**2,430**	**2,924**	**-**	**5,839**	**104**	**57**
Unquoted instruments, including:	485	2,430	2,924	-	5,839	104	57
- call options (purchase)	279	1,245	1,666	-	3,190	102	10
- put options (sale)	206	1,185	1,258	-	2,649	2	47
Related to commodity prices	**827**	**718**	**983**	**-**	**2,528**	**104**	**103**
Instruments quoted on a regulated market, including:	285	40	7	-	332	10	21
- forward contracts	285	40	7	-	332	10	21
Unquoted instruments, including:	542	678	976	-	2,196	94	82
- forward contracts	227	26	-	-	253	19	7
- SWAP transactions	252	233	190	-	675	59	59
- call options (purchase)	45	240	398	-	683	15	8
- put options (sale)	18	179	388	-	585	1	8
Total	**59,208**	**47,671**	**122,185**	**26,492**	**255,556**	**2,351**	**3,474**

35. Investment financial assets

35.1 Accounting policy

35.1.1. Recognition and classification

Financial assets are recognized in the statement of financial position at the moment when a PZU Group company becomes a party to a binding contract, under which it assumes risk and becomes a beneficiary of the benefits associated with the financial instrument. In the case of transactions concluded on an organized market, the purchase or sale of financial assets are recognized in the books on the date of the transaction.

35.1.1.1. Rules applicable as of 1 January 2018

The instrument is classified as at the time of application of IFRS 9 for the first time or at the time of recognition of the instrument. The classification may only be changed in rare cases when the business model changes. The classification of financial assets depends on:

- the entity's business model for managing financial assets and
- the contractual cash flow characteristics of the financial asset.

According to IFRS 9 financial assets are classified for valuation at:

- amortized cost;
- fair value through profit or loss;
- fair value through other comprehensive income.

Business models

Financial assets are managed in accordance with business models applied to enable the provision of information for management purposes. When analyzing business models, the PZU Group takes the following into account:

- how the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way in which those risks are managed.

Assets held by the PZU Group as at the first application date of IFRS 9 were classified as business models in effect as at that date. Assets purchased after 1 January 2018 are classified to the business model upon their initial recognition.

Description of business models	Assets held in order to collect contractual cash flows	Assets held in order to collect contractual cash flows and cash flows from selling assets	Other financial assets
Risks under management	Long-term interest rate risk, credit risk	Long-term interest rate risk, credit risk, long-term liquidity	Short-term interest rate risk, currency risk, risk of changing prices of equities, indices, commodities and short-term liquidity management.
Terms and conditions of the sale of assets in the model	• transactions are rare • the value of assets sold compared to the total value of assets in the model is insignificant • the maturity of assets sold is close, while revenues are approximating the values of contractual cash flows remaining to be received if the assets was kept in the portfolio till initial maturity • deterioration of credit quality	The permitted level of sales is higher than in the model of assets held to collect contractual cash flows, but much lower than for assets held for trading.	No restrictions on sales

Financial assets held for trading and those that are held in a model managed at fair value have been classified as measured at fair value through profit or loss.

SPPI test

A special test is performed to evaluate whether contractual cash flows consist of *solely payments of principal and interest* (so called the SPPI test). The principal amount is defined as the fair value of the financial asset at initial recognition. Interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin.

The SPPI test examines whether a financial asset contains contractual terms that could change the timing or amounts of contractual cash flows so that the condition of obtaining solely payments of principal and interest would not be met. In making its evaluation, the PZU Group takes the following into account:

- conditional events that could change the amounts and timing of cash flows;
- factors modifying the interest rate;
- terms of prepayment and extension;
- terms limiting the right to obtain cash flows;
- factors that modify the time value of money, including periodic resets of the interest rate.

The SPPI test is carried out for financial assets classified into a business model whose objective is achieved by collecting contractual cash flows or a business model whose objective is achieved by both collecting contractual cash flows and selling.

The SPPI test is carried out:

- collectively – for homogeneous groups of standard products;
- on the single contract level – for non-standard products;
- on the ISIN code level – for debt securities.

If a financial asset contains terms causing modification of the value of money over time, the so-called verification benchmark test is carried out to determine the difference between undiscounted cash flows following from the contract and the undiscounted cash flows which would occur if the value of money over time was not modified (cash flow benchmark level). If the difference is material then the instrument does not pass the SPPI test and is measured at fair value through profit or loss.

35.1.1.2. Rules applicable until 31 December 2017

Financial instruments are classified at the time of purchase into one of four categories: held to maturity, available for sale, measured at fair value through profit or loss or loans. At the time of purchase financial instruments are recognized at fair value adjusted for transaction costs that can be attributed directly to the purchase or issue of the financial instrument. Instruments measured at fair value through profit or loss are an exception. In their case, the transaction costs are charged once to the "Net investment income" item. The fair value of a financial instrument at initial recognition is usually its transaction price, unless the nature of the financial instrument suggests otherwise.

In the case of interest-bearing financial instruments, interest accrues from the day following the transaction settlement date.

35.1.2. Measurement principles

35.1.2.1. Rules applicable as of 1 January 2018

Financial assets measured at amortized cost

A financial asset is classified as financial asset measured at amortized cost if both of the following conditions are met:

- the financial asset is held within a business model whose objective is achieved by holding financial assets in order to collect contractual cash flows,
- it passes the SPPI test – the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

As at 1 January 2018, the following assets were classified as investment financial assets measured at amortized cost:

- assets classified according to IAS 39 as loans and receivables and as financial assets held to maturity, except for the financial assets, for which it was determined after SPPI tests that their terms may result in cash flows that are not solely payments of principal and interest on the principal amount outstanding;
- certain assets classified under IAS 39 as available for sale, for which the assessment of the business model has shown that it was common practice to hold them to obtain cash flows and the intentions with respect to them have not changed;
- purchased financial assets impaired due to credit risk. Such financial assets were acquired in connection with the merger with a spun-off portion of Bank BPH in 2016 and Bank Meritum in 2015. As a result, loans and debt securities of an investment nature were classified as measured at amortized cost. Under IAS 39 provisions, which were applied until 31 December 2017, the items were classified respectively as loans and receivables, financial assets available for sale and financial assets held to maturity.

Financial assets measured at amortized cost include, among others:

- payment made for debt securities purchased under a contract which shows that the seller has retained substantially all risks and benefits associated with such securities (buy-sell-back and reverse repo transactions);
- debt securities;
- term deposits with credit institutions;
- loans granted.

Upon first recognition, financial assets measured at amortized cost are recognized at fair value plus transaction costs which can be allocated directly to the purchase of issue of such assets.

The results of the measurement at amortized cost are recognized in the profit and loss account in the "Net investment income" item.

Financial assets measured at fair value through other comprehensive income

Financial assets are measured at fair value through other comprehensive income if both of the following conditions are met:

- the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets;
- it passes the SPPI test – the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

As at 1 January 2018, in particular the following asset were classified into this category:

- debt instruments which under IAS 39 were classified as financial assets available for sale;
- some assets from the portfolio of securities previously held to maturity – due to their possible sale, because the relevant business model for these securities is a model whose objective is achieved by both collecting cash flows and selling financial assets.

Interest on debt instruments accrued using the effective interest rate are recognized in the profit and loss account in the "Net investment income" item.

Fair value measurement principles are described in section 9.1. The effects of changes in the fair value are recognized in other comprehensive income until exclusion of the asset from the statement of financial position, when the cumulative effects of the measurement are moved to the profit and loss account, to the "Net result on realization of financial instruments and investments" item.

The allowances for expected credit losses is recognized in other comprehensive income and on the other side in the profit and loss account in the "Movement in allowances for expected credit losses and impairment losses on financial instruments" item. The value of the recognized allowance does not reduce the carrying amount of the asset.

This category of financial assets also includes equity instruments, for which an irrevocable designation has been made to be measured at fair value, with subsequent changes in fair value recognized in other comprehensive income. The decision on such classification is made individually for each instrument. If such assets are sold, the result on sales is transferred to supplementary capital.

Financial assets at fair value through profit or loss

This category includes other financial instruments that do not meet the conditions for being classified as financial assets measured at amortized cost or fair value through other comprehensive income. This pertains in particular to:

- financial assets designated for measurement at fair value through profit or loss;
- financial assets classified under IAS 39 as held for trading;
- participation units that are not equity instruments and to which the SPPI condition does not apply, which solely payment of principal and interest;
- financial assets that have not passed the SPPI test - for which contractual terms result in cash flows not being solely payments of principal and interest;
- financial assets held within a business model other than the one whose objective is to hold financial assets in order to collect contractual cash flows or both to collect contractual cash flows and to sell financial assets;
- equity instruments that, in accordance with IAS 39, were classified as available for sale and measured at fair value through other comprehensive income but not irrevocably designated as at fair value through other comprehensive income under IFRS9;

Fair value measurement principles are described in section 9.1. The effects of change of the measurement of financial instruments carried at fair value, including the interest income related to them and changes in the value of liabilities on account of investment contracts for the client's account and risk are recognized in the "Net movement in fair value of assets and liabilities measured at fair value" item in the period to which they pertain.

35.1.2.2. Rules applicable until 31 December 2017

Financial assets held to maturity

Financial assets held to maturity include financial assets held to maturity that are not derivatives, with fixed or determinable payments and fixed maturity, which have been purchased with the intention of holding and the PZU Group is able to hold them to maturity.

Financial assets held to maturity are carried at amortized cost and the measurement results are recognized in the "Net investment income" item.

Information on the principles of recognizing impairment losses prevailing until 31 December 2017 is presented in section 36.1.2.

Financial assets available for sale

Financial instruments available for sale include financial instruments not classified into other categories.

The instruments classified into this category are carried at fair value according to the principles described in section 9.1. The difference between the fair value at the end of the reporting period and the purchase price is recognized directly in revaluation reserve. In the case of debt securities interest accrued using the effective interest rate are recognized in the "Net investment income" item, and the difference between the fair value and the value at amortized cost is recognized in revaluation reserve.

In the case of sale of financial instruments available for sale, the value of revaluation reserve is reversed and recognized in the "Net result on realization and impairment losses on financial assets" item.

Financial assets at fair value through profit or loss

Financial instruments measured at fair value through profit or loss include:

- financial instruments held for trading – assets purchased for sale in the near future or liabilities incurred to be redeemed in the near future;
- financial instruments classified at the time of purchase as measured at fair value through profit or loss, if their fair value can be reliably estimated. Such financial instruments include:
  - some instruments earmarked to cover technical provisions and investment contracts in life insurance. The adopted classification of instruments eliminates or significantly reduces the mismatch of measurement and recognition of liabilities and assets covering them;
  - financial instruments managed and assessed in accordance with documented risk management principles on the basis of fair value.

Fair value measurement principles are described in section 9.1. The effects of change of the measurement of financial instruments carried at fair value, including the interest income related to them and changes in the value of liabilities on account of investment contracts for the client's account and risk are recognized in the "Net movement in fair value of assets and liabilities measured at fair value" item in the period to which they pertain.

Loans

Credits, loans and other receivables are financial assets which are not derivatives, with fixed or determinable payments that are not quoted on an active market, other than:

- financial assets that the entity intends to sell immediately or in the near future, which are classified as held for trading and which, upon first recognition, were designated by the entity as measured at fair value through profit or loss;
- financial assets designated by the entity upon first recognition as available for sale;

- financial assets whose holder may not recover substantially the full amount of the initial investment due reasons other than deterioration of the loan service, which are classified as available for sale.

Credits, loans and other receivables include in particular:

- payment made for debt securities purchased under a contract which shows that the seller has retained substantially all risks and benefits associated with such securities (buy-sell-back and reverse repo transactions);
- debt securities not quoted on an active market;
- term deposits with credit institutions;
- loans granted;
- receivables under concluded insurance contracts (including reinsurance);
- other receivables.

Credits, loans and other receivables, except for receivables under concluded insurance agreements an other short-term receivables are carried at the end of the reporting period at amortized cost.

Due to their nature, receivables under concluded insurance agreements and other short-term receivables are carried at nominal value, taking into account the impairment losses on doubtful receivables (the method of estimation of these losses for insurance receivables is presented in section36.1.1.6).

The result of the measurement of credits, loans and other receivables at amortized cost is recognized in the "Net investment income" item.

35.1.3. Exclusion from the statement of financial position

Financial assets are excluded from the consolidated statement of financial position when the contractual rights to the cash flows from the asset expire or are transferred to another entity. The transfer also takes place when the contractual rights to the cash flows from the asset are retained but the contractual obligation to transfer such cash flow to an entity outside the PZU Group is assumed.

When transferring financial assets, the entity assesses to that extent the risk and benefits associated with the holding of the asset is retained:

- if substantially all the risks and rewards incidental to ownership of the asset are transferred, the financial asset is excluded from the consolidated statement of financial position;
- if substantially all the risks and rewards incidental to ownership of the financial asset are retained, the financial asset continues to be recognized in the consolidated statement of financial position;
- if substantially all the risks and rewards incidental to ownership of the financial asset are not transferred and not retained, it is determined whether control over the financial asset is retained.

If control is retained the financial asset is recognized in the consolidated statement of financial position up to the value following from the permanent exposure and if there is no control the asset is excluded from the consolidated statement of financial position.

(in millions of PLN)

35.2 Quantitative data

Investment financial assets - IFRS 9	31 December 2018		
	at amortized cost	at fair value through other comprehensive income	at fair value through profit or loss
Equity instruments	**n/a**	**522**	**1,220**
Quoted on a regulated market	n/a	310	1,171
Not quoted on a regulated market	n/a	212	49
Participation units and investment certificates	**n/a**	**n/a**	**4,298**
Quoted on a regulated market	n/a	n/a	110
Not quoted on a regulated market	n/a	n/a	4,188
Debt securities	**34,652**	**38,215**	**12,176**
Government securities	27,501	26,167	11,986
Domestic	27,349	23,419	10,793
Fixed rate	24,074	10,745	8,893
Floating rate	3,275	12,674	1,900
Foreign	152	2,748	1,193
Fixed rate	152	2,748	1,193
Other	7,151	12,048	190
Quoted on a regulated market	762	4,387	41
Fixed rate	454	1,515	36
Floating rate	308	2,872	5
Not quoted on a regulated market	6,389	7,661	149
Fixed rate	869	2,986	3
Floating rate	5,520	4,675	146
Other, including:	**10,582**	**-**	**-**
Buy-sell-back transactions	3,278	-	-
Term deposits with credit institutions	2,769	-	-
Loans	4,535	-	-
Investment financial assets, total	**45,234**	**38,737**	**17,694**

Equity instruments measured at fair value through other comprehensive income	31 December 2018		31 December 2017
	Fair value	Dividends recognized in the period	
Quoted on a regulated market	310	10	n/a
Grupa Azoty SA	257	10	n/a
Polimex-Mostostal SA	38	-	n/a
Other	15	-	n/a
Not quoted on a regulated market	212	20	n/a
Biuro Informacji Kredytowej SA	173	19	n/a
PSP sp. z o.o.	22	-	n/a
Krajowa Izba Rozliczeniowa SA	13	1	n/a
Other	4	-	n/a
Equity instruments measured at fair value through other comprehensive income, total	**522**	**30**	**n/a**

(in millions of PLN)

Investment financial assets - IAS 39	31 December 2017				
	held to maturity	available for sale	at fair value – classified upon first recognition	held for trading	loans
Equity instruments	**n/a**	**664**	**1,947**	**4,617**	**n/a**
Quoted on a regulated market	n/a	262	1,781	562	n/a
Not quoted on a regulated market	n/a	402	166	4,055	n/a
Debt securities	**21,237**	**47,855**	**4,703**	**8,976**	**13,623**
Government securities	21,006	33,649	4,664	8,699	1
Domestic	20,641	32,547	4,351	6,702	-
Fixed rate	19,277	20,753	4,054	4,834	-
Floating rate	1,364	11,794	297	1,868	-
Foreign	365	1,102	313	1,997	1
Fixed rate	365	1,102	313	1,964	1
Floating rate	-	-	-	33	-
Other	231	14,206	39	277	13,622
Quoted on a regulated market	102	694	39	175	977
Fixed rate	102	694	39	175	281
Floating rate	-	-	-	-	696
Not quoted on a regulated market	129	13,512	-	102	12,645
Fixed rate	31	13,077 [1)]	-	-	1,181
Floating rate	98	435	-	102	11,464
Other, including:	**-**	**-**	**-**	**-**	**6,424**
Buy-sell-back transactions	-	-	-	-	885
Term deposits with credit institutions	-	-	-	-	1,841
Loans	-	-	-	-	3,698
Investment financial assets, total	**21,237**	**48,519**	**6,650**	**13,593**	**20,047**

[1)] Including NBP money bills in the amount of PLN 13,066 million.

