Consolidated financial statements
of Bank Gospodarstwa Krajowego Capital Group
prepared in conformity with the IFRS
for the financial year from 1 January to 31 December 2017

The above Financial Statements of Bank Gospodarstwa Krajowego is a translation from the original Polish version. In case of any discrepancies between the Polish and English version, the Polish version shall prevail.

Warsaw, 23 April 2018

Selected financial data on the consolidated financial statements

The selected financial data specified below constitute additional information to the consolidated financial statements of BGK Capital Group for 2017.

	in PLN thousand		in EUR thousand	
	For the period from 01.01.2017 to 31.12.2017	For the period from 01.01.2016 to 31.12.2016	For the period from 01.01.2017 to 31.12.2017	For the period from 01.01.2016 to 31.12.2016
Interest income	776,106	651,577	182,841	148,908
Fee and commission income	156,596	120,053	36,892	27,436
Profit (loss) on operating activities	618,460	319,236	145,702	72,957
Gross profit	690,452	263,488	162,662	60,216
Net profit	584,439	257,041	137,687	58,743
Net profit attributable to the owner of the parent	584,565	257,041	137,716	58,743
Net comprehensive income	1,016,602	211,610	239,499	48,360
Cash flows from operating activities	-1,443,384	-1,882,999	-340,044	-430,331
Cash flows from investing activities	-614,551	-748,834	-144,781	-171,135
Cash flows from financing activities	1,779,597	17,566	419,252	4,014
Net cash flows	-278,338	-2,614,267	-65,573	-597,451

	in PLN thousand		in EUR thousand	
	As at 31.12.2017	As at 31.12.2016	As at 31.12.2017	As at 31.12.2016
Balance sheet total	74,314,015	66,746,607	17,817,261	15,087,389
Total equity	20,081,034	12,769,609	4,814,557	2,886,440
Equity attributable to the owner of the parent	20,076,620	12,769,609	4,813,498	2,886,440
Solvency ratio (total capital ratio) without cash flow funds	37.96%	30.08%	37.96%	30.08%
Solvency ratio (total capital ratio) with cash flow funds	37.95%	30.08%	37.95%	30.08%
Basic funds (Tier 1)	18,864,232	12,069,782	4,522,820	2,728,251
Supplementary funds (Tier 2)	0	0	0	0

Selected financial data on the consolidated financial statements was translated to EUR in line with the following rates:

	31.12.2017	31.12.2016
▪ items from the profit and loss account, comprehensive income statement, and cash flow statement according to the average National Bank of Poland (NBP) rate calculated as an arithmetic mean of the average exchange rates applicable on the last day of each month in a given period	4.2447	4.3757
▪ items from the statement of financial position according to the average NBP rate as at the last day of the period	4.1709	4.4240

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(in PLN '000)

Consolidated Profit and Loss Account

	Note	2017	2016
Continuing operations			
Interest income	4	1,826,232	1,510,632
Interest expense	4	-1,050,126	-859,055
Net interest income		**776,106**	**651,577**
Fee and commission income	5	167,909	130,979
Fee and commission expense	5	-11,313	-10,926
Net fee and commission income		**156,596**	**120,053**
Gain/loss on financial instruments measured at fair value through profit or loss	6	26,239	54,639
Gain/loss on investments in financial assets	7	30,578	24,869
Net banking income		**989,519**	**851,138**
Other operating revenue	8	102,358	75,079
Other operating expenses	8	-29,730	-9,448
General administrative expenses	10	-394,049	-354,777
Net impairment losses and provisions	9	-49,638	-242,756
Operating profit/loss		**618,460**	**319,236**
Share of profit or loss of associates	22	71,992	-55,748
Gross profit		**690,452**	**263,488**
Income tax	11	-106,013	-6,447
Net profit		**584,439**	**257,041**
Net profit attributable to the owner of the Parent		**584,565**	**257,041**
Net profit/loss attributable to non-controlling interest		**-126**	**0**

Consolidated Statement of Comprehensive Income

	Note	2017	2016
Net profit		**584,439**	**257,041**
Other comprehensive income		**432,163**	**-45,431**
Item that are or may be reclassified subsequently to profit or loss		**432,279**	**-43,850**
Available-for-sale financial assets, of which:		432,241	-43,842
Deferred tax on available-for-sale financial assets	11	-101,401	10,285
Foreign exchange gains or losses on translating controlled entities		38	-8
Items that will not be reclassified subsequently to profit and loss account		**-116**	**-1,581**
Tangible assets and investment property, of which:		-27	-2
Deferred tax on tangible assets and investment property	11	6	0
Gains and losses due to measurement of defined benefit plans, including:		-89	-1,579
Deferred tax on measurement of defined benefit plans	11	21	371
Total net comprehensive income		**1,016,602**	**211,610**
Total net comprehensive income attributable to the owner of the parent		**1,016,728**	**211,610**
Net comprehensive income attributable to non-controlling interest		**-126**	**0**

Notes to the consolidated financial statements on the pages to follow form their integral part.

(in PLN '000)

Consolidated Statement of Financial Position

	Note	31.12.2017	31.12.2016
Assets			
Cash and balances with the Central Bank	14	988,581	646,776
Receivables from banks	15	3,247,473	3,636,366
Financial assets designated as measured at fair value through profit or loss at initial recognition	16	130,233	136,399
Financial assets held for trading	17	1,342,070	478,808
Loans and advances to customers (net), including:	18	27,223,753	24,631,524
impairment write-downs	18	-758,203	-768,331
Receivables under reverse repo and buy-sell-back transactions	19	2,105,540	3,946,887
Available-for-sale financial assets	20	37,061,252	31,619,745
Held-to-maturity financial assets	21	0	0
Investments in associates	22	1,066,205	645,437
Intangible assets	23	43,176	36,782
Property, plant and equipment (PP&E)	24	143,974	140,147
Investment property	25	834,428	587,771
Current tax receivables		1	18
Deferred tax assets	11	80,185	207,724
Other assets	26	47,144	32,223
Total assets		**74,314,015**	**66,746,607**
Liabilities and equity			
Liabilities			
Liabilities to the Central Bank	27	0	0
Liabilities to banks	28	3,594,140	3,978,829
Financial liabilities held for trading	17	1,284,618	608,005
Liabilities to customers	29	33,692,320	37,109,252
Liabilities under repo and sell-buy-back transactions	19	7,573,820	5,752,184
Liabilities due to debt securities issued	30	6,299,315	5,801,403
Other liabilities	31	1,421,778	411,191
Current tax liabilities		70,136	60,560
Deferred tax liabilities	11	7,090	2,800
Provisions	32	289,764	252,774
Total liabilities		**54,232,981**	**53,976,998**
Equity			
Statutory capital		17,950,629	11,339,138
Supplementary capital		679,249	646,414
Revaluation reserve		355,456	-76,669
Other reserve capitals		232,330	232,330
Foreign exchange gains or losses on translating controlled entities		29	-9
Retained profit (accumulated loss)		274,362	371,364
Net profit (loss) in the current year		584,565	257,041
Equity attributable to the owner of the parent		**20,076,620**	**12,769,609**
Non-controlling interest		**4,414**	**0**
Total equity		**20,081,034**	**12,769,609**
Total liabilities and equity		**74,314,015**	**66,746,607**
Solvency ratio (total capital ratio) without cash flow funds	49	37.96%	30.08%
Solvency ratio (total capital ratio) with cash flow funds	49	37.95%	30.08%

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(in PLN '000)

Consolidated Statement of Changes in Equity

Changes from 1 January to 31 December 2017	Note	Equities attributable to the parent											Non-controlling interest	Total equity
		Statutory capital	Supplementary capital	Revaluation reserve				Other reserve capitals		Foreign exchange gains or losses on translating subordinates	Retained earnings	Total		
				Available-for-sale financial assets	Actuarial gains and losses	Investment property remeasurement	PP&E revaluation reserve	Reserve capital	General banking risk fund					
1 January 2017		**11,339,138**	**646,414**	**-76,280**	**-1,996**	**1,607**	**0**	**76,830**	**155,500**	**-9**	**628,405**	**12,769,609**	**0**	**12,769,609**
Total net comprehensive income, of which:		**0**	**0**	**432,241**	**-89**	**-27**	**0**	**0**	**0**	**0**	**584,598**	**1,016,723**	**-126**	**1,016,597**
net profit for the current period		0	0	0	0	0	0	0	0	0	584,565	584,565	-126	584,439
remeasurement of available-for-sale financial assets (gross)		0	0	533,642	0	0	0	0	0	0	0	533,642	0	533,642
deferred tax		0	0	-101,401	21	6	0	0	0	0	0	-101,374	0	-101,374
remeasurement of defined benefit plan liabilities		0	0	0	-110	0	0	0	0	0	0	-110	0	-110
transfer to the current year profit or loss		0	0	0	0	-33	0	0	0	0	33	0	0	0
foreign exchange gains or losses on translation of FEZ		0	0	0	0	0	0	0	0	38	0	38		38
Profit transfer, including:		**320,906**	**34,035**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**-355,276**	**-335**	**0**	**-335**
allocation to capital		320,906	34,035	0	0	0	0	0	0	0	-354,941	0	0	0
appropriation of profit to the Inland Waterway Fund (IWF)		0	0	0	0	0	0	0	0	0	-329	-329	0	-329
income tax		0	0	0	0	0	0	0	0	0	-6	-6	0	-6
Contribution of bonds and funds by the State Treasury – increase in equity	**33**	**6,290,400**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**6,290,400**	**0**	**6,290,400**
Profit distribution (dividend payment)		**0**	**-1,200**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**1,200**	**0**	**0**	**0**
Transfer of net asset fair value of the NHF		**185**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**185**	**0**	**185**
Contribution of non-controlling interest		**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**4,540**	**4,540**
31 December 2017		**17,950,629**	**679,249**	**355,961**	**-2,085**	**1,580**	**0**	**76,830**	**155,500**	**29**	**858,927**	**20,076,620**	**4,414**	**20,081,034**

Notes to the consolidated financial statements on the pages to follow form their integral part.

(in PLN '000)

Changes from 1 January to 31 December 2016	Note	Statutory capital	Supplementary capital	Revaluation reserve				Other reserve capitals		Retained earnings	Foreign exchange gains or losses on translating controlled entities	Equity attributable to the owner of the parent	Total equity
				Available-for-sale financial assets	Actuarial gains and losses	Investment property remeasurement	PP&E revaluation reserve	Reserve capital	General banking risk fund				
1 January 2016		**8,409,540**	**614,445**	**-32,438**	**-417**	**1,607**	**2**	**76,830**	**155,500**	**484,892**	**-1**	**9,709,960**	**9,709,960**
Net comprehensive income, incl.:		**0**	**0**	**-43,842**	**-1,579**	**0**	**-2**	**0**	**0**	**257,041**	**-8**	**211,610**	**211,610**
net profit for the current period		0	0	0	0	0	0	0	0	257,041	0	257,041	**257,041**
remeasurement of available-for-sale financial assets (gross)		0	0	-54,127	0	0	0	0	0	0	0	-54,127	-54,127
deferred tax		0	0	10,285	371	0	0	0	0	0	0	10,656	10,656
remeasurement of defined benefit plan liabilities		0	0	0	-1,950	0	0	0	0	0	0	-1,950	-1,950
transfer to the current year profit or loss		0	0	0	0	0	-2	0	0	0	0	-2	-2
foreign exchange gains or losses on translation of FEZ		0	0	0	0	0	0	0	0	0	-8	-8	-8
Profit transfer, including:		**36,268**	**31,969**	**0**	**0**	**0**	**0**	**0**	**0**	**-68,638**	**0**	**-401**	**-401**
allocation to capital		36,268	31,969	0	0	0	0	0	0	-68,237	0	0	0
appropriation of profit to the Inland Waterway Fund (IWF)		0	0	0	0	0	0	0	0	-395	0	-395	-395
income tax		0	0	0	0	0	0	0	0	-6	0	-6	-6
Contribution of bonds by the State Treasury – increase in equity	**33**	**2,893,200**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**2,893,200**	**2,893,200**
Distribution of profit to the State Budget	**13**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**-44,891**	**0**	**-44,891**	**-44,891**
Transfer of net asset fair value of the NHF		**130**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**130**	**130**
Other		**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**1**	**0**	**1**	**1**
31 December 2016		**11,339,138**	**646,414**	**-76,280**	**-1,996**	**1,607**	**0**	**76,830**	**155,500**	**628,405**	**-9**	**12,769,609**	**12,769,609**

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(in PLN '000)

Consolidated Statement of Cash Flows

Consolidated Statement of Cash Flows	Note	2017	2016
A. Cash flows from operating activities			
Net profit/loss		**584,439**	**257,041**
Total adjustments:		**-2,027,823**	**-2,140,040**
Income tax recognised in profit or loss		106,013	6,447
Depreciation and amortisation	10	23,024	29,985
Profit/loss on investing activities		-88,522	38,588
Interest and dividends	35	188,724	175,396
Foreign exchange gains or losses		-16,980	8,838
Change in receivables from banks		-231,250	-17,026
Change in financial assets held for trading		-857,096	-136,419
Change in loans and advances to customers		-2,590,442	-4,855,740
Change in receivables due to reverse repo and buy-sell-back transactions		1,841,347	-2,773,174
Change in available-for-sale financial assets		-107,049	-14,830,640
Change in other assets and assets held for sale		-13,151	-4,117
Change in liabilities to banks		-348,220	-462,820
Change in financial liabilities held for trading		676,613	365,747
Change in liabilities to customers		-3,411,964	17,447,183
Change in liabilities under repo and sell-buy-back transactions		1,821,636	2,868,411
Change in provisions		37,065	8,012
Change in other liabilities		1,009,289	52,801
Income tax paid		-67,739	-62,350
Other adjustments	35	879	838
Net cash from operating activities		**-1,443,384**	**-1,882,999**
B. Cash flows from investing activities			
Inflows		**5,205**	**26,710**
Sale of property, plant and equipment		7	33
Sale of intangible assets		10	0
Sale of investment property		2,900	82
Sale of shares in associates	22	0	960
Sale of equity financial assets		0	22,294
Dividends received	35	2,288	3,341
Outflows		**619,756**	**775,544**
Purchase of property, plant and equipment	24	17,913	37,446
Purchase of intangible assets	23	16,243	18,517
Purchase of investment property	25	220,228	343,479
Purchase of shares in associates	22	348,902	366,022
Purchase of equity financial assets		16,470	10,080
Net cash from investing activities		**-614,551**	**-748,834**
C. Cash flows from financing activities			
Inflows		**4,574,037**	**1,021,651**
Net proceeds on share (stock) issued		598	0
Long-term loans		208,454	521,151
Debt securities issued		2,864,985	500,500
Increase in equity by the State Treasury		1,500,000	0
Outflows		**2,794,440**	**1,004,085**
Repayment of long-term loans		236,026	279,380
Repayment of interest		54,757	50,939
Redemption of debt securities issued		2,370,000	500,000
Interest paid on debt securities issued		133,657	128,875
Outflows to shareholders		0	44,891
Net cash from financing activities		**1,779,597**	**17,566**
D. Net cash flows		**-278,338**	**-2,614,267**
including foreign exchange gains or losses on cash and cash equivalents		0	0
E. Cash and cash equivalents at the beginning of the period		**3,498,776**	**6,113,043**
F. Cash and cash equivalents at the end of the period	35	**3,220,438**	**3,498,776**

Notes to the consolidated financial statements on the pages to follow form their integral part.

Notes to the Consolidated Financial Statements

1. General Information

Bank Gospodarstwa Krajowego ("Parent"", "Bank", "BGK") is the parent in the Bank Gospodarstwa Krajowego Capital Group ("Group", "Capital Group").

Bank Gospodarstwa Krajowego is a state-owned bank as defined by the Banking Law of 29 August 1997 (Journal of Laws of 2017, item 1876, as amended) as well as the Act of 14 March 2003 on Bank Gospodarstwa Krajowego (Journal of Laws of 2017, item 1843, as amended), along with the articles of association adopted by the Regulation of the Minister of Development of 16 September 2016 on the adoption of the articles of association of Bank Gospodarstwa Krajowego (Journal of Laws of 016, item 1527). The Bank applies in the Republic of Poland. The registered office is located in Warsaw at Al. Jerozolimskie 7, 00-955 Warszawa. The Parent's REGON statistical number is 000017319 and NIP tax identification number is 525-00-12-372. Apart from the head office, BGK also holds 16 other branches located in all province capitals.

While fulfilling the functions specified in the Banking Law of 29 August 1997, the Bank carries out its own activities, which are complementary to its core, commissioned activities.

Under Article 4 of the Act on Bank Gospodarstwa Krajowego, the primary purpose of BGK's activity is to support the economic policy of the Council of Ministers, socio-economic government programmes, including surety and guarantee programmes, as well as local government and regional development programmes, specifically:
- Projects financed by EU funds and international financial institutions,
- infrastructure projects;
- projects related to the development of micro, small and medium-sized enterprise sector, including those financed with public funds.

Tasks fulfilled by the Bank under Articles 5 and 6 of the Act on BGK involve (*inter alia*):
- administration of funds created, entrusted or transferred to BGK under separate legislation;
- handling export transactions with the use of export support instruments, in addition to supporting the export of Polish goods and services under separate legislation or government programmes,
- offering, whether directly or not, guarantee and/or guarantee or surety services under government programmes or for or on behalf of State Treasury in accordance with the Act on surety bonds and guarantees granted by the State Treasury and certain legal entity, in particular to the small and medium-sized enterprise sector,
- supporting the development of residential construction, in particular development of residential property for rent, under separate legislation or government programmes;
- maintenance of Treasury bank accounts,
- local government budget administration,
- maintenance of the accounts of national or local government legal entities established under separate legislation to carry out public functions,
- other functions carried out with the use of public funds, as specified in agreements entered into with public administration bodies.

On 17 July 2017 the Supervisory Board of Bank Gospodarstwa Krajowego endorsed a new Strategy for the years 2017-2020. It is based on BGK as a financial partner that actively supports entrepreneurship and an efficient use of development programmes and that also initiates and is involved in cooperation with business and public sectors as well as financial institutions. The New Strategy of BGK results from new challenges faced by the Polish economy and addressed, *inter alia,* as part of Strategy for Responsible Development that features an economic increase based on knowledge and excellence, a sustainable social and territorial growth, and efficiency of the State.

The culture of Bank Gospodarstwa Krajowego is based on professionalism, partnership, and commitment.

With regard to these values, a new organisational model has been defined. It focuses on four basic pillars: financing development and investments, European programmes, public finance, and operating excellence.

As a state development bank, Bank Gospodarstwa Krajowego focuses on initiating and implementing tasks that serve a general economic growth and development of enterprises. It finances infrastructural projects, provides sureties and guarantees as well as manages numerous programmes aimed at improving the situation on the real estate market. Based on one of its core values, cooperation, it establishes relations with other financial institutions, taking into account the principles of partnership. A very significant element involves supporting the economy in areas where the market does not operate effectively. This is manifested e.g. by involving private capital, participating in consortia, and a constant cooperation with development institutions.

One of the elements of the Strategy of Bank Gospodarstwa Krajowego for the years 2007-2013 is defining key indicators of strategy implementation and setting a forecast level of their implementation by 2020.

(in PLN '000)

Due to the developmental nature of the Bank, one of the basic efficiency indicators involves "a value of creative economy funding" which resembles the Bank's ability to generate an added value for the economy. In addition, a special emphasis was placed on the need to carry out a cultural transformation in order for BGK to enter into the stage of long-term development with an appropriately specified risk appetite.

A key factor in achieving expected values involves operating excellence which will be partially achieved through defined areas of staff involvement. It has been divided into four categories: a new business model, IT, communication, and HR, with each having key projects and activities aimed at achieving the Strategy of Bank Gospodarstwa Krajowego for the years 2007-2013.

The scope of commissioned activities of Bank Gospodarstwa Krajowego comprises:

Commissioned activity type		Legal basis
I. Funds created, entrusted or transferred to BGK under separate legislation		
1.	Krajowy Fundusz Drogowy (National Road Fund, NRF)	The Act on Toll Motorways and on the National Road Fund of 27 October 1994 (Journal of Laws of 2017, item 1057).
2.	Fundusz Kolejowy (Railway Fund, RF)	Act of 16 December on the Railway Fund (Journal of Laws of 2017, item 510).
3.	Fundusz Żeglugi Śródlądowej (Inland Waterway Fund, IWF)	The Act of 28 October 2002 on the Inland Waterway Fund and the Reserve Fund (Journal of Laws of 2017, 2095).
4.	Fundusz Termomodernizacji i Remontów (Thermomodernization and Repair Fund, TRF)	The Act of 18 December 1998 on supporting thermomodernisation investments (Journal of Laws of 1998, 162, item 1121, as amended – archive act); at present, the Fund acts on the basis of the Act of 21 October 2008 on supporting thermomodernisation and repair (Journal of Laws of 2017, item 130, as amended).
5.	Fundusz Pożyczek i Kredytów Studenckich (Student Loan Fund, SLF)	The Act of 17 July 1998 on Student Loans and Credits (Journal of Laws of 2017, item 357)
6.	Fundusz Dopłat (Subsidy Fund - SF) which comprises the following programmes:	
	• Mortgage Programme for Young People;	The Act on State Aid Provided For The Purchase Of The First Apartment By Young People (Journal of Laws of 2017, item 1184, as amended).
	• A Family's Own Place;	The Act of 8 September 2006 on the Financial Aid for Families and Other Persons Buying Their Own Flat (Journal of Laws of 2017, item 1057, item 1407).
	• Social Housing Programme – financial support for the development of social housing, assisted accommodation, lodging houses called "Budownictwo Socjalne",	Act of 8 December 2006 on the Financial Aid for the purposes of Social Housing, Assisted Accommodation, Lodging Houses and Houses for Homeless (Journal of Laws of 2017, item 1392).
	• Subsidized interest on fixed-rate housing loans (programme);	Act of 5 December 2002 on Interest Subsidies to Fixed Interest Rate Housing Credits (Journal of Laws of 2017, item 650).
	• Additional payments for the interest rate of loans and bonds under refundable financing of investment and construction ventures carried out by BGK as part of Program rządowy popierania budownictwa mieszkaniowego (Residential construction support government programme;	The Act of 26 October 1995 on certain forms of support for residential construction (Journal of Laws of 2017, item 79).
7.	Fundusz Wsparcia Kredytobiorców (Borrower Support Fund, BSF)	The Act of 9 October 2015 on supporting housing loan borrowers in a difficult financial condition (Journal of Laws of 2015, item 1925).
II. Special purpose state fund:		
1.	Fundusz Kredytu Technologicznego (Technology Credit Fund, TCF)	The Act of 30 May 2008 on certain forms of support for innovations (Journal of Laws of 2015, item 1710, as amended); BGK provides funding to SME businesses to carry out projects associated with implementation of innovative technologies. The purpose of funding is to pay back a certain amount of loans granted to enterprises by commercial banks co-operating with BGK. TLF is supported by the funds of the Smart Growth Operational Programme 2014-2020, subactivity 3.2.2 (former name: Innovative Economy Operational Programme 2007-2013).
III. Government's social and economic programmes, as well as programmes of local governments and regional development		
1.	JEREMIE initiative	Financing contracts concluded with Managing Authorities of Regional Operating Programmes for the years 2007-2013 within the scope of management of mutual funds in Dolnośląskie, Łódzkie, Mazowieckie, and Pomorskie Voivodeships (a non-grant support for micro, small and medium enterprises from public funds).

(in PLN '000)

2.	JESSICA initiative; consisting of the following programmes:	
	• JESSICA Initiative (2007-2013)	The Bank acts as the manager of portfolio of investment loans granted under JESSICA initiative implemented in Mazowieckie, Pomorskie, Wielkopolskie provinces. The total amount of granted loans amounts to around PLN 720 million; The loans were granted as part of regional operational programmes for the years 2007-2013 of the above provinces. The Bank will administer the Jessica loans until 2035.
	• JESSICA 2 Wielkopolska 2014-2020;	In November 2016 BGK signed two agreements with the Management Board of the Wielkopolskie province under which the Bank manages a total of PLN 285 million allocated to preferential loans that finance projects related to regeneration and energy efficiency in public buildings. The funds in this respect were granted as part of Wielkopolskie Regional Programme for the years 2014-2020. The implementation of the programme is based on experiences from JESSICA initiative 2007-2013.
	• JESSICA 2 Pomorskie (2014-2020)	In December 2017 BGK entered into an operating contract with EIB on Pomorskie Province. Under said contract BGK will receive funds in the amount of PLN 76.2 million to be allocated to preferential loans that finance projects related to regeneration under the Regional Operational Programme for the Pomorskie Region for the years 2014-2020; The Bank will act as a financial intermediary. The implementation of the programme is based on experiences from JESSICA initiative 2007-2013.
3.	Public funds consolidation administration programme.	The Public Finance Act of 27 August 2009 (Journal of Laws of 2017, item 2077, as amended); As of 1 May 2011, the Bank has administered public funds consolidation and maintained the bank accounts of entities whose public funds are consolidated; under the act of 26 September 2014 on amending the Public Finance Act and Certain Other Acts (Journal of Laws of 2014, item 1626 – archive act), the scope of public fund consolidation was extended with new units from the public finance sector and the consolidation of common courts' deposit sums was introduced. New units were subject to the 2nd public fund consolidation stage as of 1 January 2015.
4.	Administration of payments under programmes financed by EU funds and the state	The Public Finance Act of 27 August 2009 (Journal of Laws of 2017, item 2077, as amended); as of 1 January 2010, the Bank launched a system for administration of payments financed by EU funds and the state.
5.	Support of Entrepreneurship with BGK Sureties and Guarantees; Government programmes "Support of Entrepreneurship with BGK Sureties and Guarantees of Bank Gospodarstwa Krajowego"; (including de minimis)	The Act of 8 May 1997 on Sureties and Guarantees granted by the State Treasury and Certain Legal Persons" (Journal of Laws of 2017, item 2022).
6.	Payment of compensation for leaving real property outside the present borders of the Republic of Poland	The Act of 8 July 2005 on exercising the right to compensation for leaving real property outside the present borders of the Republic of Poland (Journal of Laws of 2016, item 2042, as amended).
7.	A loan from the state budget for the advance financing of projects carried out under Rural Areas Development Program for 2007-2013; A loan from the state budget for the advance financing of projects carried out under Rural Areas Development Program for 2014-2020;	The Act of 22 September 2006 on disbursement of funds from the budget of the European Union for purposes of common agricultural policy financing (Journal of Laws of 2012, item 1065, as amended); the Act of 27 May 2015 on Funding Common Rural Policy (Journal of Laws, item 1130, as amended).
8.	Social Housing Programme (closed down NHF)	The Act of 2 April 2009 amending the Act on Sureties and Guarantees Granted by the State Treasury and Certain Legal Entities, the Act on Bank Gospodarstwa Krajowego and Certain Other Acts (Journal of Laws of 2009, no. 65, item 545 – archive act); residential construction support programmes – the act of 26 October 1995 on certain forms of support for residential construction (Journal of Laws of 2017, item 79, as amended).
9.	Social Housing Programme	The Act of 26 October 1995 on certain forms of support for residential construction (Journal of Laws of 2017, item 79, as amended).
10.	"First Business" Programme	withdrawn from the Bank's offer but is still administered.
11.	"First Business – Start-Up Aid"	An agreement concluded with the Ministry of Labor and Social Policy under the Act of 20 April 2004 on employment promotion and labour market institutions (Journal of Laws of 2017, item 1065, as amended). The purpose of the programme is to develop entrepreneurship and create new jobs as constituents of the development of labour market, counteract unemployment, and promote

(in PLN '000)

		employment through refundable financing (loans) on promotional terms to cover the costs of creating new jobs, in particular by students, graduates, and unemployed. In addition to loans, the programme enables both applicants for as well as beneficiaries of start-up loans to obtain free-of-charge training and consultancy services, e.g. on how to carry out business, bookkeeping, and comply with tax regulations. The programme is financed through the Labour Fund and sale of State Treasury's stock and shares administered by a relevant labour minister. The programme's total budget amounts to around PLN 500 million.
12.	Financial Export Support (FES) Government Programme.	The Financial Exports Support (FES) Government Programme was adopted at a meeting of the Council of Ministers on 28 July 2009. Under the programme, BGK grants loans to foreign buyers (directly or through buyer's bank) to finance the purchase of Polish goods and services; FESGP is managed by Bank Gospodarstwa Krajowego based on the Agreement concluded by BGK, the Ministry of Finance, and Korporacja Ubezpieczeń Kredytów Eksportowych S.A. (Export Credit Insurance Corporation) (KUKE S.A.) of 23 May 2013 and based on the Agreement on the implementation of government programme "Finansowe Wspieranie Eksportu" ("Financial Export Support") concluded on 27-29.08.2013 by the Minister of Finance and Bank Gospodarstwa Krajowego.
13.	Banking services related to and the accounting for liabilities and receivables of the State Treasury;	The Bank provides banking services and carries out cost settlement in relation to the obligations and receivables of the State Treasury as of 1 December 2002. The programme is managed pursuant to the agreement of 21 December 2015 on entrusting BGK with banking services and settlement of selected liabilities and receivables of the State Treasury concluded between the Minister of Finance and Bank Gospodarstwa Krajowego;
14.	Rural Areas Activation Programme – Component A of Micro-loan	The programme has been completed, but BGK continues to administer loans granted as part of the programme.
15.	Special Economic Zone Programme (Zone Fund - ZF).	The Act of 2 October 2003 amending the Act on special economic zones and certain other acts (Journal of Laws of 2003, No. 188, item 1840, as amended).
16.	Subsidized interest on fixed rate export loans - SIEL	The Act of 8 June 2001 on subsidized interest on fixed rate export loans (Journal of Laws, No. 73, item 762, as amended).
17.	System project titled "Support of financial engineering for the development of social economy"	A project implemented by BGK pursuant to an agreement concluded with MRPiPS in 2012 under the Human Capital Operational Programme 2007-2013 (Activity 1.4), as amended, covering: a) monitoring preferential loans granted to social economy entities (PES) by the end of 2016 as part of loan pilot for PES (Pilot) and b) providing funds for PES in the form of guarantees granted under the Guarantee Fund based on repayments within the Pilot.
18.	Non-system project "Implementation of a loan and counter-guarantee instrument as part of Krajowy Fundusz Przedsiębiorczośc Społecznej" (the "National Social Entrepreneurship Fund")	A project implemented by BGK pursuant to an agreement concluded with MRPiPS in 2016 under Knowledge, the Education and Development Operational Programme 2014-2020 (Activity 2.9); the purpose of the project is to increase the number of PES using repayable funding, e.g. loans and counter-guarantees, as a result of which these entities will have an opportunity to strengthen and extend their actvities or undertake new ventures.
19.	State Treasury loan programme to finance public health care centre restructuring projects	The Act of 15 April 2005 on state aid and public health care centre restructuring projects (Journal of Laws of 2005, no. 78, item 684, as amended).
20.	Subsidized interest on fixed rate loans granted to physicians, dentists, nurses, and midwives and the terms of remitting them.	The Act of 24 August 2001 on subsidized interest on fixed rate loans granted to physicians, dentists, nurses, and midwives and the terms of remitting them (Journal of Laws of 2001, no. 128, item 1406, as as amended).
21.	Subsidized interest on loans for reversal of the effects of floods, landslides, and hurricanes	The Act of 8 July 1999 on subsidized interest on loans for reversal of the effects of floods (Journal of Laws, no. 62, item 690, as amended).
22.	Financial instruments under the European Social Fund as part of regional operational programmes 2014-2020.	Within the framework of implementation of operational programmes from the financial perspective 2014-2020, BGK entered into contracts for funding with Managing Authorities in 10 provinces (to carry out 11 Projects), i.e. Dolnośląskie, Lubelskie, Lubuskie, Łódzkie, Małopolskie, Opolskie, Podkarpackie, Podlaskie, Zachodniopomorskie, and Świętokrzyskie, based on which the Bank acts as the Manager of the Fund of Funds. Projects are carried out by financial intermediaries selected in line with the procedures defined by Public Procurement Law. The total allocation for projects under EFS amounts to PLN 275.64 million. Funding comprises expenditure associated with establishment of business activities by the unemployed, economically inactive and job seekers or related to the creation of a workplace.

(in PLN ‘000)

25.	Operational Programme Digital Poland (funded under European Regional Development Fund). Project titled Implementation of financial engineering instruments under Priority Axis I “Common Access to High-Speed Internet”, under Operational Programme Digital Poland for the years 2014-2020.	A funding contract of 6 February 2017 concluded by Digital Poland Project Centre (Intermediate Body) and Bank Gospodarstwa Krajowego (Fund of Funds Manager). Preferential loans allocated to telecommunication enterprises to carry out investments, mainly in terms of broadband Internet; liquidity funding of the SME sector is also possible. The total budget for the project amounts to nearly PLN 1.176 billion (EU sub-financing and national contribution). Due to the fact that loans may be granted even for a 15-year period, it is assumed that the project will be implemented by 2035.
26.	Enterprise support projects under Regional Operational Programmes 2014-2020	Financing contracts concluded with Managing Authorities of Regional Operating Programmes for the years 2014-2020 within the scope of management of fund of funds in Dolnośląskie, Kujawsko-pomorskie, Lubelskim, Lubuskie, Łódzkie, Małopolskie Mazowieckie, Opolskie, Podparpacke, Podlaskie, Pomorskie, Świętokrzyskie, Warmińsko-mazurskie, Wielkopolskie, adn Zachodniopomorskie Voivodeships (a non-grant support for micro, small and medium enterprises from public funds).
27.	Support for businesses under the Operational Programme Eastern Poland and Enterprising Eastern Poland – Tourism	Financing contacts with the Polish Agency for Enterprise Development and the State Treasury – the Ministry of Development and Finance within the scope of projects implemented under the Operational Programme Eastern Poland in the following Voivodeships: Lubelskie, Podlaskie, Podkarpackie, Świętokrzyskie, and Warmińsko-mazurskie (a non-grant support for micro, small and medium enterprises from public funds).
28.	Entrepreneurship support projects (equity instruments) under Smart Development Operational Programme	Financing contracts with the State Treasury – the Ministry of Development and Finance as part of projects carried out under the Smart Development Operational Programme 2014-2020 (equity instruments).

In addition, the Bank entered into global loan agreements with the European Investment Bank (EIB), whereby lines of credit were opened for purposes of financing specific investments carried out by public sector bodies (in particular local governments and municipal companies) as well as supporting operational activities conducted by private entities (especially SME). In practice, this means that the Bank receives grants from the European Commission to boost lending.

1.1. Composition of the Supervisory Board and Management Board of the Parent

1) Composition of the Supervisory Board of the Bank

As at 31 December 2017, the composition of the Bank's Supervisory Board was as follows:

- Paweł Borys – Chairman of the Supervisory Board,
- Witold Słowik – Deputy Chairman of the Supervisory Board
- Jakub Modrzejewski – Secretary of the Supervisory Board,
- Artur Adamski – Member of the Supervisory Board,
- Beata Gorajek – Member of the Supervisory Board,
- Kamil Mroczka – Member of the Supervisory Board,
- Jarosław Nowacki – Member of the Supervisory Board,
- Jan Filip Staniłko – Member of the Supervisory Board,
- Jerzy Szmit – Member of the Supervisory Board,
- Łukasz Robert Śmigasiewicz – Member of the Supervisory Board.

Composition of the Supervisory Board as at the date on which the consolidated financial statements were signed:

- Paweł Borys – Chairman of the Supervisory Board,
- Witold Słowik – Deputy Chairman of the Supervisory Board
- Jakub Modrzejewski – Secretary of the Supervisory Board,
- Artur Adamski – Member of the Supervisory Board,
- Beata Gorajek – Member of the Supervisory Board,
- Mariusz Gruda – Member of the Supervisory Board,
- Kamil Mroczka – Member of the Supervisory Board,
- Jarosław Nowacki – Member of the Supervisory Board,
- Jan Filip Staniłko – Member of the Supervisory Board,
- Jerzy Szmit – Member of the Supervisory Board,
- Łukasz Robert Śmigasiewicz – Member of the Supervisory Board.

2) Composition of the Management Board

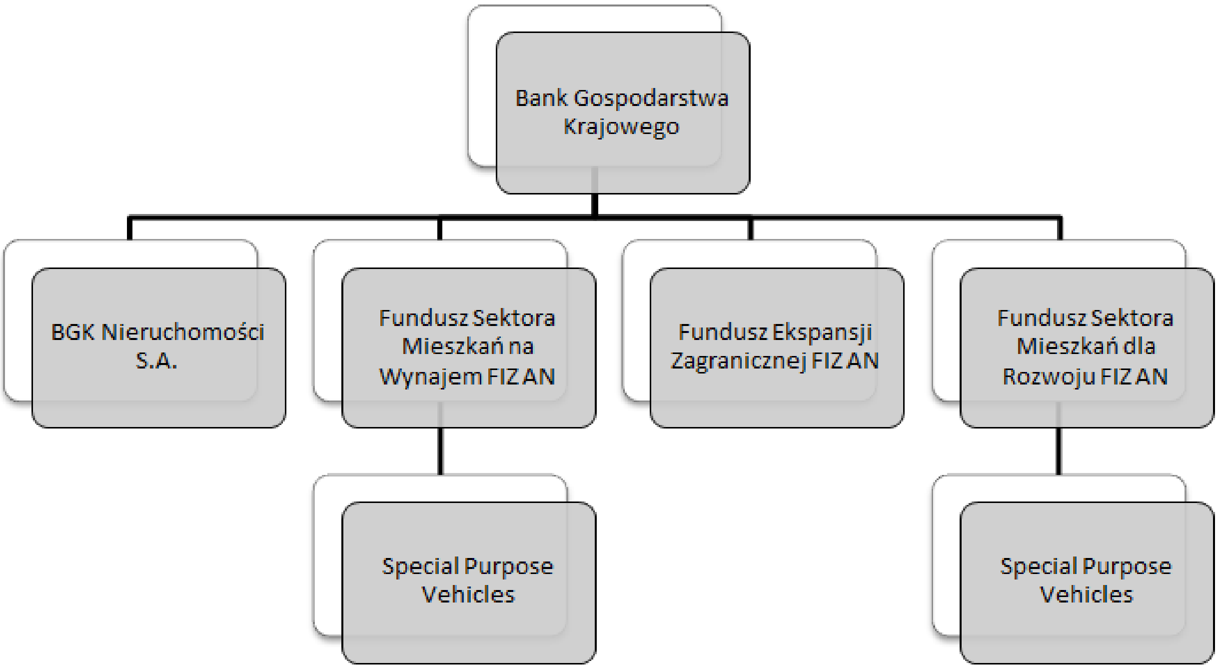
Composition of the Management Board of the Bank as at 31 December 2017 was as follows:

- Beata Daszyńska- Muzyczka – President of the Management Board,
- Paweł Nierada – First Vice-President of the Management Board,
- Włodzimierz Kocon – Vice-President of the Management Board,
- Przemysław Cieszyński – Member of the Management Board,
- Wojciech Hann – Member of the Management Board,
- Radosław Kwiecień – Member of the Management Board.

The composition of the Management Board of the Bank did not change from 31.12.2017 until the date on which the consolidated financial statements were signed.

1.2. Composition of the Bank Gospodarstwa Krajowego Capital Group

As at 31 December 2017, the composition of the Bank Gospodarstwa Krajowego Capital Group is as follows: Bank Gospodarstwa Krajowego (Parent) and the following direct or indirect subsidiaries:



* On 28 September 2017 Bank Gospodarstwa Krajowego sold 100% shares of TFI BGK S.A. to the Polish Development Fund. Due to the fact that until 28 September 2017 the Bank exercised control over TFI BGK S.A., these consolidated financial statements consolidate the financial data of TFI BGK S.A. (present name: PFR TFI S.A.) as at 30 September 2017.

