

**REPORT OF THE MANAGEMENT BOARD ON THE
ACTIVITIES OF
BANK GOSPODARSTWA KRAJOWEGO
CAPITAL GROUP IN 2017**

(comprising the report of the Management Board on the
activities of Bank Gospodarstwa Krajowego)

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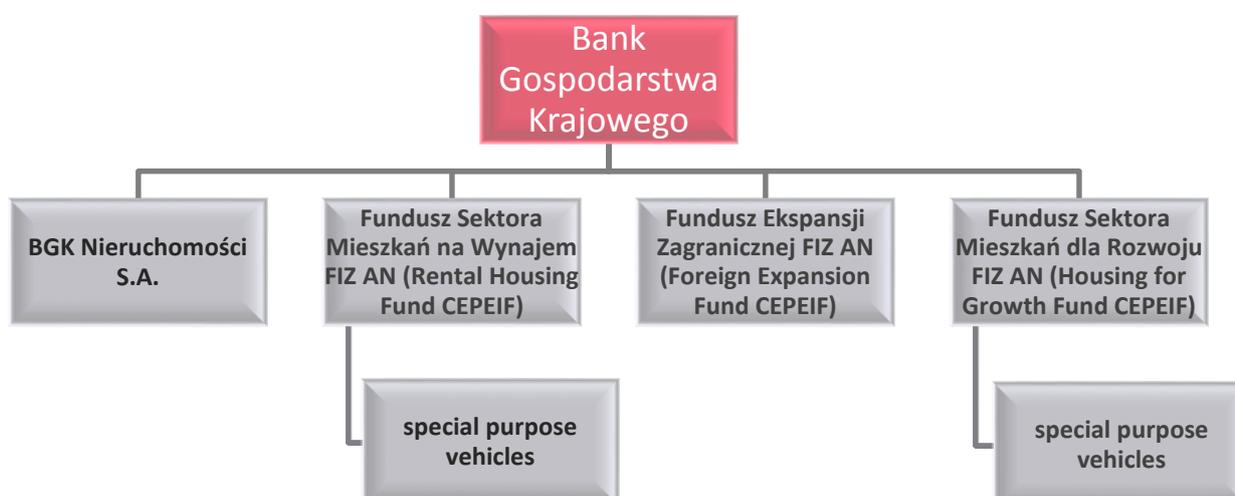
1. SUMMARY OF 2017

1.1 A BRIEF DESCRIPTION OF BGK CAPITAL GROUP

Bank Gospodarstwa Krajowego (BGK) and its capital group are Poland's main partner in supporting socioeconomic growth of the country. BGK as well as the entities of the capital group actively support the entrepreneurship and development programmes of the government by initiating and taking part in cooperation between enterprises, the public sector, and financial institutions. As at 31 December 2017 the group consisted of the following entities consolidated using the full consolidation method:

- **Bank Gospodarstwa Krajowego** as a parent, the sole state bank that constitutes at the same time a state development bank,
- **BGK Nieruchomości S.A.** – a manager of Fundusz Sektora Mieszkań na Wynajem Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych FIZ AN (Rental Housing Fund Closed-End Private Equity Investment Fund) and Fundusz Sektora Mieszkań dla Rozwoju FIZ AN (Housing for Growth Closed-End Private Equity Investment Fund),
- **Fundusz Sektora Mieszkań na Wynajem FIZ AN (Rental Housing Fund Closed-End Private Equity Investment Fund)**, the activities of which consist in depositing cash collected through a non-public offering for the purchase of investment certificates by acquiring and subscribing for shares of **special purpose vehicles** and debt securities issued by those vehicles, the corporate objective of which involves carrying out their own construction projects related to erecting buildings, property purchase and sale, as well as renting flats on their own located in multifamily residential buildings owned by the vehicle, along with real estate activities.
- **Fundusz Sektora Mieszkań dla Rozwoju FIZ AN (Housing for Growth Fund Closed-End Private Equity Investment Fund)**, which invests in the affordable housing segment and in local infrastructure. The Fund's concept is a response to the housing deficit observed in Poland and declining local government investments in the area of residential construction and social infrastructure. The Fund's investments consist in acquiring shares and debt instruments of **special purpose vehicles** established to implement investment projects. Their corporate object is the implementation of projects and construction work related to the erection of residential and non-residential buildings as well as the purchase and sale of real estate, and renting and managing own or leased real estate.
- **Fundusz Ekspansji Zagranicznej FIZ AN (Foreign Expansion Fund Closed-End Private Equity Investment Fund)**, the corporate object of which is to invest funds collected through a non-public offering for the purchase of investment certificates by acquiring and subscribing for shares of project companies. The Fund's investments are mainly in shares of foreign entities owned by Polish companies supporting foreign expansion through investments in foreign entities.