36. Impairment of financial assets and receivables

36.1 Accounting policies and material estimates

The assessment of existence of objective evidence of impairment of a financial asset or group of financial assets is carried out at the end of each reporting period.

If there is objective evidence of impairment arising from events occurring after the initial recognition of financial assets and causing a decrease in expected future cash flows then appropriate impairment losses are recognized against costs of the current period.

Objective evidence of impairment includes information on:

- significant financial difficulties of the issuer or debtor;
- failure to comply with the terms of the contract, e.g. failure to repay or default in repayment of interest or principal;
- the lender granting the borrower forbearance (for economic or legal reasons, resulting from the borrower's financial difficulties) which the lender would otherwise not grant;
- high likelihood of liquidation, bankruptcy or other financial reorganization of the borrower;
- lack of an active market for a given financial asset caused by the issuer's financial difficulties;
- observed data pointing to a measurable decrease of estimated future cash flows associated with a group of financial assets from the time of their first recognition, although it is not yet possible to determine the decrease for a single asset from the group of financial assets, including:

  - negative changes pertaining to the status of the borrowers' payments in the group (e.g. increased number of delayed payments) or
  - adverse changes in the economic condition in a specific industry, region, etc. contributing to the deterioration of the debtors' capacity for repayment;
- significant or prolonged decline in the fair value of investments in an equity instrument below the purchase cost;
- adverse changes in the technology, market, economic, legal or other environment in which the issuer of an equity instrument operates indicating that costs of investment in that equity instrument may not be recovered.

36.1.1. Rules applicable as of 1 January 2018

IFRS 9 introduced an obligation to recognize not only incurred losses, as in the case of IAS 39, but also expected credit loss (ECL). This means a significant increase in the probability weighted estimates of expected credit loss.

The new impairment model is applied to the following financial assets that are not measured at fair value through profit or loss:

- loan receivables from clients;
- debt securities;
- lease receivables;
- lending commitments and issued financial guarantees (previously impairment losses were recognized in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets).

For debt assets measured at amortized cost and at fair value through other comprehensive income, impairment is measured as:

- Lifetime ECL – the expected credit losses that result from all possible default events over the expected life of a financial instrument;
- 12-month ECL – the portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

The PZU Group measures allowances for expected credit losses at an amount equal to lifetime ECL, except for the following instruments, for which 12-month ECL is recognized instead:

- financial instruments for which credit risk has not increased significantly since initial recognition,
- debt securities featuring low credit risk at the reporting date. Low credit risk debt securities are those securities that have been assigned an external investment-grade rating.

Change of the approach to calculation of impairment losses has significant consequences in the case of modeling of the credit risk parameters and final amount of the charges made. The loss identification period or IBNR charge are longer be used. The charge is calculated in three categories:

- basket 1 – portfolio with low credit risk – 12-month ECL is recognized;
- basket 2 – portfolio in which a significant increase of credit risk occurs – lifetime ECL is recognized;
- basket 3 – portfolio of impaired loans – lifetime ECL is recognized.

The impairment loss calculation method also impacts the method of recognizing interest income – for baskets 1 and 2 interest income is determined on the basis of gross exposures, and in basket 3 on the net basis. If credit risk increases significantly (basket 2), then the expected credit losses are recognized earlier, which contributes to higher impairment losses and consequently affects the financial result.

The PZU Group recognizes the cumulative changes in lifetime ECL since initial recognition as a loss allowance for ECL from purchased or originated credit-impaired financial assets (POCI).

Changes in the value of allowances for expected credit losses is recognized in the consolidated profit and loss account in the "Movement in allowances for expected credit losses and impairment losses on financial instruments" item.

36.1.1.1. Calculation of PD and LGD parameters

PZU Group uses the following parameters to estimate allowances for expected credit losses:

- Probability of Default (PD) – probability of default of a counterparty over a specified time horizon;
- Loss Given Default (LGD) – loss given default, expressed as a percentage of the total exposure in case of a counterparty insolvency.

For issuers and exposures that are externally rated, PDs is assigned on the basis of the average market default rate for the rating classes concerned. First, the internal rating of an entity/issue is determined in accordance with the internal rating methodology. The tables published by external rating agencies are used to estimate average PD.

The Moody's RiskCalc model is used for issuers of corporate bonds and corporate loans, for which no external rating is available. The EDF parameter (expected default frequency) is used to estimate PD. When estimating lifetime PD for exposures with maturity above 5 years (in the RiskCalc model, the forward EDF curve refers to a 5-year period), it is assumed that in subsequent years PD is constant and corresponds to the value determined by the model for the 5th year.

For loan receivables from clients PD is estimated based on internal models depending on the segment group, individual credit quality of the customer, and the exposure lifecycle phase.

For issuers of corporate bonds and corporate loans, 12-month LGD is determined based on the Moody's RiskCalc model (LGD module). When estimating lifetime LGD for exposures with a maturity above 5 years, it is assumed that in subsequent years LGD is constant and corresponds to the value determined by the module for the 5th year.

If a credit rating agency has allocated a separate recovery rate to the instrument concerned then this parameter is used. For a given RR (*recovery rate*) parameter, the formula: LGD = 1-RR is applied.

Where the RiskCalc model cannot be used to estimate LGD levels and where the instrument does not have an LGD awarded by an external rating agency, then the average RR should be used, based on market data (properly differentiating the corporate and sovereign debt classes) supplied by external rating agencies using the following formula: LGD = 1-RR. When lifetime LGD must be estimated, the value of this parameter is assumed to be constant. The degree of subordination of debt is taken into account when selecting data for LGD.

36.1.1.2. Change in credit risk since initial recognition

At each reporting date, the PZU Group shall assesses whether the credit risk on a financial instrument has increased significantly since initial recognition. When making the assessment, the PZU Group should use the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses. To make that assessment, the Group compares the PD for the financial instrument as at the reporting date with the PD as at the date of initial recognition and consider reasonable and supportable information, that is available without undue cost or effort.

It is recognized that the credit risk on a financial instrument has not increased significantly at initial recognition and on the reporting date if the financial instrument features low credit risk (that is, it has an external investment-grade rating).

The PZU Group assesses whether the credit risk of financial instruments has increased significantly by comparing the PD parameter for the rest of its lifetime on the reporting date with the PD parameter for the rest of its lifetime estimated at the time of initial recognition.

The PZU Group regularly monitors the effectiveness of the criteria used to identify a significant increase in credit risk, in order to confirm that:

- the criteria allow for identification of a significant increase in credit risk before the impairment of the exposure occurs;
- the average time between identifying a significant increase in credit risk and impairment is reasonable;
- exposures are in principle not transferred directly from basket 1 (12-month ECL) to basket 3 (impairment);
- there is no unreasonable volatility of allowances for expected credit losses resulting from transfers between 12-month ECL and lifetime ECL.

In the case of loan receivables from clients, the identification of a significant credit risk growth is based on an analysis of qualitative (such as the occurrence of a 30-day past due period, customer's classification in the watch list, forbearance) and quantitative premises.

36.1.1.3. Identified impaired financial assets (basket 3)

The PZU Group classifies financial assets to basket 3 when the premises for impairment losses, such as among others delay in payment of more than 90 days, are satisfied with simultaneous satisfaction of the unpaid amount materiality threshold, exposure being included in the restructuring process or occurrence of an individual premise of impairment losses.

36.1.1.4. Financial assets impaired due to credit risk (POCI)

Financial assets impaired due to credit risk (POCI) is assets with impairment losses determined at the time of the initial recognition. The POCI classification does not change over the life of the instrument until derecognition.

POCI assets arise from:

- acquisition of a contract satisfying the definition of POCI (e.g. on combination with another entity or purchase of a portfolio);
- conclusion of a POCI contract on the initial granting (e.g. granting of a loan to a client in a poor financial condition),
- modification of a contract (e.g. in the course of restructuring) resulting in excluding an asset from the balance sheet and recognizing a new asset satisfying the definition of POCI.

As at the initial recognition, POCI assets are recognized at the fair value, without recognizing credit risk impairment.

36.1.1.5. Allocation of financial assets taken over as part of Pekao and Alior Bank acquisition deals

The financial assets acquired in the transactions to acquire Pekao and Alior Bank were classified solely to basket 1 or as POCI, respectively as of the date of acquisition (assets that were covered by impairment losses).

The financial assets that were classified as POCI as at the date of implementing IFRS 9 (assets that would be classified in the bank to basket 3 or as POCI as at the acquisition date) do not change their classification on subsequent balance sheet dates. The following standards have been endorsed for the other exposures:

- The PZU Group maintains the banks' classification in respect of exposures that were in basket 1 in the bank on the date of acquisition;
- a check is done of the exposures that were in basket 2 in the banks on the date of acquisition to see whether the loan quality deteriorated after the date of acquisition. If not – these assets are classified as basket 2, also at the PZU Group level; otherwise – the PZU Group upholds the classification to basket 1;
- the bank's classification to basket 3 is accepted for exposures for which an impairment has been identified after the date of acquisition.

The assignment of all the financial assets recognized by banks after the date of acquisition to baskets at the PZU Group level is consistent with the classification used at the level of the bank's financial statements.

36.1.1.6. Receivables from policyholders

A simplified model, in which impairment losses are estimated at the expected credit loss amount over the entire lifetime, is applied for receivables from policyholders.

Where any evidence is found that indicates the possibility of impairment of an individual receivable, an assessment is made of the debtor's economic standing and assets and the probability of repayment of the receivables. Following such analysis, a specific impairment loss may be recognized for such individual receivable item.

In the case of receivables from debtors against whom liquidation or bankruptcy proceedings have been launched, the impairment loss is recognized up to the amount of the receivable that is not covered by a guarantee or other collateral. If a petition for the debtor's bankruptcy has been dismissed and the debtor's assets are not sufficient to cover the costs of the bankruptcy procedure, the impairment loss is recognized at the full amount of the receivable.

A specific impairment loss is increased if information is received that the estimated recoverable amount has fallen or the amount of receivables for which the impairment loss was recognized, has increased. A previously recognized specific impairment loss is reversed if it is estimated that the recoverable amount is higher than it was previously estimated or if full or partial payment of the receivable amount has been confirmed. A specific impairment loss is used if the receivable has been forgiven or written down in full.

To the extent that no individual assessment has been made, a collective assessment is conducted. Receivables are grouped by similar credit risk characteristics. For receivables before maturity, the value of the receivable that is likely to become due is determined based on a historical analysis of the percentage of the ratio of receivables that are not paid before maturity. The amount of write-off for expected credit losses is determined on the basis of the uncollectibility ratio for matured receivables with the shortest past due period.

For matured receivables, an age structure is prepared, depending on the past due period. For this group, the value of the allowance for expected credit losses is calculated in separate ranges of past due periods, based on the uncollectibility ratios determined through historical analysis.

36.1.2. Rules applicable until 31 December 2017

The evidence of impairment for credit exposures may be divided into evidence relating to:

- the client, including:
  - individual client – consumer bankruptcy, death, lack of information about the customer's whereabouts, loss of employment, client's financial problems;
  - business client – receivership, bankruptcy/liquidation, significant deterioration of internal scoring/rating, significant deterioration of the economic and financial standing;
  - both individual and business clients – significant delay in payment or unauthorized debit, client's assets not being disclosed.
- account – launch of court proceedings, launch of enforcement proceedings, effective termination of the agreement, restructuring, exposure challenged by the debtor through litigation, identified fraud.

If there no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics, which are collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss has been recognized are not included in a collective assessment of impairment.

The amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). Interest income is recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Exposures for which evidence of impairment has been identified are divided into exposures measured individually and measured collectively in groups.

If evidence of impairment is identified for financial instruments available for sale then the losses previously recognized in the revaluation reserve are charged to profit or loss.

Impairment losses on financial instruments available for sale charged to profit or loss:

- in the case of equity instruments they cannot be reversed;

- in the case of debt instruments they can be reversed if, in a subsequent period, the fair value of the debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss.

36.1.2.1. Loan receivables from clients

For all on-balance sheet credit exposures (groups of on-balance sheet credit exposures) an assessment is made to identify objective indications of impairment, according to the most recent data at the remeasurement date. In order to calculate an impairment loss amount, the estimated amounts and timing of future cash flows must be assessed. The estimates are based on assumptions about many factors, so the actual results may differ. As a result, the impairment loss amount may be subject to change in the future.

Individual assessment is required for impaired exposures that exceed the accepted materiality or exposure thresholds, for which a group of assets with similar credit risk characteristics cannot be identified or where the sample is too small to estimate the group's parameters.

Individual measurement consists in a case-by-case verification whether a credit exposure is impaired and projection of future cash flows, including cash flows from seizure of collateral less cost to seize and sell, or from other repayment sources. The value of recoveries expected in individual measurements are regularly compared with actual recoveries.

Group measurement is based on the time over which an exposure remains in an impaired state; it considers the specificity of the group in terms of expected recoveries. Collateral is taken into account at the exposure level.

Credit exposures, for which no individual indications of impairment have been identified, are grouped in accordance with the risk profile homogeneity principle and a provision is recognized for the entire group of exposures to cover losses incurred but not reported (IBNR).

36.1.2.2. Equity instruments quoted on regulated markets and participation units and investment certificates in mutual funds

Impairment losses for equity instruments quoted on regulated markets, participation units in open-end mutual funds and closed-end mutual fund certificates classified as available for sale are recognized if at least one of the two conditions is met:

- the negative difference between the present value and the purchase value is at least 30% of the purchase value;
- at the end of each of the consecutive 12 months, the value of the asset was lower than the purchase value.

36.1.2.3. Assets held to maturity and loans

Impairment losses for assets held to maturity and loans are calculated at the difference between the carrying amount of the assets and the present value of estimated future cash flows discounted by the effective interest rate determined on initial recognition (initial effective interest rate).

If an impairment loss amount decreases in a subsequent periods a result of an event that occurred after the impairment, the previously recognized impairment loss is reversed through an adjustment of the balance of impairment losses. The amount of the reversal is posted to the profit and loss account under "Net result on realization and impairment losses on investments".

36.1.2.4. Receivables from policyholders

The model for recognizing allowances for receivables from policyholders did not differ materially from the one applicable as of 1 January 2018, except for the fact that it did not consider expected credit losses but rather losses incurred.