BGK Nieruchomości S.A. - the objective of the company is to support economic development of Poland and improve the quality of life of Poles. BGK Nieruchomości S.A. strengthens the potential of national housing market by carrying out investments of a major significance for local communities. The mission of the company is to increase the availability of flats for rent, including families that experience an economic hardship. BGK Nieruchomości S.A. is also the manager of Fundusz Sektora Mieszkań na Wynajem Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych (Dwelling for Rent Sector – Closed-End Investment Private Equity Fund).

Fundusz Sektora Mieszkań na Wynajem FIZ AN (Dwelling for Rent Sector – Closed-End Investment Private Equity Fund) – investment of proceeds from non-public offering of investment certificates. The Fund will attempt to achieve its investment objective mainly by purchasing and taking up shares and debt securities issued by Special Purpose Vehicles.

Fundusz Ekspansji Zagranicznej FIZ AN (Foreign Expansion Closed-End Investment Private Equity Fund) – investment of proceeds from non-public offering of investment certificates. The Fund attempts to achieve its investment objective by purchasing and taking up shares in Project Entities. It supports foreign expansion by investing in foreign operations of Polish companies.

Fundusz Sektora Mieszkań dla Rozwoju – Dwelling for Development Sector Closed-End Investment Private Equity Fund **(former name: Fundusz Municypalny FIZ AN)** – co-financing investments in real estate carried out by local governments or companies acting on their behalf. The fund invests in projects consisting in constructing or purchasing buildings that lie in significant interests of a local government, along with reconstructing and adjusting them to its needs, and in addition real estate projects carried out under rural areas regeneration projects.

Special Purpose Vehicle – an entity whose scope of business includes implementation, on own account, of construction projects involving the construction of buildings, purchase and sale of real estate, including multi-family residential buildings, as well as lease of apartments located in its multi-family residential buildings on own account, in addition to real estate services.

(in PLN '000)

1.3. Subsidiaries

Composition of the BGK Capital Group is presented below:

Composition of the BGK Capital Group				
Entity's name	Registered office	Scope of business	Direct/indirect interest held by the parent in the entity's capital	
			31.12.2017	31.12.2016
Investments of Bank Gospodarstwa Krajowego				
Towarzystwo Funduszy Inwestycyjnych BGK S.A.*	Warsaw	investment fund establishment and management	sale	100%
BGK Nieruchomości S.A.	Warsaw	real estate services, lease and rental, FSMnW FIZ AN management	100%	100%
Fundusz Ekspansji Zagranicznej FIZ AN**	Warsaw	investment of proceeds from fund participants	100%	100%
Fundusz Sektora Mieszkań dla Rozwoju (Dwelling for Development Sector Fund) FIZAN (previous name: Municipal Closed-End Investment Private Equity Fund)**	Warsaw	investment of proceeds from fund participants	100%	100%
Fundusz Sektora Mieszkań na Wynajem FIZ AN (Dwelling for Rent Sector Closed-End Investment Private Equity Fund)**	Warsaw	investment of proceeds from fund participants	100%	100%
Special Purpose Vehicles of Fundusz Sektora Mieszkań na Wynajem FIZAN (Dwelling for Rent Sector Closed-End Investment Private Equity Fund)				
FSMnW Poznań Sp. z o.o.	Warsaw	rent and management of own or rented property	100%	100%
FSMnW Kraków Sp. z o.o.	Warsaw	rent and management of own or rented property	100%	100%
FSMnW Trójmiasto Sp. z o.o.	Warsaw	rent and management of own or rented property	100%	100%
FSMnW Warszawa 1 Sp. z o.o.	Warsaw	rent and management of own or rented property	100%	100%
FSMnW Wrocław Sp. z o.o.	Warsaw	rent and management of own or rented property	100%	100%
FSMnW Katowice Sp. z o.o.	Warsaw	rent and management of own or rented property	100%	100%
FSMnW Inwestycje Sp. z o.o. (former name: FSMnW Łódź Sp. z o.o.)	Warsaw	rent and management of own or rented property	100%	100%
FSMnW Warszawa 2 Sp. z o.o.	Warsaw	rent and management of own or rented property	100%	100%
FSMnW Warszawa 3 Sp. z o.o. (former name: FSMnW Łódź 2 Sp. z o.o.)	Warsaw	rent and management of own or rented property	100%	100%
MP Biała Podlaska sp. z o.o. (former name: MP Inwestycje 1 Sp. z o.o.)	Warsaw	rent and management of own or rented property	83%	100%
MP Inwestycje 2 Sp. z o.o.	Warsaw	rent and management of own or rented property	100%	-
MP Inwestycje Sp. z o.o.	Warsaw	rent and management of own or rented property	100%	-
MP Inwestycje 3 Sp. z o.o.	Warsaw	rent and management of own or rented property	100%	-
MP Inwestycje 4 Sp. z o.o.	Warsaw	rent and management of own or rented property	100%	-
MP Wałbrzych Sp. z o.o.	Warsaw	implementing construction projects related to erecting buildings	72%	-
Special Purpose Vehicles of Fundusz Sektora Mieszkań dla Rozwoju (Dwelling for Development Sector Closed-End Investment Private Equity Fund)				
Projekt Municypalny Jarocin 1 Sp. z o. o.	Warsaw	construction of multi-family residential buildings and their rental	93%	75%
Projekt Municypalny Kępice 1 Sp. z o. o.	Warsaw	implementing construction projects related to erecting buildings	98%	-
Projekt Municypalny Kępno 1 Sp. z o. o.	Warsaw	implementing construction projects related to erecting buildings	84%	-
Projekt Municypalny Sulęcin 1 Sp. z o. o.	Warsaw	implementing construction projects related to erecting buildings	100%	-
Spółka Operacyjna Projektów Municypalnych Sp. z o.o.	Warsaw	implementing construction projects related to erecting buildings	100%	-

* On 28 September 2017 Bank Gospodarstwa Krajowego sold 100% shares of TFI BGK S.A. (at present: PFR TFI S.A) to the Polish Development Fund.
** "Direct/investment interest in capital of the parent" presents the share in the Fund's investment certificates

1.3.1. Krajowy Fundusz Kapitałowy S.A. (National Capital Fund)

The Bank holds 100% of shares and 100% of voting rights at the General Meeting of Krajowy Fundusz Kapitałowy S.A. ("KFK"). Despite its stake, in the opinion of the parent the Bank does not exercise control over the KFK within the meaning of IFRS 10 because:

- it has not impact on the activity of KFK – the company conducts its activities based on the Act on National Capital Fund and carries out its objectives related to supporting the economic policy of the Council of Ministers as regards the economic development of the state based on economic innovativeness and competitiveness;
- it has not real impact on any decisions concerning disbursement of assets from the KFK to the Bank or discontinuation of activities by the KFK;
- it is not exposed, or have rights, to variable financial results from the core operations of the Fund due to its involvement with KFK The capacity to manage KFK funds is limited to the amounts defined in regulations arranged with the supervising Minister and refers to a specific subsidy/programme.

1.3.2. Limitations in asset management

The Act of 16 December 2016 on principles of state wealth management entered into force as of 1 January 2017. (Journal of Laws of 2016, item 2259, as amended). The Act restricts the Parent's capacity to manage the shares and investment certificates of its subsidiaries and associates

Moreover, as regards companies in the form of investments financed under closed-end investment funds, there may be timely or untimely restrictions in disposal of shares or payment of dividends. These restrictions are provided for in agreements concluded between closed-end investment funds and other investors.

(in PLN '000)

1.4. Associates

BGK Capital Group has the following associates:

Associates				
Entity name	**Registered office**	**Scope of business**	**Interest held by the parent in the entity's capital**	
			31.12.2017	**31.12.2016**
Investments of Bank Gospodarstwa Krajowego				
Fundusz Inwestycji Infrastrukturalnych - Kapitałowy FIZ AN (Infrastructure Investments Capital Closed-End Investment Private Equity Fund)	Warsaw	investment of proceeds from fund participants	13.75% (86.45)*	11.79% (86.45)*
Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprises Investments Closed-End Investment Private Equity Fund)	Warsaw	investment of proceeds from fund participants	40.32% (86.40%)*	23.04% (86.40%)*
Fundusz Inwestycji Samorządowych FIZ AN (Municipal Investments Closed-End Investment Private Equity Fund)	Warsaw	investment of proceeds from fund participants	12.5% (75.00%)*	4.17% (75.00%)*
Fundusz Inwestycji Infrastrukturalnych - Dłużny FIZ AN (Infrastructure Investments Debenture Closed-End Investment Private Equity Fund)	Warsaw	investment of proceeds from fund participants	5.89% (86.45%)*	5.89% (86.45%)*
Korporacja Ubezpieczeń i Kredytów Eksportowych S.A.	Warsaw	insurance activities	36.69%	36.69%
Krajowa Grupa Poręczeniowa Sp. z o.o.	Warsaw	surety activities	39.29%	39.29%
Świętokrzyski Fundusz Poręczeniowy Sp. z o.o.	Kielce	surety activities	49.99%	49.99%
Podkarpacki Fundusz Poręczeń Kredytowych Sp. z o.o.	Rzeszów	surety activities	49.99%	49.99%
Kujawsko-Pomorski Fundusz Poręczeń Kredytowych Sp. z o.o.	Toruń	surety activities	49.38%	49.38%
Opolski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o.	Opole	surety activities	48.27%	48.27%
Fundusz Pomerania Sp. z o.o.	Szczecin	surety activities	46.95%	46.95%
Samorządowy Fundusz Poręczeń Kredytowych Sp. z o.o. in Gostyń	Gostyń	surety activities	41.65%	44.16%
Śląski Regionalny Fundusz Poręczeniowy Sp. z o.o.	Katowice	surety activities	46.08%	46.08%
Fundusz Poręczeń Kredytowych Sp. z o.o in Jelenia Góra	Jelenia Góra	surety activities	44.60%	44.60%
Poznański Fundusz Poręczeń Kredytowych Sp. z o.o.	Poznań	surety activities	44.44%	44.44%
Dolnośląski Fundusz Gospodarczy Sp. z o.o.	Wrocław	surety activities	42.62%	42.62%
Małopolski Regionalny Fundusz Poręczeniowy Sp. z o.o.	Cracow	surety activities	36.87%	36.87%
Warmińsko-Mazurski Fundusz "Poręczenia Kredytowe" Sp. z o.o.	Działdowo	surety activities	36.19%	36.19%
Małopolski Fundusz Poręczeń Kredytowych Sp. z o.o. put into liquidation	Nowy Sącz	surety activities	32.86%	32.86%
Bydgoski Fundusz Poręczeń Kredytowych Sp. z o.o.	Bydgoszcz	surety activities	31.09%	31.09%
Fundusz Rozwoju i Promocji Województwa Wielkopolskiego S.A.	Poznań	surety activities	22.47%	22.47%
Investments of Fundusz Ekspansji Zagranicznej FIZ AN (Foreign Expansion Closed-End Investment Private Equity Fund)				
Esotiq Germany GMBH	Stuttgart	retail sale of textile goods	48.78%	48.78%
UAB EMP Recycling	Galinės (near Vilnius)	acquisition, processing, and sale of recyclable waste	49.00%	-

* target interest

Closed-End Private Equity Funds (FIZ AN) whose interest is held by Bank Gospodarstwa Krajowego and Polski Fundusz Rozwoju S.A. (Polish Development Fund joint-stock company; PFR) are classified as associates. The Capital Group has significant influence over the said entities through:

- the involvement of the Parent’s representative in the work of the investment committees;
- the right of the investors’ meeting to the adoption and modification of the funds’ investment strategy - by way of unanimous resolution of the participants.

PFR is responsible for management of the assets of those FIZ AN whose interest is held by BGK and PFR. Additionally, investment committees that consist of five members, including one appointed at the request of the Parent in the Capital Group, have been established. The aforesaid committees are specifically responsible for reviewing investment projects financed under FIZ AN. A positive result of the review means that the investment decision may be taken by PFR.

2. Summary of significant accounting policies

2.1. Statement of compliance

The consolidated financial statements of Capital Group were prepared in conformity with International Accounting Standards, International Financial Reporting Standards endorsed by the European Union as at 31 December 2017, and the related interpretations published as Commission Regulations (IFRS), and to the extent not regulated by the aforesaid standards, in compliance with the requirements of the Accounting Act of 29 September 1994 (Journal of Laws of 2018, item 395) and implementing acts issued on its basis (“PAS”).

These financial statements is the first consolidated financial statements of BGK Capital Group prepared in line with IFRS within the meaning of the Accounting Act. The Parent has drawn up optional consolidated financial statements of BGK Capital Group in line with the IFRS for the years 2015-2016. The said statements have been examined by a statutory auditor, and received an unqualified opinion.

The accounting policies applied by the associates are in line with PAS. For the purposes of these financial statements, adjustments were made for the purpose of standarization with the applicable accounting principles.

These consolidated financial statements were endorsed for publishing by the Management Board of the Bank on 23 April 2018.

2.2. Going Concern

The financial statements were prepared on the assumption that the the entities of the Capital Group will continue as a going concern within twelve months of the balance sheet date. As at the date of signing of these consolidated financial statements, the Management Board of the Bank did not identify any facts or circumstances that would pose a risk for the Capital Group entities to continue as a going concern within twelve months from the balance sheet date as a result of intended or forced discontinuation or material limitation of its operations.

In 2017 and 2016, no operations were discontinued by the Capital Group entities.

2.3. Basis of preparation of the consolidated financial statements

The consolidated financial statements of the Bank Gospodarstwa Krajowego Capital Group (“Financial statements”) contain data for the financial year from 1 January to 31 December 2017 as well as comparative financial data for the financial year from 1 January to 31 December 2016. Unless otherwise stated, the financial data are presented in the Polish zloty, rounded to PLN ‘000.

The Capital Group makes some estimates and assumptions that affect both the financial statements and the accompanying notes. The estimates and assumptions are described in item 2.5

The consolidated financial statements is characterised by the following measurement principles:

- at fair value for financial assets and liabilities held for trading, including derivatives, financial assets specified at initial recognition as financial assets measured through profit or loss and financial assets available for sale, except those whose fair value cannot be reliably estimated,
- at amortised cost for other financial assets, including credits and loans and other financial liabilities,
- at historical cost for non-financial assets and liabilities and financial assets available for sale whose fair value cannot be reliably estimated,
- at fair value for investment property.

(in PLN '000)

2.4. Amendments to accounting standards

Amendments to the applicable standards adopted for the firsts time in the consolidated financial statements of BGK for 2017

Amendments to the applicable standards adopted for the firsts time in the consolidated financial statements of BGK for 2017		
Standard / interpretation	**Description**	**Impact assessment**
Amendment to IAS 7 "Statement of Cash Flows"	Initiative with regard to disclosures – amendments endorsed by the EU on 6 November 2017 (applicable to annual periods beginning on or after 1 January 2017). The amendment is intended to clarify IAS 7 to improve information provided to the users of financial statements about an entity's financing activities. The amendment requires entities to provide disclosures that enable the users of financial statements to evaluate changes in liabilities arising from financing activities, both from cash and non-cash transactions.	The Group believes that the amendment to the standard do not have a considerable impact on the financial statements for 2017
Amendment to IAS 12 "Income Taxes"	Recognising deferred income tax assets on unrealised losses – amendments endorsed in the EU on 6 November 2017 (applicable to annual periods beginning on or after 1 January 2017). The amendment to IAS 12 clarifies the method of recognition of deferred tax assets in relation to debt instruments measured at fair value.	The Group believes that the amendment to the standard do not have a considerable impact on the financial statements for 2017
IFRS 12 amendments as a result of "IFRS Amendments (2014-2016)"	The changes approved in the EU on 7 February 2018 (amendments to IFRS 12 applicable to annual periods beginning on 1 January 2018 or after that date). Changes made as part of annual IFRS amendments (IFRS 1, IFRS 12, and IAS 28) are introduced primarily with a view to removing inconsistencies and clarify wording.	The Group believes that the amendment to the standard do not have a considerable impact on the financial statements for 2017

New standards and amendments to applicable standards which were published by the International Accounting Standards Board (IASB) and endorsed by the European Union, but which have not entered into force yet.		
Standard / interpretation	**Description**	**Impact assessment**
IFRS 9 "Financial Instruments"	Endorsed in the EU on 22 November 2016 (applicable to annual periods beginning on or after 1 January 2018). The change has been described in further part of the note.	The Group has made a no-go decision with regard to pre-adoption of the new standard and amendments to the existing standards. According to estimates, the new standard will have an impact on the financial statements. The impact of the amendment is described in further part of the note.
IFRS 15 "Revenue from Contracts with Customers" and amendments	Endorsed in the EU on 22 September 2016 (applicable to annual periods beginning on or after 1 January 2018). The change has been described in further part of the note.	The Group believes that the standard will not have a considerable impact on the financial statements.
IFRS 16 "Leases"	Endorsed in the EU on 31 October 2017 (applicable to annual periods beginning on or after 1 January 2019). Under IFRS 16, the lessee recognises the right to use an asset and the lease liability. The right to use an asset is treated similarly to other non-financial assets and subject to depreciation, as appropriate. Lease liabilities are initially measured at the present value of the lease payments due over the term of the lease, discounted using the rate implicit in the lease, provided that its determination is not difficult. Should it be difficult to specify the rate, the lessee applies the residual rate. Lessors classify leases in accordance with IAS 17 – i.e. as operating or finance leases. A lease is classified by the lessor as a finance lease if substantially all risks and rewards of ownership of the assets are transferred onto the lessee. Otherwise, the lease is classified as an operating lease. In finance leases, financial revenue is recognised by the lessor over the term of the lease based on a fixed rate of return on the net investment for the period. Operating lease payments are recognised by the lessor as revenue on a straight-line or another systematic basis if it reflects the pattern of benefits derived from the use of the assets more accurately.	The Group is currently analysing the standard and it is assumed that the standard will not have a considerable impact on the financial statements of the Group as a lessee in the period of its first-time adoption.
Amendments to IFRS 4 "Insurance contracts"	Applicable to IFRS 9 "Insurance contracts" and IFRS 4 "Insurance instruments" – endorsed in the EU on 3 November 2017 (applicable to annual periods beginning on or after 1 January 2018 or at the moment of adoption of IFRS 9 "Financial instruments" for the first time). Amendments were introduced to solve problems resulting from the implementation of a new standard: IFRS 9 "Financial instruments" before the new standard is implemented to replace IFRS 4.	According to the Group, the amendment to the standard will not have a considerable impact on the financial statements in the period of its first-time adoption.

(in PLN '000)

Amendment to IFRS 2 "Share-Based Payment"	The changes approved in the EU on 27 February 2018 (applicable to annual periods beginning on or after 1 January 2018). The amendment introduces requirements for recognition of: (a) the consequences of acquisition of the rights and conditions other than conditions of acquisition of the rights on measurement of share-based payment to be settled in cash; (b) share-based payments settled in net against tax liabilities; and (c) modifications of share-based payment transactions from cash-settled to equity-settled.	According to the Group, the amendment to the standard will not have a considerable impact on the financial statements in the period of its first-time adoption.
Amendment to IFRS 9 "Financial Instruments"	The changes approved in the EU on 22 March 2018 (applicable to annual periods beginning on or after 1 January 2019). Theses changes modify the requirements of IFRS 9 regarding the rights of early contract termination for the purpose of measurement at amortised cost (or, depending on the business model, at fair value through other comprehensive income) even in the case of negative compensation. The changes presuppose that the sign (plus or minus) of prepayment amount is not significant, i.e. depending on the interest rate applicable at the moment of termination, it is possible to carry out payment for the other party giving rise to early repayment. The calculation of this compensation must be the same both in case of penalty for early repayment as well as in case of profit due to early repayment.	According to the Group, the amendment to the standard will not have a considerable impact on the financial statements in the period of its first-time adoption.
Amendment to IAS 40 "Income Property"	The changes approved in the EU on 14 March 2018 (applicable to annual periods beginning on or after 1 January 2018). The changes that the entity to carry out transfers of specific property to, or from, investment property should only be made when there is a change in use. A change in use occurs where a specific property meets or no longer meets the definition of "investment property", as appropriate. Change in the intention of the management as regards the use of the property itself does not serve as a reason for changing its use.	According to the Group, the amendment to the standard will not have a considerable impact on the financial statements in the period of its first-time adoption.
IFRS 1 amendments and IAS 28 as a result of "IFRS Amendments (2014-2016)"	The changes approved in the EU on 7 February 2018 (amendments to IFRS 1 and IAS 28 applicable to annual periods beginning on or after 1 January 2018). Changes made as part of annual IFRS amendments (IFRS 1, IFRS 12, and IAS 28) are introduced primarily with a view to removing inconsistencies and clarifying wording.	According to the Group, the amendment to the standard will not have a considerable impact on the financial statements in the period of its first-time adoption.
Interpretation of IFRIC 22 "Foreign Currency Transactions and Advance Consideration"	The interpretation was approved in the EU on 28 March 2018 (applicable to annual periods beginning on or after 1 January 2018). According to this interpretation, the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt.	According to the Group , the interpretation will not have a considerable impact on the financial statements in the period of its first-time adoption.

IFRS 9 "Financial Instruments"

As of 1 January 2018 the Parent adopted International Financial Reporting Standard 9 "Financial Instruments" ("IFRS 9"). IFRS 9 introduces certain changes concerning the principles for classification and measurement of financial instruments (especially financial assets), the new model for impairment of financial assets is based on "expected loss" as well as a new approach to hedge accounting.

Below is a summary of accounting principles of the Bank applicable as of 1 January 2018 in terms of classification and measurement of financial assets and liabilities, impairment losses on financial assets and the impact of changes resulting from the enforcement of IFRS 9 on the financial condition and own funds of the Bank.

Classification of financial assets and financial liabilities

According to the standard, the classification of financial assets is carried out at first-time adoption of IFRS 9, i.e. on 1 January 2018. After that date, financial assets are classified at initial recognition of a financial instrument.
As of 1 January 2018, the Bank classifies financial assets in line with IFRS 9 by the following categories:

- financial assets measured at amortised cost;
- financial assets measured at fair value through other comprehensive income; or
- financial assets measured at fair value through profit or loss.

Classification of financial assets according to IFRS 9 depends on a business model to which a given financial asset is assigned as well as the solely payments of principal and interest ("SPPI"):

- if financial assets are maintained in a business model which aims at obtaining contractual cash flows ("lock-in" business model) and the terms and conditions create cash flows at specific moments that only serve as repayment of principal and interest on amount due, then such assets are measured at amortised cost, as long as the Bank – at initial recognition – did not earmark them for measurement at fair value through profit or loss;
- if financial assets are maintained in a business model which aims at both obtaining contractual cash flows and selling financial assets (business model "lock-in or sell"), whereas the terms and conditions of a given asset pass SPPI test, then such assets are measured at fair value through other comprehensive income, as long as the Bank – at initial recognition – did not earmark them for measurement at fair value through profit or loss. Amendments to impairment, interest revenue, and foreign exchange rate gains or losses are recognised through profit or loss;
- in other cases, financial assets are measured at fair value through profit or loss. The principle refers to financial assets which do not meet the criteria for classification to categories measured at amortised cost or measured at fair value through other comprehensive income or to financial assets that were recognised in this category by way of decision of the Bank at initial recognition (recognition is irrevocable, but it can be effected only if the Bank eliminates or significantly reduces in this way any inconsistent measurement or recognition).

Financial assets may be reclassified to other categories only and only if there is a change in the business model concerning management of these assets and gives rise to a need for reclassifyign all financial assets affected by this change.

In line with IFRS 9 equity instruments held for trading are classified to assets measured at fair value through profit or loss. Other equity instruments purchased for long-term investment are classified to assets measured at fair value through profit or loss or the Bank may make an irrevocable choice and classify them to financial assets measured at fair value through other comprehensive income. Amendments to fair value recognised in other comprehensive income can never be relocated to financial result (except dividends), including at the moment of exclusion from the statement of financial position. However, they can be relocated as part of equity capitals.

The adoption of IFRS 9 does not have a significant impact on accounting principles concerning financial liabilities because the new standard to a large extent maintains the requirements of IAS 39 as regards the classification and measurement of financial liabilities.

Impairment

IFRS 9 imposes an obligation to use a uniform financial asset impairment testing method. As of 1 January 2018, impairment losses will be calculated in line with expected credit losses, taking into account forecasts and expected future economic conditions in the context of credit risk exposure assessment. The new impairment model is applied in case of debt instruments classified to assets measured at amortised costs and assets measured at fair value through other comprehensive income. The news standard removes the term loss identification period and the category of IBNR (incurred but not reported) impairment losses. In line with IFRS 9, debt instruments covered by impairment model will be allocated to:

- stage 1 - assets with no impairment and no significant increase in credit risk since initial recognition, and for which impairment will be measured as 12-month expected credit losses;
- stage 2 - assets with no impairment and with no significant increase in credit risk since initial recognition, and for which impairment will be measured as lifetime expected credit losses.
- stage 3 - financial assets with an identified impairment and for which impairment will be measured as lifetime expected credit losses.

The classification of financial assets to three stages and the determined impairment calculation method affect the recognition of interest revenue. Interest revenue on financial assets classified to stages 1 and 2 are determined based on gross exposures (effective interest rate on gross opening amortised cost, not adjusted for expected credit losses) using the effective interest method. As for assets belonging to stage 3 – based on net amortised cost of those assets.

POCI assets comprise separate assets. They are purchased or originated financial assets which at initial recognition are impaired due to a credit risk. Interest revenue on POCI assets are calculated based on a net carrying amount using the effective interest rate adjusted by a credit risk recognised for the entire useful life of that asset.

As of 1 January 2018, the Bank applies a simplified method for measuring impairment allowance on expected credit losses due to other receivables, in particular own operations of BGK. Allowances are determined by the Bank based on matrices with fixed percentage rates of allowances, depending on the number of days passed from the maturity date.

Hedge accounting

The Parent does not apply hedge accounting.

Disclosures

IFRS 9 introduced significant changes in the manner of presentation and scope of disclosures on financial instruments. The Bank decided to apply IFRS 9 which allowed it to be released from the obligation to transform comparative data for the previous periods with regard to changes resulting from classification and measurement (including impairment). The differences in the carrying amount of financial assets resulting from the adoption of IFRS 9 are recognised in item "Result from the previous years" as at 1 January 2018.

Impact of IFRS 9 on financial assets of the Bank

The classification of financial assets in line with IFRS 9 is carried out at their initial recognition in the statement of financial position and depends on the nature of contractual cash flows as well as the business model for financial asset management used by the Bank.

As for financial assets (credits and debt securities) classified in line with IAS 39 as loans and receivables – all assets which have not passed SSPI test and have been assigned with business model "lock-in" have been classified – in line with IFRS 9 – as financial assets measured at amortised cost. Any financial assets which, despite having been categorised to business model "lock-in", have failed the SPPI test are classified as financial assets measured at fair value through profit or loss. The reason for a negative SSPI test resulted from using a financial leverage in a loan agreement that increases contractual cash flow volatility and, in certain disbursements of debt securities, from using participation clauses in the financial result of the customer which entitle the Bank to obtain additional cash flows which do not meet the criteria of the SPPI test.

Debt securities which, in line with IAS 39, were classified as available for sale, passed SSPI test and were assigned with business model "lock-in or sale", have been classified – in line with IFRS 9 – as financial assets measured at fair value through other comprehensive income.

By applying IAS 39, the Bank classified all capital investments as financial assets available for sale. As a result of transition into IFRS 9 in case of long-term investments or investments with a significant impact on supporting state's economic policy or necessary banking activity, the Bank opted for their designation for measurement at fair value through other comprehensive income. Other equity instruments are classified at fair value through profit or loss at initial recognition.

As for financial assets which were classified by the Bank in line with IAS 39, the Bank classified them as held for trading or designated to be measured at fair value through profit or loss as a result of adoption of IFRS 9 and they will be still measured at fair value through profit or loss.

(in PLN '000)

The table below presents changes in the categories of financial assets of the Bank which took place as a result of adoption of IFRS 9.

	Classification according to IAS 39 31.12.2017	**Classification according to IFRS 9 1.01.2018**	**Carrying amount according to IAS 39 31.12.2017**	**Carrying amount according to IFRS 9 1.01.2018**
Cash and balances with the Central Bank	Loans and receivables	Measured at amortised cost	988,581	988,581
Receivables from banks	Loans and receivables	Measured at amortised cost	3,089,748	3,089,210
Financial assets designated as measured at fair value through profit or loss at initial recognition	Measured at fair value through profit or loss (designated)	Measured at fair value through profit or loss (designated)	130,233	130,233
Financial assets held for trading	Measured at fair value through profit or loss	Measured at fair value through profit or loss (mandatory)	1,342,070	1,342,070
Loans and advances to customers	Loans and receivables	Measured at amortised cost	27,031,038	27,034,684
Loans and advances to customers	Loans and receivables	Measured at fair value through profit or loss (mandatory)	202,759	209,722
Receivables under reverse repo and sell-buy-back transactions	Loans and receivables	Measured at amortised cost	2,105,540	2,105,540
Available-for-sale financial assets – debt instruments	Available for sale	Measured at fair value through other comprehensive income	35,699,238	35,699,238
Available-for-sale financial assets – equity instruments	Available for sale	Measured at fair value through profit or loss (mandatory)	136,988	136,988
Available-for-sale financial assets – equity instruments	Available for sale	Measured at fair value through other comprehensive income (designated)	1,192,397	1,192,397
Held-to-maturity financial assets	Held-to-maturity financial assets	Measured at amortised cost	0	0
Other assets	Loans and receivables	Measured at amortised cost	31,234	31,133

Impact of the calculation of impairment of financial assets in line with IFRS 9 at the Bank

Replacement of IAS 39 with IFRS 9 gives rise to a need for changing the impairment model estimating incurred loss with a new model based on "expected credit losses". A direct consequence of that change is the need to calculate impairment losses based on expected credit losses until the maturity date of exposures, taking into account forecasts and expected future economic conditions in the context of credit risk exposure assessment. This model allows to categorise financial assets classified, in line with IFRS 9, as financial assets measured at amortised cost or debt instruments classified as financial assets measured at fair value through other comprehensive income.

A change in the concept of incurred loss model (IAS 39) with expected loss (IFRS 9) had an impact on modeling the parameters of credit risk, and as a consequence – the final amount of write-downs established.

Introducing a new impairment model based on the concept of expected credit losses affects the amount of allowances at the Bank, in particular as regards exposures measured at stage 2. In the event of a significant increase in credit risk from the moment of initial recognition, there is a need to calculate losses in a lifetime horizon of an exposure. As a result of this approach, expected credit losses are recognised earlier, which translates into an increase in the amount of allowances.

(in PLN '000)

The amounts of impairment losses on expected credit losses of the Bank in line with IAS 39, IAS 37, and IFRS 9 are presented below.

			As at 31.12.2017 according to IAS 39 and IAS 37					As at 1.01.2018 according to IFRS 9*					
	Classification according to IAS 39	Classification according to IFRS 9	IBNR provisions	Impairment losses	Including: estimated individually	Total impairment losses	Total net carrying amount	Stage 1 provisions	Stage 2 provisions	Stage 3 provisions	Provisions for expected credit losses (simplified approach)	Total impairment losses	Total net carrying amount
Receivables from banks	Loans and receivables	Amortised cost	482	-	-	482	3,089,748	1,020	-	-	-	1,020	3,089,210
Loans and advances to customers	Loans and receivables	Amortised cost	220,570	515,157	352,524	735,726	27,031,038	142,914	44,941	773,502	-	961,357	27,034,684
Loans and advances to customers	Loans and receivables	Fair value through profit or loss	476	22,001	22,001	22,477	202,759	-	-	-	-	-	209,722
Available-for-sale financial assets (owing)	Available for sale	Fair value through other comprehensive income	-	-	-	-	35,699,238	1,810	-	-	-	1,810	35,699,238
Other assets	Loans and receivables	Amortised cost	-	5,302	-	5,302	31,234	-	-	-	5,403	5,403	31,133
Provisions (for off-balance-sheet exposures)	Loans and receivables	Amortised cost	141,680	29,119	25,727	170,799	-	92,168	14,856	55,121	-	162,145	-

* The table specifies changes in the amount of allowances corresponded with the same change in gross carrying amount, including an increase in allowances as a result of adjustment of the gross carrying amount to the requirements of IFRS 9 (this is a recognition change where the gross carrying amount is increased by recognising contractual interest charged in full and, as a consequence, an analogous increase in the amount of allowances).

(in PLN '000)

Impact of IFRS 9 on Bank own funds

The impact of IFRS as at the first day of its first-time adoption by the Bank is presented below. The effect associated with the commencement of adoption of IFRS 9 has been recognised in undistributed financial result from the previous years and revaluation reserve.

Impact of IFRS 9 on undistributed financial result of the Bank	
Net result from the previous years as at 31.12.2017 according to IAS 39	**319,968**
Provisions for expected credit losses	**9,501**
Reclassification of debt financial assets to FVPL category in connection with failed SPPI test, incl.:	**6,963**
Write-downs released	22,888
Adjustment of fair value measurement	-15,925
Reclassification of total equity instruments, of which:	**50,381**
Reclassification AFS -> FVPL	49,376
Reclassification AFS -> FVOCI	1,005
Other adjustments	**351**
Tax adjustment	**-10,068**
Total adjustments according to IFRS 9	**57,128**
Result from the previous years as at 01.01.2018 following adjustments related with IFRS 9 implementation	**377,096**
Impact of IFRS 9 on other comprehensive income of the Bank	
Net revaluation reserve from the previous years as at 31.12.2017 according to IAS 39	**355,559**
Establishment of provisions on expected credit losses for exposures classified previously as AFS	**1,810**
Reclassification of total equity instruments, of which:	**-50,381**
Reclassification AFS -> FVPL	-49,376
Reclassification AFS -> FVOCI	-1,005
Tax adjustment	**9,038**
Total adjustments according to IFRS 9	**-39,533**
Net revaluation reserve as at 01.01.2018 following adjustments related to IFRS 9 implementation	**316,026**

The Parent does not identify a significant impact of changes under IFRS 9 on other entities belonging to the BGK Capital Group.

The provisions of IFRS 9 are not unambiguous and are at present subject to interpretations, both by the entities applying the standard as well as the regulator and auditing companies. The market practice for applying the standard is still not established and due to ongoing discussions the information included in the disclosures above may change.

IFRS 15 "Revenue from Contracts with Customers"

IFRS 15 "Revenue from Contracts with Customers" replaces IAS 18 "Revenue", IAS 11 "Construction contracts" as well as any interpretations related with revenue disclosure. The standard applies to customers signed with customers, except for financial instruments, leasing contracts, insurance contracts, and guarantees. The core principle of the new standard is to recognise revenue that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Parent expects to be entitled in exchange for those goods or services. In line with IFRS 15, the transfer of goods or services is based on the concept of passing control onto the customer, which may take place at a defined moment (delivery of a good or performance of a service) or over time (when the service is being provided). Any costs borne to obtain or secure customer contracts are activated and settled over time for a period of deriving benefits under that contract.

IFRS 15 introduced a new, five-step model that should be used to any contracts giving rise to revenue. The model consists of the following steps:

1. Identification of contract with a customer.
2. Identification of personal obligations to carry out contractual service.
3. Determine the transaction price.
4. Allocation of transaction price to performance obligations.
5. Recognition of revenue.

The review identified that the Parent has revenue which, as a rule, should be recognised in line with IFRS 15, and specifically:

- fees for asset management as part of European Union Perspective 2014-2020;
- remuneration for management of programmes/funds of commissioned activities;
- remuneration for public funds consolidation administration.

(in PLN '000)

As a result of analyses in the said areas and the fact that a significant part of revenue of the parent results from activities regulated under different standards. The parent has not identified any items calling for a change in accounting recognition. In the opinion of the parent, the adoption of IFRS 15 will not have a significant impact on the financial condition and own funds of the Bank.

New standards and amendments to applicable standards which were published by the International Accounting Standards Board (IASB), but which have not entered into force in the EU yet.		
Standard / interpretation	**Description**	**Impact assessment**
IFRS 14 "Regulatory Deferral Accounts"	The standard applicable to annual periods beginning on or after 1 January 2016 – The European Commission decided not to begin the approval of the previous standard to be used in the EU until the final version of IFRS 14 is released. The purpose of the standard is to enable entities that apply IFRS for the first time and recognise regulatory deferral accounts in line with previous generally applicable accounting principles, a continuation of disclosing these accounts following transition to IFRS.	According to the Group, the amendment to the standard will not have a considerable impact on the financial statements in the period of its first-time adoption.
IFRS 17 "Insurance contracts"	This standard was issued by the IASB on 18 May 2017. The new standard calls for measurement of insurance contracts in an amount of present value of payment and ensures a more uniform approach for measuring and recognising all insurance contracts. The purpose of these requirements is to achieve a coherent disclosure of insurance contracts based on uniform accounting principles. IFRS 17 replaces IFRS 4 "Insurance contracts" and its interpretations on the date of adoption of the new standard (applicable to annual periods beginning on or after 1 January 2021).	According to the Group, the amendment to the standard will not have a considerable impact on the financial statements in the period of its first-time adoption.
Amendment to IAS 19 "Employee Benefits"	The amendment was issued by the IASB on 7 February 2018 According to the amendment, following a change of the plan the measurement premises should be updated in order to define current costs of services and net interest for the remaining part of the reporting period.	According to the Group, the amendment to the standard will not have a considerable impact on the financial statements in the period of its first-time adoption.
Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures".	This standard was issued by the IASB on 11 September 2014 (effective date – the effective date has been postponed until completion of research on the equity method). The purpose of these amendments is to remove any discrepancy between IAS 28 and IFRS 10 as well as to clarify that the recognition of profit or loss in transactions involving an associate or joint venture depends on whether the sold or incurred assets constitute a venture.	According to the Group, the amendment to the standard will not have a considerable impact on the financial statements in the period of its first-time adoption.
Amendments to IAS 28 "Investments in Associates and Joint Ventures".	This standard was issued by the IASB on 12 October 2017 (changes applicable to annual periods beginning on or after 1 January 2019). The changes were introduced to clarify that the unit applies IFRS 9 (including impairment regulations) with regard to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied.	According to the Group, the amendment to the standard will not have a considerable impact on the financial statements in the period of its first-time adoption.
IFRS Amendments (2015-2017)	Changes as part of annual IFRS amendments (IFRS 3, IFRS 11, IAS 12, and IAS 23) are introduced primarily with a view to removing inconsistencies and clarifying wording (applicable to annual periods beginning on or after 1 January 2019).	According to the Group, the amendment to the standards will not have a considerable impact on the financial statements in the period of its first-time adoption.
Interpretation of IFRIC 23 "Uncertainty over Income Tax Treatments"	This interpretation was issued by the IASB on 7 June 2017 (applicable to annual periods beginning on or after 1 January 2019). It may be unclear in what way does the tax law refers to a specific transaction or circumstances or whether a tax authority approves the taxation of the entity. IAS 12 "Income taxes" defines the manner of current and deferred tax settlement, but does not depict the effects of uncertainty. IFRIC 23 contains guidelines that supplement the IAS 12 requirements while specifying the way of depicting the effects of uncertainty while recognising income tax.	According to the Group , the interpretation will not have a considerable impact on the financial statements in the period of its first-time adoption.

2.5. Estimates and assumptions

The estimates and assumptions made by the Capital Group for purposes of recognition of the respective amounts of assets and liabilities are based on historical data and other factors which are available and considered appropriate under given circumstances.

The assumptions concerning the future and the available data are used for purposes of estimating the carrying amounts of assets and liabilities that cannot be measured reliably using other sources. While making such assumptions, the Capital Group takes into account the causes and sources of uncertainty that it is able to foresee at the end of the reporting period. Actual results may differ from estimates.

(in PLN '000)

The estimates and assumptions made by the Capital Group are reviewed on a regular basis. Their adjustments are recognised in the period when the estimates are modified, if they pertain to that period only. If the adjustments affect both the period of the modification and future periods, they are recognised in the period of the modification and in future periods.