Structure of BGK Capital Group as regards entities consolidated using the full consolidation method



Moreover, as at 31 December 2017 the following entities were consolidated using the equity method:

- **Funds managed by PFR S.A.** supporting the development of Polish enterprises and infrastructure, i.e.:
 - Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprise Investments Fund Closed-End Private Equity Investment Fund),
 - Fundusz Inwestycji Infrastrukturalnych – Kapitałowy FIZAN (Infrastructure Investment Equity Fund Closed-End Private Equity Investment Fund),
 - Fundusz Inwestycji Infrastrukturalnych Dłużny FIZ AN (Infrastructure Investment Debt Fund Closed-End Private Equity Investment Fund),
 - Fundusz Inwestycji Samorządowych FIZ AN (Local Government Investments Fund Closed-End Private Equity Investment Fund),
- **Surety funds** established in cooperation with local government units,
- **Krajowa Grupa Poręczenia Sp. z o.o. (National Guarantee Group, Ltd.)**
- **Korporacja Ubezpieczeń Kredytów Eksportowych S.A. (Export Credit Insurance Corporation joint-stock company)**

For a detailed description and list of subsidiaries and associates, see the consolidated financial statements.

Bank Gospodarstwa Krajowego and capital group entities focus their activities on three aspects:

- initiating and implementing actions aimed to support economic growth and enterprise development,
- mobilize capital for the economy,
- supplement the banking system by filling the market gap in key areas of the economy.

BGK Capital Group implements actions aimed to support the economic growth of Poland by financing infrastructure projects, local government projects, export projects and by co-financing the foreign expansion of Polish companies. In order to stimulate entrepreneurship and the development of micro, small and medium enterprises, BGK offers surety and guarantee systems. The Bank and group entities also operate programmes aimed to improve the situation on the housing market.

BGK mobilizes capital for the economy by participating in consortia and structuring transactions on the domestic and foreign markets. The Bank finances capital needs through cooperation with development institutions and mobilizes private capital through the development of guarantee and surety programmes.

The Bank supplements the banking system, filling the market gap in key areas of the economy by acting counter-cyclically and implementing programmes activating stagnant sectors. The Bank finances high-risk projects of significant importance to the market economy and supports economic growth in areas where the market does not function efficiently. BGK cooperates with other financial institutions on partnership terms, supplementing their offer.

In addition, BGK is a leading institution in the process of consolidating public finances as well as manages European programmes and the distribution of EU funds both on a national and regional scale.

The implementation of BGK's mission is supported by capital group entities. BGK expands its product offer in the area of debt financing as well as surety and guarantee financing through investments in funds supporting the development of entrepreneurship of Polish enterprises, funds financing infrastructure development and foreign expansion funds implemented in cooperation with PFR S.A. and PFR TFI S.A.

An important element of the Bank's and BGK Group's operations is the implementation of activities in the area of housing. Apart from activities implemented by providing debt financing to Social Housing Associations and managing government programmes, BGK provides capital to the companies owned by Fundusz Sektora Mieszkań na Wynajem FIZ AN (Rental Housing Fund CEPEIF) and Fundusz Sektora Mieszkań dla Rozwoju FIZ AN (Housing for Growth Fund CEPEIF). Real estate investments are managed by BGK Nieruchomości S.A., a managing entity established specifically for that purpose, in which BGK holds 100% of shares.