(in millions of PLN)

36.2 Quantitative data

Debt investment financial assets measured at fair value through other comprehensive income 1 January – 31 December 2018	Basket 1 (12-month expected credit loss)	Basket 2 (expected credit loss during the instrument's life cycle)	Basket 3 (impairment)	Acquired with impairment	Total
Carrying amount					
Classification at the time of applying IFRS 9	50,181	74	-	-	50,255
Recognition of instruments at the time of acquisition, creation, granting	136,513	-	-	-	136,513
Change in measurement	(155)	1	-	-	(154)
Change attributable to modification of cash flows concerning the given instrument	(1)	-	-	-	(1)
Changes attributable to sale, exclusion or expiration of the instrument	(149,227)	(2)	-	-	(149,229)
Other changes, including foreign exchange differences	831	-	-	-	831
Balance at the end of the period	**38,142**	**73**	**-**	**-**	**38,215**
Expected credit losses					
Calculation of expected credit losses at the time of applying IFRS 9	(31)	(6)	-	-	(37)
Establishment of allowances for newly acquired, created, granted instruments	(20)	-	-	-	(20)
Changes attributable to variations in measurement of instruments or credit risk level (excluding reclassification)	4	1	-	-	5
Changes attributable to sale, exclusion or expiration of the instrument	10	2	-	-	12
Balance at the end of the period	**(37)**	**(3)**	**-**	**-**	**(40)**

The allowance pertaining to debt investment financial assets measured at fair value through other comprehensive income is recognized in revaluation reserve and it does not lower the carrying amount of assets.

(in millions of PLN)

Debt investment financial assets measured at amortized cost 1 January – 31 December 2018	Basket 1 (12-month expected credit loss)	Basket 2 (expected credit loss during the instrument's life cycle)	Basket 3 (impairment)	Acquired with impairment	Total
Gross carrying amount					
Classification at the time of applying IFRS 9	32,450	186	31	16	32,683
Recognition of instruments at the time of acquisition, creation, granting	5,705	-	-	-	5,705
Change in measurement	727	2	-	(2)	727
Changes attributable to sale, exclusion or expiration of the instrument	(4,318)	(153)	-	(12)	(4,483)
Other changes, including foreign exchange differences	93	-	2	-	95
Balance at the end of the period	**34,657**	**35**	**33**	**2**	**34,727**
Expected credit losses					
Calculation of expected credit losses at the time of applying IFRS 9	(38)	(17)	(31)	-	(86)
Establishment of allowances for newly acquired, created, granted instruments	(5)	-	-	-	(5)
Changes attributable to variations in measurement of instruments or credit risk level (excluding reclassification)	(1)	1	-	-	-
Changes attributable to sale, exclusion or expiration of the instrument	5	9	-	-	14
Other changes, including foreign exchange differences	4	-	(2)	-	2
Balance at the end of the period	**(35)**	**(7)**	**(33)**	**-**	**(75)**
Net carrying amount at the end of the period	**34,622**	**28**	**-**	**2**	**34,652**

Value of allowances for expected credit losses concerning buy-sell-back transactions is zero.

Term deposits with credit institutions 1 January – 31 December 2018	Basket 1 (12-month expected credit loss)	Basket 2 (expected credit loss during the instrument's life cycle)	Basket 3 (impairment)	Acquired with impairment	Total
Gross carrying amount					
Classification at the time of applying IFRS 9	1,841	1	21	-	1,863
Recognition of instruments at the time of acquisition, creation, granting	143,630	-	-	-	143,630
Change in measurement	6	-	-	-	6
Changes attributable to sale, exclusion or expiration of the instrument	(143,300)	-	-	-	(143,300)
Other changes	593	-	(12)	-	581
Balance at the end of the period	**2,770**	**1**	**9**	**-**	**2,780**
Expected credit losses					
Calculation of expected credit losses at the time of applying IFRS 9	(1)	-	(21)	-	(22)
Establishment of allowances for newly acquired, created, granted instruments	(2)	-	-	-	(2)
Changes attributable to variations in measurement of instruments or credit risk level (excluding reclassification)	1	-	-	-	1
Other changes	-	-	12	-	12
Balance at the end of the period	**(2)**	**-**	**(9)**	**-**	**(11)**
Net carrying amount at the end of the period	**2,768**	**1**	**-**	**-**	**2,769**

(in millions of PLN)

Loans 1 January – 31 December 2018	Basket 1 (12-month expected credit loss)	Basket 2 (expected credit loss during the instrument's life cycle)	Basket 3 (impairment)	Acquired with impairment	Total
Gross carrying amount					
Classification at the time of applying IFRS 9	3,699	-	-	-	3,699
Recognition of instruments at the time of acquisition, creation, granting	1,077	-	-	-	1,077
Change in measurement	83	-	-	-	83
Changes attributable to sale, exclusion or expiration of the instrument	(264)	-	-	-	(264)
Balance at the end of the period	**4,595**	**-**	**-**	**-**	**4,595**
Expected credit losses					
Calculation of expected credit losses at the time of applying IFRS 9	(46)	-	-	-	(46)
Establishment of allowances for newly acquired, created, granted instruments	(16)	-	-	-	(16)
Changes attributable to variations in measurement of instruments or credit risk level (excluding reclassification)	2	-	-	-	2
Balance at the end of the period	**(60)**	**-**	**-**	**-**	**(60)**
Net carrying amount at the end of the period	**4,535**	**-**	**-**	**-**	**4,535**

(in millions of PLN)

Loan receivables from clients measured at amortized cost 1 January – 31 December 2018	Basket 1 (12-month expected credit loss)	Basket 2 (expected credit loss during the instrument's life cycle)	Basket 3 (impairment)	Acquired with impairment	Total
Gross carrying amount					
Classification at the time of applying IFRS 9	147,695	13,816	4,049	12,152	177,712
Recognition of instruments at the time of acquisition, creation, granting	47,886	-	-	2	47,888
Changes in the period (attributable to valuation, sale, exclusion or expiration of the instrument)	(30,946)	(496)	5,003	(5,031)	(31,470)
Change attributable to modification of cash flows concerning the given instrument	-	-	(1)	1	-
Assets written down from the balance sheet	-	-	(4,290)	(12)	(4,302)
Reclassification to basket 1	4,915	(4,851)	(64)	-	-
Reclassification to basket 2	(8,987)	9,399	(412)	-	-
Reclassification to basket 3	(1,740)	(1,809)	3,549	-	-
Foreign exchange differences	280	214	66	-	560
Other changes	509	(204)	(45)	53	313
Balance at the end of the period	**159,612**	**16,069**	**7,855**	**7,165**	**190,701**
Expected credit losses					
Calculation of expected credit losses at the time of applying IFRS 9	401	(1,821)	(2,498)	(8,097)	(12,015)
Establishment of allowances for newly acquired, created, granted instruments	(150)	(2)	-	-	(152)
Changes in the period (attributable to valuation, credit risk level, sale, exclusion or expiration of the instrument, excluding reclassification)	(980)	269	(5,375)	3,345	(2,741)
Assets written down from the balance sheet	-	-	4,290	12	4,302
Reclassification to basket 1	(309)	281	28	-	-
Reclassification to basket 2	90	(172)	82	-	-
Reclassification to basket 3	65	257	(322)	-	-
Foreign exchange differences	(2)	(2)	(30)	-	(34)
Other changes	15	1	224	(61)	179
Balance at the end of the period	**(870)**	**(1,189)**	**(3,601)**	**(4,801)**	**(10,461)**
Net carrying amount at the end of the period	**158,742**	**14,880**	**4,254**	**2,364**	**180,240**

(in millions of PLN)

Loan receivables from clients measured at fair value through other comprehensive income 1 January – 31 December 2018	Basket 1 (12-month expected credit loss)	Basket 2 (expected credit loss during the instrument's life cycle)	Basket 3 (impairment)	Acquired with impairment	Total
Carrying amount					
Classification at the time of applying IFRS 9	1,556	-	-	-	1,556
Recognition of instruments at the time of acquisition, creation, granting	401	-	-	-	401
Changes attributable to sale, exclusion or expiration of the instrument	(490)	-	-	-	(490)
Foreign exchange differences	49	-	-	-	49
Other changes	(5)	-	-	-	(5)
Balance at the end of the period	**1,511**	**-**	**-**	**-**	**1,511**
Expected credit losses					
Calculation of expected credit losses at the time of applying IFRS 9	(18)	-	-	-	(18)
Establishment of allowances for newly acquired, created, granted instruments	(1)	-	-	-	(1)
Changes attributable to variations in measurement of instruments or credit risk level (excluding reclassification)	3	-	-	-	3
Changes attributable to sale, exclusion or expiration of the instrument	2	-	-	-	2
Balance at the end of the period	**(14)**	**-**	**-**	**-**	**(14)**

The allowance pertaining to loan receivables from clients measured at fair value through other comprehensive income is recognized in revaluation reserve and it does not lower the carrying amount of assets.

Receivables 1 January – 31 December 2018	31 December 2018
Gross carrying amount	
Classification at the time of applying IFRS 9	9,950
Changes in the period	(2,668)
Balance at the end of the period	**7,282**
Expected credit losses	
Calculation of expected credit losses at the time of applying IFRS 9	(823)
Changes in the period	(116)
Balance at the end of the period	**(939)**
Net carrying amount at the end of the period	**6,343**

(in millions of PLN)

Movement in impairment losses for financial assets in the year ended 31 December 2017	Balance at the beginning of the period	Recognition through profit or loss	Reversal through profit or loss	Derecognition (sale, write-down etc.)	Change in the composition of the Group	Other changes	Balance at the end of the period
Financial assets held to maturity	**1**	**-**	**-**	**-**	**-**	**-**	**1**
Debt instruments	1	-	-	-	-	-	1
Financial assets available for sale	**54**	**-**	**(7)**	**(13)**	**-**	**-**	**34**
Equity instruments	47	-	-	(13)	-	-	34
Debt securities	7	-	(7)	-	-	-	-
Loans	**3,149**	**3,791**	**(2,653)**	**(1,149)**	**5,837**	**(20)**	**8,955**
Debt securities	71	7	(56)	(27)	104	(1)	98
Loan receivables from clients	3,062	3,784	(2,597)	(1,107)	5,716	(19)	8,839
Term deposits with credit institutions	1	-	-	-	17	-	18
Loans	15	-	-	(15)	-	-	-
Receivables	**591**	**151**	**(87)**	**(21)**	**16**	**(1)**	**649**
Receivables on direct insurance	562	145	(82)	(20)	-	(1)	604
Reinsurance receivables	8	4	(4)	(1)	-		7
Other receivables	21	2	(1)	-	16	-	38
Reinsurers' share in technical provisions	**9**	**9**	**(6)**	**-**	**-**	**-**	**12**
Cash and cash equivalents	**1**	**-**	**-**	**-**	**-**	**-**	**1**
Total	**3,805**	**3,951**	**(2,753)**	**(1,183)**	**5,853**	**(21)**	**9,652**

(in millions of PLN)

Credit quality of financial assets as at 31 December 2017	Net carrying amount of non-overdue assets		Net carrying amount of overdue assets			Net carrying amount	Impairment losses		Gross amount
	covered by impairment losses	not covered by impairment losses	up to 3 months	over 3 months up to 6 months	over 6 months		created individually	created in group	
Loan receivables from clients	**1,869**	**159,115**	**4,821**	**399**	**3,253**	**169,457**	**4,091**	**4,748**	**178,296**
Debt securities held to maturity	**-**	**21,237**	**-**	**-**	**-**	**21,237**	**1**	**-**	**21,238**
Debt securities available for sale	**-**	**47,855**	**-**	**-**	**-**	**47,855**	**-**	**-**	**47,855**
Loans	**-**	**20,047**	**-**	**-**	**-**	**20,047**	**106**	**10**	**20,163**
Debt securities	-	13,623	-	-	-	13,623	98	-	13,721
Buy-sell-back transactions	-	885	-	-	-	885	-	-	885
Term deposits with credit institutions	-	1,841	-	-	-	1,841	8	10	1,859
Loans	-	3,698	-	-	-	3,698	-	-	3,698
Receivables	**906**	**7,630**	**344**	**73**	**143**	**9,096**	**67**	**582**	**9,745**
Receivables on direct insurance	899	1,103	313	62	105	2,482	24	580	3,086
Reinsurance receivables	2	41	15	6	4	68	7	-	75
Other receivables	5	6,486	16	5	34	6,546	36	2	6,584
Reinsurers' share in technical provisions	**121**	**1,129**	**-**	**-**	**-**	**1,250**	**12**	**-**	**1,262**
Total	**2,896**	**257,013**	**5,165**	**472**	**3,396**	**268,942**	**4,277**	**5,340**	**278,559**

(in millions of PLN)

37. Receivables

Receivables – carrying amount	31 December 2018	31 December 2017
Receivables on direct insurance, including:	2,574	2,482
- receivables from policyholders	2,438	2,320
- receivables from insurance intermediaries	112	134
- other receivables	24	28
Reinsurance receivables	115	68
Other receivables	3,654	6,546
- receivables from disposal of securities and security deposits [1]	1,632	4,751
- receivables on account of payment card settlements	992	758
- trade receivables	340	295
- receivables from the state budget, other than corporate income tax receivables	237	100
- receivables by virtue of commissions concerning off-balance sheet products	178	66
- receivables from debt factoring	3	68
- prevention settlements	46	58
- receivables from direct claims handling on behalf of other insurance undertakings	27	29
- receivables for acting as an emergency adjuster	14	12
- receivables on account of Corporate Income Tax	6	57
- receivables from purchase price allocation of the acquisition of Bank BPH's Core Business	-	94
- receivables from security and bid deposits	34	91
- other	145	167
Total receivables	**6,343**	**9,096**

[1] This line item presents receivables associated with executed but outstanding transactions on financial instruments.

As at 31 December 2018 and 31 December 2017, the fair value of receivables did not differ significantly from their carrying amount, primarily due to their short-term nature and the policy of recognizing impairment losses.

Receivables – according to maturity stipulated in the terms and conditions of the agreement	31 December 2018	31 December 2017
Up to 1 year [1]	6,163	9,038
1 to 5 years	162	55
Over 5 years	18	3
Receivables – according to maturity stipulated in the terms and conditions of the agreement, total	**6,343**	**9,096**

[1] Including past due receivables.

38. Cash and cash equivalents

38.1 Accounting policy

Cash and cash equivalents include, among other things, cash at hand and on current bank accounts, including the account kept with NBP.

Cash is recognized at its nominal value.

38.2 Restricted cash

The consolidated cash flow statement carries the cash of insurance companies' Preventive Funds and VAT split-payments as restricted cash. Pursuant to the Polish regulations and the internal regulations of the PZU Group companies that are based on them, this cash may be spent only for specific purposes as part of preventive activities or VAT split-payments.

(in millions of PLN)

38.3 Quantitative data

Cash and cash equivalents carried in the statement of financial position and in the cash flow statement	31 December 2018	31 December 2017
Cash in the central bank [1)]	10,496	2,518
Cash at hand and on bank accounts	6,558	5,391
Other	1	330
Cash and cash equivalents carried in the statement of financial position and in the cash flow statement, total	**17,055**	**8,239**

[1)] The amount pertains to the loan loss reserve maintained by Pekao and Alior Bank on the current account kept with NBP, whose amount is consistent with the decisions of the Monetary Policy Board.