2.5.1 Impairment of loans and advances

As at each balance sheet date, the Capital Group tests whether there are any objective evidences of impairment of a financial asset/a group of financial assets. The impairment testing methodology and loss calculation principles have been described in Note 44 "Credit risk management".

The tables below present the estimated effect of changes in the present value of cash flows as well as PD and LGD on the amount of impairment losses/provisions – for three impairment testing methodologies. A negative value means a decrease in impairment losses/provisions.

Effect of an increase/decrease in the present value of cash flows on impairment losses/provisions - tested individually	31.12.2017		31.12.2016	
Increase/decrease in the present value of cash flows	**+ 10%**	**- 10%**	**+ 10%**	**- 10%**
Estimated change in impairment losses on on-balance sheet exposures tested individually	-54,670	174,842	-89,394	110,308
Estimated change in provisions for off-balance sheet liabilities tested individually	-9,459	87,435	-9,585	85,197

Effect of an increase/decrease in LGD on impairment losses/provisions – tested collectively	31.12.2017		31.12.2016	
Increase/decrease in LGD	**+ 10%**	**- 10%**	**+ 10%**	**- 10%**
Estimated change in impairment losses on on-balance sheet exposures tested collectively	6,377	-16,305	10,376	-15,602
Estimated change in provisions for off-balance sheet liabilities tested collectively	318	-339	238	-249

Effect of an increase/decrease in PD and LGD on impairment losses or IBNR provisions	31.12.2017		31.12.2016	
Increase/decrease in PD	**+ 10%**	**- 10%**	**+ 10%**	**- 10%**
Estimated change in IBNR provisions for on-balance sheet exposures	22,152	-22,152	21,730	-21,730
Estimated change in IBNR provisions for off-balance sheet liabilities	14,168	-14,168	10,742	-10,742
Increase/decrease in LGD	**+ 10%**	**- 10%**	**+ 10%**	**- 10%**
Estimated change in IBNR provisions for on-balance sheet exposures	22,152	-22,152	21,730	-21,730
Estimated change in IBNR provisions for off-balance sheet liabilities	14,145	-14,168	10,714	-10,742

2.5.2 Fair value of derivatives and unlisted debt securities available for sale

The fair value of derivatives and unlisted debt securities available for sale and recognised in the statement of financial position with no active market identified are measured using generally accepted measurement techniques, based on input data observable to the maximum extent possible and based on professional judgement. The measurement techniques and input data are reviewed on a regular basis. Financial instrument measurement principles have been discussed in Note 2.9.5 "Measurement of financial assets and financial liabilities".

An estimated effect of changes in the fair value measurement of derivatives with a symmetrical risk profile and of unlisted debt securities available for sale due to a parallel shift in the yield curve is presented below:

- Change in the measurement of derivatives with a linear risk profile due to a parallel shift in the yield curve:

	31.12.2017		31.12.2016	
Change in the measurement of derivatives with a linear risk profile due to a parallel shift in the yield curve by:	**+ 50bp**	**- 50bp**	**+ 50bp**	**- 50bp**
Change in measurement of derivative instruments (assets decreased by liabilities)	994	-994	2,634	-2,634

(in PLN '000)

- Change in the fair value measurement of unlisted debt securities available for sale in the context of a parallel shift in the yield curve:

	31.12.2017		31.12.2016	
Change in the measurement in the context of a parallel shift in the yield curve by:	**+ 50bp**	**- 50bp**	**+ 50bp**	**- 50bp**
Change in the measurement of unlisted financial instruments available for sale	-17,988	17,988	-9,044	9,044

2.5.3 Provisions for defined benefit plans and other provisions

A sensitivity analysis of provisions for defined benefit plans and explanations about other provisions (including those related to the National Housing Fund) have been presented in Note 33 "Provisions".

2.5.4 Deferred tax assets

The Capital Group recognises deferred tax assets based on the assumption that it will generate taxable profit sufficient to realize the assets in the future. If the actual tax results were to deteriorate in the future, the above assumption might prove baseless.

2.6. Presentation of the balance sheet and the profit and loss account of the Parent

Apart from own activities, the parent carries out commissioned activities via the following funds:

- fund associated with granting loans and advances or off-balance sheet liabilities – "funds exposed to credit risk":
  - The Inland Waterways Fund (IWF),
- funds associated with managing cash flows for specific budgetary targets – "cash flow funds", comprising:
  - Krajowy Fundusz Drogowy (the National Road Fund),
  - Fundusz Kolejowy (the Railway Fund),
  - Fundusz Termomodernizacji i Remontów (the Thermomodernisation and Repair Fund),
  - Fundusz Pożyczek i Kredytów Studenckich (the Student Loan Fund),
  - Fundusz Dopłat (the Subsidy Fund),
  - Fundusz Wsparcia Kredytobiorców (the Borrower Support Fund).

The Parent maintains separate accounting records for funds related to commissioned activities. Indirect costs are recognised in profit or loss of the funds related to commissioned activities as a result of allocation based on internal regulations.

The financial data of the Parent comprising own activities and commissioned activities carried out through the funds exposed to credit risk are prepared by adding up the respective balance sheet, off-balance sheet as well as profit and loss account items concerning the Bank's own activities and the activities of the said funds, with elimination of transactions between the Bank carrying out its own activities and the funds exposed to credit risk related to commissioned activities.

The assets and liabilities of the funds exposed to credit risk are presented within the assets and liabilities of the Parent, with the related financing being presented as "Other liabilities".

The profit and loss account of the Parent presents revenue and costs on own activities and funds exposed to credit risk.

The net profit generated on the activities of the funds exposed to credit risk is used, in accordance with the Bank's articles of association, to supplement said funds and also to increase the supplementary capital of the parent.

In accordance with articles of association of the Bank, any losses on the activities of the funds established, entrusted or transferred to the Parent under separate legislation, are offset against such funds.

The assets and liabilities of the cash flow funds are not presented on the Parent's balance sheet as they do not meet the definition of the Bank's assets and liabilities. The Parent, under relevant legislation, is responsible for financial and operational policies of the cash flow funds but it does not control them or derive any economic benefits from their operations or bear the credit risk related to such assets.

2.7. Consolidation principles

2.7.1 Subsidiaries

The consolidated financial statements comprise the financial statements of the Bank and the financial statements of its subsidiaries, prepared for the year ending 31 December 2017. The accounting policies applied by the subsidiaries are in line with PAS.

The financial data of the consolidated subsidiaries, taking account of the adjustments made to bring them into line with IFRS, are prepared for the same reporting period as the financial statements of the Parent, in line with consistent accounting principles applied to similar transactions and business events.

Subsidiaries are consolidated in the period from the date when the Capital Group assumes control of those entities to the date when control is no longer exercised. It is assumed that the Parent only if:

- it has power over the investee,
- it is exposed to variable returns from its involvement with the investee or it has the right to such variable returns,
- it has the ability to use its power over the investee to affect the amount of its returns.

If the facts and circumstances indicate that at least one of the aforesaid three elements of control has changed, the Capital Group has to reassess whether or not it still controls the entity.

When assessing whether or not it has control over an investee if it holds less than the majority of voting rights in that investee, the Bank considers other facts and circumstances to determine whether or not it has power over that investee, with particular focus on the contractual arrangements between the Capital Group and other holders of voting rights, rights resulting from other contractual arrangements, voting rights held by the Capital Group as well as potential voting rights.

In the consolidated financial statements:

- similar items of assets, liabilities, equity, income, expenses and cash flows of the Parent and its subsidiaries are aggregated;
- the carrying amount of the Parent's investment in each subsidiary and the portion of equity of each subsidiary attributable to the Parent are offset (eliminated);
- intra-group assets and liabilities, equity, income, expenses and cash flows resulting from transactions between the Capital Group entities are eliminated in whole.

2.7.2 Associates

An associate is an entity over which the Capital Group has significant influence, i.e. the power to participate in decisions about the financial and operating policy of the investee but not control or joint control of policies of that unit.

The financial statements of associates (in line with the PAS) and of the Parent are prepared for the same reporting period.

In the consolidated financial statements, the associates are recognised using the equity method. Before calculation of the share in the net assets of the associates, appropriate adjustments are made to ensure compliance between the financial information of those entities and IFRS, as applied by the Capital Group.

The consolidated financial statements present the Capital Group's share of profit or loss of associates determined by reference to its interest in their equity, from the date when significant influence begins to be exercised to the date when it expires. If the Capital Group's share of loss of an associate exceeds the value of interest in that associate, the carrying amount is reduced to zero. At that point, no additional losses are recognised, except those resulting from the Capital Group's assumption of legal or constructive obligations or from a payment made on behalf of an associate.

2.8. Foreign currencies

2.8.1 Functional and presentation currency

The Polish zloty is the functional currency (the currency of the primary economic environment where the Capital Group operates) of the Parent and other entities presented in these financial statements, except for Fundusz Ekspansji Zagranicznej FIZ AN (Foreign Expansion Closed-End Investment Private Equity Fund). EUR is the functional and presentation currency of Fundusz Ekspansji Zagranicznej FIZ AN (Foreign Expansion Closed-End Investment Private Equity Fund).

Figures in the consolidated financial statements are presented in the Polish zloty.

2.8.2 Translation of financial data of the Capital Group entities

Assets and liabilities relating to the investment in Fundusz Ekspansji Zagranicznej FIZ AN (Foreign Expansion Closed-End Investment Private Equity Fund), as recognised in the consolidated financial statements, were translated from the euro, i.e. the functional currency of the Fund, into the Polish zloty at the following exchange rates:

- translation of on-balance sheet items as at 31 December 2017 – the average exchange rate of the National Bank of Poland as at 31 December 2017: 4.1709, except for retained earnings which employs an arithmetic mean of the average exchange rates as at the last day of each month in which the Fund carried out activity,

(in PLN '000)

- translation of items of the profit and loss statement for 2017 – the arithmetic mean of the average exchange rates determined by the National Bank of Poland as at the last day of each month was used, i.e. January-December 2017: 4.2447.

Foreign exchange gains or losses on the measurement of the Fund are recognised in other comprehensive income.

2.8.3 Translation of foreign currency items

Foreign exchange gains and losses arising from the settlement of transactions and the accounting measurement of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss. Foreign exchange differences arising from translation of equity instruments classified as available-for-sale financial assets are recognised in other comprehensive income.

At the end of each reporting period:
- foreign currency monetary items are translated at the closing rate,
- non-monetary items measured at historical price of purchase or manufacturing in a foreign currency are translated at the exchange rate as at the date of transaction.
- non-monetary items measured at fair value expressed in a foreign currency are translated using the exchange rates applicable as at the date on which the fair value was specified.

Assets, liabilities, and off-balance liabilities denominated in foreign currencies and indexed to a foreign exchange rate are measured at the average exchange rate set for a given currency by the National Bank of Poland as at the balance sheet date.

Average exchange rates of selected foreign currencies relative to the Polish zloty:

Currency	As at 31.12.2017	As at 31.12.2016
EUR	4.1709	4.4240
GBP	4.7001	5.1445
USD	3.4813	4.1793
CHF	3.5672	4.1173

2.9. Financial assets and financial liabilities

2.9.1 Classification

The Capital Group classifies financial assets to the following categories:
- financial assets measured as measured at fair value through profit or loss,
- held-to-maturity financial assets,
- loans and receivables,
- available-for-sale financial assets.

Financial liabilities are classified as financial liabilities measured at fair value through profit or loss or other financial liabilities.

The Capital Group makes decisions regarding the classification of financial assets and financial liabilities at initial recognition.

2.9.1.1 Financial assets and liabilities measured at fair value through profit or loss

Assets and liabilities measured at fair value through profit or loss are items of financial assets and liabilities which meet any of the following conditions:
- financial assets or financial liabilities are classified as held for trading if acquired or incurred principally for the purpose of selling or repurchasing it in the near term; at initial recognition they are part of a portfolio managed collectively and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also classified as held for trading (unless they are a financial guarantee contract)
- at initial recognition they have been designated as measured at fair value through profit or loss. The Capital Group may indicate such a designation only where:
  – such classification eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch' that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases);
  – a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management an investment strategy, with information on the group being provided on this basis to the Bank's management.

2.9.1.2 Held-to-maturity financial assets

These are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Capital Group has an intention and ability to hold them to maturity, other than:

- designated at initial recognition as measured at fair value through profit or loss,
- designated as available for sale,
- meeting the definition of loans and receivables.

2.9.1.3 Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- financial assets which the Capital Group intends to sell immediately or in the near future and which are classified as held for trading, and those that at initial recognition were designated as measured at fair value through profit or loss,
- financial assets that the Capital Group at initial recognition designated as available for sale,
- for reasons other than credit deterioration, which shall be classified as available for sale, financial assets for which the holder may not recover substantially all of his initial investment.

2.9.1.4 Available-for-sale financial assets

Available for sale financial assets are non-derivative financial assets financial assets that are designated as available for sale measured at fair value through profit or loss, loans and receivables or held-to-maturity investments.

2.9.1.5 Other financial liabilities

Other financial liabilities are financial liabilities arising out of a contractual obligation for the release of cash or other financial asset to any other entity and not classified to the group of liabilities measured at fair value through profit or loss and being a deposit or a loan.

2.9.2 Reclassification of financial assets

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified by the Capital Group entities from available for sale to loans and receivables if the Capital Group has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

The fair value of the financial asset at the reclassification date is treated as its new amortised cost.

The Capital Group may reclassify financial instruments classified as held-for-trading (other than derivatives) and designated as measured at initial recognition as measured at fair value to loans and receivables if the instrument is no longer held to be sold or repurchased in the near term. In order to be reclassified, a financial asset has to meet the definition of loans and receivables and the Capital Group needs to have the intention and ability to hold the financial asset in the foreseeable future or until maturity.

2.9.3 Recognition of transactions in the accounting record

The Capital Group recognises a financial asset or a financial liability in the consolidated statement of financial position when they become a party to the relevant instrument. Purchases and sale of financial assets measured at fair value through profit or loss, held to maturity and available for sale are recognised in line with the recognition principle that applies to all such transactions at the date of conclusion of the transaction.

2.9.4 Derecognition of financial assets and financial liabilities from the consolidated statement of financial position

A financial asset is derecognised from the consolidated statement of financial position the moment the contractual rights to the cash flows from the financial asset expire, or when the asset is being transferred.
While transferring a financial asset, the Capital Group evaluates the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:

- if the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity derecognises the financial asset from the consolidated statement of financial position and separately recognises as assets or obligations all the rights and obligations arising or maintained as a result of transfer,
- if the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity continues to recognise the financial asset,
- if the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the Capital Group determines whether it should retain control of the financial asset. If no control is maintained, the financial asset is derecognised from the statement of financial position and separately recognised as assets or liabilities all the rights and obligations arising or maintained as a result of transfer. If control over a given financial asset is maintained, it is continued to be recognised in the same degree as the involvement in that financial asset.

The Capital Group derecognises a financial liability (or its part) from its consolidated statement of financial position when the obligation specified in the contract is discharged or cancelled or expires.

The Capital Group derecognises loans and receivables or their parts from the consolidated statement of financial position when the rights under the relevant loan agreement expire, are waived or when the amounts due are sold.

2.9.5 Measurement of financial assets and financial liabilities

2.9.5.1 Assets and liabilities measured at fair value through profit or loss

Assets and liabilities are measured at fair value, while the effects of the measurement are recognised in profit or loss. Any gains or losses resulting from changes in the fair value of the aforesaid instruments as at the end of the reporting period are presented in the profit and loss account as “Gain/loss on financial instruments measured at fair value through profit or loss”. Interest received or paid is presented within interest income or interest expense, respectively, in line with the contract.

Derivative financial instruments are classified as financial assets or financial liabilities held for trading and they are measured at fair value.

Derivative financial instruments and forward and futures transactions with a symmetrical risk profile are measured using the NPV (net present value) technique. The present value of future cash flows is measured for each transaction based on properly constructed projection and discount curves. Projection curves are built based on quoted prices of deposits, FRA and IRS rates appropriate for a given currency and the reference rate. Discount curves are built based on quoted prices of deposits, FRA and IRS rates, business swaps, currency swap basis, as well as swap points. OIS transactions are measured using a curve based on OIS rates in the transaction currency. Market quotations for curve building purposes can be downloaded from generally accessible information systems. Derivatives and forward and futures transactions denominated in a currency other than the Polish zloty are measured by reference to the average exchange rate of the National Bank of Poland as at the measurement date.

Transactions with an asymmetrical risk profile (option transactions) are measured using Black’s models, which are widely used on the market and rely on the implied volatility curves (if quoted market prices are available) or historical volatility curves (determined with the use of statistical models based on quoted market prices).

The fair value of derivatives takes into account the entity’s own credit risk and the counterparty risk. For derivatives, the credit value adjustment (CVA) and the debit value adjustment (DVA) are calculated.

In the financial statements, realized and unrealized gains (losses), including the effects of changes in the measurement of such derivatives as FX FORWARD, FX SWAP (including swap points), CIRS or FX options are recognised on an aggregate basis within “Foreign exchange gains or losses on transactions”. Realized gains (losses) and the effects of the measurement of such derivatives as FRA, IRS or OIS are recognised within “Gain/loss on financial instruments held for trading”. Derivatives in the financial statements are presented on a net basis at the transaction level (positive fair value as assets and negative fair values as liabilities).

2.9.5.2 Loans, receivables and held-to-maturity financial assets

Loans and receivables, and held-to-maturity financial assets are measured at amortised cost with the use of the effective interest rate method and taking into account impairment.

Amortised cost is determined with regard to a discount or a premium as well as fees, charges and transaction costs, which form an integral part of the effective interest rate, while the effects of the measurement are recognised as “Interest income” in profit and loss account. Impairment losses are recognised in profit or loss as “Net impairment losses and provisions”.

2.9.5.3 Available-for-sale financial assets

Available-for-sale financial assets are measured at fair value, while the effects of changes in the fair value (except impairment losses) are recognised in other comprehensive income (other comprehensive income is accumulated within the “Revaluation reserve”) until an asset is removed from the consolidated statement of financial position, at which time accumulated gains (losses) are recognised in profit and loss account. The revaluation reserve is recognised in profit or loss when the asset is sold or when objective evidence of its impairment is identified. When evidence of impairment of an asset is identified, any prior increases in its value resulting from fair value measurement reduce the revaluation reserve. If the prior increase amount is insufficient to offset the impairment loss, the difference is recognised in profit or loss.

In the case of debt instruments, interest income and a discount or a premium are deferred – with the use of an effective interest rate and recognised in net interest income as “Interest income”.

In the case of equity instruments, dividends relating to equity instruments classified as available for sale are recognised in profit or loss when the Capital Group’s right to receive payment is established.

If the fair value of investments in equity instruments which are not quoted on an active market cannot be estimated reliably using measurement techniques, they are recognised at cost of purchase and their impairment is reviewed periodically. Impairment losses are recognised in profit or loss as “Net impairment losses and provisions”.

Quoted market prices based on which the fair value of government debt securities is measured are obtained from widely available information systems. Where no quoted market prices are available for a debt security (municipal bonds, commercial bonds etc.), the fair value is not determined on the basis of the quoted market prices but using the NPV (net present value) technique. The present value is calculated by reference to market yield curves obtained from widely available information systems (zero-coupon yield curves or curves based on the yield on government debt securities are used, depending on the security type). For non-government debt securities, the present value of future cash flows is determined considering the issuer credit risk and the liquidity risk spread.

Available-for-sale financial assets include in particular stock, shares, debt securities

2.9.5.4 Other financial liabilities, including those arising from issue of securities

Financial liabilities other than those measured at fair value through profit or loss are measured at amortised cost using the effective interest rate method. If a schedule of future cash flows cannot be determined for a financial liability which means that an effective interest rate cannot be identified, the liability is measured at the amount due.

Debt instruments issued by the Capital Group are presented as financial liabilities and measured at amortised cost.

2.9.6 Offset of financial instruments

Financial assets and financial liabilities are offset and presented on a net basis in the statement of financial position where the entity has an enforceable legal title to set off recognised amounts and the intention to settle them on a net basis or where the asset is realized and the liability discharged at the same time.

2.9.7 Repo and reverse repo transactions

Repo and sell-buy-back as well as reverse repo and buy-sell-back transactions are transactions involving the sale or purchase of securities with a commitment to repurchase or resell the security at an agreed date and at an agreed price.

Financial assets sold with a commitment to buy them back (repo and sell-buy-back transactions) are recognised by the Capital Group on its balance sheet, with liabilities arising from the commitment to buy the securities back as a corresponding entry under liabilities. Such a solution is possible only where the Capital Group retains the risks and rewards of ownership of the financial asset despite its transfer.

For transactions involving the purchase of securities with a commitment to resell them (reverse repo and buy-sell-back), the financial assets held by the Bank are presented as receivables arising from the repurchase clause.

Repo, reverse repo, sell-buy-back and buy-sell-back transactions are deferred, whereas securities in repo and sell-buy-back transactions are not derecognised from the statement of financial position and are measured using the principles applicable to the relevant portfolios of securities. The difference between the sale/purchase and repurchase/resale price is treated as interest expense or income and deferred over the term of agreement.

2.9.8 Fair value of financial instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in a standard transaction between market participants on the main (or more favourable) market at the measurement date in the current market conditions (i.e. entry price), regardless of whether that amount is directly observed or evaluated using a different measurement technique.

The fair value of financial instruments which are quoted on an active, organised financial market is determined by reference to the current purchase price (for an asset) or the current sale price (for a liability).

Where the Capital Group concludes that the fair value at initial recognition differs from the transaction price, the instrument is settled as at that date in line with the following principles:

- if the fair value is reflected by the price quoted on an active market for an identical asset or an identical liability or is based on a measurement technique that relies only on observable market data, the Capital Group recognises the difference between the fair value at initial recognition and the transaction price as a gain or loss,
- otherwise in line with the measurement adjusted so as to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the deferred difference is recognised as a gain or loss insofar as it results from a change in a factor (including time) that would be considered by the market participants in the course of measurement of the asset or liability.

2.10. Impairment of financial assets

2.10.1 Assets measured at amortised cost

2.10.1.1. Loans and advances granted

As at the balance sheet date, the Capital Group verifies for loans and advances whether there is any objective evidence that a financial asset or a group of financial assets may be impaired. If any such evidence exists, the Capital Group estimates the related impairment losses. An impairment loss is incurred if there is objective evidence of impairment resulting from one or more events occurring after the initial recognition of an asset ("triggering event") and the event affects the estimated future cash flows resulting from a financial asset or a group of financial assets which may be estimated reliably.

Objective evidence of impairment of a financial asset or a group of financial assets includes, in particular, information concerning the following events:

- serious financial difficulties of a customer,
- an issuer's or a debtor's default on their obligations under a relevant contract, e.g. a failure to pay interest or repay principal or a delay in their payment/repayment,
- an arrangement made by the Capital Group with a contracting party for economic or legal reasons due to the contracting party's financial difficulties, which would not have been made otherwise.

Credit exposures for which no objective evidence of impairment was identified at the individual level or for which no impairment losses were recognised despite such evidence is tested for impairment as part of a group of exposures with similar characteristics.

The Capital Group classifies its loan receivables based on the size of exposure.

Each credit exposure in the portfolio of individually significant exposures is individually tested to determine the existence of evidence of impairment and the level of recognised impairment losses. For individually insignificant exposures, impairment losses are recognised and measured based on portfolio risk parameters estimated using statistical methods. If an individual credit exposure is found to be impaired, an appropriate impairment loss is recognised. If no impairment is recognised for an individual exposure, the exposure is included in a portfolio of assets with similar characteristics, which are tested collectively and an appropriate IBNR provision is recognised.

The IBNR provision is determined by reference to portfolio parameters which are estimated for groups of exposures with similar characteristics.

The amount of impairment loss and the IBNR provision is the difference between the carrying amount of an asset and the present value of estimated future cash flows (excluding future credit losses which have not been incurred yet), discounted using the effective interest rate as at the date when an evidence of impairment was identified for that financial asset.

The calculation of the present value of estimated future cash flows related to a collateralized financial asset takes into account cash flows resulting from the use of the collateral, less the cost to use it and cost to sell it.

When impairment losses are determined using the individual method, future cash flows are estimated taking account of the relevant background and probable exposure management scenarios.

Impairment losses on exposures which are not tested individually are estimated by reference to the following portfolio parameters:

- the recovery rates estimated for groups of exposures with similar characteristics,
- the probability of default of a liability (for exposures from the IBNR portfolio).

Future cash flows related to a group of financial assets that are collectively tested for impairment are estimated based on contractual cash flows and historical recovery parameters for assets with similar risk characteristics.

The selection of data used to estimate portfolio parameters is carried out so as to ensure that they are representative for the current economic situation.

If, in the subsequent period, the value of the impairment drops as a result of an event occurring after the impairment was recognised (e.g. improved creditworthiness of a debtor), the impairment loss recognised before is reversed through an appropriate adjustment to the impairment loss account. The reversal amount is recognised in profit or loss.

The impairment loss measurement methodology is reviewed regularly so as to reduce the differences between the estimated and actual losses to the minimum.

For a given credit exposure the Capital Group may employ restructuring measures in the form of an arrangement with a borrower that is experiencing or will soon begin to experience difficulties in complying with their financial liabilities. Such arrangements may include:

- modification of the existing terms of the agreement which may not be complied with by the borrower due to financial difficulties leading to an insufficient capacity to service the loan,
- refinancing the loan agreement at risk in whole or in part, which would not be the case if the borrower did not encounter financial difficulties.

2.10.1.2. Held-to-maturity financial assets

At each reporting balance sheet date, the Capital Group tests its held-to-maturity financial assets for impairment individually. If there is objective evidence of impairment, the amount of the impairment loss is equal to the difference between the carrying amount of an asset and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the impairment loss is recognised in profit and loss account within "Net impairment losses and provisions".

If the impairment loss decreases in the subsequent period and the decrease can be objectively linked to an event taking place after the recognition of the loss, the prior impairment loss is reversed. Reversals of impairment losses are recognised in profit and loss account within "Net impairment losses and provisions".

2.10.2 Available-for-sale financial assets

At the end of each reporting period, the Capital Group verifies whether there is any objective evidence that a financial asset classified as available for sale may be impaired for sale. If any such evidence exists, the Bank estimates the related impairment losses.

Objective evidence of impairment pertains to information concerning the following events:

- serious financial difficulties of a customer or debtor;
- default on obligations under a relevant contract, e.g. a failure to pay interest or repay principal or a delay in their payment/repayment;
- an arrangement made by the lender with a borrower for economic or legal reasons due to the contracting party's financial difficulties, which would not have been made otherwise;
- a high probability of bankruptcy or another financial reorganisation of the borrower;
- disappearance of an active market for a given financial asset due to financial difficulties;
- a measurable decrease in future cash flows associated with a group of financial assets from their initial recognition, based on observable data, despite the fact that it is not possible to determine a decrease in a single asset from a group of financial assets, including:
  - negative changes in the payment status of borrowers in a group,
  - a national or local economic situation related to default at payment of assets in a group,
- obtained information about material adverse changes in the technology, market, economic, legal or other environment in which the Capital Group operates which indicate that the cost of investment in the equity instrument may not be recovered,
- a considerable and prolonged decrease in the fair value of investment in a specific instrument below the level determined at its initial recognition.

In the first place, the Capital Group verifies whether assets have been impaired, by testing individually their credit exposures which are individually significant.

If there is objective evidence of impairment of financial assets classified as debt instruments available for sale, the impairment loss is the difference between the carrying amount of an asset and the present fair value determined as the value of future cash flows discounted using market interest rates.

Impairment losses on assets available for sale are recognised in profit or loss, which calls for removal of accumulated losses on measurement which were previously recognised in other comprehensive income and their recognition in profit and loss account.

Impairment losses on investments in equity instruments classified as available for sale are not reversed through profit or loss. Any increases in their fair value after impairment losses are recognised directly in other comprehensive income.

If, in the subsequent period, the fair value of debt instruments increases and the increase can be objectively linked to an event occurring after the impairment loss has been recognised in profit or loss, the amount of the reversed impairment loss is recognised in profit and loss account within "Net impairment losses and provisions".

2.11. Leasing

The Capital Group is a party to lease agreements whereby it accepts or grants fixed assets and investment property for a fee for an agreed period of time.

The Capital Group classifies lease agreements with regard to extent to which the risks and rewards of ownership of the leased assets are allocated to the lessor and to the lessee.

The Capital Group has entered into lease agreements under which the lessor retains substantially all the risks and rewards of ownership of the leased assets, which are classified as operating leases. Operating lease payments and the subsequent rent are recognised in profit and loss account (over the term of lease).

2.12. Cash and cash equivalents

Cash and cash equivalents include cash in hand and in nostro account at the National Bank of Poland as well as cash in current accounts in banks and other cash with a maturity date of no more than 3 months and recognised at nominal value.

2.13. PP&E and intangible assets

2.13.1 Property, plant and equipment

Property, plant and equipment includes controlled fixed assets and expenditure on their development. These are assets of an estimated useful life exceeding one year, which are held for internal use or to be leased to third parties under a lease agreement, or for administrative purposes. Property, plant and equipment (PP&E) are recognised using purchasing or manufacturing cost model, i.e. after initial recognition they are measured at historical cost less depreciation and accumulated impairment losses. Historical cost is the cost of purchase and manufacture of an asset and expenses related directly to its purchase and being brought to a working condition.

PP&E items are measured at cost less depreciation and impairment losses.

2.13.2 Investment property

Investment property is a property (land or a building – or part of a building – or both) held by the Capital Group to earn rentals or for capital appreciation or both. At the same time, such property:
- is occupied by the Capital Group only to an inconsiderable extent,
- is not intended for sale in the ordinary course of the Capital Group's business.

Initially, investment property is recognised at purchasing or manufacturing cost. After initial recognition, its value is measured in the fair value model. Any gains or losses resulting from changes in its value are recognised in profit and loss account for the period when the changes occurred. The Capital Group is provided with valuation services by chartered surveyors.

2.13.3 Intangible assets

An intangible asset is an identifiable non-monetary asset without physical substance.

Initially, intangible assets are measured at purchasing or manufacturing cost. After initial recognition, intangible assets are recognised at purchasing or manufacturing cost less amortisation and impairment losses.

The Capital Group uses the right of perpetual usufruct of land, whether acquired for consideration or free of charge.

The right of perpetual usufruct of land acquired for consideration (from third parties) is presented within intangible assets and amortised over its useful life.

The right of perpetual usufruct of land acquired free of charge from the State Treasury is not presented on the balance sheet.

Intangible assets of the Capital Group include assets with an estimated useful life of over one year, in particular: copyrights, licences, the right of perpetual usufruct of land, and costs of complete developmental work.

2.13.4 Depreciation and amortisation

Depreciation and amortisation apply to all PP&E items whose value is reduced as a result of their use or the passage of time, over their estimated useful lives.

At the time of their purchase, PP&E is divided into components of material value, to which separate useful lives may be assigned. Each component whose purchasing or manufacturing cost is material relative to the purchasing or manufacturing cost of the item as a whole is depreciated separately.

(in PLN '000)

PP&E and intangible assets are depreciated/amortised over their estimated useful lives, starting from the first day of the month following immediately the month when the item was made available for use.

It is assumed that the residual value of intangible assets is zero, unless a third party is obliged to repurchase such assets or if an active market where the value of the asset may be measured exists and will exist at the end of the useful life of the asset.

Depreciation and amortisation periods for groups of PP&E and intangible assets, as applicable at the Capital Group:

Property, plant and equipment	Amortisation/depreciation periods
Buildings, premises, cooperative rights to premises	from 40 to 49 years
Leasehold improvements (to buildings and premises)	from 2 to 10 years
Machines, technical equipment, tools and devices	from 5 to 18 years
Computer sets	from 1 to 11 years
Means of transport	from 2 to 5 years

Intangible assets	Amortisation/depreciation periods
Software	from 2 to 11 years
Other intangible assets	from 2 to 5 years
Right of perpetual usufruct of land	from 42 to 87 years

The residual value, useful life and depreciation/amortisation method are reviewed on an annual basis and adjusted if necessary.

2.13.5 Impairment losses on PP&E

At the end of each reporting period, the Capital Group verifies whether or not there is any evidence of impairment of their PP&E. The Capital Group estimates the recoverable amount as the fair value less cost of sale or the value in use of a PP&E item (whichever is higher) if such evidence is identified and annually for intangible assets which are not amortised. To estimate these values, the Capital Group needs to make assumptions, e.g. about estimated future cash flows which they may generate through continued use or sale of PP&E. Adoption of different assumptions about the measurement of future cash flows may have an effect on the carrying amounts of some PP&E items.

If the recoverable amount of a single asset cannot be estimated, the Capital Group estimates the recoverable amount of the cash generating unit to which the asset belongs (CGU).

Impairment losses are recognised where the carrying amount of the asset exceeds its recoverable amount.

Impairment losses are reversed in the event of a change in the estimates of recoverable amount. The carrying amount of an asset which is increased through reversal of an impairment loss should not exceed the carrying amount that would have been determined had no impairment loss been recognised on that asset in the preceding years. Reversals of impairment losses on assets are recognised in profit or loss.

2.14. Prepayments and accruals

Prepayments are recognised if the expenses pertain to months following the month when they were incurred. Prepayments are recognised in the statement of financial position within "Other assets". They include mainly prepaid expenses and accrued revenue. Prepaid expenses include different types of expenses that will be recognised in profit or loss after the lapse of time, in future reporting periods, such as prepaid rental costs, insurance costs, and software maintenance.

Accrued revenue includes mainly fees and charges due to deliveries and services, receivables due to settlements under management of funds and programmes. Receivables are revalued based on the probability of their payment, through recognition of appropriate impairment losses.

Accrued expenses include costs of services provided to the Capital Group which have not been classified as liabilities yet. Accruals include expenses to be incurred by the Capital Group in the future, including the cost of bonuses, outstanding sick leaves, and jubilee awards. The Capital Group settles accrued revenue where it receives payments for a service provided or goods delivered to be effected in future reporting periods. This in particular comprises deferred commissions and other income collected in advance whose recognition in profit and loss account will be effected in future reporting periods.

Accrued expenses and deferred income are presented in the statement of financial position in "Other liabilities".

2.15. Provisions

Provisions are liabilities the amount or due date of which are not certain. They are recognised when the Capital Group has a present (legal or constructive) obligation as a result of a past event, while it is probable that an outflow of resources embodying economic benefits will be required to fulfil the obligation and the amount of the obligation can be estimated reliably.

Where the effect of the time value of money is material, the amount of provision is determined by discounting estimated future cash flows to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and any potential risks specific to the liability.

The Capital Group recognises provisions in particular for disputes with its contracting parties, customers and third-party institutions, provisions for retirement, disability and survivor benefits, and provisions for liabilities and guarantees.

2.16. Employee benefits

Short-term employee benefits in the Capital Group include benefits due within twelve months of the date on which work was executed, such as salaries, wages, bonuses, paid annual leave, and social security contributions. The Capital Group recognises the estimated undiscounted amount of short-term employee benefits as an expense in the period they concern.

Long-term employee benefits in the Capital Group include benefits which are not due within twelve months of the date on which work was executed, such as retirement, disability, death, and jubilee benefits. The related provision is measured using actuarial methods by a third-party actuary as the present value of the Capital Group's future liabilities to its employees considering the payroll and the level of salaries and wages as at the measurement date. Provision for employee benefits is presented within liabilities as "Provisions" or "Other liabilities" and as "General administrative expenses" in profit and loss account in the part resulting from the current service cost and the lapse of time. A certain amount of provisions for retirement, disability, and death benefits resulting from changes in actuarial (economic and demographic) assumptions made for purposes of measurement is recognised in other comprehensive income. The Capital Group offers a post-employment benefit plan, known as the defined contribution plan, Whereby it has a contractual obligation to make defined contributions to an employee pension plan. The fund, which also includes a return on invested contributions, is used for payment of post-employment benefits to employees. As a result, the Capital Group is not subject to a legal or constructive obligation to make additional contributions, if the pension fund's assets are insufficient to finance the benefits.

2.17. Off-balance sheet liabilities granted

In the course of their operations, the Capital Group enters into transactions which are not recognised in the statement of financial position as assets or liabilities at the conclusion date but result in the occurrence of contingent liabilities. A contingent liability is:

- a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Capital Group,
- a present obligation that arises from past events but is not recognised in the statement of financial position because it is not probable that an outflow of funds or other assets will be required to settle the obligation or the amount of obligation cannot be measured with sufficient reliability.

The Bank recognises provisions for off-balance sheet liabilities granted and involving the risk of the principal's non-compliance with the agreement, in accordance with IAS 37.

Off-balance sheet liabilities granted include mainly credit commitments and guarantees granted. At initial recognition, a financial guarantee agreement is measured at fair value. After initial recognition, it is measured at the following values (whichever is higher):

- the value determined in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets", and
- the gross value reduced, where appropriate, by accumulated amortisation in line with IAS 18 "Revenue".

2.18. Equity

Classification into the items presented below is made in compliance with the requirements of the Banking Law, the Act on Bank Gospodarstwa Krajowego, and the articles of association adopted by way of Regulation of the Minister of Development of 16 September 2016 on the adoption of the articles of association of Bank Gospodarstwa Krajowego. Equity comprises: statutory capital, supplementary capital, revaluation reserve (available-for-sale financial assets, actuarial gains and losses), other reserve capitals (general banking risk reserve, other capitals), retained profit (accumulated loss), and and profit/loss for the current period.

Items of equity of the subsidiaries, other than their share capital, to the extent that the Parent is the owner of the subsidiary, are added to the relevant items of the Parent's equity.

The equities of the Capital Group comprise only those parts of equities of subsidiaries which emerged after the acquisition of shares or stock by the Parent.

2.19. Measurement of profit/loss

2.19.1 Interest income and expense

Interest income comprises interest and fees (received or due) taken into account in the calculation of the effective interest rate for loans with agreed repayment schedules, interbank deposits, and securities held to maturity, available for sale and held for trading as well as financial instruments classified as measured at fair value through profit or loss at initial recognition.

Interest income on financial assets or a group of similar financial assets for which impairment losses were recognised with an identification of impairment interest adjustment.

Income and expense related to the interest portion of gain/loss on interest rate derivatives and resulting from ongoing calculation of swap points on FX derivatives from the banking book are recognised in the net interest income.

2.19.2 Fee and commission income and expense

Revenue, commission-related costs and bank charges concern mainly financial services offered by the Capital Group and comprise in particular: commissions on credits granted and guarantee liabilities, costs of securities operations, and management fees as well as costs related to the management of funds and programmes. Commissions/fees are settled in the period of transactions, except for commissions on administrative fees which are recognised on a one-off basis in profit and loss account.

Income and expense also include fees, whether received or paid, on financial instruments without an agreed repayment schedule. Fees on overdraft facilities, guarantees, and other revolving facilities are deferred and classified as commission-related income.

In relation to bancassurance products, parent, as the policyholder, offers free-of-charge insurance coverage to credit card holders in the form of an additional card functionality, which is an intangible part of the payment card and does not involve any additional fees on the part of the customer. Payment card insurance costs are deferred and recognised in profit and loss account as commissions.

2.19.3 Gain/loss on financial instruments measured at fair value through profit or loss

This item comprises gains and losses resulting from changes in the fair value of assets classified as held for trading and those which were designated as measured at fair value through profit or loss at initial recognition as well as foreign exchange gains or losses.

Foreign exchange gains or losses comprise positive and negative exchange differences, whether realized or not, resulting from the daily measurement of foreign currency assets and liabilities at the average exchange rate of the National Bank of Poland as at the end of the reporting period and from the fair value measurement of unrealized derivatives (FX FORWARD, FX SWAP, CIRS).

2.19.4 Gain/loss on investments in financial assets

Gain/loss on investments in financial assets comprises gains and losses arising from the sale of financial instruments classified as available for sale as well as dividend income.

2.19.5 Other operating revenue and expenses

Other operating revenue and expenses comprise revenue and expenses which are not directly related to banking operations.