Fundusz Sektora Mieszkań na Wynajem FIZ AN (Rental Housing Fund CEPEIF) carries out commercial lease activities in large cities in order to increase social mobility and support the development of institutional leasing as an element of

improving the accessibility of housing. In 2017, the Fund's duties were extended to include the management of the pilot programme consisting in the construction of affordable apartments for rent for middle-income individuals, the title to which may ultimately be transferred onto the tenant. Fundusz Sektora Mieszkań dla Rozwoju FIZ AN (Housing for Growth Fund CEPEIF) implements activities consisting in the construction of apartments in cooperation with and for the purposes of communes and local government units.

The Bank and BGK Capital Group are actively supporting pro-export activities. The Bank is a shareholder of Korporacja Ubezpieczeń Kredytów Eksportowych S.A. – KUKES S.A. (Export Credit Insurance Corporation joint-stock company). Apart from its capital involvement, BGK is the main partner of KUKES S.A. in the implementation of the government export support programme, as part of which BGK grants export loans insured by KUKES S.A. In addition, BGK also finances export projects that are partially implemented at own risk, with supplementary security provided by KUKES S.A.

The activities carried out by the BGK Group have a wide development context. The implementation of activities in one area, such as financing reindustrialization, has a positive impact on other areas, i.e. on labour market development, reduction of the unemployment rate or increase in state budget revenue. Infrastructure projects implemented by the BGK Group have a positive impact on such aspects as improved quality and access to services for the public, the environment and economy.

The activities of the BGK Capital Group are carried out in a responsible and sustainable manner, while maintaining a rational risk appetite. Projects to be implemented are analyzed in terms of risk and their impact on the country's economic growth. In 2017, the liquidity of BGK was at a safe level and its level of capital adequacy, monitored using capital adequacy ratios determined in line with the Banking Law Act and CRR, was high.

1.2 MAJOR EVENTS IN THE BGK CAPITAL GROUP

Change of accounting standards applied by BGK to International Accounting Standards

Starting from January 2017, Bank Gospodarstwa Krajowego has been keeping its books and presenting the statutory financial statements in line with international accounting standards. The implementation of financial reporting compliant with the International Financial Reporting Standards made it possible to ensure unified financial reporting standards on an international scale. Consequently, BGK reduced its liquidity risk owing to easier access to foreign markets, comparability of data with similar financial institutions and enhanced image of the Bank as compliant with the same accounting principles as other banks.

Adoption of the Bank's strategy for the years 2017 - 2020 by the Supervisory Board of BGK

On 12 July 2017, the Supervisory Board of Bank Gospodarstwa Krajowego endorsed the Strategy of Bank Gospodarstwa Krajowego for the years 2017-2020. The strategy defines the role of BGK as a state development bank. It puts greater focus on its mission, i.e. to support social and economic growth of Poland and support the public finance sector in the performance of its tasks. The new Strategy of BGK addresses new challenges for the Polish economy defined, inter alia, in the Strategy for Responsible Growth (SRG) that prioritizes economic growth based on knowledge and excellence, sustainable social and territorial development and an effective State.

Capital injection received by BGK

In 2017, Bank Gospodarstwa Krajowego received a capital injection of PLN 6.3 million for the purposes of implementing new tasks in strategic sectors. The injection had a significant impact on the increase of capital adequacy and liquidity ratios as well as the concentration limits, and hence on the improved capacity of BGK to finance large infrastructure projects. Owing to the capital injection, the Bank was able to expand its activities in such industries as the energy industry or the fuel industry. Prior to the capital injection, BGK faced limitations related to the risk concentration assessment and was not able to support its clients' needs. An additional capital injection will enable BGK to fill the financial gap for large infrastructural projects and mobilize the capital of private partners and financial institutions for the implementation of projects that support the country's economic growth. The Bank prefers financing large enterprises in the form of financial institution consortia and views its role to be as an entity that fills the gap and supplements private financing.