Movement in liabilities attributable to financial activities in the period ended 31 December 2018	Balance at the beginning of the period	Changes resulting from cash flows	Interest accruals and payments as well as settlements of discount and premium	Foreign exchange differences	Balance at the end of the period
Loans received	3,380	866	3	137	4,386
Liabilities on the issue of debt securities	9,610	2,228	(29)	200	12,009
Bonds	3,821	1,856	56	189	5,922
Certificates of deposit	4,541	65	(64)	-	4,542
Covered bonds	1,248	307	(21)	11	1,545
Subordinated liabilities	5,319	549	191	2	6,061
Liabilities on account of repurchase transactions	1,167	(638)	11	-	540
Finance lease liabilities	11	-	(1)	-	10
Total financial liabilities	**19,487**	**3,005**	**175**	**339**	**23,006**

Movement in liabilities attributable to financial activities in the period ended 31 December 2017	Balance at the beginning of the period	Changes resulting from cash flows	Interest accruals and payments as well as settlements of discount and premium	Foreign exchange differences	Change in the composition of the Group	Balance at the end of the period
Loans received	305	69	92	-	2,914	3,380
Liabilities on the issue of debt securities	6,469	1,636	333	(210)	1,382	9,610
Bonds	3,680	287	64	(210)	-	3,821
Certificates of deposit	2,789	173	233	-	1,346	4,541
Covered bonds	-	1,176	36	-	36	1,248
Subordinated liabilities	1,027	3,936	356	-	-	5,319
Liabilities on account of repurchase transactions	178	(654)	(105)	-	1,748	1,167
Finance lease liabilities	3	-	1	-	7	11
Total financial liabilities	**7,982**	**4,987**	**677**	**(210)**	**6,051**	**19,487**

(in millions of PLN)

39. Assets held for sale

39.1 Accounting policy

Assets and liabilities or groups held for sale are classified as held for sale if there is a sale plan for them and there is an active program of finding the buyer.

Assets and liabilities held for sale or groups held for sale are measured as one of the two values, whichever is lower: previous carrying amount or fair value minus the costs of effecting the sale.

39.2 Quantitative data

Assets held for sale by classification before transfer	31 December 2018	31 December 2017
Groups held for sale	**1,021**	**113**
Assets	1,070	116
Investment property	973	90
Receivables	12	1
Deferred tax assets	5	6
Cash and cash equivalents	76	17
Other assets	4	2
Liabilities related directly to assets classified as held for sale	49	3
Deferred tax liability	27	-
Other liabilities	22	3
Other assets held for sale	**77**	**201**
Property, plant and equipment	34	104
Investment property	43	97
Assets and groups of assets held for sale	**1,147**	**317**
Liabilities related directly to assets classified as held for sale	**49**	**3**

The "Investment property" line item and the "Groups held for sale" section presented mainly the properties held by real estate sector mutual funds as held for sale, since the expected investment horizon has been reached.

The table below contains the list of the largest real properties designated for sale along with important parameters which were taken into consideration in valuation.

All the real properties listed in the following table were valuated by the income approach using the investment method and the straight capitalization technique. That valuation employed unobservable input data such as:

- capitalization rate – determined through analysis of rates of return obtained in transactions for similar real properties;
- monthly rental rate per m^2 of relevant space or per parking space (rental rates for individual properties are presented in the table below).

Investment property classified as Level III	Type of space	31 December 2018			31 December 2017		
		Carrying amount	Rental fees included in the measurement	Capitalization rates included in the measurement	Carrying amount	Rental fees included in the measurement	Capitalization rates included in the measurement
Office properties	Office Parking lot	44	12.90 – 14.45 EUR 79.85 – 80.00 EUR	6.40%	37	14.00 – 16.00 EUR 75 – 100 EUR	6.70%
Commercial properties	Commercial	179	depending on size of leased space	7.40% – 8.80%	-	-	-
Warehousing properties	Office Warehouse	750	2.65 – 9.00 EUR 2.42 – 4.16 EUR	6.50% – 7.55%	92	EUR 6.50 – 9.00 2.80 – 3.50 EUR	7.10% – 7.65%
Other		43			58		
Total		**1,016**			**187**		

(in millions of PLN)

40. Issued share capital and other capital attributable to equity holders of the parent

40.1 Share capital

Share capital is recognized at the amount stated in the parent company's articles of association and registered in the National Court Register

All the Shares have been fully paid for.

As at 31 December 2018 and 31 December 2017

Series/ issue	Type of shares	Type of preference	Type of limitation on rights to shares	Number of shares	Value of series/issue at par value (PLN)	Capital coverage	Date of registration	Right to dividends (from a date)
A	bearer	none	none	604,463,200	60,446,320	cash	23.01.1997	27.12.1991
B	bearer	none	none	259,059,800	25,905,980	in-kind contribution	31.03.1999	01.01.1999
Total number of shares				**863,523,000**				
Total share capital					**86,352,300**			

The structure of PZU's shareholders and information on transactions with material blocks of PZU shares are presented in section 3.

40.2 Distribution of the parent company's profit

As regards distribution of profit for 2018 and previous years, only the profit captured in the PZU standalone financial statements prepared in accordance with PAS is subject to distribution.

40.2.1.1. Distribution of the 2017 profit

Only the profit captured in the standalone financial statements of the parent company prepared in accordance with PAS is subject to distribution.

On 28 June 2018, PZU's Ordinary Shareholder Meeting distributed PZU's net profit for the year ended 31 December 2017 totaling PLN 2,434 million by earmarking:

- PLN 2,159 million as a dividend payout to shareholders, i.e. PLN 2.50 per share;
- PLN 19 million to cover retained losses resulting from the final purchase price allocation of the acquisition of the organized part of Bank BPH by Alior Bank SA;
- PLN 249 million as supplementary capital;
- PLN 7 million to the Company Social Benefit Fund.

The record date was 12 September 2018 and the dividend was paid out on 3 October 2018.

40.2.1.2. Distribution of the 2018 profit

As at the date of signing these consolidated financial statements, the PZU Management Board has not adopted a resolution in the matter of the proposed distribution of the 2018 profit.

40.3 Other capital

40.3.1. Accounting policy

Treasury shares purchased and retained by consolidated PZU Group companies are shown at purchase price.

The “Supplementary capital” item includes:

- the effect of distribution of profit, in accordance with the legal regulations in effect in the country of the company's domicile (in Poland under the Commercial Company Code) and the articles of association of PZU Group companies;
- the capital created upon the sale of investment property previously transferred from own property, according to the rules described in section 31;
- the difference between the change in value of non-controlling interest and fair value of payment in transactions with non-controlling interests.

Results of the following are posted in the “Revaluation reserve” item:

- revaluation of financial assets classified as assets measured at fair value through other comprehensive income – from 1 January 2018 (until 31 December 2017 – available-for-sale financial assets);
- revaluation of property to its fair value on the date when it is classified from own property to investment property;
- measurement of hedging instruments, in respect to the part constituting effective cash flow hedge;

after taking into account the corresponding change in deferred tax assets or liabilities;

The item “Actuarial gains and losses related to provisions for employee benefits” includes amounts resulting from increases or decreases in the present value of the defined benefit obligation because of changes in actuarial assumptions and experience adjustments – demographic (e.g. mortality, employee turnover) and financial (e.g. discount rate or projected salary growth rate).

“Foreign exchange translation differences” include differences resulting from translation of financial data of foreign entities using exchange rates, in accordance with the rules described in section 5.5.

(in millions of PLN)

40.3.2. Quantitative data

Other capital	31 December 2018	31 December 2017
Treasury shares	(11)	-
Supplementary capital	12,660	11,824
Share premium account	538	538
Distribution of results of PZU Group companies	12,079	11,231
Other	43	55
Revaluation reserve	(65)	157
Valuation of debt instruments measured at fair value through other comprehensive income	94	78
Valuation of equity instruments measured at fair value through other comprehensive income	(255)	n/a
Reclassification of real property from property, plant and equipment to investment property	78	85
Entities measured by the equity method	1	1
Cash flow hedging	17	(7)
Other reserve capital	18	5
Actuarial gains and losses related to provisions for employee benefits	-	4
Foreign exchange translation differences	(36)	(73)
Lietuvos Draudimas AB	15	(13)
AAS Balta	7	-
PZU Ukraine	(49)	(51)
PZU Ukraine Life	(10)	(10)
Other	1	1
Total other capital	**12,566**	**11,917**

Change in the revaluation reserve resulting from measurement of debt instruments measured at fair value through other comprehensive income (2018) / available for sale (2017)	1 January – 31 December 2018	1 January – 31 December 2017
Balance at the beginning of the period	78	25
Application of IFRS 9	7	n/a
Changes	9	53
- change in fair value	30	132
- sale	(21)	(79)
Balance at the end of the period	**94**	**78**

41. Technical provisions

41.1 Accounting policy

41.1.1. Non-life insurance

Provision for unearned premiums and provision for unexpired risk

Provision for unearned premiums is calculated at the end of each reporting period on a case-by-case basis, with the precision of one day.

Provision for unexpired risk is recognized as an addition to the provision for unearned premiums to cover future claims, benefits and expenses, including deferred acquisition expenses, in relation to insurance agreements that do not expire on the last day of the reporting period. The provision for unexpired risk is calculated for insurance groups at the end of each reporting period.

The total amount of the provision for unexpired risk is determined for those insurance groups where the current year loss ratio is greater than 100%, as a difference between the product of the provision for unearned premiums and the loss ratio of the current financial year and the provision for unearned premiums for the same insurance period.

Provision for outstanding claims and benefits

Provision for outstanding claims and benefits includes:

- provision for outstanding claims and benefits for losses and accidents incurred and reported (RBNP) by the end of the reporting period;
- provision for losses and accidents incurred but not reported (IBNR) by the end of the reporting period
- provision for claims handling expenses.

The RBNP provision is calculated on a case-by-case basis by claims handling units or, if available information is not sufficient to assess the provision amount, at the average claim amount determined using the actuarial method. The provision recognized takes into account the insured's deductible, the expected increase in prices of goods and repair services and may not be greater than the sum insured or indemnity. The provision is updated as soon as information influencing its amount is available, on a case-by-case assessment or estimation of losses and claims.

The IBNR provision is recognized for losses and claims that are not reported by the balance sheet date, as at which the provision is recognized. IBNR is calculated using the loss triangle analysis method: a generalized Chain Ladder method and for a small number or value of losses the Bornhuetter-Ferguson method, broken down by the years in which the losses occurred. The calculations are based on the annual triangles of claims paid and claims reported.

The provision for direct claims handling expenses for reported claims is calculated for each claim individually, and for claims incurred but not reported – using the generalized Chain Ladder method (based on the cost triangles analysis, broken down by the years in which the losses occurred).

The provision for indirect claims handling expenses is calculated using the actuarial method, as a product of the ratio of the percentage of indirect claims handling expenses in claims paid and direct claims handling expenses and the sum of provision for claims reported but not paid and the provision for losses and accidents incurred but not reported and the provision for direct claims handling expenses.

The 1st and the 2nd provisions and the provision for claims handling expenses are recognized at the nominal value, i.e. they are not discounted.

Provision for the capitalized value of annuities

Provision for the capitalized value of annuities is calculated on a case-by-case basis as the present value of an annuity (lifetime or temporary) paid in advance.

At the end of each reporting period, actuarial methods are used to recognize a provision for the capitalized value of annuities arising from losses incurred after 31 December 1990 and not recognized as annuities until the end of the reporting period (annuity IBNR). At the end of each reporting period, the amount of additional provision is also calculated to cover liabilities resulting from the increase of annuity benefits from the "legacy portfolio". The increases apply to those annuity beneficiaries, for whom a corresponding provision was calculated at the end of 1997 and the benefit at the end of the reporting period is lower than a certain percentage of the present value of average wages between 1960 and 1990.

Provision adequacy tests

Provision adequacy testing is not required in non-life insurance. However when consolidated financial statements are prepared, a procedure that is similar to the provision adequacy test in life insurance is conducted to verify whether claims provisions within individual products are sufficient. The test takes into account current trends in accident incidence, reporting rates and claim payments. If the estimates that consider current trends are higher than claims provisions then the provisions are increased up to the estimated amount. Otherwise, the provisions may be partially released.

The mechanism for recognizing the provision for unexpired risks in non-life insurance corresponds to the minimum requirements for the provisions adequacy test.

41.1.2. Life insurance

Provision for unearned premiums

Provision for unearned premiums is created as the portion of gross written premium that corresponds to future reporting periods, pro rata to the period for which the premium is written.

Life insurance provision

Life insurance provision is calculated using prospective actuarial methods, for each insurance contract individually, using the *net premium reserves* method; they are equal to the difference between:

- expected present value of guaranteed benefits that may arise out of the insurance cover provided;
- present value of premiums expected to be paid until the end of the term of these contracts.

In unit-linked insurance, a life insurance provision is created to cover current claims arising out of the insurance cover over and above the amount of the unit-linked fund; it corresponds to the part of the payments collected for the insurance cover that is attributable to future reporting periods.

The calculation of a life insurance provision also includes a mark-up on costs, while the provisions themselves are not reduced by the value of deferred acquisition expenses.

Unit-linked life insurance provision

Unit-linked life insurance provisions are recognized in the amount of the investment made under the terms of the contract.

Provision for outstanding claims and benefits

Provision for outstanding claims and benefits is created separately for:

- claims reported but not paid – using the individual method or, if the loss amount cannot be assessed (if the occurrence of losses is a mass phenomenon), using the average claim from the quarter immediately preceding the reporting quarter;
- claims incurred but not reported – using the flat-rate method, as a percentage of claims paid for the last twelve months.

The provision for outstanding claims and benefits also includes the provision for claims handling expenses.

Provisions for bonuses and discounts for insureds

This provision corresponds to the portion of insurance profits recorded at the end of the reporting period, which will be awarded and paid to the insured (profit share) after the end of the settlement period on the terms and conditions set forth in contracts.

Other technical provisions

Other technical provisions in life insurance include:

- revaluation provision for claims under individual life insurance and annuities taken over from Państwowy Zakład Ubezpieczeń;
- provision for pending court proceedings and benefits arising out of court rulings (pursuant to Article 358 § 3 of the Civil Code Act of 23 April 1964 (consolidated text: Journal of Laws of 2017, item 459 as amended) changing the amount or performance of a cash benefit;

  the amount of this provision has been determined based on the value of expected future additional benefits arising out of court cases and settlements. The value of these benefits has been determined by extrapolating the historical trend of benefits estimated based on the number of completed court proceedings and settlements and the value of the awarded amounts;
- low interest rate provision - related to the expected decrease in return on assets covering life insurance provisions for traditional individual life insurance and provisioning of children and disability pensions. The amount of this provision has been determined based on the value of expected future additional benefits arising out of court cases and settlements.
  - the amount of the mathematical provisions calculated by using appropriate mathematical formulas and by applying modified technical rates, considering their expected reduction in the future, and
  - the amount of the mathematical provisions calculated in line with the applicable provisioning regulations, at the original technical rate that was used to price the products.

Provision adequacy tests

At the end of each year, for each product in the life insurance portfolio, the amount of technical provisions recognized in the consolidated financial statements is compared with the present value of expected future cash flows, i.e. the economic value of liabilities. These cash flows projections include: premium income, expenditures on benefits, expenses, fees and commissions and are based on several assumptions regarding: mortality, loss ratio, lapse rates, servicing expenses, yields curves and other product-specific assumptions (e.g. indexation).

The assumptions used to project future cash flows, regarding expected future mortality, loss ratio, lapse rates and other product-specific assumptions, are reviewed and updated on an annual basis based on current experience and observed trends. Taken together with the assessment of their further development, they constitute the best estimate assumption for further developments in mortality, loss, lapses, etc.

Future indexations of sum insured and premium amounts resulting from the profit participating rights, defined as the excess of rates of return on investments over the technical rate, are based on a projection of future rates of return on the current portfolio of assets to cover provisions for these products, together with their expected future reinvestments at the present term structure of interest rates, i.e. in line with current market expectations.

Future costs are projected based on the expected number of contracts remaining in the portfolio in successive periods and the average unit service cost per contract. The assumptions for unit costs are adopted on the basis of expected future portfolio maintenance and servicing expenses, asset management and claims handling expenses. It is assumed that unit service costs will rise in successive years of the projection period by the cost increase ratio. The amount of future commissions is determined based on the agreed commission rates for individual contracts in their successive years.