Other operating revenue includes mainly: investment property measured at fair value, bad debt that has been recovered, damages, penalties, release of provisions for disputes and other receivables as well as from the sale of PP&E items and investment property.

Other operating expenses include mainly: donations, costs of debt collection and the costs of fair-value measurement and maintenance of investment property.

2.19.6 General administrative expenses

"General administrative expenses" includes costs relating to: employee benefits (including payroll and social insurance), material costs (including instalments under rental contracts), depreciation of fixed assets and intangible assets, along with taxes and fees.

2.19.7 Net impairment losses and provisions

“Net impairment losses and provisions” presents increases and decreases related to impairment losses on: balance-sheet and off-balance sheet items related to credits and loans (including purchased debt and fulfilled guarantees and sureties) of controlled entities and financial assets available for sale.

2.19.8 Share of profit or loss of associates

This item comprises the involvement of the Capital Group in profits and losses of its subsidiaries (in proportion to its relevant interest) in which it invested.

2.20. Income tax

Income tax consists of current tax and and deferred tax. Income tax is recognised in profit and loss account. Deferred tax, depending on the source of the temporary differences, is recognised in profit and loss account or in the statement of comprehensive income.

2.20.1 Current tax

Current tax is a tax liability related to taxable profit and determined using a tax rate in effect as at the end of the reporting period.

2.20.2 Deferred tax

Deferred tax is recognised as the difference between the tax value of assets and liabilities and their carrying amount for purposes of financial reporting. The Capital Group recognises deferred tax assets and provision. Deferred tax assets and provision of the Capital Group are recognised in the consolidated statement of financial position as assets or liabilities, as the case may be. A change in the deferred tax liabilities and assets is recognised as a statutory withholding from profit, except for the effects of measurement of available-for-sale financial assets and actuarial gains and losses recognised in other comprehensive income, in case of which changes in the deferred tax liabilities and assets are also recognised in other comprehensive income. Deferred tax is measured by reference to the deferred tax assets and provisions at the beginning and at the end of the reporting period.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that future taxable profit will be available against which the deferred tax assets can be realized in whole or in part.

The deferred tax assets and provisions are measured by reference to tax rates expected to be applicable in the period when the assets are realized or the provision – derecognised, assuming tax rates (and tax regulations) in effect at the end of the reporting period or those certain to enter into force in the future as at the end of the reporting period.

With regard to deferred income tax the Capital Group applies a 19% rate, except for entities which, based on Art. 19 sec. 1 item 2 of the Act on Corporate Income Tax, apply a 15% rate. The Bank offsets deferred income tax assets against deferred income tax provisions if and only if they have an enforceable legal title to offset their current tax assets with provisions, whereas deferred tax concerns the same tax and the same tax authority.

3. Information on operating segments

In compliance with IFRS 8, information on operating segments is presented on the basis of the reporting structure used for internal reporting to the Management Board of the Bank.

Financing investments and enterprise development, supporting exports and construction as well as services to public sector and local government units are the major areas of growth.

Four operating segments have been identified for the purpose of evaluation of the nature and financial consequences of the operations carried out by the Capital Group entities and the economic environment in which they carry on their business:

- Settlement and Treasury – the segment identification criteria are liquidity and financial risk management (including interbank deposits and placements, repo, buy-sell-back and sell-buy-back transactions, money bills, T-bonds, commercial bank bonds, nostro account and the account at the National Bank of Poland, derivatives), deposit and derivative services at the request of the Ministry of Finance as well as financing the Bank’s operations in the medium and long term (loans obtained from financial institutions and issues of own bonds). This segment includes also gain/loss on internal fund transfer pricing settlements with the remaining segments.

  The internal fund transfers are based on transfer pricing rates determined by reference to market rates and the cost of liquidity, while inter-segment transactions are made on arm’s length terms.

(in PLN '000)

- Public Sector comprises transactions with central and local government institutions, excluding those items which fall within the scope of Settlement and Treasury and are related to deposits and derivatives for the Ministry of Finance. The segment identification criterion is based on customer classification for management reporting purposes and comprises local government units, central budget entities, and public health care institutions. The key products generating the segment's revenue are loans granted, bonds acquired by the Capital Group as well as current accounts and term deposits.
- Corporate – the segment identification criterion was established based on customer classification for management reporting purposes and the type of business, which includes private companies and state-owned enterprises, municipal companies, private health care institutions as well as entities supporting the Bank's exports and construction support activities. The key products generating the segment's revenue are corporate loans and project finance products (offered individually or as part of a consortium) in the form of loans and issues of non-Treasury securities, sureties and guarantees as well as current accounts and term deposits (recognised as liabilities).
- Other – comprises the Bank's investing activities, mainly in the form of acquired investment fund certificates (in the consolidated financial statements, certificates issued by funds with the majority interest held by BGK are recognised as shares in associates), shares (mainly in subsidiaries) and their effect on the consolidated financial statements, other shares, and investment property. Additionally, this segment presents items related to and performance of the funds and programmes administered by the Bank as well as items which are not recognised in any other segment, such as transactions with financial sector entities other than banks or services provided to individuals, which are being discontinued.

3.1. Selected items of the profit and loss account and the statement of financial position

The tables below present data on revenue, costs, and performance of each operating segment of the Bank Gospodarstwa Krajowego Capital Group for 2017 and 2016 as well as assets and liabilities as at 31 December 2017 and 31 December 2016.

Information on operating segments					
for the year ending on 31 December 2017	Continuing operations				
	Settlement and Treasury	Public sector	Corporate	Other	Total Capital Group
Net interest income*	433,861	71,991	241,453	28,801	**776,106**
Fee and commission income	-1,072	46,065	98,108	13,495	**156,596**
Gain/loss on financial instruments measured at fair value through profit or loss	27,662	-194	0	-1,229	**26,239**
Gain/loss on investments in financial assets	20,520	0	0	10,058	**30,578**
Net banking income	**480,971**	**117,862**	**339,561**	**51,125**	**989,519**
Other operating revenue	0	0	2,872	99,486	**102,358**
Other operating expenses	366	0	-753	-29,343	**-29,730**
General administrative expenses**	-36,857	-96,931	-117,549	-142,712	**-394,049**
Net impairment losses and provisions	0	-6,096	-46,142	2,600	**-49,638**
Operating profit/loss	**444,480**	**14,835**	**177,989**	**-18,844**	**618,460**
Share of profit or loss of associates	0	0	0	71,992	**71,992**
Gross profit	**444,480**	**14,835**	**177,989**	**53,148**	**690,452**
Income tax					-106,013
Net profit					**584,439**

* The presentation of net interest income takes into account expenses/revenue related to internal fund transfers based on transfer prices determined by reference to market rates. Therefore, the figure is presented in the table on a net basis, without division into revenue and interest income.

** Operating expenses as well as depreciation and amortisation expense were allocated to each customer segment based on the cost of internal services determined in line with the allocation model adopted by the Bank.
Due to the indirect nature of allocation, depreciation and amortisation expense is presented to the management board without division into segments.

(in PLN '000)

Information on operating segments					
for the year ending on 31 December 2016	**Continuing operations**				
	Settlement and Treasury	**Public sector**	**Corporate**	**Other**	**Total Capital Group**
Net interest income*	343,761	62,525	193,139	52,152	651,577
Fee and commission income	404	36,286	74,805	8,558	120,053
Gain/loss on financial instruments measured at fair value through profit or loss	54,693	404	8,210	-8,668	54,639
Gain/loss on investments in financial assets	15,122	0	0	9,747	24,869
Net banking income	**413,980**	**99,215**	**276,154**	**61,789**	**851,138**
Other operating revenue	0	2,425	1,178	71,476	75,079
Other operating expenses	470	0	-876	-9,042	-9,448
General administrative expenses**	-27,826	-92,879	-116,794	-117,278	-354,777
Net impairment losses and provisions	0	-32,086	-189,282	-21,388	-242,756
Operating profit/loss	**386,624**	**-23,325**	**-29,620**	**-14,443**	**319,236**
Share of profit or loss of associates	0	0	0	-55,748	-55,748
Gross profit	**386,624**	**-23,325**	**-29,620**	**-70,191**	**263,488**
Income tax					-6,447
Net profit					**257,041**

* The presentation of net interest income takes into account expenses/revenue related to internal fund transfers based on transfer prices determined by reference to market rates. Therefore, the figure is presented in the table on a net basis, without division into revenue and interest income.

** Operating expenses as well as depreciation and amortisation expense were allocated to each customer segment based on the cost of internal services determined in line with the allocation model adopted by the Bank.
Due to the indirect nature of allocation, depreciation and amortisation expense is presented to the management board without division into segments.

Information on operating segments					
31.12.2017	**Continuing operations**				
	Settlement and Treasury	**Public sector**	**Corporate**	**Other**	**Total Capital Group**
Total assets	40,027,034	7,034,035	23,797,333	3,455,613	**74,314,015**
Total liabilities	21,896,679	7,267,642	23,086,251	1,982,409	**54,232,981**

Information on operating segments					
31.12.2016	**Continuing operations**				
	Settlement and Treasury	**Public sector**	**Corporate**	**Other**	**Total Capital Group**
Total assets	33,863,846	6,672,063	22,507,191	3,703,507	**66,746,607**
Total liabilities	23,632,908	14,478,595	13,566,018	2,299,477	**53,976,998**

3.2. Geography

The Capital Group operates within the territory of the Republic of Poland. Its operations focus on the Polish market.

(in PLN '000)

Notes to the consolidated profit and loss account

4. Interest income and expense

Interest income	2017	2016
Interest income calculated using the effective interest rate method for financial assets which are not measured at fair value through profit or loss, including:	**1,737,352**	**1,428,433**
From receivables from banks	128,517	97,377
From loans and advances to customers*, including:	840,396	732,572
- impaired loans (under IAS 39)	38,912	53,126
From available-for-sale financial assets	768,439	598,484
Other income	**88,880**	**82,199**
From financial assets held for trading, including:	85,395	78,699
- from derivatives – banking book:	57,213	68,546
From assets designated as measured at fair value at initial recognition	3,485	3,500
Total	**1,826,232**	**1,510,632**

* Revenue for 2017 comprises the recognition of full interest revenue for exposures where evidence of impairment expired in the financial year. Reverse impairment interest adjustment amounts to PLN 23,090 thousand.

Interest expense	2017	2016
Interest expense calculated using the effective interest rate method for financial liabilities which are not measured at fair value through profit or loss, including:	**921,255**	**727,929**
Related to liabilities to banks	11,146	6,261
Related to liabilities to customers	773,472	593,599
Related to debt securities issued	136,637	128,069
Related to debt securities (premium)	**122,924**	**118,423**
Related to derivatives – banking book	**5,947**	**12,676**
Other expense	**0**	**27**
Total	**1,050,126**	**859,055**

5. Fee and commission income and expense

Fee and commission income due to:	2017	2016
Securities operations	19,480	14,936
Settlements	11,044	9,884
Loans and advances granted	37,798	26,924
Custody activity	31	31
Fund and programme management	47,407	27,647
Guarantee commitments	36,158	33,210
Other	15,991	18,347
Total	**167,909**	**130,979**

Fee and commission expense related to:	2017	2016
Fee and commissions for operating services	1,375	1,120
Custody activity	1,122	1,348
Settlement activity	3,073	1,193
Fund and programme management	2,322	2,242
Guarantee commitments	237	237
Other	3,184	4,786
Total	**11,313**	**10,926**

(in PLN '000)

6. Gain/loss on financial instruments measured at fair value through profit or loss

Gain/loss on financial instruments measured at fair value through profit or loss	2017	2016
Gain/loss on financial instruments designated as measured at fair value at initial recognition, including:	**385**	**1,080**
Debt instruments	385	1,080
Gain/loss on financial instruments held for trading, including:	**372**	**8,219**
Debt instruments	-1,762	-2,760
Derivatives	2,134	10,979
Foreign exchange gains or losses	**25,482**	**45,340**
Total	**26,239**	**54,639**

7. Gain/loss on investments in financial assets

Gain/loss on investments in financial assets	2017	2016
Gain/loss on debt instruments available for sale	19,837	15,122
Gain/loss on equity instruments available for sale	8,453	6,406
Dividends	2,288	3,341
Gain/loss on investments in financial assets	**30,578**	**24,869**

As regards instruments available for sale, the Capital Group reclassified the amount of PLN 19,837 thousand in 2017 and PLN 15,122 thousand in 2016 from other comprehensive income to profit and loss account.

8. Other operating revenue and expenses

Other operating income	2017	2016
Rental income	17,438	8,297
Sale of property, plant and equipment	0	33
Received damages, penalties and fines	1,560	1,241
Bad debt collected	223	621
Reversal of provisions for disputes, other future liabilities and receivables from sundry debtors	2,471	19,328
Investment fund management fees	39,850	20,949
Measurement of investment property at fair value	34,470	16,277
Income on investment property sold	1,600	0
Other operating revenue	4,746	8,333
Total	**102,358**	**75,079**

Other operating expenses	2017	2016
Cost of donations, of which:	8,178	2,031
- statutory activities of J.K.Steczkowski BGK Foundation	8,163	2,000
Cost of debt collection	1,648	462
Cost of recognition of impairment losses on investment property	9,104	954
Cost of recognition of provisions for disputes, other future liabilities and other assets	230	781
Cost of writing off past due and cancelled receivables, bad debt, damages, penalties and fines	340	175
Cost of impairment losses on sundry debtors	10	821
Cost of investment property	1,046	945
Cost of fair value measurement of investment property	2,547	1,237
Net revenue on sale of property, plant and equipment and assets for sale	15	0
Other operating expenses	6,612	2,042
Total	**29,730**	**9,448**

(in PLN '000)

9. Net impairment losses and provisions

For the year ending on 31 December 2017	Balance at the beginning of the period	Increases		Decreases			Value at the end of the period	Recognition (net) – effect on profit and loss account
		Recognition in the period	Other	Decreases due to writing off assets and settlement	Reversal in the period	Other		
Receivables from banks	**438**	**814**	**0**	**0**	**770**	**0**	**482**	**-44**
Loans and advances to customers, including:	**768,331**	**601,486**	**1,614**	**16,719**	**596,509**	**0**	**758,203**	**-4,977**
financial sector	**7,294**	**6,964**	**0**	**0**	**12,353**	**0**	**1,905**	**5,389**
loans	7,294	6,964	0	0	12,353	0	1,905	5,389
non-financial sector	**688,243**	**525,575**	**1,313**	**16,719**	**533,216**	**0**	**665,196**	**7,641**
loans and advances, including:	335,143	319,576	1,310	16,250	193,031	0	446,748	-126,545
- housing loans	147,307	38,570	0	12,441	61,734	0	111,702	23,164
- export loans	8,961	49	0	0	7,510	0	1,500	7,461
purchased debt	308	56	0	0	279	0	85	223
used guarantees and surety bonds	73,582	10,698	0	469	5,223	0	78,588	-5,475
debt securities	279,210	195,245	3	0	334,683	0	139,775	139,438
public sector	**72,794**	**68,947**	**301**	**0**	**50,940**	**0**	**91,102**	**-18,007**
loans	70,603	62,901	301	0	48,465	0	85,340	-14,436
purchased debt	1,221	4,169	0	0	471	0	4,919	-3,698
debt securities	970	1,877	0	0	2,004	0	843	127
Investments in associates	**6,947**	**0**	**0**	**0**	**0**	**0**	**6,947**	**0**
Investments in available-for-sale financial assets	**64,595**	**7,873**	**0**	**398**	**0**	**19**	**72,051**	**-7,873**
Provision for contingent liabilities and guarantees granted	**135,667**	**295,057**	**0**	**0**	**258,313**	**1,612**	**170,799**	**-36,744**
Total	**975,978**	**905,230**	**1,614**	**17,117**	**855,592**	**1,631**	**1,008,482**	**-49,638**

(in PLN '000)

For the year ending on 31 December 2016	Balance at the beginning of the period	Increases		Decreases			Balance at the beginning of the period	Recognition (net) – effect on profit and loss account
		Recognition in the period	Other	Decreases due to writing off assets and settlement	Reversal in the period	Other		
Receivables from banks	**756**	**0**	**0**	**0**	**318**	**0**	**438**	**318**
Loans and advances to customers, including:	**597,003**	**337,917**	**0**	**26,451**	**140,138**	**0**	**768,331**	**-197,779**
financial sector	**210**	**7,151**	**0**	**0**	**67**	**0**	**7,294**	**-7,084**
loans	210	7,151	0	0	67	0	7,294	-7,084
non-financial sector	**563,112**	**276,671**	**0**	**26,451**	**125,089**	**0**	**688,243**	**-151,582**
loans and advances, including:	272,419	131,046	0	9,751	58,571	0	335,143	-72,475
- housing loans	155,488	30,977	0	2,827	36,331	0	147,307	5,354
- export loans	0	8,961	0	0	0	0	8,961	-8,961
purchased debt	1,686	278	0	290	1,366	0	308	1,088
used guarantees and surety bonds	83,106	10,107	0	16,410	3,221	0	73,582	-6,886
debt securities	205,901	135,240	0	0	61,931	0	279,210	-73,309
public sector	**33,681**	**54,095**	**0**	**0**	**14,982**	**0**	**72,794**	**-39,113**
Loans	29,946	52,630	0	0	11,973	0	70,603	-40,657
purchased debt	3,239	495	0	0	2,513	0	1,221	2,018
debt securities	496	970	0	0	496	0	970	-474
Investments in associates	**6,536**	**411**	**0**	**0**	**0**	**0**	**6,947**	**-411**
Investments in available-for-sale financial assets	**53,451**	**10,596**	**548**	**0**	**0**	**0**	**64,595**	**-10,596**
Provision for contingent liabilities and guarantees	**101,379**	**111,004**	**0**	**0**	**76,716**	**0**	**135,667**	**-34,288**
Total	**759,125**	**459,928**	**548**	**26,451**	**217,172**	**0**	**975,978**	**-242,756**

(in PLN '000)

10. General administrative expenses

General administrative expenses	2017	2016
Employee benefits	246,085	207,579
Material costs, including:	115,751	82,938
- cost of operating lease payments*	16,217	14,617
Depreciation and amortisation, including:	23,024	29,985
- property, plant and equipment	13,275	19,467
- intangible assets	9,749	10,518
Taxes and charges	9,189	6,878
Contributions and payments to the Bank Guarantee Fund	0	27,397
Total	**394,049**	**354,777**

* The cost of operating lease payments includes: service charges included in the rent, rental fees related to premises, and car lease.

Employee benefits	2017	2016
Salaries and wages	204,628	170,825
Insurance	32,484	28,567
Other employee benefits	8,973	8,187
Total	**246,085**	**207,579**

Operating lease agreements

Tenancy agreements account for around 98% of all operating leases. The majority of them has been concluded for an indefinite period of time. For indefinite-term agreements, the calculations were based on the notice period (1, 3 or 6 months). Ca. 42% of fixed-term agreements contain clauses whereby the term may be extended.

In tenancy agreements, the price may be increased mainly under clauses concerning amendments to VAT regulations and rent indexation. Additionally, under some agreements the price is conditional on foreign exchange rates (the rent is agreed in a foreign currency).

Under car leasing contracts, the Bank has the pre-emption right to the rented cars after the end of the leasing period at the prices defined in the contract.

The portfolio companies of the Funds entered into operating lease contracts with lessees for investment property held. The lease contracts are concluded for a definite period of time, with possibility of extension by mutual consent of the parties.

Information concerning operating leases concluded by the Capital Group as the lessee:

Operating lease agreements	2017	2016
Total future lease payments under irrevocable operating lease:	**21,091**	**23,062**
up to 1 year	12,030	11,750
between 1 and 5 years	8,960	11,110
over 5 years	101	202

In 2017, lease payments recognised in the period as costs totalled PLN 16,217 thousand, whereas in 2016 - PLN 14,617 thousand.

Information concerning operating leases entered into by the Capital Group as the lessor:

Operating lease agreements	2017	2016
Total future lease payments under irrevocable operating lease:	**28,921**	**16,443**
up to 1 year	13,608	9,617
between 1 and 5 years	12,526	6,657
over 5 years	2,787	159

(in PLN '000)

11. Income tax

Key items of the tax charge and reconciliation of the effective tax rate for the year ending on 31 December 2017 and 31 December 2016:

Items of the tax charge	2017	2016
Current tax charge	-77,327	127,068
Deferred tax related to occurrence and reversal of temporary differences	-28,686	-120,621
Tax charge in the consolidated profit and loss account	**-106,013**	**6,447**
Tax charge presented in other comprehensive income and related to occurrence and reversal of temporary differences	-101,374	-10,656
Total	**-207,387**	**-4,209**

Reconciliation of the effective tax rate	2017	2016
Gross profit before tax	690,452	263,488
Tax at the statutory rate applicable in Poland (19% or 15%)	131,167	50,063
Effect of permanent differences between gross profit and taxable income, including:	-132,209	-229,556
Effect of recognition/reversal of provisions and impairment losses not classified as deductible expenses/taxable income	17,356	-40,546
Effect of other non-deductible expenses	3,787	8,154
Effect of difference between gross profit and taxable income – IFRS adjustment	0	-21
Effect of other differences between gross profit and taxable income, including donations	18,413	5,212
Non-taxable income	-161,338	-202,355
Settlement of tax loss	-10,427	0
Income tax in the consolidated profit and loss account at 19% or 15%	-106,013	6,447
Effective tax rate	15.35%	2.45%

Under Article 17 sec. 1 item 37 and 51 of the Corporate Income Tax Act of 19 February 1992 (Journal of Laws of 2016, item 1888, as amended), the income generated by the funds and government programmes is not subject to income tax where it is used for purposes related to their activities. In light of the above, the Bank does not recognise any income tax charge on the profit generated by the funds or government programmes, which applies to Fundusz Żeglugi Śródlądowej (Inland Waterway Fund), Rządowy Program Wspierania Budownictwa Mieszkaniowego (Residential Construction Support Government Programme), Rządowy Program Społecznego Budownictwa Czynszowego (Government Programme for Construction of Buildings for Rent), and Rządowy Program Wspierania Przedsiębiorczości (Support for Entrepreneurship Government Programme) with the use of surety bonds and guarantees of BGK.

(in PLN '000)

Deferred tax for the year ending on 31 December 2017 and 31 December 2016 results from the following items:

Deferred tax assets/liabilities	Consolidated Statement of Financial Position				Consolidated Profit and Loss Account	
	31.12.2017		31.12.2016		2017	2016
	Provision	Asset	Provision	Asset		
Assets	**150,675**	**176,237**	**59,773**	**204,977**	**119,642**	**-63,929**
Cash and balances with the Central Bank	477	0	400	0	77	400
Receivables from banks	660	0	791	0	-131	304
Financial assets designated as measured at fair value through profit or loss at initial recognition	699	0	604	0	95	326
Financial assets held for trading	9,178	0	7,453	0	1,725	5,623
Loans and advances to customers	8,337	135,710	10,650	112,435	-25,588	-47,617
Receivables under reverse repo and buy-sell-back transactions	135	0	116	0	19	89
Available-for-sale financial assets	107,947	40,476	37,652	92,059	121,878	-15,386
Investments in associates	1,563	0	-12,399	0	13,962	-10,079
Intangible assets	1,887	0	905	0	982	116
Property, plant and equipment (PP&E)	7,089	0	6,786	0	303	-1,965
Investment property	11,354	0	5,344	0	6,010	4,902
Other assets	1,349	51	1,471	483	310	-642
Liabilities	**0**	**47,534**	**0**	**59,720**	**12,186**	**-67,345**
Liabilities to banks	0	324	0	350	26	-263
Financial liabilities held for trading	0	12,630	0	47,067	34,437	-42,722
Liabilities to customers	0	3,605	0	-14,717	-18,322	-20,107
Liabilities under repo and sell-buy-back transactions	0	619	0	267	-352	-172
Liabilities due to debt securities issued	0	8,033	0	7,416	-617	130
Other liabilities	0	17,170	0	17,641	471	-11,557
Provisions	0	5,153	0	1,696	-3,457	7,346
Gross deferred tax liabilities, incl.:	**150,675**		**59,773**		**90,902**	**-5,804**
- recognised in profit or loss	63,625		44,785		18,840	2,056
- recognised in other comprehensive income	87,050		14,988		72,062	-7,860
Gross deferred tax assets, including:	**223,771**		**264,697**		**-40,926**	**125,473**
- recognised in profit or loss	220,113		231,727		-11,614	122,677
- recognised in other comprehensive income	3,658		32,970		-29,312	2,796
Total effect of temporary differences, including:	**73,096**		**204,924**		**-131,828**	**131,277**
- recognised in profit or loss	156,488		186,942		-30,454	120,621
- recognised in other comprehensive income	-83,392		17,982		-101,374	10,656
Deferred tax assets (presented in the statement of financial position)	80,185		207,724		-127,539	0
Deferred tax liabilities (presented in the statement of financial position)	7,090		2,800		4,290	0
Net deferred tax on deconsolidation adjustment following the sale of BGK TFI S.A.	-		-		-1,768	0
Net effect of deferred tax on profit and loss account	-		-		-28,686	120,621

The long-term portion of deferred and current income tax to be realized or paid following the expiry of 12 months is:

	31.12.2017	31.12.2016
assets – long-term portion	137,246	111,486
liabilities – long-term portion	20,342	1,567

	31.12.2017	31.12.2016
The nature of evidence supporting recognition of deferred tax assets in connection with realization of deferred tax assets depending on generation of a taxable profit in the future that will exceed gains arising from reversal of the existing temporary differences and which the deferred tax assets concern is related to, with the assumption that the annual financial result fluctuates around at least PLN 81.5 million. This means that it is highly probable that the disclosed tax assets will be realized within the upcoming five years.	based on future yield rate in the upcoming 5 years at the cumulative level of at least PLN 407.6 million	based on future yield rate in the upcoming 5 years at the cumulative level ofat least PLN 1,078.5 million

11.1. Tax disputes

In 2017 and 2016, the Capital Group did not enter into any disputes with tax authorities.

12. Net profit per one share

The Bank is not an issuer of shares. The legal status of the Parent is described in Note 1.

13. Contribution to the State Budget

In 2017 the Bank did not make any contribution to the State Budget from the distribution of financial result for 2016.

In 2Q 2016, the Bank made a contribution to the State Budget from its net profit for 2015 in the amount of PLN 44,891 thousand.

(in PLN '000)

Notes to the consolidated statement of financial position

14. Cash and balances with the Central Bank

Cash and balances with the Central Bank	31.12.2017	31.12.2016
Current account at Central Bank	812,677	640,545
Cash	5,897	6,231
One-day deposit	170,007	0
Total	**988,581**	**646,776**

The Bank is obliged to maintain a compulsory provision at the National Bank of Poland that can be used by the Bank on condition that an average balance per month in the current account at NBP is not smaller than the declared one.

From 30 November 2017 to 1 January 2018, the Bank was obliged to keep an average balance totalling PLN 2,089,153 thousand, whereas from 31 December 2016 to 31 January 2017 – a total of PLN 1,724,016 thousand.

15. Receivables from banks

Receivables from banks	31.12.2017	31.12.2016
Current accounts	1,755,870	2,298,102
Bank deposits	476,121	553,930
Loans and advances	637,024	745,741
Other receivables	378,940	39,031
Total	**3,247,955**	**3,636,804**
Impairment losses on receivables	-482	-438
Total net	**3,247,473**	**3,636,366**

Cash deposited with banks includes assets securing the payment of the Bank's liabilities, including settlements related to loss on valuation of derivatives. As at 31 December 2017, said assets totalled PLN 312,253 thousand, versus PLN 34,783 thousand as at 31 December 2016.

16. Financial assets designated as measured at fair value through profit or loss at initial recognition

Financial assets designated as measured at fair value through profit or loss at initial recognition		
At carrying amount	**31.12.2017**	**31.12.2016**
Debt instruments	130,233	136,399
Total	**130,233**	**136,399**

Debt instruments at nominal value	31.12.2017	31.12.2016
Issued by the State Treasury	83,418	88,480
Issued by local government units	40,000	40,000
Total	**123,418**	**128,480**

Change in financial assets designated as measured at fair value through profit or loss at initial recognition	2017	2016
Balance at the beginning of the period	**136,399**	**133,567**
fair value measurement*, including:	-6,166	2,832
- credit risk	-249	343
Balance at the end of the period	**130,233**	**136,399**

* apart from price difference, it also comprises interest, the settlement of a bonus/discount and exchange rate differences

(in PLN '000)

17. Financial assets and financial liabilities held for trading

Financial assets held for trading		
At carrying amount	**31.12.2017**	**31.12.2016**
Derivatives	1,341,019	429,281
Debt instruments	1,051	49,527
Total	**1,342,070**	**478,808**

Debt instruments at nominal value	31.12.2017	31.12.2016
Issued by the State Treasury	964	51,133
Total	**964**	**51,133**

Change in debt instruments held for trading	2017	2016
Balance at the beginning of the period	49,527	**119,553**
purchase	2,586,778	7,232,035
sale	2,591,773	7,366,726
redemption	0	0
fair value measurement*	-43,481	64,665
Balance at the end of the period	**1,051**	**49,527**

* apart from price difference, it also comprises interest, the settlement of a bonus/discount and exchange rate differences

The fair values of derivatives as at 31 December 2017 and 31 December 2016 are presented in the table below:

Derivative financial instruments – fair value				
Contract type	**31.12.2017**		**31.12.2016**	
	Assets	**Liabilities**	**Assets**	**Liabilities**
FX Swap	81,595	16,432	8,526	7,844
Forward	752	10,086	11,069	1,123
Options	0	0	556	0
CIRS	1,210,382	1,191,629	371,091	351,320
IRS	48,290	66,471	38,039	247,718
Total	**1,341,019**	**1,284,618**	**429,281**	**608,005**

Derivative financial instruments – nominal value				
Contract type	**31.12.2017**		**31.12.2016**	
	Purchase	**Sale**	**Purchase**	**Sale**
FX Swap	838,099	4,131,589	193,202	3,014,950
Forward	409,916	88,952	540,938	196,116
Options	0	0	87,000	0
CIRS	27,383,488	0	29,536,182	0
IRS	5,370,255	5,303,211	4,804,706	2,928,731
Total	**34,001,758**	**9,523,752**	**35,162,028**	**6,139,797**

(in PLN '000)

18. Loans and advances to customers

Loans and advances to customers as at 31.12.2017	Gross loans	Loans without evidence of impairment	IBNR provisions	Loans with evidence of impairment	Impairment losses	Including: estimated individually	Total impairment losses	Total net loans
Loans and advances to customers (gross), including:	**27,981,956**	**25,179,578**	**221,045**	**2,802,378**	**537,158**	**374,526**	**758,203**	**27,223,753**
financial sector	**263,451**	**263,451**	**1,905**	**0**	**0**	**0**	**1,905**	**261,546**
loans	183,119	183,119	1,905	0	0	0	1,905	**181,214**
debt securities	1	1	0	0	0	0	0	**1**
other receivables	80,331	80,331	0	0	0	0	0	**80,331**
non-financial sector	**21,668,971**	**19,459,394**	**147,012**	**2,209,577**	**518,184**	**373,846**	**665,196**	**21,003,775**
loans and advances, including:	16,065,737	14,951,867	108,004	1,113,870	338,744	264,802	446,748	**15,618,989**
- housing loans	4,296,308	4,097,328	26,888	198,980	84,814	53,778	111,702	**4,184,606**
- export loans	251,734	137,274	0	114,460	1,500	1,500	1,500	**250,234**
purchased debt	121,147	121,147	85	0	0	0	85	**121,062**
used guarantees and surety bonds	87,423	499	7	86,924	78,581	8,185	78,588	**8,835**
debt securities	5,394,651	4,385,868	38,916	1,008,783	100,859	100,859	139,775	**5,254,876**
other receivables	13	13	0	0	0	0	0	**13**
public sector	**6,049,534**	**5,456,733**	**72,128**	**592,801**	**18,974**	**680**	**91,102**	**5,958,432**
loans	5,636,438	5,052,866	71,230	583,572	14,110	680	85,340	**5,551,098**
debt securities	335,169	331,165	843	4,004	0	0	843	**334,326**
purchased debt	77,927	72,702	55	5,225	4,864	0	4,919	**73,008**

(in PLN '000)

Loans and advances to customers as at 31.12.2016	Gross loans	Loans without evidence of impairment	IBNR provisions	Loans with evidence of impairment	Impairment losses	Including: estimated individually	Total impairment losses	Total net loans
Loans and advances to customers, including:	**25,399,855**	**22,624,220**	**216,867**	**2,775,635**	**551,464**	**395,445**	**768,331**	**24,631,524**
financial sector	**136,824**	**136,824**	**7,294**	**0**	**0**	**0**	**7,294**	**129,530**
loans	107,861	107,861	7,294	0	0	0	7,294	**100,567**
other receivables	28,963	28,963	0	0	0	0	0	**28,963**
non-financial sector	**19,682,099**	**17,515,808**	**145,151**	**2,166,291**	**543,092**	**394,605**	**688,243**	**18,993,856**
loans and advances, including:	14,021,106	13,101,963	93,597	919,143	241,546	159,291	335,143	**13,685,963**
- housing loans	4,444,018	4,078,131	25,463	365,887	121,844	83,470	147,307	**4,296,711**
- export loans	240,404	34,491	0	205,913	8,961	8,961	8,961	**231,443**
purchased debt	161,650	161,290	200	360	108	0	308	**161,342**
used guarantees and surety bonds	83,542	0	0	83,542	73,582	7,458	73,582	**9,960**
debt securities	5,415,791	4,252,545	51,354	1,163,246	227,856	227,856	279,210	**5,136,581**
other receivables	10	10	0	0	0	0	0	**10**
public sector	**5,580,932**	**4,971,588**	**64,422**	**609,344**	**8,372**	**840**	**72,794**	**5,508,138**
Loans	5,235,872	4,643,809	63,273	592,063	7,330	829	70,603	**5,165,269**
debt securities	269,625	259,216	959	10,409	11	11	970	**268,655**
purchased debt	75,431	68,559	190	6,872	1,031	0	1,221	**74,210**
other receivables	4	4	0	0	0	0	0	**4**

(in PLN '000)

Share of loans with evidence of impairment

As at 31 December 2017, the share of loans with evidence of impairment in total gross loans amounted to 10% (versus 10.9% as at 31 December 2016), while the coverage ratio for loans with evidence of impairment (calculated as the share of impairment losses on total loans and advances to customers without IBNR in the gross carrying amount of loans with evidence of impairment) amounted to 19.2% (versus 19.9% as at 31 December 2016).

18.1. Reclassification of securities

Similarly to 2016, the Capital Group did not reclassify any financial assets in 2017.

19. Receivables and liabilities due to buy sell-back, reverse repo, sell buy-back and repo transactions

Buy sell-back, reverse repo, sell buy-back and repo transactions	31.12.2017	
	Receivables	Liabilities
From banks	1,142,098	3,002,254
From customers	963,442	4,571,566
Total	**2,105,540**	**7,573,820**

Buy sell-back, reverse repo, sell buy-back and repo transactions	31.12.2016	
	Receivables	Liabilities
From banks	1,277,219	1,552,450
From customers	2,669,668	4,199,734
Total	**3,946,887**	**5,752,184**

20. Available-for-sale financial assets

Available-for-sale financial assets	31.12.2017	31.12.2016
Debt securities (gross)	35,699,238	30,767,822
- issued by the State Treasury	9,232,632	8,392,397
- treasury bonds	9,232,632	8,392,397
- issued by the National Bank of Poland (NBP)	21,526,556	15,803,817
- money bills	21,526,556	15,803,817
- issued by banks	1,122,031	1,583,235
- corporate bonds	159,803	540,226
- subordinated bonds	600,333	158,591
- commercial bills	336,420	884,418
- covered bonds	25,475	0
- issued by other financial sector entities	562,172	1,014,366
- corporate bonds	255,066	1,014,366
- subordinated bonds	307,106	0
- issued by non-financial sector entities	2,201,386	3,026,209
- corporate bonds	2,201,386	3,026,209
- issued by local government units	1,054,461	947,798
- municipal bonds	1,054,461	947,798
Total debt securities (net)	**35,699,238**	**30,767,822**
Equity securities (gross)	1,371,447	875,088
- listed	1,244,275	806,874
- unlisted	127,172	68,134
- investment certificates	0	80
Impairment losses on equity securities	-72,051	-64,595
Total equity securities (net)	**1,299,396**	**810,493**
Other financial assets (gross)	62,618	41,430
Other financial assets (net)	62,618	41,430
Total available-for-sale financial assets (net)	**37,061,252**	**31,619,745**

Q2 2016 witnessed the settlement of the transaction associated with the conversion of one share of Visa Europe Limited held by the Bank into 369 preference C series shares of Visa Inc. As part of the transaction, BGK received also a payment amounting to EUR 1,018,827.09.

On 13.10.2016, the Bank concluded the sale of 1,132,363 shares of PEKAES S.A. with a nominal value of PLN 1 to KH Logistyka sp. z o.o. SK (the company associated with Innova Capital investment fund). The transaction was carried out as a response for tender offer for the sale of shares announced on 19.08.2016.

(in PLN '000)

Change in available-for-sale financial assets	2017	2016
Balance at the beginning of the period	**31,619,745**	**13,958,898**
Increases, including:	**1,746,429,465**	**1,098,194,625**
- purchase	1,744,494,807	1,098,194,077
- fair value measurement	1,934,658	0
- other changes (recognition of shares from the PARP pool)*	0	548
Decreases, including:	**1,740,987,958**	**1,080,533,778**
- sale	298,909,899	153,859,788
- maturity	1,441,872,652	926,033,264
- interest payment	172,538	351,246
- fair value measurement	24,532	278,336
- impairment	7,873	11,144
- other changes	403	0
- changes in the structure of the Group	61	0
Balance at the end of the period	**37,061,252**	**31,619,745**

* concerns the shares of the entities, i.e. Metanel, Wałbrzyski Rynek Hurtowy, Zakłady Sprzętu Instalacyjnego Polam - Nakło S.A.

Change in impairment losses on available-for-sale financial assets	2017	2016
	equity	equity
Balance at the beginning of the period	**64,595**	**53,451**
Increases, including:	**7,873**	**11,144**
- recognition	7,873	10,596
- other changes (recognition of impairment of shares from the PARP pool)*	0	548
Decreases, including:	**417**	**0**
- due to assets written off and settled	398	0
- changes in the structure of the Group	19	0
Balance at the end of the period	**72,051**	**64,595**

* concerns the shares of the entities, i.e. Metanel, Wałbrzyski Rynek Hurtowy, Zakłady Sprzętu Instalacyjnego Polam - Nakło S.A.

In 2016, the Group recognised the shares of three companies: Metanel S.A., Wałbrzyski Rynek Hurtowy S.A., and Polam-Nakło S.A., which were subscribed based on the Regulation of the Minister of Treasury of 27 February 2003 on free-of-charge submission of stock and shares owned by the State Treasury to Bank Gospodarstwa Krajowego (Journal of Laws of 2003, no. 50, item 432 – archive act). The Group recognised shares in its assets in the amount of PLN 1,096 thousand as AFS, corresponded in 50% with Group's revenue and 50% as an obligation towards PARP S.A. (according to the agreement, at the moment of sale of the shares, the Group is obliged to provide 50% of the income from the sale to the PARP). In 2016, an impairment loss was created on shares of the above entities in the amount of PLN 1,096 thousand, of which 50% was recognised as cost and 50% as decrease of liability to the PARP.

Guaranteed Deposit Protection Fund

As at 31 December 2016, the Parent created a Guaranteed Deposit Protection Fund under Article 25 of the Act of 14 December 1994 on Bank Guarantee Fund (Journal of Laws of 2009, No. 84, item 711, as amended).

Guaranteed Deposit Protection Fund	31.12.2016
Fund value	135,844
Nominal value of collateral	138,550
Collateral type	treasury bonds
Redemption date	2017-07-25
Carrying amount of collateral	**137,449**

The assets provided as a security for the Guaranteed Deposit Protection Fund comprised T-bonds whose redemption date guarantees that the carrying amount will be protected during the period specified in the Act. The aforesaid amounts were treated as assets held to secure the Bank's own liabilities.