De minimis guarantees, work on the National Guarantee Fund (NGF)

In 2017, Bank Gospodarstwa Krajowego granted portfolio sureties and guarantees for nearly PLN 10.5 bn, of which nearly PLN 10 bn was granted under the Bank's flagship product – de minimis guarantees. In 2017, BGK was involved in works on the new systemic instrument to support micro, small and medium enterprises. The said instrument is to replace de minimis guarantees in 2018. On 24 November 2017, The Sejm (Polish Parliament) adopted the Act amending the Act on Sureties and Guarantees Granted by the State Treasury and Certain Legal Entities as well as Certain Other Acts. The amendments consisted in the introduction of a new instrument supporting the development of SMEs, based on the National Guarantee Fund (NGF). The establishment of the NGF will make it possible to use funds released from financial instruments of operational programmes at the central level of the current and previous financial perspective of the European Union, funds reallocated from BGK's capitals and voluntary participation of stakeholders, if any, thus diversifying the source of financing for de minimis guarantees. The state budget will play a supplementary and supporting role as the guarantor of the system's liquidity.

Update of the National Road Construction Programme for the years 2014-2023

In 2017, the *National Road Construction Programme for the years 2013-2023 (with an outlook to the year 2025)* was updated in connection to the adoption of a new Strategy for Responsible Growth by the Council of Ministers. In result of the update, the limit of expenditures to be financed by BGK from the National Road Fund (NRF) resources was raised from PLN 107 bn to PLN 135 bn. The NRF is the main source of financing for national roads constructed and modernized

as part of multi-annual government road programmes. The ensuring of financing for the National Road Fund and development of transport infrastructure are key tasks carried out by BGK as part of its pro-development activities and services provided to the public finance sector.

Increased extent of BGK's operations in the area of implementing European programmes

In 2017, BGK increased its regional scope of operation in the area of implementing European programmes from 6 to 15 regions as compared to the perspective for the years 2007-2013. The total amount allocated under the aforesaid agreements was PLN 6.6 bn. As part of activities carried out under the EU perspective 2014-2020, BGK will focus on increasing the pace of absorption of EU funds under regional operational programmes and on actively managing programmes on the national level. In February 2017, BGK entered into an agreement for co-financing with Centrum Projektów Polska Cyfrowa (Digital Poland Project Centre), whereby BGK acts as the Fund of Funds Manager responsible for the implementation of financial instruments under the Operational Programme Digital Poland 2014-2020 (OP DP). Funds amounting to nearly PLN 1 bn are made available to telecommunications enterprises through the network of selected financial intermediaries, in the form of loans for the implementation of investments related to the construction, expansion and modification of broadband Internet access network.

Changes regarding the support of the housing industry

The amendment to the Act on Certain Forms of Support for Residential Construction entered into force in July 2017, whereas the amendment to the ordinance of the Council of Ministers issued in relation to that Act entered into force in December 2017. The most important changes included the removal of the obligation to allocate at least 50% of residential units for persons raising at least one child, introduction of the option to finance cooperative tenant's right to residential premises, introduction of two editions (of calls for applications) in a year, extension of the disbursement period for funds from refundable financing to 36 months, increase of the tenant's contribution amount limit to 30% of the costs of construction of residential premises and an increase of income limits for persons who made a minimum contribution of 10%. These changes made the new social housing for rent programme implemented by BGK more attractive. It is an important element of BGK Group's offer related to the area of residential housing, next to investment activities implemented by dedicated funds and government programmes operated by the Subsidy Fund.

Operation financing and issuance of bonds on behalf of the NRF

In 2017, BGK issued Eurobonds with a maturity of 10.5 years and a nominal value of EUR 750 mn on behalf of the NRF. The bond issue was carried out on foreign markets under the already running Euro Medium Terms Notes programme. The issued bonds will mature in April 2028 and their interest rate is fixed throughout the entire maturity period and amounts to 1.625%. This was the single biggest issue in EUR carried out so far and one with the lowest cost of acquiring funds in relation to corresponding treasury securities. In 2017, three issues of 3-year and 4-year bonds for the total amount of PLN 2,859 mn took place. The said bonds are based on a floating interest rate determined by reference to WIBOR 6M plus a mark-up. The mark-up rates obtained were the lowest compared to corresponding treasury securities.