The present value of future cash flows is calculated using the discount factors based on the unadjusted yield of Polish government bonds according to their current market quotations.

The test compares the present value of projected cash flows with the amount of provisions shown at the end of each year. If provisions are found to be insufficient in relation to the value of discounted cash flows, changes are introduced to the existing provisioning rules and consequently their value is adjusted.

The purpose of the provision adequacy test is to assess whether the technical provision amounts captured in the consolidated financial statements are sufficient, rather than to assess adequacy of the individual assumptions. Accordingly, the provision adequacy test does not directly identify the degree of adequacy or inadequacy of the individual assumptions adopted in technical provision estimation process.

41.1.3. Reinsurers' share

Reinsurers' share in the provision for unearned premiums, in the provision for unexpired risk and in the provision for outstanding claims and benefits is determined at the amount stated in the terms and conditions of the relevant reinsurance treaties.

Reinsurers' share in claims and benefits is determined for those insurance groups, for which there is reinsurance coverage, to the extent to which reinsurers participate in the claims and benefits according to the terms and conditions of the pertinent reinsurance treaties in effect in a given period.

41.2 Estimates and assumptions

41.2.1. Non-life insurance

In the calculation of provisions for outstanding claims and benefits, the uncertainty related to bodily injury claims is taken into account. For such claims, changes in the legal environment and uncertain jurisprudence may affect the ultimate amount of benefits paid.

When calculating the provision for the capitalized value of annuities, the future increase in average annuity is estimated based on historical data and taking into account other information that may contribute to an increase in annuities in the future (for example, growing insurance awareness, legislative changes, etc.).

Both as at 31 December 2018 and 31 December 2017, a technical rate of 3.6% was assumed for all annuities and an annuity growth rate of 3.9%, estimated on the basis of inflation and salary growth forecasts.

For lifetime annuities, the period in which the annuity will be payable is determined using publicly available statistics, which in Poland include Polish Life Expectancy Tables published by the Central Statistical Office. Additionally, the provision for the capitalized value of annuities is calculated taking into account the cost of future handling services at 3% of the value of benefits paid.

The estimated final value of claims and benefits paid in provision development triangles and the analysis of sensitivity of the net result and equity to changes in the assumptions used to calculate the provision for the capitalized value of annuities are presented in section 7.5.2.1.

41.2.2. Life insurance

The amount of the life insurance provision corresponds to the value of liabilities under insurance contracts concluded. It is calculated as the difference between the present value of expected benefits and the present value of expected premiums, using the net premium reserve method. The calculation of provisions takes into account all the benefits and premiums provided for in contracts as contractual liabilities and receivables, regardless of whether a contract is performed by the policyholder until the end of the agreed term or terminated by the policyholder. The assumptions made for the frequency of events covered by insurance, i.e. mortality, morbidity and accident rate, are determined based on publicly available statistics, such as the Polish Life Expectancy Tables in Poland or based on own statistics developed using historical data on particular groups of products in the portfolio.

In the case of technical rates (discount rates) used to calculate present values of benefits and premiums, the assumptions are based on the expected rates of return on existing assets and their future reinvestments, taking into account the maximum technical rate limit for new contracts, announced annually by KNF.

The assumptions used to calculate life insurance provisions are made separately for each insurance product at the time the premium tariffs are adopted and product's sales are launched (" lock-in-assumptions"). Every year, the assumptions are verified for adequacy. If it is found that an assumption is inadequate, it is verified and adjusted, which leads directly to a change in the value of liabilities presented in the consolidated financial statements. The above assumptions are subject to natural uncertainty resulting from the long term of the projection.

(in millions of PLN)

Incidence of insured events

The following data are taken into account in the calculation of provisions: data on the level of guaranteed sums insured and benefits, data on the age and sex of respective insured persons and also, in the case of group employee insurance products in work establishments and employee and family individually continued insurance products, assumptions about the age structure of the co-insured persons (family members of the insured persons).

For insurance products with a profit participation feature, the life insurance provision also includes previously granted profit participation rights in the form of changes in sums insured and premiums and restatements of guaranteed benefits, including the revaluation of annuities performed by PZU Życie.

The analysis of sensitivity of the net result and equity to changes in the assumptions used to calculate technical provisions in life insurance is presented in section 7.5.2.2.

41.3 Quantitative data

Technical provisions	31 December 2018			31 December 2017		
	gross	reinsurers' share	net	gross	reinsurers' share	net
Technical provisions in non-life insurance	**23,508**	**(1,512)**	**21,996**	**22,000**	**(1,250)**	**20,750**
Provision for unearned premiums	8,416	(594)	7,822	7,877	(466)	7,411
Provision for unexpired risk	10	-	10	37	(3)	34
Provisions for outstanding claims and benefits	9,098	(724)	8,374	8,301	(585)	7,716
- for reported claims	3,280	(603)	2,677	3,187	(533)	2,654
- for claims not reported (IBNR)	3,939	(103)	3,836	3,348	(41)	3,307
- for claims handling expenses	1,879	(18)	1,861	1,766	(11)	1,755
Provision for the capitalized value of annuities	5,981	(194)	5,787	5,776	(190)	5,586
Provisions for bonuses and discounts for insureds	3	-	3	9	(6)	3
Technical provisions in life insurance	**22,331**	**-**	**22,331**	**22,558**	**-**	**22,558**
Provision for unearned premiums	99	-	99	94	-	94
Life insurance provision	16,204	-	16,204	16,060	-	16,060
Provisions for outstanding claims and benefits	592	-	592	597	-	597
- for reported claims	152	-	152	153	-	153
- for claims not reported (IBNR)	434	-	434	437	-	437
- for claims handling expenses	6	-	6	7	-	7
Provisions for bonuses and discounts for insureds	4	-	4	5	-	5
Other technical provisions	256	-	256	287	-	287
Unit-linked provision	5,176	-	5,176	5,515	-	5,515
Total technical provisions	**45,839**	**(1,512)**	**44,327**	**44,558**	**(1,250)**	**43,308**

(in millions of PLN)

41.3.1. Technical provisions in non-life insurance

Provisions (by accounting classes prescribed by section II of the attachment to the Insurance Activity Act)	31 December 2018			31 December 2017		
	gross	reinsurers' share	net	gross	reinsurers' share	net
Accident and sickness insurance (group 1 and 2)	439	(10)	429	392	(10)	382
Motor third party liability insurance (group 10)	14,323	(380)	13,943	13,544	(361)	13,183
Other motor insurance (group 3)	2,968	(21)	2,947	2,769	(21)	2,748
Marine, aviation and transport insurance (groups 4, 5, 6, 7)	110	(42)	68	88	(20)	68
Insurance against fire and other property damage (groups 8 and 9)	2,489	(706)	1,783	2,221	(547)	1,674
TPL insurance (groups 11, 12, 13)	2,336	(162)	2,174	2,157	(106)	2,051
Credit and suretyship (groups 14, 15)	233	(89)	144	196	(77)	119
Assistance (group 18)	302	(1)	301	280	(1)	279
Legal protection (group 17)	14	-	14	10	-	10
Other (group 16)	294	(101)	193	343	(107)	236
Total technical provisions	**23,508**	**(1,512)**	**21,996**	**22,000**	**(1,250)**	**20,750**

Technical provisions in non-life insurance	31 December 2018			31 December 2017		
	gross	reinsurers' share	net	gross	reinsurers' share	net
Short-term	6,314	(374)	5,940	5,162	(312)	4,850
Non-current	17,194	(1,138)	16,056	16,838	(938)	15,900
Total technical provisions	**23,508**	**(1,512)**	**21,996**	**22,000**	**(1,250)**	**20,750**

Non-current provisions are provisions from which projected cash flows will occur after elapse of more than 12 months of the end of the reporting period, i.e. 31 December 2018.

Movement in provisions

Movement in provision for unearned premiums in non-life insurance	1 January - 31 December 2018			1 January - 31 December 2017		
	gross	reinsurers' share	net	gross	reinsurers' share	net
Balance at the beginning of the period	7,877	(466)	7,411	6,957	(377)	6,580
Increase (decrease) in provisions for policies concluded in the current year	7,759	(525)	7,234	7,334	(429)	6,905
Increase (decrease) in provisions for policies concluded in previous years	(7,246)	400	(6,846)	(6,366)	336	(6,030)
Foreign exchange differences in the period	26	(3)	23	(48)	4	(44)
Total technical provisions	**8,416**	**(594)**	**7,822**	**7,877**	**(466)**	**7,411**

Movement in provision for unexpired risk	1 January - 31 December 2018			1 January - 31 December 2017		
	gross	reinsurers' share	net	gross	reinsurers' share	net
Balance at the beginning of the period	37	(3)	34	26	-	26
Increase (decrease) in provisions for policies concluded in the current year	6	-	6	33	(3)	30
Increase (decrease) in provisions for policies concluded in previous years	(34)	3	(31)	(21)	-	(21)
Foreign exchange differences in the period	1	-	1	(1)	-	(1)
Balance at the end of the period	**10**	**-**	**10**	**37**	**(3)**	**34**

(in millions of PLN)

Movement in provisions for outstanding claims and benefits in non-life insurance	1 January - 31 December 2018			1 January - 31 December 2017		
	gross	reinsurers' share	net	gross	reinsurers' share	net
Balance at the beginning of the period	8,301	(585)	7,716	7,730	(421)	7,309
Claims paid for losses in previous years, including:	(3,126)	238	(2,888)	(2,713)	177	(2,536)
- claims paid	(2,703)	234	(2,469)	(2,308)	170	(2,138)
- claims handling expenses	(423)	4	(419)	(405)	7	(398)
Increase (decrease) in provisions, of which:	3,904	(371)	3,533	3,305	(348)	2,957
- for losses in current year	3,765	(489)	3,276	3,212	(223)	2,989
- for losses in previous years	139	118	257	93	(125)	(32)
Other changes	-	(3)	(3)	6	4	10
Foreign exchange differences in the period	19	(3)	16	(27)	3	(24)
Balance at the end of the period	**9,098**	**(724)**	**8,374**	**8,301**	**(585)**	**7,716**

Movement in provision for the capitalized value of annuities in non-life insurance	1 January - 31 December 2018			1 January - 31 December 2017		
	gross	reinsurers' share	net	gross	reinsurers' share	net
Balance at the beginning of the period	5,776	(190)	5,586	5,673	(192)	5,481
Claims paid for losses in previous years	(319)	7	(312)	(355)	11	(344)
Increase (decrease) in provisions for losses in previous years	250	(11)	239	212	(4)	208
Change in assumptions resulting from a change of technical rates	(16)	1	(15)	(16)	1	(15)
Increase in provisions for losses in current year	288	-	288	203	(4)	199
Other changes	2	(1)	1	59	(2)	57
Balance at the end of the period	**5,981**	**(194)**	**5,787**	**5,776**	**(190)**	**5,586**

41.3.2. Technical provisions in life insurance

Movement in life insurance provisions, provisions for bonuses and discounts and other technical provisions - insurance contracts	1 January - 31 December 2018			1 January - 31 December 2017		
	gross	reinsurers' share	net	gross	reinsurers' share	net
Balance at the beginning of the period	16,352	-	16,352	16,254	-	16,254
Increase (decrease) in provisions for policies concluded in current year	350	-	350	333	-	333
Increase (decrease) in provisions for policies concluded in previous years	(246)	-	(246)	(218)	-	(218)
Foreign exchange differences	8	-	8	(17)	-	(17)
Balance at the end of the period	**16,464**	**-**	**16,464**	**16,352**	**-**	**16,352**

Movement in technical provisions for life insurance movement if the policyholder bears the investment risk	1 January - 31 December 2018			1 January - 31 December 2017		
	gross	reinsurers' share	net	gross	reinsurers' share	net
Balance at the beginning of the period	5,515	-	5,515	4,917	-	4,917
Increases in the fund due to premiums	1,045	-	1,045	1,411	-	1,411
Fees charged	(104)	-	(104)	(90)	-	(90)
Fund's investment income	(182)	-	(182)	287	-	287
Decreases in the fund on account of benefits, surrenders, etc.	(1,054)	-	(1,054)	(952)	-	(952)
Other changes	(44)	-	(44)	(58)	-	(58)
Balance at the end of the period	**5,176**	**-**	**5,176**	**5,515**	**-**	**5,515**

(in millions of PLN)

Movement in provisions for outstanding claims and benefits	1 January - 31 December 2018			1 January - 31 December 2017		
	gross	reinsurers' share	net	gross	reinsurers' share	net
Balance at the beginning of the period	597	-	597	542	-	542
Utilization of claims provisions during the year	(598)	-	(598)	(572)	-	(572)
Establishment of claims provisions during the year	593	-	593	627	-	627
Balance at the end of the period	**592**	**-**	**592**	**597**	**-**	**597**

42. Provisions for employee benefits

42.1 Accounting policy

In connection with the adopted accounting policies and the fact that PZU Group companies have not singled out defined benefit plan assets, the carrying amount of defined benefit plan provisions equals to the present value of liabilities corresponding to them.

Defined contribution plans include the costs of contributions constituting statutory charges on employee salaries incurred by the employer. They include, among others, part of the contributions for retirement and disability pension insurance, Labor Fund, Guaranteed Employee Benefit Fund and the charge for the Company Social Benefit Fund. The costs of defined contribution plans are charged to the profit and loss account in the period to which they pertain.

Defined benefit plans include, among others, the costs of retirement severance pays and post-mortem benefits. The costs of defined benefit plans estimated using actuarial methods are recognized on an accrual basis by applying the forecast specific entitlements method.

Actuarial gains and losses are recognized in full in the period in which they occurred in the “Actuarial gains and losses related to provisions for employee benefits” item in other comprehensive income. More information is presented in section 40.3.1.

The cost of employee vacation time is recognized on an accrual basis, using the liability method. The liability on account of employee vacation time is determined based on the difference between the actual amount of vacation time used by employees and the amount that would have been used if the vacation time had been taken pro rata to the elapse of time in the period when the employees are entitled to their vacation time.

42.2 Estimates and assumptions

The provisions for retirement severance pays and post-mortem benefits are estimated with actuarial methods using appropriate actuarial techniques and assumptions – discount rates, consistent with the zero-coupon Treasury bond yield curve, mortality rate adopted at the level specified in the PLET, expected salary increase rate in individual PZU Group companies, employee turnover rate (diversified in terms of, among others, the employee’s age, years in service and gender) and the disability rate (disability pensions) adopted as an appropriate percentage of the mortality rate.

42.3 Quantitative data

Provisions for employee benefits	31 December 2018	31 December 2017
Provisions for holidays	145	158
Defined benefit plans	335	353
- provisions for retirement severance pays	313	330
- provisions for post-mortem benefits	22	23
Other non-current employee benefits	51	45
Total provisions for employee benefits	**531**	**556**

(in millions of PLN)

43. Other provisions

43.1 Accounting policy

Provisions are liabilities the amount or payment date of which are uncertain. Provisions are established on the basis of a current obligation following from past events, whose fulfillment will cause an outflow of resources embodying economic benefits. The provision amount is calculated on the basis of a reliable estimate of such outflow as at the balance sheet date.

Provisions for granted guarantees and sureties are calculated as the difference between the expected value of the balance sheet exposure which will result from a granted off-balance sheet liability and the present value of expected future cash flows obtained from the balance sheet exposure resulting from the granted liability.

The provision of restructuring costs if established only when general criteria for recognition of provisions are satisfied, and additionally specific criteria for provisions of restructuring costs, such as holding a detailed, formal restructuring plan and evoking a justified expectation of the parties to which the plan pertains that restructuring actions will be taken (through commencement of implementation of the plan or announcement of its key elements).