In line with the Act of 10 June 2016 on Bank Guarantee Fund, the system of deposit guarantee and mandatory restructuring, the Bank was excluded from the Act and, as a result, it does not contribute to the Guaranteed Deposit Protection Fund as of 1 January 2017.

(in PLN '000)

21. Held-to-maturity financial assets

Held-to-maturity financial assets	31.12.2017	31.12.2016
Debt securities (gross)	166	166
- issued by non-financial sector entities	166	166
- commercial bills	166	166
Impairment losses on debt securities	-166	-166
Total held-to-maturity financial assets (net)	**0**	**0**

22. Investments in associates

In the consolidated financial statements all associates are measured using the equity method.

Investments in associates	31.12.2017	31.12.2016
Value at cost	**1,036,226**	687,450
Measurement using the equity method	36,926	-35,066
Impairment losses	-6,947	-6,947
Carrying amount	**1,066,205**	**645,437**

Investments in associates	2017	2016
Investments in associates at the beginning of the period	**645,437**	**336,534**
Share of profit or loss	71,992	-55,748
Purchased shares/investment certificates*	348,902	366,022
Sale of share held by an associate	0	-960
Other changes	-126	0
Change in impairment losses	0	-411
Investments in associates at the end of the period	**1,066,205**	**645,437**

*The group purchased investment certificates/shares (value at cost):

– Fundusz Inwestycji Infrastrukturalnych Kapitałowy Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych	20,624	70,087
– Fundusz Inwestycji Polskich Przedsiębiorstw Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych	183,769	287,871
– Fundusz Inwestycji Samorządowych Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych	7,459	2,148
– Fundusz Inwestycji Infrastrukturalnych Dłużny Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych	118,740	3,704
– Esotiq Germany GmbH	-	2,212
– UAB EMP Recycling	18,310	-

On 02.09.2016, BGK sold to Bielsko-Biała Municipality a total of 960 shares in Bielski Fundusz Poręczeń Kredytowych with a unit nominal value of PLN 1,000.

In 2017 and 2016, the units of the Group did not receive dividends from the associates.

(in PLN '000)

Condensed information about associates measured using the equity method as at 31.12.2017

Entity name	Current assets	Property, plant and equipment	Short-term liabilities	Long-term liabilities	Revenue	Net profit/loss	Net assets	% interest in capital	% interest in voting rights	Adjusted net assets	Carrying amount
KUKE S.A.	52,894	507	0	0	31,203	3,972	214,891	36.69	36.69	214,981	67,563
Śląski Regionalny Fundusz Poręczeniowy Sp z o.o.	59,616	110	24,109	20,884	2,356	190	9,521	46.08	46.08	8,625	3,974
Fundusz Rozwoju i Promocji Województwa Wielkopolskiego S.A.	38,807	200	176	0	6,169	379	36,165	22.47	22.47	26,024	5,848
Poznański Fundusz Poręczeń Kredytowych Sp. z o.o.	24,258	159	29	0	2,380	806	18,865	44.44	44.44	12,517	5,563
Kujawsko-Pomorski Fundusz Poręczeń Kredytowych Sp. z o.o.	45,323	34	68	11,208	3,031	52	31,316	49.38	24.64	30,414	15,019
Dolnośląski Fundusz Gospodarczy Sp. z o.o.	27,376	63	74	0	3,069	80	26,441	42.62	42.62	21,614	9,212
Opolski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o.	18,224	400	49	11,616	957	-135	6,552	48.27	33.50	6,192	2,989
Bydgoski Fundusz Poręczeń Kredytowych Sp. z o.o.	5,570	861	12	3,019	1,302	59	1,722	31.09	22.64	1,718	534
Fundusz Poręczeń Kredytowych Sp. z o.o.	6,817	38	7	0	1,239	-149	6,399	44.60	44.60	5,713	2,548
Samorządowy Fundusz Poręczeń Kredytowych sp. z o.o.	28,064	154	2	0	2,656	50	19,637	41.65	41.65	12,016	5,005
Podkarpacki Fundusz Poręczeń Kredytowych Sp. z o.o.	9,343	54	138	7,226	4,595	-1,788	-2,741	49.99	49.99	-2,741	0
Fundusz Pomerania Sp. z o.o. (former name: Zachodniopomorski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o.)	31,893	278	133	0	4,304	56	30,841	46.95	46.95	28,911	13,574
Warmińsko-Mazurski Fundusz "Poręczenia Kredytowe" Sp. z o.o.	46,257	5,455	63	34,329	1,651	21	16,945	36.19	23.49	15,207	5,503
Małopolski Fundusz Poręczeń Kredytowych Sp. z o.o. put into liquidation	7,222	553	6,041	0	339	-643	-395	32.86	32.86	-395	0
Krajowa Grupa Poręczeniowa Sp. z o.o.	15	610	45	0	248	-128	574	39.29	39.29	574	226
Świętokrzyski Fundusz Poręczeniowy Sp. z o.o.	28,882	674	21,672	0	2,199	715	6,681	49.99	49.99	4,709	2,354
Małopolski Regionalny Fundusz Poręczeniowy Sp. z o.o.	83,612	196	54,725	0	2,696	178	22,941	36.87	36.87	17,114	6,310
Fundusz Inwestycji Infrastrukturalnych - Kapitałowy FIZ AN (Infrastructure Investments Capital Closed-End Investment Private Equity Fund)	0	0	2,363	0	12	5,458	297,749	86.45*	86.45**	297,564	257,256
Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprises Investments Closed-End Investment Private Equity Fund)	22	0	3,101	0	2,051	79,176	572,532	86.40*	86.40**	572,452	494,599
Fundusz Inwestycji Samorządowych FIZ AN (Municipal Investments Closed-End Investment Private Equity Fund)	150	0	1,541	0	10	-3,050	49,335	75.00***	75.00**	49,285	27,665
Fundusz Inwestycji Infrastrukturalnych - Dłużny FIZ AN (Infrastructure Investments Debenture Closed-End Investment Private Equity Fund)	142	0	2,369	0	2,262	3,265	141,498	86.45*	86.45**	141,293	122,153
Esotiq Germany GmbH	1,539	1,310	129	3,677	1,556	-1,574	-1,012	48.78	48.78	-1,012	0
UAB EMP Recycling	26,080	12,641	21,786	367	142,661	6,899	16,243	49.00	49.00	16,243	18,310
Total											**1,066,205**

* target interest
** target interest, with the proviso that certain conditions may call for an unanimous decision of the Investors' Meeting
***the calculation of MPW cwas based a 56.13% share, taking into account the degree of payment of the investment certificates by the Bank

(in PLN '000)

Condensed information about associates measured using the equity method as at 31.12.2016											
Entity's name	**Current assets**	**Property, plant and equipment**	**Short-term liabilities**	**Long-term liabilities**	**Revenue**	**Net profit/loss**	**Net assets**	**% interest in capital**	**% interest in voting rights**	**Adjusted net assets**	**Carrying amount**
KUKE S.A.	37,968	535	0	0	24,095	6,233	210,075	36.69	36.69	210,075	65,750
Śląski Regionalny Fundusz Poręczeniowy Sp z o.o.	3,603	76	24,066	20,847	2,191	187	9,332	46.08	46.08	9,312	4,291
Fundusz Rozwoju i Promocji Województwa Wielkopolskiego S.A.	120	357	173	0	6,006	545	35,786	22.47	22.47	26,454	5,944
Poznański Fundusz Poręczeń Kredytowych Sp. z o.o.	47	148	46	0	2,706	421	18,059	44.44	44.44	15,580	6,924
Kujawsko-Pomorski Fundusz Poręczeń Kredytowych Sp. z o.o.	5	54	140	38,136	4,296	-29	31,264	49.38	24.64	29,903	14,766
Dolnośląski Fundusz Gospodarczy Sp. z o.o.	2,537	81	54	0	3,289	34	26,361	42.62	42.62	23,794	10,141
Opolski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o.	9	370	13	11,497	1,390	-275	6,686	48.27	33.50	6,366	3,073
Bydgoski Fundusz Poręczeń Kredytowych Sp. z o.o.	1,512	880	8,090	6,912	1,889	9	1,693	31.09	22.64	1,693	526
Fundusz Poręczeń Kredytowych Sp. z o.o in Jelenia Góra	24	52	10	0	1,002	-336	6,548	44.60	44.60	5,359	2,390
Samorządowy Fundusz Poręczeń Kredytowych Sp. z o.o. in Gostyń	209	17	11	0	2,165	47	18,977	44.16	44.16	8,911	3,935
Podkarpacki Fundusz Poręczeń Kredytowych Sp. z o.o.	85	105	445	20,143	3,099	-862	-953	49.99	49.99	-953	0
Fundusz Pomerania Sp. z o.o. (former name: Zachodniopomorski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o.)	609	290	75	0	4,789	36	29,068	46.95	46.95	27,753	13,030
Warmińsko-Mazurski Fundusz "Poręczenia kredytowe" Sp. z o.o.	52	5,438	63	34,361	1,594	10	16,924	36.19	23.49	15,462	5,596
Małopolski Fundusz Poręczeń Kredytowych Sp. z o.o.	125	655	9,252	0	401	-256	1,677	32.86	32.86	1,410	463
Krajowa Grupa Poręczeniowa Sp. z o.o.	0	749	0	0	243	-151	702	39.29	39.29	702	276
Świętokrzyski Fundusz Poręczeniowy Sp. z o.o.	147	730	22,301	0	2,028	-840	5,967	49.99	49.99	4,543	2,271
Małopolski Regionalny Fundusz Poręczeniowy Sp. z o.o.	73	210	54,375	0	2,570	294	23,056	36.87	36.87	18,030	6,648
Fundusz Inwestycji Infrastrukturalnych - Kapitałowy FIZ AN (Infrastructure Investments Capital Closed-End Investment Private Equity Fund)	0	0	1,181	0	79	-5,722	268,441	86.45*	86.45**	268,251	231,914
Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprises Investments Closed-End Investment Private Equity Fund)	68,918	0	1,431	0	28	-53,137	314,023	86.40*	86.40**	280,580	242,421
Fundusz Inwestycji Samorządowych FIZ AN (Municipal Investments Closed-End Investment Private Equity Fund)	0	0	763	0	14	-1,414	44,462	75.00*	75.00**	44,407	22,204
Fundusz Inwestycji Infrastrukturalnych - Dłużny FIZ AN (Infrastructure Investments Debenture Closed-End Investment Private Equity Fund)	305	0	1,078	0	315	-3,974	888	86.45*	86.45**	683	590
Esotiq Germany GmbH	0	1,149	180	121	1,439	-1,937	4,535	48.80	48.80	4,535	2,283
Total											**645,436**

* target interest
** target interest, with the proviso that certain conditions may call for an unanimous decision of the Investors' Meeting

(in PLN '000)

The adjustment of net assets in surety funds was made due to the adjustment of the accounting principles with regard to the establishment of impairment losses.

The adjustment of net assets once measured at the fair value of investment certificate FIZ AN that are held by BGK consists in decreasing such assets by the equivalent of the payment effected by PFR S.A. on account of certificates paid in initial value. The proceeds from those certificates are not directly related to investment projects generating financial benefits.

23. Intangible assets

Intangible assets	31.12.2017	31.12.2016
Software	22,931	24,684
Right of perpetual usufruct of land	3,520	3,576
Expenditure on intangible assets	16,723	8,494
Other	2	28
Total	**43,176**	**36,782**

- Change in intangible assets from 1 January 2017 to 31 December 2017.

Change in intangible assets from 1 January to 31 December 2017	Software	Right of perpetual usufruct of land	Expenditure on intangible assets	Other	Total
Gross value at the beginning of the period	**98,273**	**3,664**	**8,495**	**3,315**	**113,747**
Increases, including:	**8,003**	**0**	**15,462**	**0**	**23,465**
- purchase	781	0	15,462	0	**16,243**
- reclassification from expenditure	7,222	0	0	0	**7,222**
Decreases, including:	**318**	**0**	**7,234**	**35**	**7,587**
- liquidation	318	0	0	0	**318**
- reclassification from expenditure	0	0	7,222	0	**7,222**
- other	0	0	12	0	**12**
- sale of entity	0	0	0	35	**35**
Gross value at the end of the period	**105,958**	**3,664**	**16,723**	**3,280**	**129,625**
Accumulated amortisation at the beginning of the period	**73,589**	**88**	**0**	**3,288**	**76,965**
Increases, including:	**9,756**	**56**	**0**	**16**	**9,828**
- depreciation for the period	9,677	56	0	16	**9,749**
- other	79	0	0	0	**79**
Decreases, including:	**318**	**0**	**0**	**26**	**344**
- liquidation	318	0	0	0	**318**
- sale of entity	0	0	0	26	**26**
Accumulated amortisation at the end of the period	**83,027**	**144**	**0**	**3,278**	**86,449**
Net carrying amount at the beginning of the period	**24,684**	**3,576**	**8,495**	**27**	**36,782**
Net carrying amount at the end of the period	**22,931**	**3,520**	**16,723**	**2**	**43,176**

(in PLN '000)

- Change in intangible assets from 1 January 2016 to 31 December 2016.

Change in intangible assets from 1 January to 31 December 2016	Software	Right of perpetual usufruct of land	Expenditure on intangible assets	Other	Total
Gross value at the beginning of the period	**82,622**	**3,664**	**7,464**	**3,315**	**97,065**
Increases, including:	**17,461**	**0**	**18,517**	**0**	**35,978**
- purchase	0	0	18,517	0	18,517
- reclassification from expenditure	17,430	0	0	0	17,430
- other	31	0	0	0	31
Decreases, including:	**1,810**	**0**	**17,487**	**0**	**19,297**
- liquidation	1,810	0	0	0	1,810
- reclassification from expenditure	0	0	17,430	0	17,430
- other	0	0	57	0	57
Gross value at the end of the period	**98,273**	**3,664**	**8,494**	**3,315**	**113,746**
Accumulated amortisation at the beginning of the period	**64,911**	**25**	**0**	**3,268**	**68,204**
Increases, including:	**10,488**	**63**	**0**	**19**	**10,570**
- depreciation for the period	10,436	63	0	19	10,518
- other	52	0	0	0	52
Decreases, including:	**1,810**	**0**	**0**	**0**	**1,810**
- liquidation	1,810	0	0	0	1,810
Accumulated amortisation at the end of the period	**73,589**	**88**	**0**	**3,287**	**76,964**
Net carrying amount at the beginning of the period	**17,711**	**3,639**	**7,464**	**47**	**28,861**
Net carrying amount at the end of the period	**24,684**	**3,576**	**8,494**	**28**	**36,782**

The value of intangible assets considered material for the financial statements of the Capital Group

The Bank holds a license to use the Ferryt business process management platform of PLN 456 thousand (net). The amortisation period ends on 31.12.2023.

Bgk24 system – PLN 6,591 thousand net, the amortisation period ends on 30.11.2023.

As at 31 December 2017 and 31 December 2016, the Capital Group did not have any intangible assets whose legal title would be limited or which would have been provided as collateral securing the payment of liabilities.

The Capital Group entered into agreements to purchase in future periods the intangible assets of PLN 63,339 thousand.

24. Property, plant and equipment

Property, plant and equipment	31.12.2017	31.12.2016
Land and buildings	92,625	95,789
Machines and equipment	30,250	28,072
Means of transport	1,961	3,934
PP&E under construction	17,070	9,572
Other assets	2,068	2,780
Total	**143,974**	**140,147**

(in PLN '000)

- Change in property, plant and equipment from 1 January to 31 December 2017

Change in PP&E for the year ending on 31.12.2017	Land and buildings	Machines and equipment	Means of transport	Property, plant and equipment under construction	Other assets	Total
Gross value of PP&E at the beginning of the period	**108,009**	**103,718**	**5,448**	**9,572**	**12,475**	**239,222**
Increases, including:	**82**	**9,836**	**164**	**17,542**	**215**	**27,839**
- purchase	0	237	85	17,542	49	**17,913**
- reclassification from expenditure	82	9,595	79	0	166	**9,922**
- other	0	4	0	0	0	**4**
Decreases, including:	**16**	**9,016**	**0**	**10,044**	**560**	**19,636**
- sale	16	113	0	0	141	**270**
- liquidation	0	8,811	0	0	390	**9,201**
- reclassification from expenditure	0	0	0	9,918	0	**9,918**
- other	0	0	0	126	0	**126**
changes in the structure of the Group	0	92	0	0	29	**121**
Gross value of PP&E at the end of the period	**108,075**	**104,538**	**5,612**	**17,070**	**12,130**	**247,425**
Accumulated amortisation at the beginning of the period	**12,220**	**75,646**	**1,514**	**0**	**9,695**	**99,075**
Increases, including:	**3,234**	**7,594**	**2,137**	**0**	**918**	**13,883**
- depreciation for the period	3,150	7,257	1,982	0	886	**13,275**
- other	84	337	155	0	32	**608**
Decreases, including:	**4**	**8,952**	**0**	**0**	**551**	**9,507**
- sale	4	103	0	0	141	**248**
- liquidation	0	8,810	0	0	390	**9,200**
- changes in the structure of the Group	0	39	0	0	20	**59**
Accumulated amortisation at the end of the period	**15,450**	**74,288**	**3,651**	**0**	**10,062**	**103,451**
Net carrying amount at the beginning of the period	**95,789**	**28,072**	**3,934**	**9,572**	**2,780**	**140,147**
Net carrying amount at the end of the period	**92,625**	**30,250**	**1,961**	**17,070**	**2,068**	**143,974**

(in PLN '000)

- Change in property, plant and equipment from 1 January to 31 December 2016

Change in PP&E for the year ending on 31.12.2016	Land and buildings	Machines and equipment	Means of transport	Property, plant and equipment under construction	Other assets	Total
Gross value of PP&E at the beginning of the period	**100,270**	**87,359**	**1,570**	**5,266**	**12,832**	**207,297**
Increases, including:	**7,739**	**20,800**	**3,878**	**36,778**	**663**	**69,858**
- purchase	0	137	526	36,778	5	37,446
- reclassification from expenditure	7,739	20,639	3,352	0	658	32,388
- other	0	24	0	0	0	24
Decreases, including:	**0**	**4,441**	**0**	**32,472**	**1,020**	**37,933**
- sale	0	346	0	0	867	1,213
- liquidation	0	4,093	0	0	153	4,246
- reclassification from expenditure	0	0	0	32,388	0	32,388
- other	0	2	0	84	0	86
Gross value of PP&E at the end of the period	**108,009**	**103,718**	**5,448**	**9,572**	**12,475**	**239,222**
Accumulated amortisation at the beginning of the period	**7,992**	**66,355**	**486**	**0**	**9,493**	**84,326**
Increases, including:	**4,228**	**13,716**	**1,028**	**0**	**1,193**	**20,165**
- depreciation for the period	4,142	13,333	867	0	1,125	19,467
- other	86	383	161	0	68	698
Decreases, including:	**0**	**4,425**	**0**	**0**	**991**	**5,416**
- liquidation and sale	0	4,423	0	0	991	5,414
- other	0	2	0	0	0	2
Accumulated amortisation at the end of the period	**12,220**	**75,646**	**1,514**	**0**	**9,695**	**99,075**
Net carrying amount at the beginning of the period	**92,278**	**21,004**	**1,084**	**5,266**	**3,339**	**122,971**
Net carrying amount at the end of the period	**95,789**	**28,072**	**3,934**	**9,572**	**2,780**	**140,147**

As at 31 December 2017 and 31 December 2017, the Capital Group did not have any property or equipment whose legal title would be limited or which would have been provided as collateral securing the payment of liabilities.

The Capital Group signed agreements on future purchase of property, plant and equipment worth PLN 16,838 thousand.

25. Investment property

Change in investment property

Investment property	2017	2016
Gross carrying amount at the beginning of the period	**587,771**	**230,263**
Decreases, including:	**12,951**	**2,248**
- fair value measurement	2,547	1,237
- sale	1,300	82
- other (liquidation)	0	929
- revaluation of assets	9,104	0
Increases, including:	**259,608**	**359,756**
- purchase of investment property	224,428	343,479
- fair value measurement	34,470	16,277
- other	710	0
Gross carrying amount at the end of the period	**834,428**	**587,771**

The Capital Group adopted the fair value measurement model for identified investment property. The fair value of investment property is classified at Level 3 of the fair value measurement hierarchy. The fair value of property investments is recognised in the valuation prepared by chartered surveyors.

The valuation was carried out based on a comparative method (pairwise comparison and average price adjustment method), income method (by investment), and mixed.

The best indicator of fair value is the applicable prices on an active market for similar assets. If no such information is available, the fair value is estimated. Various information are taken into account (including unobservable inputs) to carry out the valuation, including:

- the market price for property (transactions) of a similar nature, condition, and location (or provided for in a different agreement or contract), adjusted to resemble the difference between the properties;
- discounted cash flow projections based on reliable estimations of future cash flows specified in the terms and conditions of present lease agreements and other contracts or in external sources, such as current market rental prices of similar property in the same location and condition, rental price growth rate, the time where flats are not inhabited, along with occupancy rate.

The following items of revenue and expenses related to investment property were recognised in profit and loss account:

	2017	2016
Rental income from investment property	7,351	6,374
Direct operating expenses (including the cost of repair and maintenance) which generated rental income in the period	4,589	3,054
Direct operating expenses (including the cost of repair and maintenance) which did not generate rental income in the period	292	278

The Group entered into contracts for repair, maintenance or improvement of investment property totalling 289 PLN thousand

26. Other assets

Other assets	31.12.2017	31.12.2016
Accrued revenue, including:	19,430	8,301
- fees for asset management as part of European Union Perspective 2014-2020*	12,927	2,311
Sundry debtors (net), of which:	8,101	8,711
- impairment losses	5,302	5,398
Public law settlements	319	365
Payment card settlements	3,703	1,123
Receivables from settlements with funds and programmes	11	5,721
Pre-paid costs, of which:	8,068	5,505
- costs of telecommunication services	4,777	3,212
- costs of commissions on guarantees received	1,349	1,555
- management fees – EIF/PGFF	1,072	0
Other	7,512	2,497
Total	**47,144**	**32,223**

* The first financing contract as part of the Perspective of the European Union 2014-2020 with asset management fees was concluded on 30 September 2016. Any subsequent contracts were concluded successively in 2016 and 2017. Pursuant to the provisions of said contracts, the management fees were determined and charged in line with the indicators applicable in specific periods. BGK recognises fees corresponding to the borne costs. Any surplus in management fees over costs incurred by BGK and related to the service of said contracts constitute deferred revenue.

Change in impairment losses on other assets	2017	2016
Impairment losses on other assets (opening balance)	5,398	6,298
Write-downs created	10	821
Write-downs released	83	93
Utilization	0	1,444
Other adjustments	-23	-184
Impairment losses on other assets (closing balance)	**5,302**	**5,398**

27. Liabilities to the Central Bank

Similarly to 2016, the Bank did not hold any liabilities to the Central Bank.

28. Liabilities to banks

Liabilities to banks	31.12.2017	31.12.2016
Current accounts	106	43
Bank deposits	302,051	511,114
Loans and advances received	2,990,888	3,027,357
Other	301,095	440,315
Total	**3,594,140**	**3,978,829**

(in PLN '000)

29. Liabilities to customers

Liabilities to customers	31.12.2017	31.12.2016
Liabilities to financial sector	**1,626,187**	**1,649,631**
Current accounts and O/N deposits	928,108	594,702
Term deposits	684,573	1,042,060
Other liabilities	13,506	12,869
Liabilities to non-financial sector	**14,087,938**	**12,891,534**
Current accounts and O/N deposits	3,777,480	2,080,740
Term deposits	9,134,209	9,527,642
Other liabilities	1,176,249	1,283,152
Liabilities to the public sector	**17,978,195**	**22,568,087**
Current accounts and O/N deposits	13,750,062	12,716,931
Term deposits	4,079,105	9,335,312
Other liabilities	149,028	515,844
Total	**33,692,320**	**37,109,252**

30. Liabilities due to debt securities issued

Issue date	Nominal value	Currency	Maturity date	Interest rate	Carrying amount as at 31 December 2017
2017-10-03	500,000	PLN	2021-10-03	WIBOR6M + margin	502,750
2017-05-19	1,200,000	PLN	2020-05-19	WIBOR6M + margin	1,203,168
2017-02-27	1,158,600	PLN	2020-02-27	WIBOR6M + margin	1,167,510
2016-10-05	500,000	PLN	2019-10-05	WIBOR6M + margin	502,650
2015-02-19	1,392,000	PLN	2019-02-19	WIBOR6M + margin	1,402,871
2014-09-30	500,000	PLN	2019-09-30	fixed	503,565
2012-11-20	1,000,000	PLN	2018-01-25	WIBOR6M + margin	1,009,860
2016-12-30	500	PLN	2021-12-31	changeable	505
2017-01-25	500	PLN	2022-01-26	changeable	505
2017-02-24	1,000	PLN	2022-02-25	changeable	1,012
2017-03-21	1,500	PLN	2022-03-22	changeable	1,516
2017-08-10	500	PLN	2022-08-10	changeable	505
2017-10-06	1,000	PLN	2022-10-06	changeable	1,010
2017-03-23	1,313	PLN	2042-03-23	fixed	1,315
2017-11-09	572	PLN	2042-11-09	fixed	573
Total	**6,257,485**				**6,299,315**

Issue date	Nominal value	Currency	Maturity date	Interest rate	Carrying amount as at 31 December 2016
2016-12-30	500	PLN	2021-12-31	changeable	500
2016-10-05	500,000	PLN	2019-10-05	WIBOR 6M + margin	502,630
2015-02-19	1,392,000	PLN	2019-02-19	WIBOR 6M + margin	1,402,760
2014-09-30	500,000	PLN	2019-09-30	fixed	503,565
2014-05-19	1,370,000	PLN	2017-05-19	WIBOR 6M + margin	1,373,398
2013-07-15	500,000	PLN	2017-07-17	WIBOR 6M + margin	505,055
2013-02-27	500,000	PLN	2017-02-27	WIBOR 6M + margin	503,725
2012-11-20	1,000,000	PLN	2018-01-25	WIBOR 6M + margin	1,009,770
Total	**5,762,500**				**5,801,403**

(in PLN '000)

31. Other liabilities

Other liabilities	31.12.2017	31.12.2016
Deferred costs	5,672	12,905
Future revenue	72,576	38,832
Provisions for annual leaves	6,959	6,752
Personnel costs – annual and jubilee awards, payments in lieu of leave, bonuses	43,641	43,398
Other liabilities (by basis):	**1,292,930**	**309,304**
- interbank settlements	99,925	56,105
- settlements with funds and programmes	590,833	164,855
- liabilities to suppliers of works and services	14,441	10,977
- employee settlements	182	168
- fuel fee liabilities	510,573	30,638
- payment card liabilities	701	39
- other	76,275	46,522
Total	**1,421,778**	**411,191**

As at 31 December 2017 and 31 December 2016, the Capital Group had no delinquent contractual liabilities under concluded agreements.

32. Provisions

Provisions for liabilities and guarantees	31.12.2017	31.12.2016
Provisions for liabilities and guarantees	170,799	135,667
Provisions for disputes	11,994	14,187
Provisions for defined benefit plans	13,643	6,029
Other provisions	93,328	96,891
Total provisions	**289,764**	**252,774**

Provisions for defined benefit plans

Provisions for defined benefit plans include: retirement, disability and survivor benefits. Provisions are estimated based on actuarial valuation using the discount rate: market yield of 10-year T-bonds of 3.0% and 3.5% assumed at the end of 2017 and at the end of 2016, respectively. The long-term annual wage growth rate of 2.0% has been assumed for calculation purposes. The provision for actuarial valuation is recognised and revalued annually.

Reconciliation of the present value of liabilities due to defined benefit plans

Reconciliation of the opening and closing balances of the present value of liabilities due to defined benefit plan is presented in the table below.

	2017	2016
Balance at the beginning of the period	**6,031**	**3,851**
Current employment costs	488	343
Past employment costs	7,372	0
Interest expense	131	80
Revaluation of liability:	110	2,017
- actuarial gains and losses arising from changes in demographic assumptions	34	1,291
- actuarial gains and losses arising from changes in financial assumptions	396	-241
- actuarial gains and losses arising from ex-post adjustments of assumptions	-320	967
Benefits paid	-424	-260
Changes in the structure of the Group	-65	0
Balance at the end of the period	**13,643**	**6,031**

Employment costs comprise:

- present employment costs: an increase in the present value of liabilities due to defined benefit plans resulting from work carried out by employees in the current period;
- costs of former employment: a change in the present value of the liability due to defined benefits for work carried out by employees in the past and appearing in the present period as a result of change of the plan (introduction, cancellation or change of the conditions of defined benefit plan) or limitation of said plan (a significant decrease by the unit of the number of employees subject to the plan) and
- any and all gains or losses resulting from settlement.

(in PLN '000)

Sensitivity analysis

The impact of 1 p.p. changes in actuarial valuations on liabilities due to defined benefit plans is presented below.

Liabilities due to defined benefit plans as at 31 December 2017	Increase by 1 percentage point	Decrease by 1 percentage point
Discount rate	-13,512	15,261
Payroll growth rate	15,261	-13,498
Liabilities due to defined benefit plans as at 31 December 2016	**Increase by 1 percentage point**	**Decrease by 1 percentage point**
Discount rate	-5,621	6,236
Payroll growth rate	6,238	-5,614

Maturity of liabilities due to defined benefit plans

Maturity of liabilities due to defined benefit plans is presented in the table below.

	31.12.2017	31.12.2016
Weighted average period of liabilities due to defined benefit plans (years)	7.12	6.7

Other provisions

Other provisions in individual periods:

Other provisions	31.12.2017	31.12.2016
Provision for off-balance sheet liabilities of liquidated National Housing Fund (NHF)	93,328	96,891
Total provisions	**93,328**	**96,891**

In 2009, in line with the Act of 2 April 2009 amending the Act on Sureties and Guarantees Granted by the State Treasury and Certain Legal Entities, the Act on Bank Gospodarstwa Krajowego and Certain Other Acts (Journal of Laws, no. 65, item 545), the National Housing Fund was liquidated as of 31 May 2009 and its net assets, whose value was determined based on the data from the financial statements drawn up at the liquidation date, increased the statutory capital of Bank Gospodarstwa Krajowego. Receivables of the National Housing Fund were measured at fair value. Fair value adjustment was applied to the Bank's receivables which were amortised in profit and loss account in "net interest income". Blocked funds concerning credit commitments were recognised by the Bank as "Provision". If the commitment is used, an adjustment is recognised in receivables and accounted for in line with the approach applied to adjustment of balance-sheet receivables. If the commitment expires unused or if it is used in an amount lower than originally committed, the statutory fund is adjusted pro rata from the provision.

Krajowy Fundusz Kapitałowy S.A. (KFK S.A.) supports investment funds providing financing to companies registered in the territory of the Republic of Poland. The sources of KFK S.A. funding include targeted grants and subsidy agreements signed with the Ministry of Economy.

As the Ministry of Development confirmed in 2016 that unallocated funds from grants belong to the company and considering the obligation of the Ministry of Development granted in 2017 to refund certain management costs borne by KFK S. A., the premises for maintaining a provision for future liabilities towards KFK S.A. no longer apply. National Capital Fund - KFK S.A.

Provisions for the year ending on 31.12.2017	Provisions for disputes	Provisions for defined benefit plans	Provisions for liabilities and guarantees	Other provisions	Total
Balance as at 1 January 2017, incl.:	**14,187**	**6,029**	**135,667**	**96,891**	**252,774**
Short-term provision	0	37	0	0	**37**
Long-term provision	14,187	5,992	135,667	96,891	**252,737**
Provision establishment/remeasurement	230	8,010	295,057	0	**303,297**
Release of provisions	2,388	0	258,313	0	**260,701**
Provision utilization	35	331	1,612	3,563	**5,541**
Changes in the structure of the Group	0	-65	0	0	**-65**
Balance as at 31 December 2016, incl.:	**11,994**	**13,643**	**170,799**	**93,328**	**289,764**
Short-term provision	0	4,047	47,192	0	**51,239**
Long-term provision	11,994	9,596	123,607	93,328	**238,525**

(in PLN '000)

Provisions for the year ending on 31.12.2016	Provisions for disputes	Provisions for defined benefit plans	Provisions for liabilities and guarantees	Other provisions	Total
Balance as at 1 January 2016, incl.:	**13,852**	**3,851**	**101,379**	**123,859**	**242,941**
Short-term provision	0	17	0	0	**17**
Long-term provision	13,852	3,834	101,379	123,859	**242,924**
Provision establishment/remeasurement	781	2,532	111,004	0	**114,317**
Release of provisions	162	0	76,716	19,073	**95,951**
Provision utilization	284	260	0	7,895	**8,439**
Other changes and reclassifications	0	-94	0	0	**-94**
Balance as at 31 December 2016, incl.:	**14,187**	**6,029**	**135,667**	**96,891**	**252,774**
Short-term provision	0	37	0	0	**37**
Long-term provision	14,187	5,992	135,667	96,891	**252,737**

33. Capital

Statutory capital

The statutory capital of the Parent is recognised in the amount specified in the Articles of Association and the Act on Bank Gospodarstwa Krajowego and comprises:

- cash and other assets contributed by the State Treasury, including treasury securities provided by the minister competent for public finance;
- annual appropriations of the Bank's net profit in the amount of at least 10% of the profit.

In view of investment activities and liquidity needs of the Bank, it received a capital injection in the following form:

- T-bonds and cash issued by the State Treasury in Q4 2017. The Bank recognised the bonds and cash in the statutory capital in the amount of PLN 2,848,200 thousand and PLN 1,500,000 thousand;
- T-bonds issued in Q3 2017. The Bank recognised the bonds in the statutory capital in the amount of PLN 1,942,200 thousand;
- T-bonds issued in Q4 2016. The Bank recognised the bonds in the statutory capital in the amount of PLN 2,893,200 thousand;

Supplementary capital

The supplementary capital is recognised in line with applicable Articles of Association of Capital Group entities and is used to cover balance sheet losses of these entities.

Revaluation reserve

Revaluation reserve comprises the effects of measurement of available-for-sale financial assets and the related deferred tax, effects of revaluation of PP&E at the moment of their reclassification to investment property, actuarial gains and losses and the related deferred tax, along with foreign exchange gains or losses on translating subordinate entities into PLN at an exchange rate equal to the arithmetic mean of average exchange rates as at the last day of each financial month as published by the National Bank of Poland.

Other reserve capitals

Other reserve capitals comprise appropriations of net profit and are used for purposes specified in the Articles of Association or other provisions of law applicable to Capital Group entities.

They also include the fund for general banking risk established for unidentified risks arising from banking activity, which in line with the Parent's Articles of Association, is established from appropriations of the annual net profit of the Parent.

Detailed information on payments from capital to the Treasury is presented in Note 13.

(in PLN '000)

33.1. Non-controlling interest

Name of subsidiary	Country of incorporation and place of business activity	Non-controlling interest in % (in the entity's capital)		Net profit per non-controlling interest		Total non-controlling interest	
		31.12.2017	31.12.2016	31.12.2017	31.12.2016	31.12.2017	31.12.2016
MP Biała Podlaska sp. z o.o. (previous name: MP Inwestycje 1 Sp. z o.o.)	Polska	17%	-	-70	-	1,556	-
MP Wałbrzych Sp. z o.o.	Polska	28%	-	-43	-	529	-
Projekt Municypalny Jarocin 1 Sp. z o. o.	Polska	7%	-	-7	-	1,737	-
Projekt Municypalny Kępice 1 Sp. z o. o.	Polska	2%	-	-1	-	0	-
Projekt Municypalny Kępno 1 Sp. z o. o.	Polska	16%	-	-5	-	592	-
Total				**-126**		**4,414**	

(in PLN '000)

Other notes

34. Contingent liabilities and guarantees

34.1. Securities underwriting (maximum underwriting amount committed by the Capital Group):

Issuer of securities underwritten as at 31 December 2017	Type of underwritten securities	Off-balance underwriting liabilities	Contract period	Marketability
Client 1	commercial bonds	550,000	2027-09-15	Non-marketable
Client 3	commercial bonds	1,000,000	2024-09-30	Marketable
Client 4	commercial bonds	4,000	2027-12-31	Non-marketable
Client 7	commercial bonds	9,752	2019-12-31	Non-marketable
Client 10	commercial bonds	10,156	2034-12-31	Non-marketable
Client 13	commercial bonds	400,000	2031-06-30	Non-marketable
Client 16	commercial bonds	3,794	2044-12-20	Non-marketable
Client 19	municipal bonds	20,000	2036-12-31	Marketable
Client 21	commercial bonds	9,333	2047-03-20	Non-marketable
Client 23	commercial bonds	2,850	2044-12-20	Non-marketable
Client 28	commercial bonds	189,393	2020-12-30	Marketable
Client 29	municipal bonds	10,000	2031-12-31	Marketable
Client 35	commercial bonds	44,810	2025-12-21	Non-marketable
Client 35	commercial bonds	5,034	2018-09-30	Non-marketable
Client 39	municipal bonds	3,000	2024-12-31	Marketable
Client 40	municipal bonds	11,900	2035-11-20	Marketable
Client 41	municipal bonds	6,530	2029-11-20	Marketable
Client 42	municipal bonds	13,000	2027-04-01	Marketable
Client 43	municipal bonds	11,320	2024-11-20	Marketable
Client 44	municipal bonds	5,000	2024-12-31	Marketable
Client 45	municipal bonds	20,600	2030-02-28	Marketable
Client 46	municipal bonds	17,825	2033-11-20	Marketable
Client 47	municipal bonds	7,500	2026-12-31	Marketable
Client 48	municipal bonds	3,300	2032-12-20	Marketable
Client 49	municipal bonds	20,000	2024-11-20	Marketable
Client 50	municipal bonds	19,500	2027-12-31	Marketable
Client 51	municipal bonds	5,000	2026-12-31	Marketable
Client 52	municipal bonds	36,300	2028-12-31	Marketable
Client 53	commercial bonds	10,800	2027-12-31	Non-marketable
Client 54	commercial bonds	30,000	2022-12-30	Non-marketable
Client 54	commercial bonds	27,800	2035-06-20	Non-marketable
Client 54	commercial bonds	21,800	2027-12-20	Non-marketable
Client 54	commercial bonds	40,000	2042-12-20	Non-marketable
Client 55	commercial bonds	13,240	2041-12-20	Non-marketable
Client 56	commercial bonds	2,700	2038-03-20	Non-marketable
Total		**2,586,237**		

(in PLN '000)

Issuer of securities underwritten as at 31 December 2016	Type of underwritten securities	Off-balance underwriting liabilities	Contract period	Marketability
Client 1	commercial bonds	700,000	2027-09-15	Marketable
Client 3	commercial bonds	138,393	2024-09-30	Marketable
Client 4	commercial bonds	6,000	2027-12-31	Non-marketable
Client 5	commercial bonds	267,620	2018-03-31	Non-marketable
Client 7	commercial bonds	20,500	2019-12-31	Non-marketable
Client 10	commercial bonds	4,000	2020-12-31	Non-marketable
Client 12	commercial bonds	150,400	2022-12-20	Non-marketable
Client 16	commercial bonds	7,200	2044-12-20	Marketable
Client 20	commercial bonds	284	2040-06-20	Non-marketable
Client 21	commercial bonds	6,800	2046-09-20	Non-marketable
Client 23	commercial bonds	2,850	2044-12-20	Non-marketable
Client 24	municipal bonds	3,000	2024-12-31	Marketable
Client 25	municipal bonds	2,900	2024-06-15	Marketable
Client 28	commercial bonds	306,819	2020-12-30	Marketable
Client 29	municipal bonds	20,000	2031-12-31	Marketable
Client 30	municipal bonds	14,000	2026-12-31	Marketable
Client 31	municipal bonds	3,900	2024-12-31	Marketable
Client 32	municipal bonds	4,465	2030-12-31	Marketable
Client 33	commercial bonds	4,800	2031-12-31	Non-marketable
Client 34	commercial bonds	6,655	2042-09-20	Non-marketable
Client 35	commercial bonds	28,069	2025-12-21	Non-marketable
Client 36	commercial bonds	2,170	2045-12-20	Non-marketable
Client 37	commercial bonds	1,750	2046-03-20	Non-marketable
Client 38	commercial bonds	140,000	2020-07-04	Non-marketable
Total		**1,842,575**		

34.2. Financial liabilities granted

Financial liabilities granted	31.12.2017	31.12.2016
Credit lines and limits	**38,403,444**	**36,550,670**
- to financial institutions	1,529,735	950,970
- to non-financial institutions	6,029,481	4,924,614
- to public sector entities	30,844,228	30,675,086
Total	**38,403,444**	**36,550,670**

34.3. Guarantee liabilities granted

Guarantee liabilities granted	31.12.2017	31.12.2016
Sureties and guarantees	**14,541,564**	**8,434,339**
- to financial institutions	547,042	851,718
- to non-financial institutions	13,766,316	7,517,368
- to public sector entities	228,206	65,253
Letters of credit granted	**9,866**	**19,873**
- to financial institutions	9,866	19,873
Total	**14,551,430**	**8,454,212**

34.4. Off-balance sheet liabilities received

At nominal value	31.12.2017	31.12.2016
Financial	11,227,709	11,202,648
Guarantee	25,349,960	23,410,915
Total	**36,577,669**	**34,613,563**

The Municipal Fund (at present: Dwelling for Development Sector Fund) in 2017 and 2016 entered into contingent investment agreements for funding the construction of semi-detached houses as well as for funding the acquisition of property. As at 31.12.2017, total contingent liabilities of the Fund in respect of the above amount to PLN 43,745 thousand.