1.3 HISTORICAL OVERVIEW OF THE BGK CAPITAL GROUP

Establishment of BGK

Bank Gospodarstwa Krajowego is the only state bank in Poland. It was established by an order of the President of the Republic of Poland in 1924. During the interwar period, it focused on supporting public and municipal institutions as well as armament manufacturers, in addition to managing industrial plants the control of which was assumed by the State. It was also responsible for administering special-purpose government funds and contributed substantially to the funding of the modernization and development of the Polish economy in that period (the Central Industrial District as well as the port and city of Gdynia). After WWII, the operations of BGK were suspended in 1948.

Resumed operation in 1989

The Bank was reactivated in 1989 as an institution specializing in the provision of services to the public sector. The operations of BGK are governed by the Act on Bank Gospodarstwa Krajowego of 14 March 2003 with subsequent amendments and the Ordinance of the Minister of Development on the adoption of the articles of association of Bank Gospodarstwa Krajowego, dated 16 September 2016. Currently, BGK is the major institution supporting the State in the administration of socio-economic government programs aimed to promote entrepreneurship as well as infrastructure and residential investment at the national, regional and local level.

Establishment of the National Housing Fund (NHF)

One of the first funds implementing government programmes at BGK was the National Housing Fund, the main corporate object of which was to provide loans for the construction of social housing for rent and technical infrastructure accompanying residential construction. The legal basis of the NHF's operations was the Act of 26 October 1995 on Certain Forms of Support for Residential Construction. As of 31 May 2009, the National Housing Fund has been transformed into the Residential Construction Support Programme, whereas the portfolio of loans granted by the National Housing Fund is managed by BGK.

Establishment of the Subsidy Fund (SF)

The Subsidy Fund was established at BGK pursuant to the Act of 5 December 2002 on Interest Subsidies for Fixed-Rate Housing Loans. The Subsidy Fund commenced its operations in 2003 by subsidising interest on fixed-rate housing loans. In the first year of its operation, it also took over the programme of interest subsidies for loans and bonds as part of the refundable financing of investments and construction ventures carried out by BGK under a residential construction support programme operated by the government. In the following years, subsequent residential construction support programmes have been launched by the fund "Rodzina na Swoim" (Interest Subsidies for Loans granted to Families) – was launched under the Act of 8 September 2006 on the Financial Aid for Families and Other Persons Buying Their Own Apartment. A programme of financial aid for the development of social housing, assisted accommodation, lodging houses called "Budownictwo Socjalne" was launched in the same year under the Act of 8 December 2006. The Apartment for the Young programme was launched in 2013 under the Act of 27 September 2013 on State Aid Provided for the Purchase of the First Flat by Young People.

Establishment of the National Road Fund

The **National Road Fund (NRF)** was established at Bank Gospodarstwa Krajowego under the Act of 27 October 1994 on Toll Motorways and the National Road Fund. The purpose of the fund was to finance the construction and reconstruction of national roads, including highways and expressways, as well as cover any expenditure due to toll motorway operators and costs of construction and maintenance of toll collection systems on national roads. The NRF started functioning as part of BGK since 2004.

Taking management of the government programme "Support of Entrepreneurship with Sureties and Guarantees of Bank Gospodarstwa Krajowego"

The support of access of micro, small and medium enterprises to financing for development needs, including investments, is carried out as part of BGK's surety and guarantee operations. Such operations have been carried out under the government programme since 2009, in accordance with provisions laid down in the Act of 8 May 1997 on Sureties and Guarantees Granted by the State Treasury and Certain Legal Persons. The Bank carries out these operations directly in the form of surety and guarantee activities and by performing tasks related to the development of the system of regional and local surety funds.