43.2 Estimates and assumptions

Provisions for disputable cases are calculated using the individual method, taking into account the likelihood of occurrence of an outflow of resources embodying economic benefits to fulfill an existing obligation. An outflow of resources is deemed likely if it is more possible that the event will occur than that it will not occur, i.e. when the probability of occurrence of the event is higher than the probability that the event will not occur.

Detailed descriptions and provision amounts are presented in section 50.

43.3 Quantitative data

Other provisions	31 December 2018	31 December 2017
Short-term	256	279
Non-current	263	218
Total other provisions	**519**	**497**

Movement in other provisions in the year ended 31 December 2018	As at 31 December 2017	Application of IFRS 9	Balance at the beginning of the period	Increase	Utilization	Reversal	Other changes	Balance at the end of the period
Provisions for guarantees and sureties given	260	159	419	441	(25)	(477)	(42)	316
Provision for disputed claims and potential liabilities	82	-	82	52	(12)	(55)	-	67
Provision for penalties imposed by the Office of Competition and Consumer Protection	57	-	57	-	-	-	28	85
Provision for restructuring expenses	63	-	63	-	(36)	(7)	-	20
Other	35	-	35	10	(13)	(1)	-	31
Total other provisions	**497**	**159**	**656**	**503**	**(86)**	**(540)**	**(14)**	**519**

(in millions of PLN)

Movement in other provisions in the year ended 31 December 2017	Balance at the beginning of the period	Increase	Utilization	Reversal	Change in the composi-tion of the Group	Other changes	Balance at the end of the period
Provisions for guarantees and sureties given	18	76	-	(48)	214	-	260
Provision for disputed claims and potential liabilities	11	16	(7)	(1)	56	7	82
Provision for penalties imposed by the Office of Competition and Consumer Protection	58	-	-	(1)	-	-	57
Provision for restructuring expenses	252	61	(222)	(28)	-	-	63
Other	28	26	(4)	(3)	24	(36)	35
Total other provisions	**367**	**179**	**(233)**	**(81)**	**294**	**(29)**	**497**

Provisions for guarantees and sureties given

This item includes provisions recognized by banks for the potential loss of economic benefits resulting from off-balance sheet exposures (e.g. granted guarantees or credit exposures).

Provision for penalties imposed by the Office of Competition and Consumer Protection

The amount of 28 million pertains to a penalty returned by the Office of Competition and Consumer Protection to Pekao. Due to the potential risk of outflow of resources in connection with this case the PZU Group has not recognized the revenue on account of the refunded resources but recognized a provision.

Information about the penalty imposed on PZU in the proceedings of the President of the Office of Competition and Consumer Protection is presented in section 50.2.

Provision for restructuring expenses

The item includes primarily the restructuring provision established by Alior Bank, earmarked for disbursement of statutory severance pays in connection with termination of the employment relationship under group lay-offs and a provision earmarked for the costs of restructuring of the branch network. The provisions as at 31 December 2018 were PLN 10 million (PLN 39 million as at 31 December 2017).

The remaining balance (PLN 10 million as at 31 December 2018, PLN 24 million as at 31 December 2017) pertains to the restructuring process conducted in PZU and PZU Życie.

44. Deferred tax

44.1 Accounting policy

The level of deferred tax liabilities and assets is determined using the balance sheet method using the corporate income tax rates which are expected to be in effect when the asset or liability is realized, in accordance with the provisions of tax law in the countries of registered offices of PZU Group companies, issued by the end of the reporting period.

In the case of all consolidated companies participating in the PGK Tax Group, the deferred tax assets and liabilities are set off based on the assumption that the Tax Group will be extended for the next periods, therefore for the needs of this set-off, the period in which the temporary differences are expected to be reversed is not analyzed.

(in millions of PLN)

44.2 Estimates and assumptions

PZU Group Companies have estimated the future taxable income for the possibility of realizing deductible temporary differences on account of tax losses incurred by these companies. As a result of these estimates, no deferred tax assets have been recognized pertaining to some of the tax losses.

44.3 Quantitative data

44.3.1. Deferred tax assets

Unrecognized deferred tax assets resulting from the tax loss according to legally permissible realization term	31 December 2018	31 December 2017
up to 1 year	4	5
1 to 5 years	9	14
over 5 years	6	5
term unlimited by law	2	2
Total	**21**	**26**

Movement in deferred tax assets in the year ended 31 December 2018	Balance at the beginning of the period	The effect of the application of IFRS 9	Changes recognized in the financial result	Changes recognized in other compre-hensive income	Other changes	Balance at the end of the period
Loan receivables from clients	809	308	48	(7)	-	1,158
Upfront bank commissions	478	45	57	-	-	580
Liabilities to clients under deposits	68	-	(10)	-	-	58
Intangible assets – trademarks and client relations	(340)	-	49	-	-	(291)
Financial instruments	248	-	11	(21)	(1)	237
Real property	(74)	-	13	-	-	(61)
Accrued reinsurance income and expenses	18	-	16	-	-	34
Provisions for employee benefits	85	-	(13)	-	-	72
Provisions for bonuses	67	-	7	-	-	74
Other provisions and liabilities	193	-	139	-	-	332
Tax losses carried forward	31	-	7	-	(1)	37
Provision for restructuring expenses	7	-	(3)	-	-	4
Total deferred tax assets	**1,590**	**353**	**321**	**(28)**	**(2)**	**2,234**

(in millions of PLN)

Movement in deferred tax assets in the year ended 31 December 2017 (restated)	**Balance at the beginning of the period**	**Changes recognized in the financial result**	**Changes recognized in other compre-hensive income**	**Change in the composi-tion of the Group**	**Other changes**	**Balance at the end of the period**
Loan receivables from clients	324	(39)	-	524	-	809
Upfront bank commissions	294	6	-	178	-	478
Liabilities to clients under deposits	24	11	-	33	-	68
Intangible assets – trademarks and client relations	(48)	39	-	(331)	-	(340)
Financial instruments	36	66	(25)	169	2	248
Real property	-	15	-	(85)	(4)	(74)
Accrued reinsurance income and expenses	-	18	-	-	-	18
Provisions for employee benefits	(1)	4	(2)	74	10	85
Provisions for bonuses	-	20	-	31	16	67
Other provisions and liabilities	(54)	103	-	171	(27)	193
Tax losses carried forward	5	1	-	25	-	31
Provision for restructuring expenses	48	(41)	-	-	-	7
Tax relief for activity in a special economic zone	13	(13)	-	-	-	-
Total deferred tax assets	**641**	**190**	**(27)**	**789**	**(3)**	**1,590**

44.3.2. Deferred tax liability

Movement in deferred tax liabilities in the year ended 31 December 2018	**Balance at the beginning of the period**	**The effect of the application of IFRS 9**	**Changes recognized in the financial result**	**Changes recognized in other compre-hensive income**	**Other changes**	**Balance at the end of the period**
Financial instruments	229	(3)	(45)	(60)	1	122
Recourse receivables	9	-	-	-	-	9
Real property	73	-	14	1	(31)	57
Deferred acquisition expenses	268	-	9	-	-	277
Accrued reinsurance income and expenses	14	-	(20)	-	-	(6)
Intangible assets – trademarks and client relations	61	-	(3)	-	-	58
Provisions for employee benefits	(12)	-	(3)	-	-	(15)
Provision for bonuses	(50)	-	(3)	-	-	(53)
Liabilities unpaid to natural persons (under mandate contracts, agency contracts etc.)	(65)	-	(8)	-	-	(73)
Other provisions and liabilities	(89)	(1)	(15)	-	-	(105)
Prevention fund	17	-	(3)	-	-	14
Equalization provision	137	-	8	-	-	145
Tax losses carried forward	(18)	-	(2)	-	3	(17)
Other differences	64	(3)	12	-	-	73
Total movement in deferred tax liabilities	**638**	**(7)**	**(59)**	**(59)**	**(27)**	**486**

(in millions of PLN)

Movement in deferred tax liabilities in the year ended 31 December 2017	Balance at the beginning of the period	Changes recognized in the financial result	Changes recognized in other compre-hensive income	Change in the composi-tion of the Group	Other changes	Balance at the end of the period
Financial instruments	108	122	3	-	(4)	229
Recourse receivables	4	5	-	-	-	9
Real property	60	(7)	-	1	19	73
Deferred acquisition expenses	254	14	-	-	-	268
Accrued reinsurance income and expenses	28	(14)	-	-	-	14
Intangible assets – trademarks and client relations	41	(12)	-	33	(1)	61
Provisions for employee benefits	(11)	-	-	(1)	-	(12)
Provision for bonuses	(46)	(3)	-	(1)	-	(50)
Liabilities unpaid to natural persons (under mandate contracts, agency contracts etc.)	(60)	(5)	-	-	-	(65)
Other provisions and liabilities	(80)	(9)	-	1	(1)	(89)
Prevention fund	16	1	-	-	-	17
Equalization provision	127	10	-	-	-	137
Tax losses carried forward	(22)	4	-	-	-	(18)
Other differences	50	10	1	3	-	64
Total movement in deferred tax liabilities	**469**	**116**	**4**	**36**	**13**	**638**

45. Financial liabilities

45.1 Accounting policy

Financial liabilities are recognized in the statement of financial position when the PZU Group company becomes a party to a binding contract in which it assumes the risk associated with the financial instrument. In the case of transactions concluded on an organized market, the purchase or sale of financial liabilities are recognized in the books on the date of the transaction.

A financial liability (or part thereof) is excluded from the consolidated statement of financial position when the obligation specified in the contract is discharged or canceled or expires.

Under IFRS9, financial liabilities measured at fair value through profit or loss include those instruments that were classified in the same category also under IAS 39, in particular:

- derivatives with a negative measurement;
- liabilities on borrowed securities (short sale);
- investment contracts for the client’s account and risk (unit-linked);
- liabilities to members of consolidated mutual funds.

Financial liabilities measured at amortized cost include those instruments that were classified in the same category also under IAS 39, in particular:

- deposits obtained by the PZU Group’s banks;
- securities issued by banks;
- loans received;
- liabilities on the issue of own debt securities;
- subordinated liabilities;
- liabilities under repurchase transactions.

Due to the short-term nature, trade liabilities are recognized at the amount of the required payment.

(in millions of PLN)

45.2 Quantitative data

Financial liabilities	31 December 2018	31 December 2017 (restated)
Financial liabilities measured at fair value	**4,017**	**4,956**
Derivatives held for trading	2,450	2,606
Cash flow hedge derivatives	771	682
Fair value hedge derivatives	144	186
Liabilities on borrowed securities (short sale)	120	750
Investment contracts for the client's account and risk (unit-linked)	266	312
Liabilities to members of consolidated mutual funds	266	420
Financial liabilities measured at amortized cost	**232,299**	**219,594**
Liabilities to banks	6,044	5,323
Current deposits	1,058	996
One-day deposits	207	372
Term deposits	7	311
Loans received	4,386	3,380
Other liabilities	386	264
Liabilities to clients under deposits	207,635	198,163
Current deposits	137,559	122,956
Term deposits	69,350	74,453
Other liabilities	726	754
Liabilities on the issue of own debt securities	12,009	9,610
Subordinated liabilities	6,061	5,319
Liabilities on account of repurchase transactions	540	1,167
Investment contracts with guaranteed and fixed terms and conditions	-	1
Finance lease liabilities	10	11
Total financial liabilities	**236,316**	**224,550**

Financial liabilities by maturity	31 December 2018	31 December 2017 (restated)
Up to 1 year	218,952	206,158
1 to 5 years	10,332	11,801
Over 5 years	7,032	6,591
Total financial liabilities by maturity	**236,316**	**224,550**

45.2.1. Financial derivatives

More information on derivative financial instruments is presented in section 34.

45.2.2. Subordinated liabilities

	Par value (in millions)	Currency	Interest rate	Issue (receipt) date / Maturity date	Carrying amount 31 December 2018 (in PLN m)	Carrying amount 31 December 2017 (in PLN m)
Liabilities classified as PZU's own funds						
Subordinated bonds – PZU	2,250	PLN	WIBOR 6M + margin	30 June 2017 29 July 2027	2,279	2,285
Liabilities classified as Pekao's own funds						
A series bonds	1,250	PLN	WIBOR 6M + margin	30 October 2017 29 October 2027	1,257	1,257
B series bonds	550	PLN	WIBOR 6M + margin	15 October 2018 16 October 2028	548	n/a
C series bonds	200	PLN	WIBOR 6M + margin	15 October 2018 14 October 2033	196	n/a
Liabilities classified as Alior Bank's own funds						
Subordinated loan	10	EUR	EURIBOR 3M + margin	12 October 2011 12 October 2019	43	42
F series bonds	322	PLN	WIBOR 6M + margin	26 September 2014 26 September 2024	225	225
G series bonds	193	PLN	WIBOR 6M + margin	31 March 2015 31 March 2021	196	196
I and I1 series bonds	183	PLN	WIBOR 6M + margin	4 December 2015 6 December 2021	148	147
K and K1 series bonds	600	PLN	WIBOR 6M + margin	20 October 2017 20 October 2025	605	605
Meritum Bank series B bonds	67	PLN	WIBOR 6M + margin	29 April 2013 29 April 2021	68	68
Meritum Bank series C bonds	80	PLN	WIBOR 6M + margin	21 October 2014 21 October 2022	81	80
EUR001 series bonds	10	EUR	LIBOR 6M + margin	4 February 2016 4 February 2022	44	43
P1A series bonds	150	PLN	WIBOR 6M + margin	14 April 2016 16 May 2022	151	150
P1B series bonds	70	PLN	WIBOR 6M + margin	21 April 2016 16 May 2024	70	70
P2A series bonds	150	PLN	WIBOR 6M + margin	27 December 2017 29 December 2025	150	151
Subordinated liabilities					**6,061**	**5,319**

The lower carrying amount of subordinated liabilities compared to the nominal value ensues from some of the bonds issued by Pekao and Alior Bank were subscribed for by consolidated mutual funds.

45.2.3. Liabilities on the issue of own debt securities

Liabilities on the issue of own debt securities	31 December 2018	31 December 2017 (restated)
Bonds of PZU Finance AB (publ.)	3,676	3,478
Alior Bank series J bonds	268	253
Pekao bonds	1,978	90
Certificates of deposit	4,542	4,541
Covered bonds	1,545	1,248
Liabilities on the issue of own debt securities	**12,009**	**9,610**

(in millions of PLN)

	Par value	Interest rate	Issue dates	Maturity date
Bonds of PZU Finance AB (publ.)	EUR 850 million	1.375%	3 July 2014 16 October 2015	3 July 2019
Alior Bank series J bonds	PLN 250 million	WIBOR 6M + margin	11 August 2017	11 August 2020

Bonds classified as measured at amortized cost.

The liabilities of PZU Finance AB (publ.) arising from the bonds are secured by a guarantee granted by PZU which covers all issue-related liabilities of the issuer (including the obligation to pay the par value of the bonds and interest on the bonds) in favor of all bondholders. The maximum amount of the guarantee in effect until the expiration of the bondholders' claims against PZU Finance AB (publ.), has not been specified.