Right to sell or pledge a collateral established for the Capital Group

As at 31 December 2017 and 31 December 2016, the Capital Group of the Bank held no collaterals which could be sold or pledged by the Capital Group of the Bank if the collateral owner met all of its obligations.

(in PLN '000)

35. Additional information to the consolidated statement of cash flows

Cash and cash equivalents include cash in hand and in the nostro account at the National Bank of Poland as well as cash in the current accounts in banks and other cash with a maturity period of up to 3 months.

Cash recognised in the cash flow statement	31.12.2017	31.12.2016
Cash and balances with the Central Bank	988,581	646,776
Cash in other banks	2,231,857	2,852,000
Total	**3,220,438**	**3,498,776**

Difference between balance sheet changes in individual items and changes in these items presented in the consolidated statement of cash flows	31.12.2017	31.12.2016
Interest and dividends	**188,724**	**175,396**
a) interest:	191,012	178,737
- cost of interest on long-term loans	54,428	50,669
- cost of interest on debt securities issued	136,584	128,068
b) dividends:	-2,288	-3,341
- PZU S.A.	-2,160	-3,208
- EFI Luksemburg	-122	-126
- VISA International	-6	-7
Change in receivables from banks	**-231,250**	**-17,026**
a) balance sheet changes	388,893	-1,637,193
b) assets included in change in cash	-620,143	1,620,167
Change in loans and advances to customers	**-2,590,442**	**-4,855,740**
a) balance sheet changes	-2,592,229	-4,855,910
b) valuation of debt securities reclassifed from available-for-sale portfolio.	1,787	170
Change in investments in available-for-sale financial assets	**-107,049**	**-14,830,638**
a) balance sheet changes	-5,441,507	-17,660,847
b) equity instruments recognised in investment activities	12,205	-8,696
c) T-bonds shares transferred to increase statutory capital	4,790,400	2,893,200
d) measurement recognised in revaluation reserve	531,853	-54,295
Change in other assets and assets held for sale	**-13,151**	**-4,117**
a) balance sheet changes	-14,921	-4,117
b) deconsolidation of TFI BGK S.A (at present: PFR TFI S.A.)	1,770	0
Change in liabilities to banks	**-348,220**	**-462,820**
a) balance sheet changes	-384,689	-149,001
b) loans included in financing activities	36,469	-313,819
Change in liabilities to customers	**-3,411,964**	**17,447,183**
a) balance sheet changes	-3,416,932	17,383,757
b) loans included in financing activities	4,968	63,426
Changes in liabilities due to securities issued	**0**	**0**
a) balance sheet changes	497,912	-307
b) issues included in financing activities	-497,912	307
Change in provisions	**37,065**	**8,011**
a) balance sheet changes	36,990	9,833
b) adjustment of measurement of National Housing Fund liabilities recognised in BGK's statutory capital	186	130
c) remeasurement of defined benefit plan liabilities	-111	-1,952
Change in other liabilities	**1,009,289**	**52,801**
a) balance sheet changes	1,010,587	53,196
b) appropriation of profit to funds exposed to credit risk	-330	-395
c) settlement of the acquisition of investmen property	-968	0
Other adjustments	**879**	**837**
a) transfer of PP&E and intangible assets to commissioned activities (flow funds)	816	837
b) transfer of PP&E – changes in the structure of the Group	63	0

(in PLN '000)

36. Transactions with the Treasury and government linked entities

BGK is a state bank with the State Treasury as the sole shareholder. The Bank carries out activities commissioned by the State Treasury through the administration of funds and implementation of government programmes described in note 1 to these financial statements.

Revenue generated and expenses incurred by the Bank in relation to the commissioned activities comprise fee and commission income and bank's general administrative expenses.

The consolidated statement of financial position of the Capital Group presents receivables, securities, and liabilities from transactions with the Treasury, the public sector and government linked entities, with the Treasury as the shareholder.

Transactions of the BGK Capital Group with the State Treasury								
Entity	31.12.2017				2017			
	Receivables	Including loans	Liabilities	Off-balance sheet guarantee and financial liabilities	Total revenue	Including interest and fee	Total expenses	Including interest and fee
State Treasury entity	9,808,257	0	5,089,428	30,004,000	276,591	276,591	388,203	2,818
Other State Treasury entities	0	0	0	0	0	0	0	0

Transactions of the BGK Capital Group with the State Treasury								
Entity	31.12.2016				2016			
	Receivables	Including loans	Liabilities	Off-balance sheet guarantee and financial liabilities	Total revenue	Including interest and fee	Total expenses	Including interest and fee
State Treasury entity	9,304,364	0	8,270,939	30,004,000	208,674	208,674	301,535	301,535
Other State Treasury entities	0	0	0	0	1	1	0	0

(in PLN '000)

Material transactions of the BGK Capital Group with entities associated with the State Treasury						
Entity	31.12.2017			2017		
	Total receivables	Total liabilities	Off-balance sheet guarantee and financial liabilities granted	Interest income	Commission income	Interest expense
Entity 2	59,863	32	0	1,150	216	0
Entity 4	1,119,416	665,515	550,000	31,776	1,178	0
Entity 5	33,052	45,605	70,000	1,062	99	9
Entity 7	0	1	0	4,208	2,159	0
Entity 13	215,098	100,168	234,940	5,501	951	1
Entity 14	0	35,415	0	0	2	5
Entity 17	0	23	2,932,408	0	3,308	0
Entity 19	0	67,788	0	0	25	5
Entity 20	0	528	0	0	4	3
Entity 22	53,665	5,309	20,000	2,275	94	26
Entity 26	1,703,717	200,283	0	54,864	1,499	293
Entity 31	14,938	32,020	0	570	95	184
Entity 33	1,949,590	100,030	0	42,900	632	1,019
Entity 34	1,793,858	200,381	495,682	55,334	1,832	0
Entity 35	90,799	4,368	0	3,400	59	87
Entity 36	1,499,451	163,519	0	40,943	438	2
Entity 37	112,130	157,264	113,615	6,855	1,210	0
Entity 38	801,052	807	635,337	13,904	1,642	32
Entity 40	230,645	0	0	34,767	614	0
Entity 43	0	1	0	2,363	543	30
Entity 47	8,565	3,724	0	233	1	0
Entity 50	3,286	50	0	140	8	0
Entity 54	0	290	0	0	2	0
Entity 55	0	63,097	0	0	71	2
Entity 56	0	33,059	0	0	6	46
Entity 58	0	301,438	0	0	1	0
Entity 59	0	216	0	0	2	0
Entity 60	0	1,120	0	0	0	3
Entity 61	0	3,783	0	0	0	5
Entity 62	0	814	0	0	0	1
Entity 63	31,542	5,902	15,000	1,193	89	1
Entity 64	32,518	10,008	1,044	1,384	129	10
Entity 65	250	0	0	0	0	6
Entity 66	0	50,825	0	0	6	38
Entity 67	54,203	0	0	1,480	607	0
Entity 68	0	1,728	0	0	5	0
Entity 69	25,860	7,570	0	1,097	71	8
Entity 70	0	3,155	0	0	1	0
Entity 71	0	25,300	0	0	3	0
Entity 72	0	120,428	0	0	1	0
Entity 73	0	200,693	0	0	1	0
Entity 74	0	100,304	0	0	1	0
Entity 76	0	441	0	0	0	1

(in PLN '000)

Material transactions of the BGK Capital Group with entities associated with the State Treasury						
Entity	31.12.2017			2017		
	Total receivables	Total liabilities	Off-balance sheet guarantee and financial liabilities granted	Interest income	Commission income	Interest expense
Entity 77	0	1,488	0	0	0	2
Entity 78	0	2,143	0	0	0	6
Entity 79	0	64,316	0	0	4	823
Entity 80	0	0	129	0	0	0
Entity 81	172	11	226	4	3	0
Entity 82	0	6,486	7,000	3	51	4
Entity 83	0	0	0	66	189	0
Entity 84	0	0	0	0	1,015	0
Entity 85	0	4,016	0	0	1	19
Entity 86	22,913	227	0	1,052	66	1
Entity 87	0	399,209	1,588,740	0	6,869	598
Entity 88	0	5,867	0	0	1	1
Entity 89	0	104	0	0	2	0
Entity 90	0	308,402	330,536	0	180	2
Total	**9,856,583**	**3,505,271**	**6,994,657**	**308,524**	**25,986**	**3,273**

(in PLN '000)

Material transactions of the BGK Capital Group with entities associated with the State Treasury						
Entity	31.12.2016			2016		
	Total receivables	Total liabilities	Off-balance sheet guarantee and financial liabilities granted	Interest income	Commission income	Interest expense
Entity 2	59,842	33	0	1,186	182	0
Entity 4	1,008,390	553,356	700,000	28,187	1,399	0
Entity 5	0	203	120,000	3,383	765	7
Entity 9	0	304,401	380,898	0	1,844	1,586
Entity 13	215,167	66	234,870	5,436	954	0
Entity 14	0	27,060	0	0	2	31
Entity 16	0	0	15,000	11	13	0
Entity 17	0	1,729,061	2,033,908	0	3,082	1
Entity 19	0	78,416	0	0	21	3
Entity 20	0	28	0	0	4	1
Entity 21	32,874	219,521	27,301	1,047	414	104
Entity 26	2,555,575	261	0	72,665	1,498	256
Entity 27	772	1,027	0	38	6	21
Entity 31	21,240	36,227	0	774	96	125
Entity 33	1,948,936	750,153	0	21,400	1,779	619
Entity 34	1,715,262	4	97,185	46,605	958	0
Entity 35	105,906	12,880	0	4,544	200	94
Entity 36	1,498,989	149,537	0	11,440	522	1
Entity 37	757,274	2	237,230	23,544	1,183	0
Entity 38	562,151	261	169,262	5,771	971	9
Entity 39	519,681	300,031	300,171	9,909	407	0
Entity 40	341,891	175,024	0	19,893	768	0
Entity 41	147,982	89,892	0	4,300	86	1
Entity 42	120,215	188,180	0	1,830	123	20
Entity 43	59,737	15,911	0	5,281	397	50
Entity 44	37,989	25,886	98,896	803	1,042	9
Entity 45	35,553	59	24,500	544	9	0
Entity 46	28,567	1	329,481	1,200	3,136	0
Entity 47	9,635	2,824	0	308	1	0
Entity 48	6,282	45,649	44,470	452	197	20
Entity 49	6,002	2,014	12,746	312	175	1
Entity 50	1,763	304	0	26	3	0
Entity 51	0	64,237	40,000	0	22	3
Entity 52	0	633,276	800,000	0	509	52
Entity 53	0	1,954	0	0	2	17
Entity 54	0	293	0	0	2	0
Entity 55	0	4,464	2,842	0	60	7
Entity 56	0	66,572	0	0	6	74
Entity 57	0	0	469,231	0	1,315	0
Entity 58	0	425,287	0	0	0	0
Entity 59	0	101	0	0	2	0
Total	**11,797,675**	**5,904,456**	**6,137,991**	**270,889**	**24,155**	**3,112**

(in PLN '000)

37. Related party transactions (capital or personal links)

All related party transactions were entered into on arm's length terms. Standard market transactions involving loans, current and term deposits (short-term), liabilities due to repo and sell-buy-back transactions with related interest are presented below.

Entity name	31.12.2017				2017			
	Receivables	Including loans	Liabilities	Off-balance sheet liabilities granted	Total revenue	Including interest and commissions	Total expenses	Of which: interest and commissions
Associates								
Bydgoski Fundusz Poręczeń Kredytowych Sp. z o.o.	0	0	0	0	1	1	0	0
Dolnośląski Fundusz Gospodarczy Sp. z o.o.	0	0	4,828	0	1	1	124	124
Fundusz Pomerania Sp. z o.o.	0	0	8,460	0	0	0	131	131
Kujawsko-Pomorski Fundusz Poręczeń Kredytowych Sp. z o.o.	0	0	12,177	0	0	0	121	121
KUKE S.A.	0	0	33,059	0	6	6	46	46
Małopolski Regionalny Fundusz Poręczeniowy Sp. z .o.o.	0	0	213	0	1	1	1	1
Opolski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o.	0	0	2,311	0	0	0	69	69
Podkarpacki Fundusz Poręczeń Kredytowych Sp. z o.o.	0	0	7,222	4,570	120	120	104	104
Samorządowy Fundusz Poręczeń Kredytowych sp. z o.o.	0	0	5,142	0	0	0	96	96
Świętokrzyski Fundusz Poręczeniowy Sp. z o.o.	0	0	9,804	0	1	1	145	145
Warmińsko-Mazurski Fundusz "Poręczenia Kredytowe" Sp. z o.o.	0	0	0	0	1	1	0	0
Fundusz Inwestycji Infrastrukturalnych - Dłużny FIZ AN (Infrastructure Investments Debenture Closed-End Investment Private Equity Fund)	0	0	0	2,746	0	0	0	0
Fundusz Inwestycji Infrastrukturalnych - Kapitałowy FIZ AN (Infrastructure Investments Capital Closed-End Investment Private Equity Fund)	0	0	0	40,715	0	0	0	0
Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprises Investments Closed-End Investment Private Equity Fund)	0	0	0	129,902	0	0	0	0
Fundusz Inwestycji Samorządowych FIZ AN (Municipal Investments Closed-End Investment Private Equity Fund)	0	0	0	43,009	0	0	0	0
Other units								
Krajowy Fundusz Kapitałowy S.A. (KFK S.A.)	0	0	146,726	0	20	20	1,405	1,405
Lubuski Fundusz Poręczeń Kredytowych Sp z o.o.	0	0	18,344	0	0	0	200	200
Mazowiecki Fundusz Poręczeń Kredytowych Sp. z o.o.	0	0	21,482	0	3	3	307	307
PFR TFI S.A. (former TFI BGK S.A.)	0	0	31,148	0	688	5	1,058	1,058
Polski Fundusz Rozwoju S.A.(PFR S.A.)	78	0	815	0	3	0	2,059	0
Total	**78**	**0**	**301,731**	**220,942**	**845**	**159**	**5,866**	**3,807**

(in PLN '000)

Entity name	31.12.2016				2016			
	Receivables	Including loans	Liabilities	Off-balance sheet liabilities granted	Total revenue	Including interest and commissions	Total expenses	Of which: interest and commissions
Associates								
Bydgoski Fundusz Poręczeń Kredytowych Sp. z o.o.	0	0	0	0	1	1	0	0
Dolnośląski Fundusz Gospodarczy Sp. z o.o.	0	0	8,321	0	1	1	0	0
Fundusz Pomerania Sp. z o.o.	0	0	5,459	0	0	0	0	0
KUKE S.A.	0	0	66,572	0	6	6	74	74
Małopolski Regionalny Fundusz Poręczeniowy Sp. z o.o.	0	0	68	0	1	1	2	2
Opolski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o.	0	0	4,128	0	0	0	0	0
Podkarpacki Fundusz Poręczeń Kredytowych Sp. z o.o.	0	0	193	0	5	5	1	1
Samorządowy Fundusz Poręczeń Kredytowych sp. z o.o.	0	0	5,046	0	0	0	0	0
Świętokrzyski Fundusz Poręczeniowy Sp. z o.o.	0	0	2,136	0	1	1	1	1
Warmińsko-Mazurski Fundusz "Poręczenia Kredytowe" Sp. z o.o.	0	0	0	0	1	1	0	0
Fundusz Inwestycji Infrastrukturalnych - Dłużny FIZ AN (Infrastructure Investments Debenture Closed-End Investment Private Equity Fund)	0	0	0	121,486	0	0	0	0
Fundusz Inwestycji Infrastrukturalnych - Kapitałowy FIZ AN (Infrastructure Investments Capital Closed-End Investment Private Equity Fund)	0	0	0	18,111	0	0	0	0
Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprises Investments Closed-End Investment Private Equity Fund)	0	0	0	54,471	0	0	0	0
Fundusz Inwestycji Samorządowych FIZ AN (Municipal Investments Closed-End Investment Private Equity Fund)	0	0	0	468	0	0	0	0
Other units								
Krajowy Fundusz Kapitałowy S.A. (KFK S.A.)	0	0	304,360	0	8	8	5,137	5,137
Lubuski Fundusz Poręczeń Kredytowych Sp z o.o.	0	0	8,306	0	0	0	0	0
Mazowiecki Fundusz Poręczeń Kredytowych Sp. z o.o.	0	0	17,620	0	2	2	2	2
Polski Fundusz Rozwoju S.A.(PFR S.A.)	0	0	399,200	0	0	0	0	0
Total	**0**	**0**	**821,409**	**194,536**	**26**	**26**	**5,217**	**5,217**

(in PLN '000)

38. Remuneration of the top executives of Capital Group entities

Top executives of the Bank – excluding the Chairman and members of the Management Board – are remunerated in accordance with the Remuneration Regulations for BGK employees, annexed to Resolution of the Management Board of BGK of 27 July 2010 (as amended; entered into force by Resolution of the Management Board of BGK 23 February 2011 and Resolution of the Management Board of BGK of 5 July 2011).

Members of the Management Board of BGK are remunerated in accordance with the Act on remuneration of the management of certain entities of 9 June 2016 (Journal of Laws of 2016, item 1202), the Declaration of the Minister of Development and Finance of 14 October 2016 on remuneration of Members of the Management Board of Bank Gospodarstwa Krajowego as well as the Remuneration Policy for Members of the Management Board of BGK, attached as an appendix to the Resolution of the Supervisory Board, dated 3 November 2016.

38.1. Remuneration of Members of the Management Board and Supervisory Board

Remuneration of Members of the Supervisory Board of the Bank		
	2017	**2016**
Supervisory Board of the Bank	590	532

Remuneration paid or due to Members of the Management Board of the Bank

Employee benefits	2017					
	Short-term employee benefits		Benefits after the employment period	Other long-term benefits	Benefits due to termination of employment relationship	
	Salaries and wages	Other*			Paid in 2017**	Paid at a later date**
Management Board	4,393	30	none	none	283	none

* basic remuneration, additional remuneration for 2016
** benefits due to a post-employment non-competition clause for previous members of the Management Board

Employee benefits	2016					
	Short-term employee benefits		Benefits after the employment period	Other long-term benefits**	Benefits due to termination of employment relationship	
	Salaries and wages	Other*			Paid in 2016***	Paid at a later date***
Management Board	1,609	387	none	21	1,089	283

* including: rent, additional insurance coverage
** Employee Retirement Plan
*** severance due to termination of a contract of employment, post-employment non-competition compensation

Remuneration of members of management boards and supervisory boards of the Capital Group entities		
Short-term employee benefits	**2017**	**2016**
Management Board	2,975	2,652
Supervisory Board	216	653
Total	**3,191**	**3,305**

39. Principles of variable remuneration for top executives of the Capital Group

To meet the requirements of the Resolution of the Polish Financial Supervision Authority No. 258/2011 of 4 October 2011 on detailed principles of functioning of the risk management system and internal control system and detailed conditions of internal capital assessment by banks and of reviewing the process of internal capital assessment and maintenance, and the principles of determining the policy on variable components of remuneration of persons holding managerial positions at the Bank (PFSA resolution), the Bank implemented the following resolutions:

- Resolution 58/2016/IX of the Supervisory Board of 3 October 2016 "Policy governing variable remuneration components of BGK managers" (Policy);
- Resolution no. 362/2016/DZK/PRA of the Management Board of BGK 2 October 2016 "Guidelines on implementation of the "Policy governing variable remuneration components of BGK managers" ("Policy Guidelines").

The regulations in question define the principles of awarding and paying variable remuneration associated with performance. BGK established a Remuneration Committee, composed of members appointed from the Supervisory Board. The competencies of the Committee have been defined in the Remuneration Committee Regulations. Due to its legal form (a state-owned bank), to the nature of its activities, and to the individual risk profile, the Bank — in line with the proportionality principle — neutralises some requirements, e.g. by not paying the variable remuneration portion in shares and instruments other than shares. As regards variable remuneration, the Bank applies the following principles:

(in PLN '000)

- variable remuneration shall not exceed 100% of the base pay;
- where the variable remuneration exceeds the total amount of PLN 100 thousand, 40% of the excess amount is deferred.
- 40% of variable remuneration due over PLN 100 thousand is paid in the form of deferred variable remuneration in a period of 3 years from the end of assessment period for which the remuneration is due, with the remuneration being paid in equal annual instalments.

The Bank has developed and followed appropriate Policy monitoring procedures, such as those on monitoring the limits of variable remuneration components awarded to persons covered by the Policy. In 2017, there were 6 persons covered by the Policy and whose respective variable remuneration exceeded PLN 100 thousand limit, including two persons from senior management (variable remuneration paid in 2017 comprised a commission for Q4 2016 and a commission for Q1, Q2, and Q3 2017) as well as four Members of the Management Board of the Bank (the payment in 2017 also comprises additional remuneration for 2016). 40% of the variable remuneration above the limit for said persons has been deferred for a period of 3 years. The variable remuneration depends on the appraisal of performance of a given person in a 3-year period, taking into account the risk incurred by the Bank as a result of decisions made by this employee and their impact on the Bank's current results. The type and amount of variable pay is awarded based on the degree to which the employee fulfilled their tasks as well as work quality and performance (targets sheet). Variable pay also depends on whether the Bank has achieved a positive net financial result cumulatively from the beginning of the year.

The policies were also implemented in subsidiaries. As at 31 December 2017 the following variable remuneration policies applied at subsidiaries:

- BGK Nieruchomości S.A. – Resolution no. 2/2015 of the SB of 16 February 2015 approving "The variable remuneration policy for top executives of BGK Nieruchomości S.A."

40. Changes in Capital Group entities

On 28 September 2017 the Bank sold 100% shares of TFI BGK S.A. (at present: PFR TFI S.A) to the Polish Development Fund.

In 2016, the Bank acquired 543,780 investment certificates of Fundusz Sektora Mieszkań na Wynajem FIZ AN (Dwelling for Rent Sector Closed-End Investment Private Equity Fund). As at 31 December 2017, the Bank was the sole investor of the Fund holding 1,103,946 investment certificates in that Fund.

At the end of 2017, Dwelling for Rent Sector Closed-End Investment Private Equity Fund and Dwelling for Development Sector Closed-End Investment Private Equity Fund held interest in the following special purpose vehicles:

SPV	Articles of Association of:	Entity entered into the National Court Register on:
Fundusz Sektora Mieszkań na Wynajem FIZ AN (Dwelling for Rent Sector Closed-End Investment Private Equity Fund):		
FSMnW Poznań Sp. z o.o.	2014.11.18	2014.11.28
FSMnW Warszawa 1 Sp. z o.o.	2014.12.15	2015.01.29
FSMnW Wrocław Sp. z o.o.	2014.12.15	2015.04.24
FSMnW Trójmiasto Sp. z o.o.	2015.02.04	2015.04.16
FSMnW Kraków Sp. z o.o..	2015.03.10	2015.04.13
FSMnW Katowice Sp. z o.o.	2015.05.27	2015.06.19
FSMnW Inwestycje Sp. z o.o. (former name: FSMnW Łódź Sp. z o.o.)	2015.05.27	2015.06.18
FSMnW Warszawa 2 Sp. z o.o.	2015.09.24	2015.11.16
FSMnW Warszawa 3 Sp. z o.o. (former name: FSMnW Łódź 2 Sp. z o.o.)	2015.11.13	2015.12.03
MP Biała Podlaska sp. z o.o. (previous name: MP Inwestycje 1 sp. z o.o.)	2016.11.25	2016.12.29
MP Inwestycje 2 sp. z o.o.	2017.03.13	2017.04.24
MP Inwestycje sp. z o.o.	2017.03.13	2017.05.12
MP Inwestycje 3 sp. z o.o.	2017.06.13	2017.08.22
MP Inwestycje 4 sp. z o.o.	2017.06.13	2017.08.04
MP Wałbrzych sp. z o.o.	2017.06.13	2017.07.26
Fundusz Sektora Mieszkań dla Rozwoju (Dwelling for Development Sector Closed-End Investment Private Equity Fund)		
Projekt Municypalny Sulęcin 1 Sp. z o. o.	2017.08.10	2017.10.13
Spółka Operacyjna Projektów Municypalnych Sp. z o.o.	2017.08.03	2017.09.06
Projekt Municypalny Jarocin 1 Sp. z o. o.	2016.10.13	2016.12.05
Projekt Municypalny Kępice 1 Sp. z o. o.	2017.05.23	2017.08.29
Projekt Municypalny Kępno 1 Sp. z o. o.	2017.07.27	2017.09.29

Projekt Municypalny Nysa 1 Sp. z o. o.	2017.12.07	2018.02.08

41. Fair value of financial assets and financial liabilities

41.1. Categories of the measurement of the fair value of financial assets and financial liabilities measured at fair value in the consolidated statement of financial position

Based on fair value measurement methods, the Capital Group has classified its financial assets and financial liabilities to the following levels:

- Level 1 prices quoted in active markets,
- Level 2 valuation techniques based on observable market inputs,
- Level 3 other valuation techniques.

Level 1 Prices quoted in active markets
Financial assets and liabilities, whose fair values are determined based on unadjusted, quoted prices for identical assets or liabilities in active markets. This category includes debt and equity instruments with an active market in place and the fair value determined based on the market purchase price:

- T-bonds denominated in PLN in the held-for-trading portfolio,
- T-bonds denominated in PLN in the available-for-sale portfolio,
- shares in listed companies in continuous trading at the Warsaw Stock Exchange and NYSE (shares in VISA) in the available-for-sale portfolio,
- municipal bonds denominated in PLN in the portfolio measured at fair value through profit or loss.

Level 2 Valuation techniques on observable market inputs
Financial assets and liabilities, whose fair value is determined using valuation models in which all inputs are observed in the market either directly (prices) or indirectly (price-based inputs). This category includes financial instruments with no active market:

- T-bonds denominated in EUR and USD, bonds issued in PLN and EUR, and NBP (money market) bills in the available-for-sale portfolio,
- derivative instruments.

Level 3 Other valuation techniques
Financial assets and liabilities, whose fair value is determined based on models using unobservable inputs. The category includes:

- commercial and municipal bonds and debt securities issued by financial institutions in the available-for-sale portfolio,
- investment certificates and other stocks and shares not held for trading and classified in available-for-sale portfolio.

Financial instruments are transferred between Level 1 and Level 2 based on the availability of quoted prices from the active market at the end of the reporting period. Reclassification from Levels 2 to Level 3 occurs if an observable input is replaced with an unobservable one or if a new unobservable risk is used in the valuation, which, at the same time, considerably affects the price of the instrument. Reclassification from Levels 3 to Level 2 occurs if an unobservable input is replaced with an observable one or if the pricing effect of an unobservable input becomes negligible. Transfers between individual measurement levels are recognised as at the end of the reporting period.

In 2016, there was no transfer between the Levels. As of January 2017, measurement of derivative financial instrument takes into account CVA/DVA, thus the recognition for this category was transfered from Level 2 to Level 3.

(in PLN '000)

The carrying amounts of individual categories of financial assets and liabilities by measurement level as at 31 December 2017 along with comparable data are presented below:

Assets and liabilities measured at fair value as at 31 December 2017	Carrying amount	Level 1	Level 2	Level 3
		Prices quoted in active markets	Valuation techniques based on observable market inputs	Other valuation techniques
Financial assets designated as measured at fair value through profit or loss at initial recognition	130,233	0	130,233	0
- debt instruments	130,233	0	130,233	0
Financial assets held for trading	1,342,070	0	1,051	1,341,019
- debt instruments	1,051	0	1,051	0
- derivative financial instruments	1,341,019	0	0	1,341,019
Available-for-sale financial assets	37,061,252	8,782,364	24,691,348	3,587,540
- debt securities	35,699,238	7,562,502	24,691,348	3,445,388
- equity securities	1,299,396	1,219,862	0	79,534
- other financial assets	62,618	0	0	62,618
Total assets measured at fair value	**38,533,555**	**8,782,364**	**24,822,632**	**4,928,559**
Derivative financial instruments	1,284,618	0	0	1,284,618
Total liabilities measured at fair value	**1,284,618**	**0**	**0**	**1,284,618**

Assets and liabilities measured at fair value as at 31 December 2016	Carrying amount	Level 1	Level 2	Level 3
		Prices quoted in active markets	Valuation techniques based on observable market inputs	Other valuation techniques
Financial assets designated as measured at fair value through profit or loss at initial recognition	136,399	45,569	90,830	0
- debt instruments	136,399	45,569	90,830	0
Financial assets held for trading	478,808	48,234	430,574	0
- debt instruments	49,527	48,234	1,293	0
- derivative financial instruments	429,281	0	429,281	0
Available-for-sale financial assets	31,619,745	6,497,607	18,567,074	6,555,064
- debt securities	30,767,822	5,720,575	18,567,074	6,480,173
- equity securities	810,493	777,032	0	33,461
- other financial assets	41,430	0	0	41,430
Total assets measured at fair value	**32,234,952**	**6,591,410**	**19,088,478**	**6,555,064**
Derivative financial instruments	608,005	0	608,005	0
Total liabilities measured at fair value	**608,005**	**0**	**608,005**	**0**

	Gains and losses recognised in profit or loss		Gains and losses recognised in equity	
Instrument type	2017	2016	2017	2016
Commercial bonds	74,255	98,107	31,045	-16,188
Municipal bonds	29,629	29,924	20,061	-18,189
Shares	2,288	13,937	464,692	-8,552
Other financial assets	0	0	8,196	5,791

Acquisitions, sale, issues and settlements for Level 3 are presented below.

2017				
Instrument type	Matured	New issues	Issued and maturing in the same year	Sale
Commercial bonds	1,533,872	1,314,051	2,493,375	879,271
Municipal bonds	120,577	289,038	0	13,819

2016				
Instrument type	Matured	New issues	Issued and maturing in the same year	Sale
Commercial bonds	439,243	759,090	5,052,218	0
Municipal bonds	105,517	61,900	0	23,887

(in PLN ‘000)

41.2. Financial assets and financial liabilities in the consolidated statement of financial position not recognised at fair value

In the absence of expected considerable differences between the carrying amounts and the fair values of selected groups of financial instruments, resulting from the characteristics of such groups (such as short term, high correlation with market parameters) and low market interest rates, it was assumed that their carrying amounts correspond to the fair values. This pertains, in particular, to items such as: cash and balances with the Central Bank, deposits, interbank deposits, and liabilities to customers.

The fair value of credit exposures was measured using the discounted cash flow method at an interest rate appropriate for each credit transaction (taking into account the market risk margin). For irregular exposures, the value was estimated based on historical loss parameters for similar exposures.

The fair value of the Bank’s assets related to debt securities classified as loans and advances to customers was estimated using a valuation technique consisting in discounting future cash flows, where a curve based on WIBOR rates up to one year (inclusive), IRS rate over one year and FRA rate were used as the projection curve, while a curve based on the yield on T-bonds, shifted by the credit spread, was used as the discount curve.

The fair value of the Bank’s liabilities due debt securities issued was determined on the basis of:

- quoted prices in the Catalyst system – for publicly traded bonds,
- a measurement technique of discounted future cash flows – for other securities – where a curve based on WIBOR rates up to one year (inclusive), IRS rate over one year and FRA rate were used as the projection curve, while a curve based on the yield on T-bonds, shifted by the credit spread, was used as the discount curve.

As regards other assets and liabilities which are not measured at fair value, the Bank assumed that there were no major differences between the fair value of an asset or liability and its carrying amount.

Presented below are the fair values of financial assets and financial liabilities not measured at fair value.

	Fair value hierarchy	31.12.2017	
		Carrying amount	Fair value
Cash and balances with the Central Bank	3	988,581	988,581
Receivables from banks	3	3,247,473	3,247,473
Loans and advances to customers	3	27,223,753	27,506,769
Receivables under reverse repo and buy-sell-back transactions	3	2,105,540	2,105,540
Liabilities to banks	3	3,594,140	3,594,140
Liabilities to customers	3	33,692,320	33,692,320
Liabilities under repo and sell-buy-back transactions	3	7,573,820	7,573,820
Liabilities due to debt securities issued	1	2,407,405	2,420,673
Liabilities due to debt securities issued	3	3,891,910	3,912,695

	Fair value hierarchy	31.12.2016	
		Carrying amount	Fair value
Cash and balances with the Central Bank	3	646,776	646,776
Receivables from banks	3	3,636,366	3,636,366
Loans and advances to customers	3	24,631,524	24,973,513
Receivables due to reverse repo and buy-sell-back transactions	3	3,946,887	3,946,887
Liabilities to banks	3	3,978,829	3,978,829
Liabilities to customers	3	37,109,252	37,109,252
Liabilities due to repo and sell-buy-back transactions	3	5,752,184	5,752,184
Liabilities due to debt securities issued	1	3,785,928	3,790,505
Debt securities issued	3	2,015,475	2,012,606

(in PLN '000)

42. Custody business

In 2017 and 2016, the Parent maintained the following securities accounts (deposit accounts) with dematerialized securities as follows:

Securities	As at 31.12.2017	As at 31.12.2016
National Depository for Securities (KDPW)	**240,102,623**	**256,172,291**
Bonds	89,490	114,600
Treasury bonds entity 1	240,013,133	256,057,691
National Bank of Poland (NBP)	**698,200**	**683,200**
Money bills	698,200	683,200
BGK	**371,459**	**257,167**
Municipal bonds	98,667	103,167
Other bonds	272,792	154,000
Total	**241,172,282**	**257,112,658**

These accounts do not comply with the definition of assets, hence they are not disclosed in the consolidated financial statements of the Group.

In the financial years 2017 and 2016, the Bank maintained securities accounts only with dematerialized securities of its clients.

Risk management objectives and principles

43. Risk management at the Capital Group

The internal objective of risk management at the Capital Group is to maintain stability and security of banking operations as well as to keep a high quality of assets and achieve anticipated financial result within an acceptable risk level.

1The main risk management guidelines at BGK are defined in the Bank's risk management strategy as well as in policies for managing particular types of risks. Risk appetite is determined, inter alia, by the acceptable level of solvency, short-term liquidity ratio, and the acceptable level of individual risk types. In the allocation process, the required capital is distributed among individual risk types, with limits levels defined for individual risks at BGK. The limits account for the activities of the Bank's subsidiaries indirectly (transactions with subsidiaries included in utilization of the limits) and directly (separate limits for subsidiaries).

The diagram below presents the general structure of the areas subject to the limits.

The risk management is based on:
- Risk management strategy at BGK endorsed by the Supervisory Board of the Bank,
- Capital Management Policy and Internal Capital Assessment at BGK endorsed by the Supervisory Board of the Bank,
- risk management policies, principles, and procedures related to risk identification, measurement or assessment, monitoring, reporting, and control, developed in written form and endorsed by the Supervisory Board or Management Board of the Bank,
- corporate governance principles, principles of selection, remuneration and monitoring of employees performing crucial functions for the Bank and Policies of variable pay of persons holding managerial positions endorsed by the Supervisory Board of the Bank or Management Board of the Bank,
- regulations on risk management at subsidiaries.

The risk management principles applied at the Bank's subsidiaries in the case of non-financial risks comply with the risk management principles applied by the Bank. However, with respect to financial risks, they reflect the nature of subsidiaries.

The regulations are reviewed systematically so that they can be adjusted to the changes in the risk profile, business environment and good professional practices.

The risk management system is designed to ensure a uniform and efficient process of identification, measurement/assessment, monitoring, reporting, and controlling of risks, and to enable active safety measures.

The risk identification process includes determination of risk types, their sources (factors), significance and relationships between individual types of risk.

The risk measurement/assessment process includes methods of risk quantification and performing stress tests.

The risk control process comprises the determination and enforcement of risk control mechanisms (i.e. limit systems, ensuring independence between first-level risk management from second-level risk management, insurance, risk transfer, financing plans).

The risk monitoring process includes supervision of the level of risk taken, reviews of relevance and accuracy of the applied methods of risk assessment, and evaluation of efficiency of the tools used.

The risk reporting process includes information on the risk profile, identification of possible threats, and information on the measures adopted.

The risk management method at the Bank's subsidiaries, including the methods of risk identification, measurement and mitigation, stems from the Bank's strategy and reflects the types of activities pursued by those entities in line with the proportionality principle.

Organisation of risk management for the key risk types:

	Risk management supervision	Risk appetite	Strategic management	Tactical management	Risk monitoring
Credit Risk	Supervisory Board	Supervisory Board Management Board	Management Board CC	CC	Risk Division
Market Risk	Supervisory Board	Supervisory Board Management Board	Management Board FC	Financial Markets Management Division	Risk Division
Liquidity Risk	Supervisory Board	Supervisory Board Management Board	Management Board FC	Financial Markets Management Division	Risk Division
Operational Risk	Supervisory Board	Supervisory Board Management Board	Management Board ORC	Each internal unit	Risk Division
Capital adequacy	Supervisory Board	Supervisory Board Management Board	Management Board FC	Each business unit	Risk Division

Presented below are the Bank's authorities involved in the Bank's risk management process.

Supervisory Board of the Bank

The Supervisory Board exercises supervision over the introduction of risk management system and evaluates its adequacy and efficiency in particular through approving acceptable risk level and monitoring its compliance.

Risk Committee

The Risk Committee supports operations of the Bank's Supervisory Board, supervising the management system for all risks identified in the Bank's operations, in particular by providing opinions as to the Bank's overall ongoing and future risk appetite. The Risk Committee includes persons appointed from among the members of the Bank's Supervisory Board.

Audit Committee

The Audit Committee supports the Bank's Supervisory Board, in particular through oversight over the internal audit area and monitoring the financial and management reporting process, as well as financial audit activities carried out at the Bank. The Audit Committee includes persons appointed from among the members of the Bank's Supervisory Board.

Management Board of the Bank

The Management Board of the Bank is responsible for organising and administering the risk management process and ensuring the efficiency of the risk management system. One of the Management Board members, who has obtained consent of the Polish Financial Supervision Authority to be appointed as a Management Board member, supervises the banking risk area that covers organisational units managing credit, financial, operating, and other risks.