Establishment of investment funds managed by TFI BGK

In carrying out the mission of supporting the economic growth of Poland, apart from banking instruments and operations under government programmes, the Bank also actively carries out operations related to capital investments. These operations are carried out by closed-end investment funds and entities established by those funds. Investment

funds were created by Towarzystwo Funduszy Inwestycyjnych (Investment Fund Company) established by BGK in November 2013. The first investment fund created by TFI BGK and managed by BGK Nieruchomości S.A. was Fundusz Sektora Mieszkań na Wynajem (Rental Housing Fund), which commenced its operations in November 2014. Next to commence their operations within the structure of the BGK Group were funds managed by PFR S.A., i.e. Fundusz Ekspansji Zagranicznej FIZ AN (Foreign Expansion Fund CEPEIF), Fundusze Inwestycji Infrastrukturalnych (Dłużny i Kapitałowy) FIZ AN (Infrastructure Investment (Debt and Equity) Funds CEPEIF), Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprises Investments Fund CEPEIF), and Fundusz Inwestycji Samorządowych FIZ AN (Local Government Investments Fund CEPEIF), created in the middle of 2015. The last fund was Fundusz Municipalny FIZ AN (Municipal Fund CEPEIF) created at the end of 2015, which was transformed into Fundusz Sektora Mieszkań dla Rozwoju FIZ AN (Housing for Growth Fund CEPEIF). In September 2017, TFI BGK S.A. was sold to Polski Fundusz Rozwoju S.A. (Polish Development Fund joint-stock company), while maintaining the right to appoint 3 members of the Supervisory Board).

1.4 IMPORTANT EVENTS FOR BGK CAPITAL GROUP IN 2017

| Major events in 2017 | |
|----------------------|---|
| January | <ul style="list-style-type: none"> Introduction of the International Financial Reporting Standards (IFRS) as of the beginning of the year, standardization of accounting and reporting practices on an international level. |
| February | <ul style="list-style-type: none"> BGK issued own bonds at the end of February. Three-year bonds with a total value of PLN 1.2 bn were issued as part of building the book. |
| March | <ul style="list-style-type: none"> BGK signed a financing agreement for the construction of the tagiewnicka Route and a new tram line with the EIB. Loan granted by the EIB was secured with a guarantee under the European Fund for Strategic Investments (EFSI) – one of the pillars of the investment plan for Europe developed by the European Commission under the chairmanship of Jean-Claude Juncker. The 21st edition of the government social and municipal housing support programme was launched on March 1st. BGK received PLN 75 mn from the state budget to subsidize investments that satisfy the housing needs of the poorest. On March 29th, disbursements under the 2014-2020 perspective reached the level of PLN 20 bn. As of January 2010, BGK is responsible for disbursing the majority of EU funds granted to Poland. |
| April | <ul style="list-style-type: none"> BGK and KUKE S.A. signed the agreement for commercial cooperation between Poland and Mexico with Bancomext during the official economic visit of President Andrzej Duda to Mexico. BGK increased its share in the equity of its subsidiary, BGK Nieruchomości S.A., by PLN 5.0 mn to PLN 23.0 mn. |
| May | <ul style="list-style-type: none"> On May 12th, BGK issued additional own bonds. Three-year bonds with a total value of PLN 1.2 bn were issued as part of building the book. BGK entered into an agreement with the European Investment Bank establishing the investment platform aimed to support projects related to the construction of social rental housing in municipalities all over Poland. Loan guarantees that allow to generate credit financing for innovation in the SME sector totalling PLN 1.75 bn were launched within the framework of the Operational Programme Smart Growth. |
| June | <ul style="list-style-type: none"> BGK participated in a global conference of guarantee institutions financing SMEs, organized by the European Association of Guarantee Institutions, World Bank Group and SME Finance Forum during the annual meeting of association members in Madrid. |
| July | <ul style="list-style-type: none"> The Supervisory Board adopted the Strategy of Bank Gospodarstwa Krajowego for the years 2017-2020. |
| August | <ul style="list-style-type: none"> BGK increased its equity by PLN 1.9 bn through a capital injection in the form of two-year Treasury bonds with a nominal value of PLN 2 bn. |
| September | <ul style="list-style-type: none"> BGK issued additional own bonds at the end of September. Four-year bonds with a total value of PLN 0.5 bn were issued as part of building the book. It was the third issue of own bonds by BGK in the year and fully satisfied the bank's needs for financing in this form. The Bank sold 100% of shares of Towarzystwo Funduszy Inwestycyjnych BGK S.A. (BGK Investment Fund Company) to Polski Fundusz Rozwoju – PFR (the Polish Development Fund). As a result, the company changed its name to PFR TFI S.A. |
| October | <ul style="list-style-type: none"> BGK made a capital injection of PLN 2.5 mn into BGKN S.A. (PLN 7.5 mn throughout the entire year), raising its equity to PLN 25.5 mn. |
| November | <ul style="list-style-type: none"> BGK increased its equity by PLN 4.3 bn through a capital injection in the form of two-year Treasury bonds with a nominal value of PLN 3 bn and a cash injection of PLN 1.5 bn from the State budget. |
| December | <ul style="list-style-type: none"> In partnership with European development banks and the European Investment Bank, BGK launched the Marguerite II international infrastructure fund. The total exposure of the fund amounts to approximately EUR 700 mn. The fund focuses on supporting key infrastructure investments in the EU energy, transportation and digitization sectors. |