46. Other liabilities

Other liabilities	31 December 2018	31 December 2017 (restated)
Accrued expenses	**1,578**	**1,462**
Accrued expenses of agency commissions	361	336
Accrued sales commission expenses in group insurance	2	8
Accrued payroll expenses	192	160
Accrued reinsurance expenses	373	367
Accrued employee bonuses	345	320
Other	305	271
Deferred revenue	**282**	**354**
Other liabilities	**5,547**	**7,280**
Liabilities due under transactions on financial instruments	909	1,772
Liabilities to banks for payment documents cleared in interbank clearing systems	934	2,125
Liabilities on direct insurance	835	840
Liabilities on account of payment card settlements	419	437
Regulatory settlements	165	151
Liabilities for contributions to the Bank Guarantee Fund	182	80
Reinsurance liabilities	269	140
Estimated non-insurance liabilities	157	126
Liabilities to employees	141	163
Estimated refunds of compensation in connection with banks' clients lapsing or withdrawing from insurance purchased during the sale of credit products	98	121
Trade liabilities	367	320
Current income tax liabilities	570	421
Liabilities to the state budget other than for income tax	111	110
Liabilities on account of donations	25	28
Liabilities on account of non-market lease contracts	4	14
Alior Bank's liabilities for insurance of bank products offered to the bank's clients	20	17
Insurance Indemnity Fund	15	16
Liabilities for direct claims handling	30	14
Other	296	385
Other liabilities, total	**7,407**	**9,096**

As at 31 December 2018 and 31 December 2017, the fair value of other liabilities did not differ significantly from their carrying amount, primarily due to fact that over 94% of them are short-term liabilities.

Other liabilities by maturity	31 December 2018	31 December 2017 (restated)
Up to 1 year	7,012	8,781
1 to 5 years	337	269
Over 5 years	58	46
Total other liabilities by maturity	**7,407**	**9,096**

(in millions of PLN)

47. Leases

47.1 Accounting policy

The classification of leases is based on the extent to which the risks and rewards incidental to ownership of the leased item lie with the lessor or the lessee. PZU Group companies are parties to lease agreements, both as lessors and as lessees.

47.1.1. Finance leases

In the case of lease agreements under which substantially all risks and rewards incidental to ownership of a leased asset are transferred, it stops being recognized in the lessor's balance sheet. Instead the lessor recognizes a receivable in an amount equal to the present value of minimum lease payments, which are then divided between interest income and decrease in the balance of receivables.

47.1.2. Operating leases

Operating lease agreements pertain primarily to real property.

Lease payments under operating leases are recognized in the profit and loss account as income using the straight line method throughout the term of the lease.

47.2 Quantitative data

47.2.1. Finance leases

PZU Group as the lessor

Gross financial lease receivables	31 December 2018			31 December 2017		
	Gross lease investment	Present value of minimum lease payments	Unrealized income	Gross lease investment	Present value of minimum lease payments	Unrealized income
Up to 1 year	2,796	2,783	313	1,917	1,842	195
1 to 5 years	5,634	5,636	402	3,299	3,238	236
Over 5 years	541	521	29	351	340	15
Total	**8,971**	**8,940**	**744**	**5,567**	**5,420**	**446**

47.2.2. Operating leases

47.2.2.1. PZU Group as the lessor

Operating lease transactions pertain principally to investment property lease agreements. The table below presents future minimum lease payments under operating lease (undiscounted amounts).

Future minimum receivables on lease payments	31 December 2018	31 December 2017
Up to 1 year	224	219
1 to 5 years	561	438
Over 5 years	320	213
Total future minimum receivables on lease payments	**1,105**	**870**

(in millions of PLN)

47.2.2.2. PZU Group as the lessee

Operating lease liabilities result primarily from the lease of commercial and office space. The PZU Group pursues a policy of concluding agreements for a definite term from 3 to 5 years with a renewal option. The table below presents future minimum lease payments under operating lease (undiscounted amounts).

Minimum operating lease payment liabilities	31 December 2018	31 December 2017
Up to 1 year	291	307
1 to 5 years	740	698
Over 5 years	149	56
Total minimum operating lease payment liabilities	**1,180**	**1,061**

48. Assets securing receivables, liabilities and contingent liabilities

Financial assets pledged as collateral for liabilities and contingent liabilities	31 December 2018	31 December 2017
Carrying amount of financial assets pledged as collateral for liabilities	8,254	10,421
Repurchase transactions	543	1,166
Coverage of the Guaranteed Funds Protection Fund for the Bank Guarantee Fund	1,043	1,348
Coverage of liabilities to be paid to the guarantee fund at the Bank Guarantee Fund	95	44
Coverage of liabilities to be paid to the mandatory restructuring fund (BFG)	133	73
Lombard and technical credit	3,700	4,697
Other loans	569	652
Issue of covered bonds	1,462	1,577
Coverage of the Settlement Guarantee Fund for the National Depository for Securities	54	52
Derivative transactions	655	812
Carrying amount of financial assets pledged as collateral for contingent liabilities	-	-
Financial assets pledged as collateral for liabilities and contingent liabilities, total	**8,254**	**10,421**

49. Contingent assets and liabilities

Contingent assets and liabilities	31 December 2018	31 December 2017
Contingent assets, including:	6	6
- guarantees and sureties received	6	6
Contingent liabilities	57,667	58,978
- for renewable limits in settlement accounts and credit cards	13,211	14,536
- for loans in tranches	28,523	29,766
- guarantees and sureties given	7,682	7,574
- disputed insurance claims	576	711
- other disputed claims	231	212
- other, including:	7,444	6,179
- guaranteeing securities issues	4,470	3,492
- factoring	1,275	899
- intra-day limit	755	844
- letters of credit and commitment letters	822	818
- potential liabilities under loan agreements concluded by the Armatura Group	33	30
- other	89	96

The “other contingent liabilities” item includes, among others, potential liabilities resulting from tax risks associated with different interpretations of the provisions of the Swedish tax law pertaining to taxation on foreign exchange differences realized on repayment of loans granted in a currency other than the functional currency of the company granting the loan.

Granting of sureties or guarantees for loans or borrowings by PZU or its subsidiaries

In 2018, neither PZU nor its subsidiaries granted any sureties for a loan or borrowing or gave guarantees to any single entity or any subsidiary of such an entity if the total amount of outstanding sureties or guarantees would be significant, except for the first guarantee securing loan repayment by a subsidiary with a guarantee sum of PLN 495 million after conversion.

50. Disputes

The PZU Group entities participate in a number of litigations, arbitration disputes and administrative proceedings. Typical litigations involving the PZU Group companies include disputes pertaining to concluded insurance contracts, disputes concerning labor relationships and disputes relating to contractual obligations. Typical administrative proceedings involving the PZU Group companies include proceedings related to the possession of real properties. Such proceedings and litigation are of a typical and repetitive nature and usually no particular case is of material importance to the PZU Group.

The majority of disputes involving the PZU Group companies concerned four companies: PZU, PZU Życie, Pekao and Alior Bank. Additionally, PZU and PZU Życie are parties to proceedings conducted before the President of the Office of Competition and Consumer Protection.

PZU and PZU Życie take disputed claims into account in the process of establishing their technical provisions for known losses, considering the probability of an unfavorable outcome of the dispute and estimating the probable awarded amount. In the case of disputed claims pertaining to restatement of annuities in PZU Życie, the claims are carried in other technical provisions at the annual value of annuities above the corresponding amount of provision set within the framework of mathematical life provisions.

In 2018 and by the date of signing the consolidated financial statements, the PZU Group companies were not involved in any proceedings conducted before a court, an arbitration body or a public administration authority which concerned any liabilities or receivables of PZU or any of its direct or indirect subsidiaries the unit value of which would be material, save for the issues described in the sections below.

As at 31 December 2018, the total value of the subject matter of the litigation in all 217,810 cases pending before courts, arbitration bodies or public administration authorities in which PZU Group entities take part, was PLN 7,804 million. PLN 4,108 million of that amount pertains to liabilities and PLN 3,696 million to the accounts receivable of PZU Group companies.

Estimates of the provision amounts for individual cases take into account all information available on the date of publishing the consolidated financial statements; however, this figure may change in the future.

50.1 Resolutions of the Ordinary Shareholder Meeting of PZU to distribute the profit earned in the financial year 2006

On 30 July 2007, an action was brought by Manchester Securities Corporation (“MSC”) with its registered office in New York against PZU to repeal Resolution No. 8/2007 adopted by the Company’s Ordinary Shareholder Meeting on 30 June 2007 to distribute PZU’s profit for the financial year 2006 as contradicting good practices and aimed at harming the plaintiff as a shareholder of PZU.

The challenged resolution of the Ordinary Shareholder Meeting of PZU distributed the 2006 net profit of PLN 3,281 million as follows:

- PLN 3,261 million was transferred to supplementary capital;
- PLN 20 million was transferred to the Company Social Benefit Fund.

In its judgment of 22 January 2010, the Regional Court in Warsaw repealed the aforementioned resolution adopted by PZU’s Ordinary Shareholder Meeting in its entirety. PZU has used all the available appeal measures, including a cassation appeal to the Supreme Court which, on 27 March 2013, dismissed the cassation appeal. The judgment is final and non-appealable.

PZU believes that repealing the aforementioned resolution of the PZU’s Ordinary Shareholder Meeting will not give rise to shareholders’ claim for a dividend payout by PZU.

As the judgment repealing Resolution no. 8/2007 became final, on 30 May 2012, Ordinary Shareholder Meeting of PZU adopted a resolution to distribute the profit for the financial year 2006 in a manner that reflects the distribution of profit in the repealed resolution no. 8/2007. MSC filed an objection against the resolution of 30 May 2012 and the objection was recorded in the minutes.

On 20 August 2012, a copy of a statement of claim filed by MSC with the Regional Court in Warsaw was delivered to PZU. In the statement of claim, the Manchester Securities Corporation demanded that the resolution on the distribution of profit for the financial year 2006 adopted on 30 May 2012 by the PZU Ordinary Shareholder Meeting be repealed. According to the plaintiff, the value of the litigation is PLN 5 million. PZU then submitted a statement of defense requesting to dismiss the statement of claim in its entirety.

On 17 December 2013, the Regional Court passed a judgment in which it accepted the claim in its entirety and awarded the costs of proceedings from PZU to MSC. On 4 March 2014, PZU filed an appeal against the above judgment, contesting it in its entirety. On 11 February 2015, the Appellate Court in Warsaw handed down a judgment that changed the judgment of the Regional Court of 17 December 2013 in its entirety, dismissed MSC's claim and charged MSC with the court expenses. The Appellate Court's judgment is final and non-appealable. MSC challenged the Appellate Court's judgment in its entirety in a cassation appeal of 9 June 2015. PZU filed its reply to the cassation appeal. By decision of 19 April 2016, the Supreme Court refused to review MSC's cassation appeal. According to the provisions of the Code of Civil Procedure, the Supreme Court's ruling is final non-appealable and ends the proceedings in the case.

In the meantime on 16 December 2014, MSC summoned PZU to pay PLN 265 million as compensation in connection with repealing Resolution no. 8/2007 adopted by the PZU Ordinary Shareholder Meeting on 30 June 2007 to distribute PZU's profit for the financial year 2006. PZU refused to effect the performance on account of its groundlessness.

On 23 September 2015, a copy of the statement of claim with attachments was delivered to PZU in the case launched by MSC against PZU for payment of PLN 169 million with statutory interest from 2 January 2015 to the date of payment. The statement of claim includes a demand to pay compensation for depriving MSC and J.P. Morgan (MSC acquired the claim from J.P. Morgan) as minority shareholders of PZU of their share in profits for the financial year 2006 in connection with the adoption of Resolution no. 8/2007 on 30 June 2007 by the PZU Ordinary Shareholder Meeting. The case is pending before the Regional Court in Warsaw. On 18 December 2015, PZU's attorney replied to the statement of claim, requesting to dismiss it in its entirety. On 1 April 2016, MSC filed a pleading in which it responded to PZU's assertions, allegations and petitions and raised new arguments in the case. On 30 June 2016, PZU filed a response to MSC's most recent pleading along with requests for evidence. In its decision of 21 July 2016, the Court referred the case to a mediation procedure, to which PZU did not agree. In subsequent court sessions, evidentiary hearings have taken place.

The Management Board of PZU believes that MSC's claims are groundless. As a result, as at 31 December 2018, no changes were made to the presentation of PZU's equity that could potentially stem from the repeal of resolution no. 8/2007 adopted by the PZU Ordinary Shareholder Meeting on the distribution of profit for the financial year 2006, including the line items "Supplementary capital" and "Retained earnings (losses)", and the funds in the Company Social Benefit Fund were not adjusted.

Other demands for payment pertaining to the distribution of PZU's profit for the 2006 financial year

On 13 November 2018 the Regional Court in Warsaw served a copy of the statement of claim lodged by Wspólna Reprezentacja SA in restructuring, which pertained to a claim against PZU for payment of PLN 34 million with statutory interest from 1 October 2015 to the payment date with court expenses. The claim comprises a claim for payment of damages for depriving the shareholders of their share of profits for the 2006 financial year. The plaintiff claims that the claims for damages were transferred by the shareholders to the plaintiff based on mandate agreements together with a fiduciary transfer of receivables and the claim pursued by the statement of claim is the total damage caused to the shareholders. PZU does not accept the claims as unjustified and replied to the statement of claim, requesting to dismiss it in its entirety.

Additionally, shareholders or their legal successors sent to PZU demands for payment based on the facts presented above. Some of them did not indicate any specific amounts but the number of shares or demanded a payment only. PZU gave its replies in writing, stating that their claims are non-existent and that they will not be accepted.

50.2 Proceedings conducted by the President of the Office of Competition and Consumer Protection against PZU

On 30 December 2011, the President of the Office of Competition and Consumer Protection ("UOKiK") issued a decision to impose a fine of PLN 57 million on PZU for its use of a practice restricting competition and violating the prohibition prescribed in Article 6 Section 1 Item 3 of the Act on Competition and Consumer Protection by the execution, by PZU and Maximus Broker Sp. z o.o. with its registered office in Toruń ("Maximus Broker"), of an agreement restricting competition in the domestic market for sales of group accident insurance for children, youths and staff of educational institutions consisting of dividing the sales market by entity and transferring PZU's clients from the Kujawsko-Pomorskie voivodship to Maximus Broker for the provision of services in exchange for their recommending PZU as the insurer of choice and at the same time prohibited PZU from the use of this alleged practice.

The PZU Management Board does not agree with the determination of facts and the legal argumentation in the decision, because not all the evidence was taken into account when making the decision and an erroneous legal qualification was made.

On 18 January 2012 PZU submitted an appeal against the aforementioned decision (as a result of which it did not become final). In its appeal, PZU indicated the following, among other issues:

- no agreement (other than a brokerage agreement) was entered into between PZU and Maximus Broker;
- the President of the Office of Competition and Consumer Protection misunderstands the principles of execution of insurance agreements involving a broker;
- the majority of insurance agreements involving Maximus Broker were entered into with insurance companies other than PZU;
- PZU and Maximus Broker cannot and could not in the past conduct competitive activity in the markets in which they operate.

On 27 March 2015, the Regional Court in Warsaw issued a judgment in which it repealed the decision of the UOKiK President of 30 December 2011. By judgment of 6 December 2016, following an appeal of the UOKiK President, the Appellate Court in Warsaw repealed the judgment issued by the Regional Court in Warsaw and referred the case for re-examination. On 31 July 2017, the Regional Court in Warsaw issued a judgment in which it repealed the decision of the UOKiK President of 30 December 2011. On 4 October 2017, the UOKiK President filed an appeal with the Appellate Court in Warsaw. The Appellate Court in Warsaw, by its judgment of 23 January 2019, dismissed the appeal put forward by the UOKiK President. The judgment is final. The UOKiK President may file a cassation appeal with the Supreme Court against the final judgment.

PZU held a provision for this fine, which amounted to PLN 57 million as at 31 December 2018 and 31 December 2017.