Bank's Financial Committee

The Committee offers opinions and participates in the decision-making process. The primary objective of the Committee is to define the current, mid-, and long-term management policy for the Bank’s assets and liabilities. The aim of the policy is to optimise results and allocate the Bank’s capital efficiently. It takes into account the relevant level of exposure to risk and the nature of public tasks commissioned to the Bank. These include tasks fulfilled by the Bank as part of the management of funds created, entrusted, or transferred to the Bank under separate regulations or other legal acts.

Bank’s Operational Risk Committee (ORC)

The main objective of the Committee is to ensure efficient management of the operating and compliance risks. The Committee offers opinions and participates in the decision-making process. The Committee is responsible for reducing the operating and compliance risks, specifically through: initiation and coordination of activities aimed to identify, measure, and monitor the operating and compliance risks; providing opinions on the level of limits reducing the operating risk; and assessment of the risk reduction techniques applied for such risks. The Committee coordinates the activities aimed to identify, measure, and monitor the reputation risk and the related reporting.

Bank's Credit Committee (BCC)

The primary tasks of the Committee include: appraisal of loan applications and applications for restructuring or enforcement. It also provides recommendations to the Bank’s Management Board on matters reserved for the competence of the Board, performing reviews of the credit portfolio, annual reviews of business lines and deciding on their classification to relevant investment risk categories.

Bank’s Change Committee

The Committee offers opinions and participates in the decision-making process. The basic tasks of the Committee include managing the portfolio of undertakings within the authorisation limits granted to the Committee and accepting, in connection with the objectives provided for in the Bank’s Strategy, basic rules for banking products and services, processes, applications, and IT infrastructure.

Expenditure Authorisation Committee

The Committee offers opinions and participates in the decision-making process. The primary objective of the Committee is to ensure a high efficiency of expenditure, including those supporting Bank’s strategic operations. High expenditures are assessed by the Committee in terms of their business rationality, possibility of price and process optimisation, as well as adopted implementation method. The Committee issues recommendations for Bank’s expenditure policy.

Data Quality Management Committee

The Committee offers opinions and participates in the decision-making process. The primary tasks of the Committee is to define goals and activities related to data quality management as well as the management of and supervision over data quality control and quality monitoring.

44. Credit risk management

Credit risk is one of the most important risk types to which the Bank is exposed in its operations and which is defined as a threat of a borrower's default on the payment of liability under an agreement, i.e. failure to repay receivables under credit exposure along with the Bank's remuneration within time limits within the contractual deadlines.

Main credit risk management purposes are as follows:

- identification of credit risk areas and its mitigation to a level accepted by the Bank,
- regular review of actions adopted in this risk area,
- shaping balance-sheet and off-balance-sheet items of the Bank to minimise the risk of negative deviation of the financial result from the Bank’s financial plan.

Credit risk management at the Capital Group

The credit risk management engages relevant units of the Bank's Risk Division and dedicated units in the Capital Group's subsidiaries. Among other things they provide opinions about projects and internal regulations regarding subsidiaries and – at the same time – evaluation of credit risk and recommend changes in the regulations. The Bank actively supports the Capital Group's entities in this process.

The credit risk management process is carried out at the level of customer risk with individual credit exposure and credit portfolio risk taken into account, on the basis of:
- Risk management strategy at BGK,
- planned, targeted actions defined in the credit policy,
- internal regulations,
- available support systems and tools,
- recommendations and guidance for branches and other units of the Bank.

Credit risk management helps to identify, measure or estimate, monitor, report, and control the risk.

The Management Board of the Bank defines the credit policy taking into account the Bank's risk tolerance and Risk management strategy at BGK as well as the existing level of credit risk borne by the Bank, the structure of credit portfolio, the structure of legal collaterals, repayments of the transactions bearing credit risk, and external macroeconomic factors. Among other elements, the credit policy indicates, *inter alia*, tolerance for risk per credit portfolio, credit purposes and recommendations, credit profile for individual customer and product segments, risk management process, and the related prudent practices.

Pursuant to applicable regulations, the Bank performs - at least once a year - stress tests of credit exposure sensitivity to changes in the exchange rates, interest rate and the value of the existing mortgage collaterals.

Credit risk management and control involve setting risk limits which are acceptable with respect to individual sectors and industries, counterparty and product segments, as well as in monitoring exposures relevant to such limits.

Active management of the evaluation of credit quality ensures fast identification of possible changes in the counterparties' credit worthiness and regular reviews of collateral.

The limits for counterparties are determined e.g. using the level of exposure with respect to the counterparty and credit risk classification system which assigns a risk grade to every counterparty.

The risk grades are subject to regular reviews. The objective of the evaluation of credit quality is to assess potential loss resulting from the risk and to take remedial measures.

The Bank compiles regular reports on credit risk and risk concentration:
- a monthly report for the Bank's Management Board, Credit Committee and FC,
- a quarterly report for the Bank's Management Board, Credit Committee, FC and the Supervisory Board's Risk Committee; and every six months also to the Bank's Supervisory Board,
- an annual report for the Bank's Management Board, Credit Committee, FC, the Supervisory Board's Risk Committee and the Supervisory Board,

as well as a range of other reports and analyses related to the fields of operation exposed to credit risk.

Impairment

For accounting purposes the Bank recognises losses resulting from impaired financial assets using an impairment model. This means that the impairment may be recognised only when there is objective evidence that there have been events (impairment evidence) leading to impairment. Impairment evidence includes e.g.:
- granting of a concession by the Bank to counterparty, for economic or legal reasons relating to the counterparty's financial difficulty, that the Bank would not otherwise consider (restructuring of the loan agreement),
- significant financial difficulties of the counterparty,
- disappearance of an active market of a given credit exposure due to the counterparty's financial problems,
- micro- and macroparameters suggesting an identifiable decrease in future cash flows within a specific portfolio of credit exposures, despite the fact that it was not observed that the quality of individual items in the portfolio has deteriorated,
- termination of the agreement,
- questioning the balance-sheet credit exposure at court by the counterparty,
- Bank's motion for instigating enforcement proceedings against the counterparty,
- default on repayment of principal or interest exceeding 90 days.

Balance-sheet and off-balance-sheet credit exposures are regularly analysed to check for any evidence of impairment. If such evidence is identified, impairment needs to be calculated, and if impairment is identified, an impairment loss has to be recognised to account for the expected loss on the credit exposure due to the customer's failure to meet their obligation.

Impairment losses are recognised for all balance-sheet credit exposures and portfolios of balance-sheet credit exposures which have been impaired.

There are three methods of impairment testing:
- individual − applied to exposures which are individually significant with identified evidence of impairment,
- portfolio − applied to exposures which are individually insignificant with identified evidence of impairment,
- IBNR approach - applied to exposures without individual evidence of impairment with the risk of incurred but not reported losses and to exposures for which the individual approach has not indicated impairment.

The impairment loss on the carrying amount of credit exposure is the difference between the carrying amount of the exposure and the present value of estimated future cash flows from this exposure.

When determining the impairment loss amount using the individual approach, expected future cash flows are estimated for each credit exposure individually.

The Bank uses the scenario analysis to specify expected cash flows. The amounts of impairment are determined based on e.g. such data as the feasibility of the counterparty's business plan, the counterparty's ability to improve the results if its financial position is difficult, forecast proceeds, and expected payment in the case of bankruptcy, availability of other financial support, realizable value of the collateral and dates of expected cash flows.

Impairment losses are measured as at the reporting date, unless they require more attention due to unexpected circumstances.

The impairment loss on credit exposures tested using the portfolio or IBNR approach equals the difference between the carrying amount of these exposures and the present value of expected future cash flows estimated using statistical methods based on historical data on exposures in homogeneous portfolios. Impairment losses for each portfolio are determined separately as at the reporting date.

Derivative financial instruments

In the case of derivatives, the Bank is exposed to the risk of default by the counterparty to a transaction related to a given derivative. In the case of customers other than banks, settlements are usually made in net amounts which hedges the Bank against a potential settlement risk. In justified cases, the Banks applies additional collaterals in the form of margin deposits from customers in order to limit the risk.

Credit risk resulting from granted liabilities

The Bank offers their customers guarantees whereby the Bank may be obliged to make a payment on their behalf and enter into obligations to extend granted loans to satisfy their liquidity needs. Under the terms of letters of credit and guarantees (including standby letters of credit), the Bank is obliged to make payments on behalf of its customers in specific cases, usually related to imports and exports of goods. Such obligations expose the Bank to a risk similar to the risk related to loans which is mitigated by the same control processes and policies.

(in PLN '000)

Analysis of the maximum exposure to credit risk, risk related to collaterals, and other elements improving the lending terms and conditions

The table below presents the maximum exposure to credit risk, broken down into financial assets classes.

Maximum exposure to credit risk excluding collaterals (by classes of financial instruments)		
	31.12.2017	**31.12.2016**
Cash in Central Bank	**982,684**	**640,545**
Receivables from banks	**3,247,473**	**3,636,366**
Financial assets held for trading, including:	**1,342,070**	**478,808**
Measurement of derivative instruments	1,341,019	429,281
Debt instruments	1,051	49,527
Financial assets designated as measured at fair value through profit or loss at initial recognition	**130,233**	**136,399**
Available-for-sale investment securities	**37,061,252**	**31,619,745**
Debt instruments	35,699,238	30,767,822
Equity instruments	1,299,396	810,493
Other financial assets	62,618	41,430
Other assets	**1,113,349**	**677,660**
Loans and advances to customers, including:	**27,223,753**	**24,631,524**
financial sector	**261,546**	**129,530**
Loans	181,214	100,567
Debt securities	1	0
Other receivables	80,331	28,963
non-financial sector	**21,003,775**	**18,993,856**
Loans and advances, including:	15,618,989	13,685,963
- housing loans	4,184,606	4,296,711
- export loans	250,234	231,443
Purchased debt	121,062	161,342
Used guarantees and surety bonds	8,835	9,960
Debt securities	5,254,876	5,136,581
Other receivables	13	10
public sector	**5,958,432**	**5,508,138**
Loans	5,551,098	5,165,269
Debt securities	334,326	268,655
Purchased debt	73,008	74,210
Other receivables	0	4
Receivables due to reverse repo and buy-sell-back transactions	**2,105,540**	**3,946,887**
Total	**73,206,354**	**65,767,934**

	31.12.2017	**31.12.2016**
Maximum exposure to credit risk in connection with guarantees given by the Group	13,164,922	6,099,088

The amount and type of collateral depends on the evaluation of the credit risk related to an individual counterparty.

The Bank follows specific guidelines on the acceptability and evaluation of each type of collateral.

Main types of collaterals:
- for securities lending and reverse repo − cash and securities;
- for commercial loans − collateral in the form of mortgages and registered pledges on movables.

The Bank monitors the market value of collateral for each lending transaction and, if necessary, it demands additional collateral in line with the master contract.

Pursuant to the adopted policy, the Bank tries to manage the collateral seized in an orderly manner. Any proceeds are used to reduce or repay overdue liabilities. The Bank does not use seized collateral for business purposes.

The Bank manages the credit quality of assets using a whole range of methods to mitigate credit risk, including internal credit ratings. For several years the Bank has been using internal ratings with respect to local government units. In the years 2014-2015 the Bank introduced internal ratings with respect to enterprises, healthcare entities conducting full financial reporting, housing cooperatives and social housing associations.

Concentration of exposures from the perspective of geographical areas is monitored based on the regional division of branches. The Bank has regional branches in all province capitals.

(in PLN '000)

Since the geographical concentration is limited and does not lead to an increased credit risk, so far the Bank has had no need to set geographical limits. However, the Bank sets industry limits.

44.1. Portfolio structure by industry

Concentration of exposures from the perspective of economy sectors is monitored on a daily basis pursuant to the internal procedures for the internal industry limits.

Concentration of exposures in national economy sectors (balance sheet exposure*)				
Industry	31.12.2017		31.12.2016	
	Amount of exposure	Total share in exposure	Amount of exposure	Total share in exposure
Public administration and defence, compulsory social security	6,037,173	19.4%	5,016,297	19.7%
Construction	4,632,556	14.9%	4,863,986	19.2%
Financing activities	879,644	2.8%	462,320	1.8%
Scientific, professional, technical, and educational activities	295,563	1.0%	187,330	0.7%
Mining and extraction	1,719,807	5.5%	1,505,721	5.9%
Wholesale trade	304,121	1.0%	253,322	1.0%
Hotels and restaurants	205,972	0.7%	37,213	0.1%
Real estate market, administration	1,660,702	5.3%	1,076,459	4.2%
Health care and social assistance	689,024	2.2%	588,289	2.3%
Other services, sports, entertainment, and recreation	99,867	0.3%	114,649	0.5%
Other (natural persons, no Polish Classification of Activity (PKD) number)	870,151	2.8%	530,066	2.1%
Industrial processing	2,694,027	8.7%	2,307,113	9.1%
Transport, storage and communication	5,275,144	17.0%	3,184,024	12.5%
Electricity, gas and water supply	5,746,422	18.4%	5,273,067	20.9%
Total	**31,110,173**	**100.0%**	**25,399,856**	**100.0%**

* the table accounts for the principal of loans and advances, purchased debts, bill of exchange discounting, used guarantees given to customers, excluding banks

The Bank applies industry limits to mitigate the risk related to financing customers operating in selected industries with a high level of credit risk and to avoid excessive levels of industry concentration.

The portfolio is dominated by public administration due to BGK's close cooperation with the government and local governments. Another relatively large group of exposures is the transportation, storage, and communication industries as well as electricity, gas and water supply industry, mainly due to the fact that the Bank engages in funding ventures which are strategic from the point of view of the State Treasury, including in the sectors of energy, fuel and chemistry, and transport. Such ventures are implemented in the form of large investment projects.

(in PLN '000)

44.2. Qualitative structure

The Bank uses tools and methods that support the monitoring of credit exposures and customers, help react swiftly if the quality of the portfolio or individual credit exposures deteriorate, and take remedial measures.

Financial assets other than past-due, without evidence of impairment, and their ratings*		
Loans and advances to customers	Exposure	
	31.12.2017	31.12.2016
with external rating	**4,909,397**	**5,293,153**
Rating 1	98,270	0
Rating 2	4,580,899	5,191,225
Rating 3	230,228	101,928
without external rating	**20,240,802**	**17,322,284**
with external rating – financial sector customers	**126,854**	**107,861**
Rating from 1 to 13	126,854	70,859
Rating from 14 to 17	0	0
Rating 18 and below	0	37,002
with external rating – non-financial sector customers	**17,271,320**	**17,507,026**
Rating from 1 to 13	16,897,908	13,508,717
Rating from 14 to 17	255,298	3,789,653
Rating 18 and below	118,114	208,656
with external rating – public sector customers	**5,428,592**	**4,961,056**
Rating from 1 to 13	5,220,673	4,676,734
Rating from 14 to 17	180,668	260,910
Rating 18 and below	27,251	23,412
without external rating – financial, non-financial and public sector customers	**2,323,433**	**39,494**
Total	**25,150,199**	**22,615,437**

* the table accounts for the principal of loans and advances, purchased debts, bill of exchange discounting, used guarantees given to customers of the financial, non-financial, and budget sectors

The Bank applies a master scale for the rating methods used for individual customer segments. Initially, the rating methods were applied to local government units, followed by the selection of groups of entities with full financial reporting, Social Housing Associations and housing cooperatives.

Pursuant to the adopted policy, the Bank applies risk rating to the majority of credit exposures in the loan portfolio. This helps appropriately manage the existing risk and compare the credit risk with reference to various customer and product segments. The rating system uses various financial analytical tools and processed market information to obtain major input data for measuring the risk related to an individual customer. The rating models are monitored and validated on an ongoing basis.

When determining and monitoring customers' credit risk, the Bank also used the ratings assigned to the customers by reputable rating agencies.

44.3. Concentration risk analysis

The risk of concentration of exposure is the risk resulting from exposure with respect to individual entity or entities with capital and organisational links, entities operating in the same industry, economy sector, entities operating in the same geographical region, using the same type of collateral or collateral offered by the same provider, in the same currency, with respect to the entities referred to in Article 79.1 of the Banking Law, which may have a material impact on the stability and security of the Bank's operations in case of default by such individual entity, by entities with capital and organisational links or by groups of entities where the default probability of default depends on shared factors.

The Bank controls the credit risk exposure level:

- jointly and by own activities as well as related to the maintenance of funds created, entrusted or transferred under separate laws;
- for exposure concentration to one entity and/or entities associated by capital or management,
- for large exposures,
- in relation to individual industries,
- separately under mortgage-backed exposures,
- in relation to selected segments and products,
- under currency or currency-indexed transactions,
- under off-balance sheet liabilities granted by the Bank (guarantees, sureties, and letters of credit).

The Bank applies regulatory concentration limits resulting from the CRR, Banking Law and specific regulations included in the Act on BGK. These limits are additionally reduced by the resolution of the Bank's Management Board on the maximum level of exposure to an individual customer or group of related customers as at the time of making a funding decision.

(in PLN ‘000)

Utilization of the concentration limit is assessed on a daily basis. The Bank’s adopted safe level of exposure to a group of related entities and to a single customer was not exceeded as at the end of 2017.

Capital Group's exposure to the 20 biggest customers, other than banks				
No.	31.12.2017		31.12.2016	
	Exposure*	Share in the loan portfolio	Exposure*	Share in the loan portfolio
1.	3,059,999	5.2%	2,546,945	5.7%
2.	2,955,458	5.0%	2,217,122	4.9%
3.	2,220,566	3.8%	2,033,968	4.5%
4.	2,028,662	3.4%	1,893,890	4.2%
5.	1,734,900	2.9%	1,768,000	3.9%
6.	1,720,243	2.9%	1,724,000	3.8%
7.	1,694,005	2.9%	1,250,799	2.8%
8.	1,588,740	2.7%	995,125	2.2%
9.	973,383	1.6%	987,752	2.2%
10.	860,001	1.5%	985,000	2.2%
11.	834,847	1.4%	819,630	1.8%
12.	675,859	1.1%	800,000	1.8%
13.	668,308	1.1%	731,378	1.6%
14.	563,335	1.0%	567,750	1.3%
15.	557,987	0.9%	515,261	1.1%
16.	532,607	0.9%	507,555	1.1%
17.	475,456	0.8%	483,021	1.1%
18.	472,037	0.8%	467,007	1.0%
19.	409,742	0.7%	442,842	1.0%
20.	406,100	0.7%	442,257	1.0%
Total	**24,432,235**	**41.3%**	**22,179,302**	**49.2%**

* includes balance-sheet and off-balance-sheet credit exposure: loans, advances, purchased debts, bill of exchange discounts, used guarantees, debt securities available for sale, and derivative transaction limits.
The amount of exposure is calculated for the purposes of external limits (concentration limits) without deductions.

Capital Group's exposure to the 5 biggest capital groups other than banks				
	31.12.2017		31.12.2016	
No.	Exposure*	Share in the loan portfolio	Exposure*	Share in the loan portfolio
1.	3,654,448	6.2%	3,386,382	7.5%
2.	3,605,944	6.1%	2,575,040	5.7%
3.	3,230,353	5.5%	2,422,885	5.4%
4.	2,741,450	4.6%	2,218,141	4.9%
5.	2,220,566	3.8%	1,918,277	4.3%
Total	**15,452,761**	**26.2%**	**12,520,725**	**27.8%**

* includes balance-sheet and off-balance-sheet credit exposure: loans, advances, purchased debts, bill of exchange discounts, used guarantees, debt securities available for sale, and derivative transaction limits.
The amount of exposure is calculated for the purposes of external limits (concentration limits) without deductions.

Credit risk concentration by currencies		
	31.12.2017	31.12.2016
PLN	81.0%	86.1%
Foreign currencies, including:	19.0%	13.9%
- CHF	0.1%	0.2%
- EUR	13.0%	10.1%
- USD	5.0%	3.4%
- other	0.9%	0.2%
Total	**100.0%**	**100.0%**

44.4. Collaterals and other forms of credit risk mitigation

The main instrument used to reduce the credit risk is legal security of the Bank’s receivables. The Bank applies an internal procedure for the establishment and evaluation of legal security of receivables as at the conclusion of the transactions bearing credit risk and for monitoring the security during the transaction’s life.

The Bank uses the following instruments and methods to limit or reduce the credit risk to acceptable levels:
- risk diversification,
- risk hedging,

(in PLN '000)

- risk sharing,
- risk compensation.

To mitigate the credit risk, when calculating the risk-weighted exposures in the Bank's portfolio, the Bank accounts for the credit protection, in line with the internal procedures on legal securities of the Bank's receivables.

The basis for calculation of the recoverable amount of collateral is the measurement value verified by the Bank using the indicators adjusting the value of collaterals. In the case of unfunded credit protection, the economic and financial standing of the collateral issuer is in addition examined. Moreover, the fulfilment of formal and legal conditions for acceptance of collateral is verified each time, as well as whether it is funded and liquid, and also its correlation to the economic and financial standing of the debtor.

The Bank monitors the legal collaterals of lending transactions on a periodical basis.

Collaterals and other forms of credit risk mitigation	Fair value of the collateral	
	31.12.2017	31.12.2016
Mortgage	37,922,037	28,189,875
Pledges	2,172,003	2,459,538
Guarantees and surety bonds, including:	7,094,902	7,911,313
- bank guarantees	196,854	71,588
- government guarantees	5,090,479	6,882,285
- other guarantees and sureties	1,807,569	957,440
Cash deposits	713,349	467,939
Other	3,549,071	1,402,021

Credit exposures are most often secured (at fair value) by mortgages, guarantees and surety bonds. The maximum risk reduction is guaranteed for credit exposures hedged by guarantees provided by the State Treasury and local government units. Local government units provide securities mainly for the exposures related to Social Housing Associations, hospitals and municipal companies.

44.5. Forbearance practices

The Bank applies the definition of restructured exposure understood as credit exposure which has been addressed with restructuring measures. The restructuring measures comprise facilities offered by the Bank to the borrower who experiences or will soon begin to experience difficulties with repayment of financial liabilities (financial distress).

Restructuring measures comprise the following:
- change in the terms and conditions of a contract underlying the credit exposure which has been classified as at-risk before the change or which would have been classified as at-risk, if it had not been changed,
- change in the terms and conditions of a contract underlying the credit exposure consisting in a full or partial write-downs on the exposure,
- Bank's approval for the use of embedded restructuring clauses by a borrower at risk of defaulting or who would have been considered at risk of defaulting if such clauses had not been applied,
- repayment of the principal amount or interest on another credit exposure at the Bank by the borrower, if the exposure was at risk at the time or around the time when the Bank applied the facility in the form of additional funding or would have been classified as at risk if the facility had not been applied,
- change leading to payments which were possible as a result of utilization of the collateral, if such change qualify as a facility.

It is considered that the exposures are no longer restructured, if all the conditions presented below have been met:
- a credit exposure is no longer considered at-risk when it has been removed from the category of at-risk exposures,
- following an analysis of the financial condition of the borrower which revealed that the contract no longer qualifies as at-risk,
- after at least two-year follow-up period (24 months) of the date when the restructured exposure was classified as not at-risk;
- regular payments of interest and principal amount were made for at least 12 out of 24 months of the follow-up period,
- as at the end of the conditional period none of the exposures with respect to the borrower was overdue by more than 30 days.

(in PLN '000)

Forbearance exposures – share in the loan portfolio	**Carrying amount**	
	31.12.2017	**31.12.2016**
Loans and advances to customers (gross), including:	27,981,956	25,399,855
- forborne exposures:	806,756	986,340
- non-financial sector	703,299	875,679
- public sector	103,457	110,661
Impairment losses on loans and advances - forborne exposures	171,991	267,277
Loans and advances to customers (net) - forborne exposures	**634,765**	**719,063**

	Forborne loans and advances granted to customers			
	Carrying amount of exposure (gross)		**Collateral value**	
	31.12.2017	**31.12.2016**	**31.12.2017**	**31.12.2016**
Impaired loans and advances	419,089	867,874	1,426,235	569,437
Non-impaired loans and advances	387,667	118,466	1,338,011	28,002
- current	376,228	112,742	1,273,057	22,286
- overdue	11,439	5,724	64,954	5,716
Total gross	**806,756**	**986,340**	**2,764,246**	**597,439**

44.6. Ageing structure of financial assets

Ageing structure of financial assets (no impairment)	**Delinquency structure of non-impaired financial assets as at 31 December 2017**			
	up to 1 month	**over 1 month to 3 months**	**over 3 months**	**Total**
Loans and advances to customers (gross), including:	**21,004**	**8,375**	**0**	**29,379**
non-financial sector	**7,255**	**8,375**	**0**	**15,630**
loans and advances, including:	6,869	8,375	0	15,244
- housing loans	2,999	8,375	0	11,374
purchased debt	386	0	0	386
public sector	**13,749**	**0**	**0**	**13,749**
loans	12,739	0	0	12,739
purchased debt	1,010	0	0	1,010
Total	**21,004**	**8,375**	**0**	**29,379**

Ageing structure of financial assets (no impairment)	**Delinquency structure of non-impaired financial assets as at 31 December 2016**			
	up to 1 month	**over 1 month to 3 months**	**over 3 months**	**Total**
Loans and advances to customers (gross), including:	**8,304**	**479**	**0**	**8,783**
non-financial sector	**8,304**	**479**	**0**	**8,783**
loans and advances, including:	8,304	479	0	8,783
- housing loans	7,689	479	0	8,168
Total	**8,304**	**479**	**0**	**8,783**

44.7. Financial assets measured using the individual approach, with individual impairment recognised at gross carrying amount

The Capital Group considers the following factors when determining impairment losses on financial assets measured individually:

- delinquency period,
- loan acceleration,
- enforcement proceedings instigated against the debtor,
- debtor's declaration of bankruptcy or bankruptcy petition filed,
- debt questioned by the debtor,
- reorganisation proceedings instigated against the debtor,
- receivership over the debtor's activities or suspension of its activities,
- deterioration of the debtor's credit rating to the level indicating significant risk of default,
- debt restructuring or relief,
- expected cash flows from exposure and collaterals,
- future business and financial condition of the customer,
- projection performance by the customer.

(in PLN '000)

Ageing structure of impaired financial assets measured individually	Delinquency structure of impaired financial assets measured individually as at 31.12.2017			
	up to 1 month	over 1 month to 3 months	over 3 months	Total
Loans and advances to customers (gross), including:	**30,083**	**0**	**142,741**	**172,824**
non-financial sector	**30,083**	**0**	**142,741**	**172,824**
loans and advances, including:	30,083	0	142,741	**172,824**
- housing loans	0	0	101,561	**101,561**
- export loans	0	0	1,500	**1,500**
Total	**30,083**	**0**	**142,741**	**172,824**

Ageing structure of impaired financial assets measured individually	Delinquency structure of impaired financial assets measured individually as at 31.12.2016			
	up to 1 month	Over 1 month to 3 months	Over 3 months	Total
Loans and advances to customers (gross), including:	**0**	**36**	**261,346**	**261,382**
non-financial sector	**0**	**36**	**261,346**	**261,382**
loans and advances, including:	0	36	261,346	261,382
- housing loans	0	0	155,758	155,758
- export loans	0	0	67,069	67,069
Total	**0**	**36**	**261,346**	**261,382**

Impairment of credit exposures

The Capital Group regularly reviews credit exposures to identify credit exposures with impairment risk, measure impairment of credit exposure and recognise impairment losses or provisions.

The process of recognising impairment losses and provisions comprises the following stages:
- identifying evidence of impairment and impairment triggers,
- registering impairment triggers for credit exposures in IT systems of the Capital Group,
- determining the method of impairment measurement,
- measuring impairment and determining the impairment loss or provision amount,
- reviewing and aggregating results of impairment measurement,
- reporting results of impairment measurement.

The method of determining amount of impairment loss depends on the type of impairment objective evidence and individual size of the credit exposure.

Individual impairment triggers include in particular:
- delinquency period of 3 months of more,
- deterioration of the customer's financial condition,
- conclusion of a debt restructuring agreement or debt relief (evidence is recognised if these actions were required for business and legal reasons resulting from financial difficulty of the client).

When determining the delinquency period, the Bank accounts for overdue interest and principal amounts in excess of thresholds determined.

Impairment testing methods

The Capital Group applies three methods of impairment testing:
- individual approach applied to individually significant exposures with identified evidence of impairment, ,
- portfolio approach applied to loans which are individually insignificant with identified evidence of impairment,
- collective approach (IBNR), applied to exposures without individual objective evidence of impairment with the risk of incurred but not reported losses, and to exposures for which the individual approach has not indicated an impairment.

The impairment loss on the carrying amount of credit exposure is the difference between the carrying amount of the exposure and the present value of estimated future cash flows from this exposure and the present value of estimated future cash flows from this exposure.

When determining the impairment loss amount using the individual approach, estimated future cash flows are estimated for each credit exposure individually.

The impairment loss on credit exposures tested using the portfolio or IBNR approach equals the difference between the carrying amount of these exposures and the present value of estimated future cash flows estimated using statistical methods based on historical data on exposures in homogeneous portfolios.

Off-balance sheet provisions

Provisions for off-balance sheet credit exposures are determined as the difference between the expected value of the balance sheet exposure resulting from the off-balance sheet liability granted (from the test date to the date of overdue debt constituting the objective evidence of impairment of individually significant exposures) and the present value of future cash flows from the balance sheet exposure resulting from the off-balance sheet liability.

When determining the provision amount using the individual approach, expected future cash flows are estimated for each credit exposure individually.

The Bank determines the provision amount by the portfolio or collective approach using portfolio parameters estimated with statistical methods, based on historical data on exposures of the same nature.

45. Liquidity risk management

Liquidity risk is a threat of losing the ability to pay liabilities in a timely manner as a result of unfavourable changes in assets and liabilities, off-balance-sheet transactions, improper timing of current cash flows, and possible losses resulting from the foregoing.

The Bank applies liquidity risk management procedures which define how the risk is monitored and managed. Liquidity risk exposure occurs mainly in the Bank, while in other Capital Group entities such risk is assessed as immaterial. Still, these entities are also obliged to manage the liquidity risk and prepare regular reports on liquidity risk.

Liquidity risk management aims to:
- ensure and maintain the Bank's ability to meet both current and planned future liabilities, including costs of liquidity and return on equity;
- prevent crises,
- define solutions which will enable the Bank to survive a potential crisis (contingency planning).

The Bank's liquidity risk measurement system includes the following methods:
- liquidity ratios, liquidity gap analysis, fund stability analyses, daily monitoring of the deposit base,
- stress tests.

In order to reduce risk and secure liquidity, the Bank applies the following measures:
- transactions on the money market, including deposit transactions, reverse repo, repo, NBP money market bills, Treasury bills, bonds, and other instruments,
- maintaining a portfolio of liquid securities,
- daily monitoring of the money balance and financing possibilities from the NBP,
- facilities securing liquidity of the Bank,
- own bond issuances and deposit level management to optimise the structure of the sources of funding,
- emergency plans in case of emergency situations of reduced or endangered liquidity.

Additionally, in accordance with Article 3.3 of the Act on Bank Gospodarstwa Krajowego, the minister competent for public finance provides funds to meet liquidity standards.

A system of limits is an important liquidity risk management tool at BGK. Limits and thresholds are applied to appropriate liquidity ratios.

The risk monitoring process involves a cyclical review of the values of limited parameters and analysis of the limit usage. Additionally, the Bank analyzes the impact of a possible increase in security deposits on liquidity levels.

The Bank prepares current reports on liquidity risk presenting utilization of regulatory liquidity limits and internal liquidity limits, balance of deposits, external funds stability analysis, results of stress tests, and periodic simulations of liquidity measures and long-term liquidity analysis. Periodic reports also cover information on subsidiaries.

Supervisory liquidity measurements defined in PFSA's resolution no. 386/2008 of 17 December 2008 on defining liquidity norms binding for banks (Official Journal of the PFSA No. 8, item 39, as amended) and in Commission Delegated Regulation No. 2015/61 (EU) of 10 October 2014 to supplement Regulation (EU) No. 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions (OJ L 11, 17.01.2015, p. 1) and internal liquidity standards were not breached.

Supervisory liquidity measures are presented in the table below.

(in PLN '000)

Item	Limit	Including cash flow funds		Additional information – excluding cash flow funds	
		31.12.2017	31.12.2016	31.12.2017	31.12.2016
M1 - short-term liquidity gap	0.00	17,524,409	15,503,763	16,468,759	14,464,773
M2 – short-term liquidity ratio	1.00	1.58	1.55	1.66	1.57
M3 – own funds to non-liquid assets	1.00	5.38	4.96	5.38	4.96
M4 – own funds and stable external funds to non-liquid and limited-liquidity assets	1.00	1.27	1.24	1.70	1.64
LCR—liquidity coverage ratio)*	80%**	207%	252%	272%	328%

* the indicators are specified individually due to the fact that it is not necessary to carry out prudential consolidation in line with the CRR

** the limit applicable as at 31 December 2017

A change in the liquidity measures was mainly driven by expansion of the Bank's lending operations and an increase in equity investments.

The Capital Group's market-based liquidity gap is presented below. Key realigned items include deposits (based on estimated residue deposits), liquid securities (recognised in amounts recoverable in individual periods), and off-balance sheet liabilities granted in the form of financing and guarantees (estimated amounts and schedules).

The Capital Group's market-based liquidity gap								
		up to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 – 3 years	3 – 5 years	more than 5 years
31.12.2017	Gap	19,560,005	-148,111	-949,932	-490,023	-13,472,322	3,366,227	-15,850,246
	Aggregate gap	19,560,005	19,411,894	18,461,962	17,971,939	4,499,617	7,865,844	-7,984,402
31.12.2016	Gap	17,452,739	-3,875,384	-1,410,103	-1,218,435	-22,630,957	3,862,727	-1,540,002
	Aggregate gap	17,452,739	13,577,355	12,167,252	10,948,817	-11,682,140	-7,819,413	-9,359,415

The Bank has diversified sources of funding, including deposits from customers, funds from issues of own bonds, and loans granted by international financial institutions. The liabilities structure by contractual maturity is presented below. The amounts include cash flows from the principal amount and interest (if applicable) for the entire financing period. For off-balance sheet liabilities, exposures are presented by contractual maturity.

Liabilities of the Capital Group as at 31 December 2017									
		up to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 – 3 years	3 – 5 years	more than 5 years	Total
Balance sheet liabilities	Liabilities to banks	2,241,389	85,345	116,324	194,879	895,592	930,654	1,034,631	**5,498,814**
	Liabilities to customers	34,519,858	2,398,191	985,376	215,610	3,028	0	0	**38,122,063**
	Own issues*	1,011,400	32,768	24,401	66,437	4,913,323	516,057	3,705	**6,568,091**
	IN TOTAL	**37,772,647**	**2,516,304**	**1,126,101**	**476,926**	**5,811,943**	**1,446,711**	**1,038,336**	**50,188,968**
Off-balance sheet liabilities granted	Financing commitments	31,496,291	78,108	653,320	774,683	1,746,287	1,291,397	2,363,358	**38,403,444**
	Guarantee liabilities	1,255,443	735,398	264,953	862,662	4,430,968	5,544,414	1,457,592	**14,551,430**
	IN TOTAL	**32,751,734**	**813,506**	**918,273**	**1,637,345**	**6,177,255**	**6,835,811**	**3,820,950**	**52,954,874**

* issues purchased before the maturity date following the balance sheet date are presented by their early purchase dates

(in PLN '000)

Liabilities of the Capital Group as at 31 December 2016										
		up to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 – 3 years	3 – 5 years	more than 5 years	Total
Balance sheet liabilities	Liabilities to banks	4,453,909	30,368	113,895	152,704	777,834	852,162	1,421,789	**7,802,661**
	Liabilities to customers	34,189,357	3,945,809	908,471	290,906	606	0	0	**39,335,149**
	Own issues	16,710	520,072	1,389,771	546,942	3,510,678	542	0	**5,984,715**
	IN TOTAL	**38,659,976**	**4,496,249**	**2,412,137**	**990,552**	**4,289,118**	**852,704**	**1,421,789**	**53,122,525**
Off-balance sheet liabilities granted	Financing commitments	30,708,333	520,596	588,325	466,272	1,021,038	845,156	2,400,950	**36,550,670**
	Guarantee liabilities	1,191,182	862,725	363,030	303,210	2,793,306	1,557,917	1,382,842	**8,454,212**
	IN TOTAL	**31,899,515**	**1,383,321**	**951,355**	**769,482**	**3,814,344**	**2,403,073**	**3,783,792**	**45,004,882**

Cash flows from derivative financial instruments

Derivative financial instruments used by the Bank include IRSs, FRAs, FX Swaps, FX Forwards, CIRSs and options. Other Capital Group entities did not enter into derivative transactions.

Undiscounted cash flows under derivative contracts as at 31 December 2017 and 31 December 2016 are presented below.

Cash flows from derivative financial instruments									
		up to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 – 3 years	3 – 5 years	more than 5 years	Total
31.12.2017	Proceeds	4,666,946	656,218	327,715	522,965	8,482,895	4,266,781	17,214,717	**36,138,237**
	Payments	-4,605,972	-665,381	-327,179	-515,188	-8,475,401	-4,262,146	-17,218,642	**-36,069,909**
31.12.2016	Proceeds	3,407,594	480,401	481,470	602,396	4,909,581	5,597,038	23,564,266	**39,042,746**
	Payments	-3,414,941	-478,601	-554,887	-712,350	-4,899,892	-5,594,311	-23,556,127	**-39,211,109**

46. Market risk

Market risk is understood as a threat of possible deterioration in the value of the Bank's financial instruments portfolio or Bank's financial result as a consequence of unfavourable changes in market parameters (exchange rates, interest rates, prices of debt instruments and capital instruments).

Market risk at the Bank is managed in accordance with procedures specifying the methods of monitoring and managing individual market risk types. Market risk in the operations of other entities of the Capital Group is regarded as insignificant.

The management of specific market risk types focuses on:
- for interest rate risk (including the price risk of debt securities) — reducing the risk of losing a part of the interest income as a result of a change in market interest rates and the risk of an unfavourable change in the market value of the interest-bearing financial instruments held by the Bank,
- for currency risk – reducing the risk of losses as a result of changes in market exchange rates,
- for the equity price risk – reducing the risk of losses as a result of changes in equity prices.

Market risk assessment in BGK is based on two approaches:
- measure of position volumes,
- sensitivity analysis (basis point value – BPV, duration, net interest income sensitivity to changes in interest rates),
- value at risk (VaR),
- stress tests.

An important element of market risk management is the system of limits applicable at the Bank. The following limits are used:
- for interest rate risk—limit of sensitivity measures (BPV for banking and trading book, interest income risk for the banking book), and loss limits,
- for foreign exchange risk—limits of the Bank's total position volume, limits of trading book positions, and loss limits.

Risk monitoring process involves, *inter alia*, cyclical review of risk measure levels and analysis of the limit usage.

(in PLN '000)

Market risk reports cover in particular:

- interest rate risk: utilization of internal interest rate risk limits, BPV, modified duration, VAR, gain/loss on interest rate changes, interest rate gap in individual repricing periods, interest income sensitivity, stress test results,
- foreign exchange risk: utilization of internal foreign exchange risk limits, open foreign exchange positions, VaR, gain/loss on foreign exchange changes, stress test results,
- equity price risk: value of equity securities portfolio, VaR.

Key market risk measures have been presented below. The measures do not include cash flow funds. VaR is calculated for the assumed 99% confidence level and a one-year period. The model is back-tested by comparing the sensitivity values against remeasurement and actual results. The Bank also analyses the impact of worst-case scenarios on the change in revaluation reserve for debt securities available for sale.