1.5 KEY FINANCIAL FIGURES OF BGK CAPITAL GROUP FOR THE YEAR 2017

The detailed data and financial figures stated and quoted in this report on the activities may differ from those stated in the financial statements for the year 2017. The differences are presentational and result from the fact that in the present report the data and figures are stated for management reporting purposes, rather than accounting reporting purposes.

The BGK Group's net profit for the year 2017 amounted to PLN 584.4 mn and was PLN 327.4 mn higher to profit achieved for the year 2016. The increase in profit was primarily the result of increased scale of banking activity and improved quality of BGK's loan portfolio as well as higher valuation of investments in funds supporting the development of Polish enterprises and infrastructure investments.

The following had the greatest impact on the increase of net profit by over 127% in relation to the previous year:

- Net impairment losses and provisions – cost reduced by PLN 193.2 mn,
- net banking income – increase by PLN 138.4 mn,
- share in profits and losses of affiliates – result improved by PLN 127.7 mn.

The increase of operating expenses, depreciation and amortization was lower than the increase of net banking income and amounted to 11.0%, as compared to 16.3% on the income side. The increases pertained primarily to group entities and were related to the greater scale of investment activity, with a moderate 3% increase in the expenses of BGK.

TABLE 1: Basic financial parameters of BGK Group's operations consolidated

| Item | Performance | | | Change 2017/2016 |
|---|-------------|----------|----------|---------------------|
| | 2015 | 2016 | 2017 | |
| Profitability | | | | |
| Net banking income (in PLN mn) | 778.4 | 851.1 | 989.5 | 16.3% |
| Operating expenses, amortization and depreciation (in PLN mn) | 420.5 | 354.8 | 394.0 | 11.0% |
| Net impairment losses and provisions (in PLN mn) | 48.9 | -242.8 | -49.6 | -79.6% |
| Share in profits and losses of affiliates (in PLN mn) | -11.0 | -55.7 | 72.0 | -229.3% |
| Gross profit (in PLN mn) | 424.4 | 263.5 | 690.5 | 162.0% |
| Net profit (in PLN mn) | 380.8 | 257.0 | 584.4 | 127.4% |
| Scale of activity | | | | |
| Gross credit exposure (PLN million), of which: | 27,874.7 | 32,345.3 | 33,184.0 | 2.6% |
| Gross loans (in PLN mn) | 22,417.2 | 27,352.4 | 29,710.4 | 8.6% |
| Deposits from customers (in PLN mn) | 19,842.2 | 37,492.1 | 33,959.3 | -9.4% |
| Own funds (in PLN mn) ¹ | 9,710.0 | 12,766.7 | 20,068.6 | 57.2% |
| Balance sheet total (in PLN mn) | 43,092.7 | 66,746.6 | 74,314.0 | 11.3% |
| Operating performance² | | | | |
| | | | | pp |
| C/I ³ ratio | 54.0% | 41.7% | 39.8% | -1.9 |
| ROE (Net profit / average equity) | 4.1% | 2.6% | 4.0% | 1.4 |
| ROA (net profit / average assets) | 0.6% | 0.4% | 0.6% | 0.2 |
| Interest margin ⁴ | 1.0% | 0.9% | 0.8% | -0.1 |

¹Own funds - share capital, supplementary capital, reserve capital, general banking risk reserve, revaluation reserve, prior year profit and net profit