50.3 Proceedings conducted by the President of the Office of Competition and Consumer Protection against PZU Życie

On 1 June 2005, the President of the Office of Competition and Consumer Protection launched, at the request of several applicants, an anti-monopoly procedure in the matter of a suspicion of PZU Życie's abuse of its dominating position in the group employee insurance market, which could constitute a breach of Article 8 of the Competition and Consumer Protection Act and Article 82 of the Treaty establishing the European Community. As a result of the procedure, on 25 October 2007 the President of the Office of Competition and Consumer Protection imposed a fine on PZU Życie in the amount of PLN 50 million for hindering clients from taking advantage of the offers of the company's competitors.

The PZU Życie Management Board did not concur with the findings and with the legal arguments set out in the decision. It filed an appeal with SOKiK, raising 38 formal and substantial objections against the decision made by the UOKiK President. The Management Board of PZU Życie is of the opinion that, in its decision, UOKiK failed to consider all the evidence, made an incorrect legal qualification, and, as a consequence, groundlessly assumed that PZU Życie has a dominating position on the market.

After many years of proceedings, on 30 September 2015, PZU Życie paid the imposed fine of PLN 50 million and the awarded costs of proceedings. On 18 March 2016, PZU Życie filed a cassation appeal with the Supreme Court. During the hearing of 26 September 2017, the Supreme Court decided to refer the case for resolution to the Court of Justice of the European Union in Luxembourg.

Since the fine has already been paid by PZU Życie in 2015, no additional provision for this purpose had to be maintained.

50.4 Notification of PZU's claim to the bankruptcy estate of companies of the PBG Group

PZU is a creditor of PBG SA ("PBG") and Hydrobudowa Polska SA ("Hydrobudowa"), both companies with registered offices in Wysogotowo near Poznań, on account of insurance guarantees (contractual guarantees) issued and paid out.

In 2012, bankruptcy proceedings were initiated against PBG and Hydrobudowa. On 21 September 2012, PZU joined the proceedings by notifying its claims to the bankruptcy estate of the two companies.

PBG and Hydrobudowa belong to the same group in which PBG is the parent company. The two companies provided sureties for each other's liabilities. As a consequence, all claims submitted against the bankruptcy estate of Hydrobudowa in the amount of PLN 101 million were concurrently submitted against the bankruptcy estate of PBG.

On 8 October 2015, the Bankruptcy Court announced a decision in which it approved the composition with PBG's creditors and on 20 July 2016 it issued a decision to close the bankruptcy proceedings. The decision is final. Following the execution of the composition and reduction of claims to 20.93% of the reported figures, PZU received 206,139 PBG's bonds with the nominal value of PLN 21 million and 24,241,560 PBG shares with the nominal value of PLN 24 million. The carrying amount of PBG's shares as at 31 December 2018 was PLN 2 million (PLN 4 million as at 31 December 2017). Bonds – on 31 December 2018 and an 31 December 2017, they were recognized in off-balance sheet records only and the carrying amount of bonds was zero.

The first list of claims presented by Hydrobudowa's trustee in bankruptcy to the judge commissioner contained PZU SA's claims in the amount of PLN 16 million and the fourth supplementary list of claims contained PZU SA's claims in the amount of PLN 16 million. Accordingly, the total value of claims pursued by PZU on this account is PLN 32 million. In respect of claims for the amount of over PLN 66 million, on 24 October 2018 PZU filed an objection to the judge commissioner against the refusal to accept the submitted claim. The final list of claims submitted against the bankruptcy estate of Hydrobudowa has not been determined yet. Bankruptcy proceedings against Hydrobudowa are pending and the determination of the final list of claims is merely an initial step in these proceedings that precedes the drafting of the distribution plan (after the liquidation of the bankruptcy estate).

50.5 Class action against Alior Bank

On 5 March 2018, a natural person representing a group of 84 natural and legal persons filed a class action against Alior Bank to rule Alior Bank's liability for a loss caused by the improper performance of Alior Bank's disclosure obligations to clients and improper performance of agreements to provide services of accepting and forwarding purchase or sale orders of investment certificates of mutual funds managed previously by Fincrea TFI SA and currently by Raiffeisen Bank International AG (Spółka Akcyjna) Branch in Poland. The plaintiffs believe that Alior Bank failed to provide clients with information on the actual risk of investing in investment products, by which it exposed the clients to a loss resulting from the loss of value of investment certificates and loss of guaranteed profits. The PZU Management Board believes that the class action has no justified factual or legal grounds and therefore it should not be resolved favorably to the clients. As at the date of signing the consolidated financial statements, the court with which the class action was filed has not issued a decision on the admissibility of the class action. Additionally, the PZU Group estimates that the risk of this action being resolved unfavorably to Alior Bank and the risk of incurring material loss on this account is at the level below medium; accordingly, as at 31 December 2018, the PZU Group had not recognized any provisions in relation to this action. At the current stage, it is not possible to estimate the possible financial consequences for Alior Bank and the PZU Group if the court hands down a resolution other than the one assumed by the PZU Group.

51. Related party transactions

51.1 Key management

The PZU Management Board Members and PZU Group Directors are assumed to be the key management of the PZU Group.

In 2018 and in 2017, the PZU Group companies did not grant any loans or similar benefits to members of their key management

Compensation of the key management and members of the PZU SA Supervisory Board

Compensation of PZU's key management (Management Board members, senior managers and Supervisory Board members who discharged their functions for at least one day in 2018 or 2017). The figures are presented in thousands of PLN.

Compensation and other short-term employee benefits paid by PZU	**1 January – 31 December 2018** (000s PLN)		**1 January – 31 December 2017** (000s PLN)	
		including bonuses and special awards:		including bonuses and special awards:
Management Board, of which:	**3,857**	**-**	**6,870**	**2,042**
Paweł Surówka	793	-	683	74
Rodger Hodgkiss	766	-	1,171	412
Tomasz Kulik	766	-	319	-
Maciej Rapkiewicz	766	-	1,152	379
Małgorzata Sadurska	766	-	421	-
Michał Krupiński	n/a	n/a	2 086[1)]	895
Andrzej Jaworski	n/a	n/a	945[2)]	282
Marcin Chludziński	n/a	n/a	93	-
High-level managers (PZU Group Directors), including:	**1,451**	**11**	**5,138**	**1,381**
Aleksandra Agatowska	203	-	854	254
Tomasz Karusewicz	307	-	1,031	356
Bartłomiej Litwińczuk	307	-	754	122
Roman Pałac	317	-	986	378
Dorota Macieja	317	11[3)]	501	-
Paweł Surówka	n/a	n/a	261[4)]	72
Sławomir Niemierka	n/a	n/a	751	199

Compensation and other short-term employee benefits paid by PZU	1 January – 31 December 2018 (000s PLN)		1 January – 31 December 2017 (000s PLN)	
Supervisory Board, of which:	**1,420**	**-**	**1,344**	**-**
Maciej Łopiński	169	-	n/a	n/a
Paweł Górecki	170	-	131	-
Alojzy Nowak	170	-	154	-
Marcin Chludziński	156	-	133	-
Agata Górnicka	156	-	133	-
Robert Jastrzębski	127	-	n/a	n/a
Katarzyna Lewandowska	157	-	115	-
Robert Śnitko	156	-	105	-
Maciej Zaborowski	156	-	146	-
Aneta Fałek	3	-	114	-
Bogusław Banaszak	n/a	-	142	-
Marcin Gargas	n/a	-	18	-
Paweł Kaczmarek	n/a	-	48	-
Eligiusz Krześniak	n/a	-	13	-
Jerzy Paluchniak	n/a	-	39	-
Piotr Paszko	n/a	-	13	-
Radosław Potrzeszcz	n/a	-	13	-
Łukasz Świerżewski	n/a	-	27	-

[1] Including non-competition fee of PLN 600 thousand.
[2] Including non-competition fee of PLN 276 thousand.
[3] Bonus for the Sponsoring Director function discharged from 1 January to 14 March 2017.
[4] Compensation for the period of discharging the PZU Group Director's function until 12 April 2017.

As at 31 December 2018, the benefits for 2017 and for 2018 for PZU Management Board members under the variable compensation system have not been awarded. According to the compensation system in place, these persons may be entitled to a bonus for 2017 and 2018, which can be distributed in subsequent periods. Accordingly, a provision has been recognized for the payment of the bonus for 2017-2018 with the total amount of PLN 9,054 thousand as at 31 December 2018 (including the employer's burdens; PLN 2,625 thousand as at 31 December 2017).

Compensation and other short-term employee benefits paid by other PZU Group entities	1 January – 31 December 2018 (000s PLN)		1 January – 31 December 2017 (000s PLN)	
		including bonuses and special awards:		including bonuses and special awards:
Management Board, of which:	**90**	**-**	**2,835**	**801**
Paweł Surówka	90[1]	-	499	214
Rodger Hodgkiss	-	-	491	214
Tomasz Kulik	-	-	840	103
Maciej Rapkiewicz	-	-	446	135
Michał Krupiński	n/a	-	67[2]	-
Andrzej Jaworski	n/a		492[3]	135
High-level managers (PZU Group Directors), including:	**2,206**	**6**	**3,030**	**706**
Aleksandra Agatowska	344	-	509	137
Tomasz Karusewicz	460	-	604	192
Bartłomiej Litwińczuk	460	-	455	66
Roman Pałac	476	-	604	204
Dorota Macieja	466	6[4]	319	-
Sławomir Niemierka	n/a	n/a	539	107

[1] Remuneration for the function of Pekao Supervisory Board Member discharged from 1 January to 20 June 2018.
[2] Remuneration for the function of Alior Bank's Supervisory Board Member discharged from 1 January to 14 June 2017.
[3] Including non-competition fee of PLN 149 thousand (PZU Życie).
[4] Bonus for the Sponsoring Director function discharged from 1 January to 14 March 2017.

Total estimated value of non-cash benefits granted by PZU and PZU's subsidiaries	1 January – 31 December 2018 (000s PLN)	1 January – 31 December 2017 (000s PLN)
Management Board, of which:	**515**	**701**
Paweł Surówka	149	62
Rodger Hodgkiss	115	144
Tomasz Kulik	77	76
Maciej Rapkiewicz	64	107
Małgorzata Sadurska	110	15
Michał Krupiński	n/a	162
Andrzej Jaworski	n/a	135
High-level managers (PZU Group Directors), including:	**525**	**924**
Aleksandra Agatowska	111	201
Tomasz Karusewicz	89	138
Bartłomiej Litwińczuk	118	151
Roman Pałac	129	168
Dorota Macieja	78	119
Sławomir Niemierka	n/a	147

51.2 Related party transactions concluded by PZU or subsidiaries on non-arm's length conditions

In 2018, neither PZU nor its subsidiaries executed any transaction with their related parties which were of material significance individually or collectively and were executed on non-arm's length conditions.

51.3 Other related party transactions

Balances and turnovers resulting from commercial transactions between the PZU Group and related parties	1 January – 31 December 2018 and as at 31 December 2018		1 January – 31 December 2017 and as at 31 December 2017	
	Key management	Other related parties [1]	Key management	Other related parties [1]
Gross written premium				
in non-life insurance	-	4	-	4
in life insurance (including volumes in investment contracts)	-	-	-	-
Commission income	-	-	-	100 [2]
Expenses	-	-	-	2
Receivables		-		-
Liabilities	-	-	-	-
Contingent assets	-	-	-	-
Contingent liabilities	-	-	-	-

[1] Unconsolidated companies in liquidation and associates measured by the equity method.
[2] Revenues from Pekao TFI, PIM, Xelion for the period when they were associates.

51.4 Transactions with State Treasury's related parties

Transactions with subsidiaries, joint ventures and associates of the State Treasury were predominantly non-life insurance agreements, life insurance agreements and investment contracts and banking services. Such transactions are concluded and settled on terms and conditions available to customers, who are not related parties. Receivables from and liabilities to parties related to the State Treasury under insurance contracts are usually short-term.

52. Headcount

The following table presents average headcount (in FTEs) in PZU Group companies.

Item	1 January – 31 December 2018	1 January – 31 December 2017
Management Boards (number of persons at the end of the reporting period)	133	154
Management	4,333	5,807
Other employees	37,006	37,349
Total	**41,472**	**43,310**

53. Other information

53.1 Audit fee payable to the audit firm auditing the financial statements

The table below presents the amounts due to the PZU Group's audit firm (KPMG Audyt sp. z ograniczoną odpowiedzialnością sp. k., "KPMG") for the audit of financial statements of the consolidated PZU Group companies performed by KPMG, paid or payable for the period, plus VAT, determined in accordance with the accrual principle.

Item	1 January – 31 December 2018 (000s PLN)	1 January – 31 December 2017 (000s PLN)
Audit of financial statements	7,813	7,673
Other assurance services	4,814	3,568
Total	**12,627**	**11,241**

On 18 February 2014, the PZU Supervisory Board selected KPMG Audyt Spółka z ograniczoną odpowiedzialnością Sp.k. with its registered office in Warsaw, ul. Inflancka 4A, 00-189 Warsaw, entered by the National Chamber of Statutory Auditors in the list of audit firms under no. 3546 as an entity auditing financial statements for the years 2014-2016, and on 27 April 2017, the PZU Supervisory Board exercised the option of extending this cooperation to include the years 2017-2018.

53.2 KNF Office inspections in PZU and PZU Życie

Between 5 April and 4 May 2018, a supervisory visit of KNF in PZU and PZU Życie was held, focusing on the system to manage operational risk related to the distribution of insurance products, in particular on the fraud prevention measures.

In the period from 19 June 2018 to 17 August 2018, a KNF inspection was conducted in PZU pertaining to claims handling and entering into short-term insurance contracts. On 31 December 2018, the supervisory authority issued two key post-audit recommendations for the claims and benefits handling area and one recommendation regarding the execution of short-term insurance agreements with the deadline of 31 January 2019. The recommendations were fulfilled within the deadline.

The Management Board of PZU believes that the results of the audit have not exerted any impact on the consolidated financial statements.

53.3 KNF's proceedings to impose a fine on Alior Bank

On 14 September 2018, the KNF launched proceedings against Alior Bank to impose a fine on Alior Bank pursuant to art. 167 sec. 2 item 1 in conj. with art. 167 sec. 1 item 1 of the Financial Instruments Trading Act in connection with the irregularities found. The proceedings are related to the audit conducted by KNF from November 2017 to May 2018, which concerned the correct operation of Alior Bank and the Bank's Brokerage House in terms of distribution of investment certificates of funds previously managed by Fincrea TFI SA, and currently by Raiffeisen Bank International AG (Spółka Akcyjna) Branch in Poland. As at the date of signing the consolidated financial statements, the KNF has failed to end the proceedings to impose the fine.

53.4 Subsequent events

No material events occurred after the end of the reporting period, which would have an impact on the consolidated financial statements.

On 31 January 2019, PZU Zdrowie acquired 1,432 shares in Alergo-Med Tarnów sp. z o.o. constituting 100% of the capital and votes at shareholder meetings.

On 31 January 2019, the KNF decided that Alior Bank would take over Spółdzielcza Kasa Oszczędnościowo-Kredytowa Jaworzno (SKOK Jaworzno). As per KNF's decision, starting on 1 February 2019, Alior Bank assumed management over the SKOK Jaworzno and starting on 1 April 2019 it will be acquired by Alior Bank.

Signatures of the PZU Management Board Members:

Name	**Position**	
Paweł Surówka	President of the PZU Management Board	Signed by qualified electronic signature
Tomasz Kulik	Member of the PZU Management Board	Signed by qualified electronic signature
Roger Hodgkiss	Member of the PZU Management Board	Signed by qualified electronic signature
Maciej Rapkiewicz	Member of the PZU Management Board	Signed by qualified electronic signature
Małgorzata Sadurska	Member of the PZU Management Board	Signed by qualified electronic signature

Person responsible for drawing up the consolidated financial statements:

Katarzyna Łubkowska	Director of the Accounting Department	Signed by qualified electronic signature

Warsaw, 12 March 2019