Selected market risk measures of the Bank		31.12.2017	31.12.2016
Interest rate risk			
BPV	banking book	-1,465	-891
	trading book	8	-11
Interest income sensitivity to changes in interest rates by:	-2,p.p.	-189,869	-111,575
	+2 p.p.	179,414	100,754
Sensitivity of securities available for sale to interest rate change by:	-2,p.p.	361,974	291,021
	+2 p.p.	-361,974	-291,021
Foreign exchange risk			
Total foreign currency position		131,056	206,404
Sensitivity of securities available for sale to interest rate change by 20%		-384,375	751,971

VaR for market risk of the Bank	Date	As at	Average value*	Minimum value*	Maximum value*
VaR 1D – interest rate risk	31.12.2017	5,346	3,929	2,020	8,860
	31.12.2016	3,931	3,783	2,316	7,625
VaR 1D – foreign exchange risk**	31.12.2017	700	1,831	700	2,861
	31.12.2016	3,311	1,076	633	2,088
VaR 1D – equity price risk	31.12.2017	37,728	37,053	30,706	47,994
	31.12.2016	43,071	39,749	33,298	45,257

* Average, minimum and maximum value in the reporting period ending at the date specified.

**For VaR for the foreign exchange risk – average, minimum and maximum value in the reporting period for the foreign currency position determined in line with PAS.

Repricing gap for the Capital Group									
		up to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 – 3 years	3 – 5 years	more than 5 years	Total
31.12.2017	Gap	4,409,181	2,753,373	5,876,080	119,839	6,643,681	551,780	-59,455	**20,294,479**
	Aggregate gap	**4,409,181**	**7,162,554**	**13,038,634**	**13,158,473**	**19,802,154**	**20,353,934**	**20,294,479**	
31.12.2016	Gap	-709,701	2,852,240	6,061,886	740,537	4,560,228	336,939	267,852	**14,109,981**
	Aggregate gap	**-709,701**	**2,142,539**	**8,204,425**	**8,944,962**	**13,505,190**	**13,842,129**	**14,109,981**	

(in PLN '000)

46.1. Currency structure

Currency structure of assets	Currency translation to PLN as at 31 December 2017					
	PLN	EUR	USD	CHF	Other	Total
Cash and balances with the Central Bank	712,161	9,217	427	174	266,602	**988,581**
Receivables from banks	1,106,908	1,703,384	282,213	1,273	153,695	**3,247,473**
Financial assets designated as measured at fair value through profit or loss at initial recognition	43,829	86,404	0	0	0	**130,233**
Financial assets held for trading	979,024	13,044	2,889	0	347,113	**1,342,070**
Loans and advances to customers (net), including:	22,040,608	3,546,138	1,357,196	34,645	245,166	**27,223,753**
- impairment write-downs	-663,377	-48,608	-41,360	-2,868	-1,990	**-758,203**
Receivables under reverse repo and buy-sell-back transactions	2,105,540	0	0	0	0	**2,105,540**
Available-for-sale financial assets	35,034,629	1,769,734	224,260	0	32,629	**37,061,252**
Investments in associates	1,045,661	20,544	0	0	0	**1,066,205**
Financial assets held for sale	0	0	0	0	0	**0**
Intangible assets	43,176	0	0	0	0	**43,176**
Property, plant and equipment (PP&E)	143,974	0	0	0	0	**143,974**
Investment property	834,428	0	0	0	0	**834,428**
Current tax receivables	1	0	0	0	0	**1**
Deferred tax assets	80,185	0	0	0	0	**80,185**
Other assets	45,421	1,718	4	1	0	**47,144**
Total assets	**64,215,545**	**7,150,183**	**1,866,989**	**36,093**	**1,045,205**	**74,314,015**

Currency structure of liabilities	Currency translation to PLN as at 31 December 2017					
	PLN	EUR	USD	CHF	Other	Total
Liabilities to banks	2,574,570	728,806	196,742	0	94,022	**3,594,140**
Financial liabilities held for trading	1,270,594	12,870	1,154	0	0	**1,284,618**
Liabilities to customers	30,477,709	3,122,226	70,655	4,611	17,119	**33,692,320**
Liabilities under repo and sell-buy-back transactions	5,781,829	1,573,212	218,779	0	0	**7,573,820**
Liabilities due to debt securities issued	6,299,315	0	0	0	0	**6,299,315**
Other liabilities	889,089	532,291	310	0	88	**1,421,778**
Current tax liabilities	70,136	0	0	0	0	**70,136**
Deferred tax liabilities	7,090	0	0	0	0	**7,090**
Provisions	260,401	17,537	10,163	8	1,655	**289,764**
Equity	20,062,967	18,142	-75	0	0	**20,081,034**
Total liabilities and equity	**67,693,700**	**6,005,084**	**497,728**	**4,619**	**112,884**	**74,314,015**

(in PLN '000)

Currency structure of assets	Currency translation to PLN as at 31 December 2016					
	PLN	EUR	USD	CHF	Other	Total
Cash and balances with the Central Bank	642,431	3,283	564	305	193	**646,776**
Receivables from banks	684,746	2,799,313	126,991	4,133	21,183	**3,636,366**
Financial assets designated as measured at fair value through profit or loss at initial recognition	45,570	90,829	0	0	0	**136,399**
Financial assets held for trading	470,303	5,435	3,070	0	0	**478,808**
Loans and advances to customers (net), including:	21,201,494	2,493,576	829,355	47,437	59,662	**24,631,524**
- impairment write-downs	-612,019	-39,824	-113,116	-3,201	-171	**-768,331**
Receivables under reverse repo and buy-sell-back transactions	3,946,887	0	0	0	0	**3,946,887**
Available-for-sale financial assets	27,809,413	3,771,316	39,016	0	0	**31,619,745**
Investments in associates	643,154	2,283	0	0	0	**645,437**
Financial assets held for sale	0	0	0	0	0	**0**
Intangible assets	36,782	0	0	0	0	**36,782**
Property, plant and equipment	140,147	0	0	0	0	**140,147**
Investment property	587,771	0	0	0	0	**587,771**
Current tax receivables	18	0	0	0	0	**18**
Deferred tax assets	207,724	0	0	0	0	**207,724**
Other assets	31,499	717	6	1	0	**32,223**
TOTAL ASSETS	**56,447,939**	**9,166,752**	**999,002**	**51,876**	**81,038**	**66,746,607**

Currency structure of liabilities	Currency translation to PLN as at 31 December 2016					
	PLN	EUR	USD	CHF	Other	Total
Liabilities to banks	3,429,881	547,930	1,018	0	0	**3,978,829**
Financial liabilities held for trading	600,489	6,810	706	0	0	**608,005**
Liabilities to customers	29,227,763	7,783,057	86,622	4,565	7,245	**37,109,252**
Liabilities due to repo and sell-buy-back transactions	5,752,184	0	0	0	0	**5,752,184**
Debt securities issued	5,801,403	0	0	0	0	**5,801,403**
Other liabilities	398,040	12,777	371	0	3	**411,191**
Current tax liabilities	60,560	0	0	0	0	**60,560**
Deferred tax liabilities	2,800	0	0	0	0	**2,800**
Provisions	211,555	41,021	198	0	0	**252,774**
Equity	12,741,681	28,074	-146	0	0	**12,769,609**
Total liabilities and equity	**58,226,356**	**8,419,669**	**88,769**	**4,565**	**7,248**	**66,746,607**

47. Operating risk

The operating risk is understood as the risk of losses the Bank can incur as a result of misalignment or unreliability of internal processes, people, or systems or as a result of external events. This definition includes legal risk but excludes reputational risk understood as the risk of negative perception of the Bank's brand and strategic risk, defined as the risk related to disadvantageous or wrong strategic decisions, inadequate strategy implementation or a failure to carry out such strategy and changes in the external environment and inappropriate relation to such developments, although it applies to the relevant control processes. Operational risk is inherent in all major areas of the Bank's operations, including any new, existing and modified products, processes and systems, and it takes account of internal factors (such as the organisational structure, business profile, IT systems used, client profile, client complaints, HR quality, organisational changes and staff turnover) and external factors (external environment of the Bank).

The Bank manages operational risk by introducing:

- the function of an operational risk coordinator,
- a process-based approach to the assessment of business lines, elevated products and risk generated by branches and organisational units of the Bank's head office,
- operational risk indicators.

The operating risk management process covers all branches/organisational units of the Bank's head office and subsidiaries supervised by relevant organisational units of the Bank's head office in line with the Head Office Organisational Regulations and their respective responsibilities.

All Capital Group entities follow the same operational risk principles developed by appropriate organisational units or their designated employees.

Operational risk coordinators draw up reports assessing processes, internal risk, and KRIs for individual subsidiaries.

Operational risk is identified by collecting information on operational risk data sources, which can be either: internal (including operational events, incidents reported, customer complains, surveys); or external (operational risk events databases of the Polish Banks Association and external analysis).

Potential risk is determined based on self-assessed of: internal risk generated by organisational units of the head office and branches of the Bank as well as subsidiaries, processes in active business lines of the Bank and products with elevated operational risk.

The actual risks are assessed using operational risk ratios and limits and the analysis of operational events, including estimations of the probability of loss entailing the need to recognise provisions for future losses.

The purpose of operational risk measurement is to evaluate threats resulting from operational risks using pre-determined risk measurements. Operational risk assessment includes: calculation of KRIs, calculation of the capital requirement using BIA, stress tests, and determination of the internal capital.

The Bank regularly monitors the level of operational risk and efficiency as well as timeliness of activities aimed at reducing or transferring operational risk.

Information on operational risk for the Bank and its subsidiaries is reported on a regular basis.

To reduce the impact of operational events, the Bank applies risk mitigants and implements various kinds of preventive actions, such as:
- training for employees,
- BCP emergency plans,
- Risk transfer, including outsourcing and insurance coverage,
- other safeguards (legal, organisational and technical).

48. Other risks

48.1. Compliance risk management

Compliance risk includes the risk of negative effects resulting from non-compliance with the provisions of applicable law, internal regulations or market standards in the processes of the Bank or subordinates.

Compliance risk management includes risk identification, measurement, assessment, monitoring, and reporting and is carried out in line with written policies and procedures determining the code of conduct of the Bank and supporting compliance risk management in the subordinates. All subordinates follow uniform compliance risk principles developed by relevant organisational units of those subordinates.

The unit responsible for coordination of the compliance risk management process is the compliance unit which develops and implements compliance risk management principles and methods for investigation procedures and compliance tests. To reduce the compliance risk in the Bank's organisational units and subsidiaries, a compliance risk coordinator was appointed that supports the Compliance Unit.

Reporting information on compliance risk concerning the Bank and other subsidiaries takes place on a regular basis.

48.2. Reputational risk management

Reputational risk is defined as the risk of negative perception of the Bank by its clients, counterparties, supervisors, regulators, opinion-makers, government institutions, public benefit organisations, associations, foundations and public opinion, which can adversely affect the performance of the Bank.

Reputational risk is managed to protect the Bank's brand image and reduce losses resulting from any damage to the Bank's reputation and the probability of such risk.

Reputational risk is managed through classification of reputational risk events with ex ante and ex post risk assessment carried out.

Reporting information on compliance risk concerning the Bank and other subsidiaries takes place on a regular basis as part of compliance risk reporting.

48.3. Business risk management

Business risk is understood as the risk of failure to achieve key business goals, in particular financial result, due to changes in economic, social, legal, business and market environment or a failure to achieve the business and social goals implemented by the Bank as part of missions and tasks defined by the owner. Business risk involves strategic risk.

The objective of business risk management is to mitigate a negative financial impact of adverse changes in business environment, inappropriate decisions, inadequate implementation of decisions or inadequate response to changes in the business environment.

Business risk measurement

Business risk identification consists in identifying and determining actual and potential risks related to the existing and planned activities of the Bank which can considerably affect its financial condition, originate or change its revenue and expenses. Business risk is identified based on the analysis of selected revenue and cost items of the profit and loss account and significant interest-bearing balance sheet and off-balance sheet figures. Business risk as regards financial result is carried out by the Bank through a prospective assessment of business risk to the implementation of the Bank's Strategy and the schedule of works for the next year, as well as through the analysis of deviations from the Bank's Strategy and the the schedule of works of the Bank, including trends in the implementation of main items and expected results in the periods to follow. Key parameters of the schedule of works and expenditures of the Bank which are assessed and analysed include key items of balance sheet, profitability, portfolio quality, margin, and solvency ratio.

In business risk management the Bank also takes into account aspects associated with the activity of BGK Group, in particular as regards investments and equity instruments. Risk assessment comprises issues associated with the implementation of plans in this respect, their impact on the liquidity of the Bank, both in the present as well as in the future, i.e. any projects to be carried out in the future and prospects being reviewed at the moment. Regardless of the accounting classification in the stand-alone statement, the assessment also concerns present measurements and any impairment losses that translate into the consolidated profit or loss. Any risks related to the activity of subsidiaries in capital investments of the Bank are analysed and assessed as part of annual business risk assessment.

The Bank, as part of periodical reporting process, in the event of emergence of business risk factors which have an impact on lack of implementation of the Bank's annual result of over PLN 25 million, they are subject to an in-depth analysis and clarification. A report summarizing a given financial year discusses key risks, risk mitigants and recommendations. Thes elements are also examined in the process of drawing up the schedule of works and expenditures for the year to follow.

Along with updating the Strategy, the Bank analyses Strategy performance and deviations from the financial projections. Performance of business and financial goals is assessed together with changes in the macroeconomic environment.

As part of risk management process, the Bank carries out stress tests based on the schedule of works and expenditures of the Bank and its Strategy to determine the impact of the assumptions made on the risk measures, in particular capital adequacy and liquidity ratios. Stress testing of risk measures is carried out in line with the applicable risk management principles.

Projecting and monitoring business risk

Business risk is monitored by way of a monthly analysis of the Bank's performance, semi-annual profitability analysis of selected bank products presented at the Bank's FC that includes a detailed list of product profitability factors, such as interest margin, net fee and commission income and liquidity margin as well as factors related to covering estimated cost of risk and operating expenses. The annual review is carried out for regulatory risk, market risk and business risk.

Apart from preparing annual and long-term plans in the process of the Bank's Strategy review, when the Management Board of the Bank is presented with key factors affecting the Bank's performance and financial condition and key risks for the schedule of works and expenditures, which are tantamount to its business risks, the Bank regularly reviews its performance and balance sheet projections. The projections are aimed at assessing the probability of meeting the objectives determined in the schedule and include action plans supporting achievement of such business and financial goals.

Business risk reporting

Business risk reports are prepared on a monthly, quarterly and annual basis. Monthly and quarterly reports cover key indicators of the Bank, balance sheet, deposit, credit and performance data. Quarterly reports also contain information on the results of companies from the BGK Group. The annual report is prepared for the Management Board, Risk Committee, Audit Committee, and Supervisory Board. The report presents performance details of the schedule of works and expenditures, Strategy of the Bank and also contains information on the factors of risk from the business environment, such as marcoeconomic risk factors, changes in legal regulations for banking activity, as well as market trends and changes in the banking sector, along with the domain of offered services and banking technologies.

48.4. Macroeconomic risk management

Macroeconomic risk is defined as the risk of changes in macroeconomic environment, which may adversely affect the Capital Group and minimum capital requirements in the future.

The objective of macroeconomic risk management is to identify macroeconomic factors that significantly affect the operations of the Capital Group and to reduce the adverse impact of such macroeconomic changes on the financial condition of the Capital Group.

Macroeconomic risk management process involves identifying those macroeconomic factors that significantly affect the operations of the Capital Group and determining potential scenarios for individual factors.

When designing the Bank's Strategy, Schedule of works and expenditures, Risk Management Strategy at the Bank, Credit Policy, and other documents important for the activities of the Capital Group, the Bank takes into account its macroeconomic environment and potential changes therein.

Macroeconomic risk is measured based on stress tests of macroeconomic factors (interest rates, exchange rates, changes in real estate prices, changes of prices of selected assets on goods markets, e.g. changes in energy commodity prices), and aggregate stress tests of capital adequacy analyzing the impact of given assumptions, including macroeconomic factors, on capital requirements and internal capital. Macroeconomic risk is also measured based on the Bank's exposure in individual industries, clients or products. Internal limits are determined in line with the expected sector risk.

Macroeconomic risk is reported in monthly, quarterly and annual credit risk reports which present the impact of macroeconomic environment on the Bank's lending activity and in individual stress test reports. The reports are drawn up for the Bank Credit Committee, the Bank Financial Committee, the Management Board, the Risk Committee, and the Supervisory Board.

48.5. Model risk management

Model risk means the potential loss the Bank may incur as a consequence of decisions that could be significantly based on the output of internal models used by the Bank, due to errors in the development, implementation or use of such models.

The process of model risk management involves:

1. Identifying (specifying models, their significance as well as risks).
2. Assessing/measuring (methods for assessment of model risk significant for a single model and aggregate risk for all models, specify acceptable risk level).
3. Monitoring and controlling (exercising supervision over the level of risk taken, reviews of relevance and accuracy of the applied methods of risk assessment, and evaluation of efficiency of the tools used).
4. Reporting (information on risk profile, the assessment of the level of risk based on the measurement methodology applied, identification of possible threats, and information on the measures adopted).
5. Undertaking activities aimed at risk mitigation (regulations, principles, methodologies, procedures, regulations, systems, and tools which support the planning of activities, including: validations, registers, logbooks, model documentation, preventive and remedial actions, recommendations and guidelines for organisational units).

All significant models subject to the process of independent periodical validation in line with the annual schedule of works endorsed by the Bank and prepared by an independent validation unit. An independent validation unit (independent in relation to the organisational units of the Bank that act as model owners or users) answers directly to the Member of the Management Board supervising the risk division. The results of model validation and recommendations are presented by an independent validation unit to relevant committees of the Bank.

A quarterly model report (submitted to the Bank's Finance Committee – BFC) and semi-annual model report (submitted to the Bank's Finance Committee and the Management Board) contains in particular information on: models register, models logbooks, changes in the number of models in use, the scope of their application and reasons for such changes, schedule of tasks for a given period with the evaluation of its implementation, reasons for delay (if any), and key findings of monitoring activities, model validation, and internal audits (if any), along with model risk level assessment.

As for the annual report presented to the Supervisory Board of the Bank, the Risk Committee, the Management Board of the Bank, and BFC contains information analogical to the quarterly and mid-year reports and in addition information on the system of model risk management with the list of scheduled activities associated with the management of models and their risks and efficiency assessment.

(in PLN '000)

49. Capital adequacy

Capital adequacy is monitored with the use of capital adequacy ratios:

- capital ratios determined in accordance with CRR provisions[1]:
  - Common Equity Tier 1 ratio,
  - Tier 1 ratio,
  - solvency ratio.
- internal capital ratio referred to in Article 128.1 (2) of the Banking Law.

The above indicators are specified individually due to the lack of need to carry out prudential consolidation in line with the CRR.

In 2017, the Bank met the capital adequacy standards specified in the CRR and the Banking Law.

Capital adequacy management includes:

- setting and monitoring capital adequacy ratios,
- setting and monitoring the use of capital limits for individual activity areas, based on the amount of internal capital,
- aggregate stress testing,
- reporting capital adequacy levels,
- capital budgeting,
- developing a capital emergency plan.

As part of capital adequacy management process, the Bank prepares regular reports on capital adequacy ratios, total capital requirement, internal capital and own funds, utilization of capital limits, and stress tests results.

Additionally, the Bank manages excessive leverage risk. Excessive leverage risk management is integrated with capital adequacy management and includes, *inter alia*, determining leverage in line with Commission Delegated Regulation No. 2015/62 (EU) of 10 October 2014 to supplement Regulation (EU) No. 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions (OJ L 11, 17.1.2015, p. 37) as Tier 1 capital measure divided by total exposure measure.

Dynamics of capital adequacy ratios and their components are presented in the tables below.

Capital adequacy ratios in line with CRR - including cash flow funds			
No.	**Ratio**	**31.12.2017**	**31.12.2016**
I	CET1	37.95%	30.08%
II.	Tier 1 ratio	37.95%	30.08%
III.	Solvency ratio (total capital ratio)	37.95%	30.08%
IV.	Internal capital ratio	24.64%	31.76%
V.	Own funds	18,864,232	12,069,782
V.1	Tier1	18,864,232	12,069,782
V.1.1	CET1	18,864,232	12,069,782
V.1.2	AT1	0	0
V.2	Tier2	0	0
VI.	Total capital requirement	3,976,310	3,210,111
VII.	Internal capital	4,648,867	3,833,559

- Additional information

Capital adequacy ratios - excluding cash flow funds			
No.	**Ratio**	**31.12.2017**	**31.12.2016**
I	CET1	37.96%	30.08%
II.	Tier 1 ratio	37.96%	30.08%
III.	Solvency ratio (total capital ratio)	37.96%	30.08%
IV.	Internal capital ratio	24.64%	31.76%
V.	Own funds	18,864,232	12,069,782
V.1	Tier1	18,864,232	12,069,782
V.1.1	CET1	18,864,232	12,069,782
V.1.2	AT1	0	0
V.2	Tier2	0	0
VI.	Total capital requirement	3,975,779	3,209,779
VII.	Internal capital	4,648,331	3,833,220

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 Text (OJ L 176, 27.6.2013, p. 1, as amended):

Changes in the capital ratios and the internal capital ratio mainly resulted from:

- increase in own funds as a result of the BGK's statutory fund increase by the State Treasury through the transfer of State Treasury securities amounting to PLN 4,8 billion and cash to PLN 1.5 billion,
- increase in the total capital requirement caused mainly by an increase in capital requirement under credit risk in connection with, inter alia, the development of the Bank's activities in the corporate finance area and the purchase of investment certificates of Closed-Ended Investment Funds.

49.1. Own funds for capital adequacy purposes

Own funds to solvency ratio are determined in accordance with 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.

For capital adequacy purposes, own funds are determined on a separate basis, as no prudential consolidation is required under the CRR.

BGK's own funds, determined in accordance with the CRR, include:

1) Tier 1:

- Tier I (CET1, Common Equity Tier 1 capital):

  – statutory fund that constitutes – pursuant to Article 3.3c of the Act on BGK – an equity instrument within the meaning of Articles 26(1)(a) and 28 of the CRR.

  The authorised fund is created from monies and other assets contributed by the State Treasury (including Treasury securities provided by the minister competent for public finance) as well as annual write-downs on the Bank's net profit, in accordance with the principles specified in BGK's Articles of Association.

  – reserve capitals, including supplementary capital and reserve fund

  The supplementary capital and the reserve fund are established from the distribution of the annual net profit, in line with the principles defined in BGK's Articles of Association.

  – general banking risk fund

  The general banking risk fund is established from the distribution of the annual net profit, in line with the principles defined in BGK's Articles of Association.

  – accumulated other comprehensive income

  Unrealised gains and losses related to assets and liabilities measured at the fair value are subject to the transition period; in 2017, the Bank included 100% of unrealised losses in Tier 1 and removed 20% of unrealised gains from Common Equity Tier 1.

  – deductions under intangible assets

  The amount deducted from Common Equity Tier 1 is decreased by the related deferred tax liabilities.

  – deductions of deferred tax assets depending on future profitability and not resulting from temporary differences.

  – Additional Valuation Adjustments (AVA)

  AVA is a simplified approach pursuant to Commission Delegated Regulation (EU) No. 2016/101 of 26 October 2015 supplementing Regulation (EU) No. 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for prudent valuation under Article 105 (14) (OJ L 21, 28.1.2016, p. 54).

  – Direct and indirect capital involvement of the Bank in financial sector entities, if the institution did not make a significant investment in those entities in the form of stock or shares held or of other instruments of the share capital or instruments of Tier 2 of those entities, as long as their aggregate exceeds 10% of Tier 1 share capital of the Bank.

  If the amount of decreases lowers Tier 2 capital below zero, the surplus of those decreases over the Tier 2 capital shall be deducted from Tier 1 basic funds.

(in PLN '000)

- AT1, i.e. Additional Tier 1 Capital – as at 31 December 2017, the Bank did not hold any positions in Additional Tier 1

Own funds*		
	31.12.2017	**31.12.2016**
Basic funds (Tier 1)	**18,864,232**	**12,069,782**
Statutory capital	17,950,629	11,339,138
Supplementary capital	671,393	643,460
Other reserve capitals	76,830	76,830
General banking risk fund	155,500	155,500
Other comprehensive income	355,477	-76,699
Tier 1 capital transition adjustments	-78,290	-643
Intangible assets	-42,399	-36,753
Deferred tax liabilities related to intangible assets	1,887	905
Deferred tax assets depending on future profitability and not resulting from temporary differences	0	0
Tier 1 adjustments resulting from prudential filters	-37,187	-31,956
Capital involvement	-189,608	0
Supplementary funds (Tier 2)	**0**	**0**
Subordinated liabilities included in supplementary funds	0	0
Capital involvement	0	0
Total own funds	**18,864,232**	**12,069,782**

*excluding figures for Inland Waterways Fund.

49.2. Capital requirements (Pillar I)

In order to define minimum capital requirements under individual risk types (Pillar I), the Bank applies methods described in the table below.

Capital requirement under:	Method
credit risk and counterparty credit risk	– standardised method (Articles 111 to 141 of the CRR) – financial collateral comprehensive method (Articles 223 to 224 of the CRR) – balance sheet equivalent of derivative transactions in line with the mark-to-market method (Article 274 of the CRR) – alternative calculation of own funds requirement for exposures to a QCCP (Article 310 of the CRR)
foreign exchange risk	basic calculation (Article 351 of the CRR)
commodities risk	simplified approach (Article 360 of the CRR)
trading portfolio risk, including:	
- specific and general risk in the scope of equity instruments	pursuant to Articles 342 and 343 of the CRR
- specific risk of debt instruments	pursuant to Article 336 of the CRR
- general risk of debt instruments	maturity ladder approach (Article 339 of the CRR)
credit valuation adjustment (CVA) risk	standardised method (Article 384 of the CRR)
settlement risk	pursuant to Articles 378 to 380 of the CRR
large exposures in the trading book	pursuant to Article 397 of the CRR
operational risk	basic indicator approach (Articles 315 to 316 of the CRR)

Capital requirements structure in BGK – including cash flow funds

NO.	Capital requirement under:	31.12.2017	31.12.2016
I.	credit risk and counterparty credit risk	3,667,771	2,906,173
II.	foreign exchange risk	0	0
III.	commodities risk	0	0
IV.	trading portfolio risk, including:	119,498	123,121
1	- specific and general risk in the scope of equity instruments	0	0
2	- specific risk of debt instruments	11	21
3	- general risk of debt instruments	119,487	123,100
V.	credit valuation adjustment (CVA) risk	66,212	61,088
VI.	settlement risk	0	0
VII.	large exposures in the trading book	0	0
VIII.	operational risk	122,829	119,729
Total		**3,976,310**	**3,210,111**

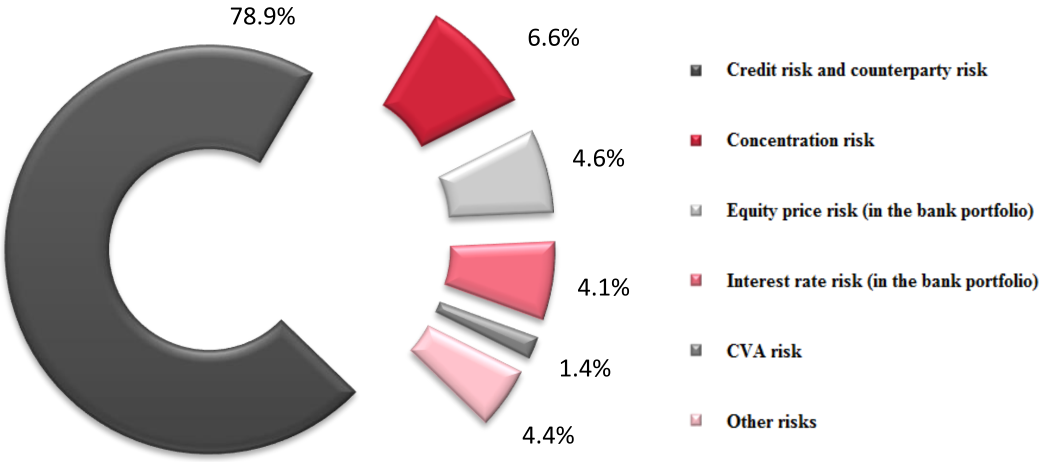
49.3. Internal capital (Pillar II)

Internal capital (Pillar II) is an amount estimated by the Bank which is necessary to cover all identified significant risk types occurring in the Bank's operation as well as changes in the economic environment, which takes account of the expected risk level. The amount of internal capital is estimated to cover unexpected losses.

The internal capital is estimated to cover risks identified as significant. For insignificant risks, the Bank does not establish internal capital to cover them. The total amount of internal capital is determined as the sum of internal capital under individual types of risk.

In order to estimate the internal capital under individual risk types, the Bank uses the methods applied to determine capital requirements or internal methods developed by the Bank.

As at 31 December 2017, internal capital totalled PLN 4,648,867 thousand, with the internal capital ratio accounting for 24.64%. The percentage structure of internal capital (with cash flow funds) is presented below.



Other notes

50. Information on the entity authorized to audit the consolidated financial statements

On 16 September 2015, the Bank entered into an agreement for the audit of the financial statements with Deloitte Polska Spółka z ograniczoną odpowiedzialnością sp.k. (from 19 March 2018: Deloitte Audyt spółka z ograniczoną odpowiedzialnością sp. k) for a definite term of three years.

Fees paid or due for 2017:
- audit of annual financial statements: PLN 449 thousand gross,
- other services: PLN 38 thousand gross,

for 2016:
- audit of the annual financial statements: PLN 228 thousand gross,
- audit of the optional consolidated financial statements for 2016: PLN 86 thousand gross,
- audit of the optional financial statements prepared in line with the IFRS for 2015: PLN 86 thousand gross,
- other services: PLN 102 thousand gross.

51. Assets pledged as collateral for the payment of liabilities

The Capital Group's assets include loans granted from the funds of the former National Housing Fund, which have been pledged as collateral for the repayment of a loan obtained from the Ministry of Finance (funds from the Council of Europe Development Bank) and for the State Treasury guarantees for loans obtained from International Financial Institutions (the European Investment Bank and the Council of Europe Development Bank).

The value of receivables transferred by BGK to the State Treasury in relation to loans granted and guaranteed by the Ministry of Finance to increase the National Housing Fund is presented below.

Lender	Loan amount	Loan amount guaranteed by the State Treasury	State Treasury guarantee amount	Loan amount transferred as collateral for the loan or guarantee	
				31.12.2017	31.12.2016
Ministry of Finance using a loan granted by the Council of Europe Development Bank	PLN 630,000	-	-	0	5,823
European Investment Bank (EIB) - Financial Contract No. 21.426	EUR 10,000	EUR 10,000	EUR 16,800	20,027	25,749
European Investment Bank (EIB) - Financial Contract No. 21.607	EUR 200,000	EUR 200,000	EUR 296,000	587,983	653,419
Council of Europe Development Bank	PLN 700,000	PLN 700,000	PLN 1,260,000	539,760	623,760

*all data in the table above are indicated in PLN '000

The liabilities of the Capital Group have been secured with the following assets:

- As at 31 December 2017

Type of transaction	Collateral	Carrying amount of assets held as security against liabilities	Amount of liabilities secured
Reverse repo and buy-sell-back transactions	bonds	7,569,464	7,573,820
Other loans	loans	881,649	708,827
Derivative transactions	deposits	453,858	530,408

- As at 31 December 2016:

Type of transaction	Collateral	Carrying amount of assets held as security against liabilities	Amount of liabilities secured
Reverse repo and buy-sell-back transactions	bonds	5,724,857	5,752,184
Other loans	loans	1,045,000	808,095
Derivative transactions	deposits	63,759	41,979
Payment to the Guaranteed Deposit Protection Fund in the Bank Guarantee Fund	bonds	137,449	-

Basis for securities blocking:

- for repo and sell-buy-back transactions – under standard procedures applicable to a given type of transactions in the money market,

- for other loans, derivative transactions - under agreements concluded with the Bank,
- for blocking for the benefit of the Bank Guarantee Fund – under applicable provisions of the Act on Bank Guarantee Fund.

52. Major events after the Balance Sheet Date not included in the statements

1) Based on the Act of 24 November 2017 amending the Act on Sureties and Guarantees Granted by the State Treasury and Certain Legal Entities as well as Certain Legal Acts, (Journal of Laws, item 2433), the Bank established a National Guarantee Funds ("NGF") – a cash-flow fund. Based on said Act, BGK injected into the NGF a total of PLN 900 million. The amount decreased the Bank's authorised fund.

2) On 22 January 2018 the Extraordinary General Meeting of Shareholders of Małopolski Fundusz Poręczeń Kredytowych Sp. z o.o. passed a resolution to put the Company into liquidation.

3) Payments and additional payments for investment certificates in 2018:

- Fundusz Sektora Mieszkań na Wynajem FIZ AN (Dwelling for Rent Sector Closed-End Investment Private Equity Fund):
  - additional payment for T series investment certificates of PLN 6,000,136.10 made on 24 January 2018
  - additional payment for P series investment certificates of PLN 2,641,077.12 made on 21 March 2018
- Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprises Investments Closed-End Investment Private Equity Fund)
  - additional payment for O series investment certificates of PLN 314,496.00 made on 15 January 2018
  - additional payment for P series investment certificates of PLN 43,195,680.00 made on 15 January 2018
  - additional payment for Q series investment certificates of PLN 43,195,680.00 made on 15 January 2018
  - additional payment for R series investment certificates of PLN 17,394,912.00 made on 15 January 2018
  - payment for the acquisition of S series investment certificates of PLN 4,320.00 made on 9 February 2018
  - additional payment for S series investment certificates of PLN 29,656,800.00 made on 13 February 2018
  - additional payment for R series investment certificates of PLN 25,800,768.00 made on 13 February 2018
  - payment for the acquisition of T series investment certificates of PLN 4,320.00 made on 14 March 2018
  - additional payment for S series investment certificates of PLN 13,538,880.00 made on 16 March 2018
  - additional payment for T series investment certificates of PLN 25,945,920.00 made on 16 March 2018
- Fundusz Inwestycji Samorządowych FIZ AN (Municipal Investments Closed-End Investment Private Equity Fund)
  - additional payment for B series investment certificates of PLN 38,682,000.00 made on 15 January 2018
  - additional payment for B series investment certificates of PLN 3,393,000.00 made on 30 January 2018
  - payment for the acquisition of C series investment certificates of PLN 3,750.00 made on 27 March 2018
  - additional payment for B series investment certificates of PLN 934,000.00 made on 30 March 2018
  - additional payment for C series investment certificates of PLN 1,211,250.00 made on 30 March 2018
- Fundusz Inwestycji Infrastrukturalnych - Dłużny FIZ AN (Infrastructure Investments Debenture Closed-End Investment Private Equity Fund)
- Fundusz Inwestycji Infrastrukturalnych - Kapitałowy FIZ AN (Infrastructure Investments Capital Closed-End Investment Private Equity Fund)
  - additional payment for G series investment certificates of PLN 11,601,262.26 made on 15 January 2018
  - additional payment for G series investment certificates of PLN 6,140,827.62 made on 28 February 2018
  - additional payment for G series investment certificates of PLN 1,962,505.80 made on 30 March 2018
- Fundusz Sektora Mieszkań dla Rozwoju (Dwelling for Development Sector Closed-End Investment Private Equity Fund), FSMDR FIZ AN)
  - payment for G series investment certificates of PLN 96,601,839.51 made on 24 January 2018
  - additional payment for D series investment certificates of PLN 3,578,877.00 made on 31 January 2018
  - additional payment for E series investment certificates of PLN 1,297,500.00 made on 31 January 2018
  - additional payment for F series investment certificates of PLN 2,986,820.00 made on 26 February 2018
  - additional payment for B series investment certificates of PLN 6,127,930.12 made on 28 February 2018
  - additional payment for E series investment certificates of PLN 1,946,250.00 made on 29 March 2018
  - payment for H series investment certificates of PLN 380,251,831.60 made on 6 April 2018
- Fundusz Ekspansji Zagranicznej FIZ AN (Foreign Expansion Closed-End Investment Private Equity Fund)
  - payment for B series investment certificates of EUR 42,299,906.25 made on 27 March 2018

4) Other major investments in Q1 2018:
- payment totalling EUR 14,000,000.00 to Marguerite II SCSp (société en commandite spéciale)
- payment totalling EUR 2,000,000.00 to Polski Fundusz Funduszy Wzrostu - Polish Growth Fund of Funds
- on 5 February 2018 the Management Board of the Bank passed a resolution on acquisition of 13,000 ordinary registered H series shares of BGK Nieruchomości S.A with a nominal value of PLN 1,000 each and an issue price equivalent to the nominal value for a total of PLN 13,000,000.00.

Major events in other entities of the Capital Group

1) An increase of the capital in the following special purpose vehicles:

- FSMnW Trójmiasto Sp. z o.o: an increase by PLN 5,950,000 (of PLN 59,000 and PLN 5,890,500 have been allocated to the share capital and the supplementary capital, respectively) - the capital was transferred to the company on 29 January 2018, the change in the NCR (KRS) was not recorded up to the date of preparation of these financial statements
- MP Inwestycje 4 Sp. z o.o: an increase by PLN 6,605,400 (of which a total of PLN 6,605,400 has been allocated to the share capital) – the capital was transferred to the company on 31 January 2018, the change in the NCR (KRS) was recorded on 12 March 2018.
- MP Wałbrzych Sp. z o.o.: by PLN 1,600,000 (of which a total of PLN 1,600,000 has been allocated to the share capital) – the capital was transferred to the company on 5 February 2018, the change was not recorded in the NCR (KRS) up to the date of preparation of these financial statements.
- MP Inwestycje 2 Sp. z o.o: an increase by PLN 76,295,500 (of which a total of PLN 61,036,400 and 15,259,100 have been allocated to the share capital and the supplementary capital, respectively) – the capital was transferred to the company on 26 January 2018, the change in the NCR (KRS) was recorded on 21 February 2018.
- MP Biała Podlaska Sp. z o.o.: the capital of the company was increased on 20 February 2018 by PLN 1,457,600 (i.e. 14,576 shares, PLN 100 each), whereas the new shares in the capital of the company were designated to be acquired solely by FSMnW. On 21 February 2018, as a result of the increase in said capital, the company received PLN 1,457,600, of which a total of PLN 1,457,600 has been allocated to the share capital. The change in the capital was recorded in the NCR (KRS) on 6 April 2018..

2) Other major events in special purpose vehicles

- MP Inwestycje 2 Sp. z o.o.: property (land) located in Cracow was purchased on 26 January 2018 for a total of PLN 62,328,890 gross.
- FSMnW Trójmiasto Sp. z o.o.: a notarial deed concerning the purchase of property in Gdańsk for a total of PLN 17,660,617 gross was signed on 30 January 2018.
- In January 2018 FSMnW sold two companies: MP Inwestycje 2 Sp. z o.o. and MP Inwestycje 4 Sp. z o.o.
- MDR Inwestycje 7 Sp. z o.o. (entered into the NCR (KRS) on 17 April 2018) acquired an investment (land) in Warsaw for a total of PLN 121,664,452 gross on 29 March 2018.
- MP Inwestycje Sp. z o.o. received on 5 April 2018 a payment totalling PLN 12,438,248 from the guarantor of the investment as part of arranged settlement for non-performance of the investment in Pruszków. As at 31 December 2017, in light of initial pessimistic assumptions, a write-off on that investment in the amount of PLN 8,624,876 was established.
- On 4 April 2018 the division of FSMnW Warszawa 1 Sp. z o.o. into FSMnW Warszawa 1 Sp. z o.o. and FSMnW Warszawa 4 sp. z o.o. was registered with the NCR (KRS).

These consolidated financial statements of the Capital Group of Bank Gospodarstwa Krajowego for the financial year from 1 January to 31 December 2017 consists of 115 pages numbered consecutively.

Warsaw, 23 April 2018

Prepared by:

Head of Accounting Department

Krzysztof Gołubowski

Signatures of the Members of the Management Board of Bank Gospodarstwa Krajowego:

President of the Management Board	First Vice-President of the Management Board	Vice-President of the Management Board
Beata Daszyńska - Muzyczka	**Paweł Nierada**	**Włodzimierz Kocon**
Member of the Management Board	Member of the Management Board	Member of the Management Board
Przemysław Cieszyński	**Wojciech Hann**	**Radosław Kwiecień**