²Carrying amounts for the period of 13 months (e.g. December 2016 - December 2017) were used as average balances used to calculate the measures

³C/I (cost to income ratio) = (operating expenses + amortization and depreciation) / net banking income

⁴Interest margin = net interest income / average interest-bearing assets

BGK Group closed the year 2017 with a balance sheet total of PLN 74,314.0 mn. It went up by PLN 7,567.4 mn, i.e. 11.3%, compared to the figure at the end of 2016. The said increase in the balance sheet total was mainly attributable to:

- a capital injection of nearly PLN 6.3 bn received by BGK, improving the Group's potential to finance investment needs in the area of reindustrialization and large infrastructure projects in strategic industries,
- the increase of credit exposures by nearly PLN 1 bn,
- the increase of investments in Group entities earmarked for investment activity by PLN 0.7 bn,
- changes in assets and liabilities resulting from the management of BGK's liquidity position.

Key performance indicators of BGK Group for the year 2017 have improved compared to the previous year. ROE went up by 1.4 pp to 4.0%, whereas ROA went up by 0.2 pp to 0.6%. C/I ratio improved, i.e. went down by 1.9 pp YOY to 39.8%.

The strong capital position of BGK Group at the end of 2017 improves the potential to achieve BGK's mission in future years and allows to increase lending and improve net interest income as well as expand investment activity supporting the country's economic growth.

1.6 KEY FINANCIAL FIGURES OF BGK FOR THE YEAR 2017

In 2017, the Bank reported a net profit of PLN 517.8 mn, which means an increase of PLN 215.4 mn as compared to the previous year. The improved result is attributable mainly to the positive change in net impairment losses (positive impact on the result amounting to PLN 193.1 mn) resulting from improved portfolio quality and greater scale of operations.

Key performance indicators for the year 2017 were better than those achieved in 2016. ROE went up by 0.4 pp to 3.5%, ROA went up by 0.2 pp to 0.6%, whereas the C/I ratio improved significantly due to the increase in net banking income and moderate increase of expenses, i.e. went down by 3.9 pp YOY to 32.8%. Solvency ratio remained at a high and stable level of 38.0%. The potential for financing large investment projects improved in 2017.

TABLE 2: Basic financial parameters of BGK's operations

| Item | Performance | | | Change |
|---|-------------|----------|----------|-----------|
| | 2015 | 2016 | 2017 | 2017/2016 |
| Profitability | | | | |
| Net banking income (in PLN mn) | 777.8 | 849.7 | 978.9 | 15.2% |
| Net banking income (in PLN mn), excluding non-recurring events | 777.8 | 835.1 | 978.9 | 17.2% |
| Operating expenses, amortization and depreciation (in PLN mn) | 384.7 | 311.5 | 320.9 | 3.0% |
| Operating expenses, amortization and depreciation (in PLN mn), excluding non-recurring events | 306.1 | 311.5 | 320.9 | 3.0% |
| Net impairment losses and provisions (in PLN mn) | 48.9 | -242.7 | -49.6 | -79.6% |
| Gross profit (in PLN mn) | 447.4 | 318.0 | 606.2 | 90.6% |
| Gross profit (in PLN mn), excluding non-recurring events | 526.0 | 303.3 | 606.2 | 99.9% |
| Net profit (in PLN mn) | 399.5 | 302.4 | 517.8 | 71.2% |
| Net profit (in PLN mn), excluding non-recurring events | 463.2 | 290.6 | 517.8 | 78.2% |
| Scale of activity | | | | |
| Gross credit exposure (PLN million), of which: | 27,874.7 | 32,345.3 | 33,194.1 | 2.6% |
| Gross loans (in PLN mn) | 22,417.2 | 27,352.4 | 29,720.4 | 8.7% |
| Deposits from customers (in PLN mn) | 19,874.1 | 37,599.7 | 34,075.0 | -9.4% |
| Own funds (in PLN mn) ¹ | 9,702.3 | 12,766.7 | 20,068.6 | 57.2% |
| Balance sheet total (in PLN mn) | 43,102.0 | 66,861.9 | 74,334.2 | 11.2% |
| Operating performance² | | | | |
| | | | | pp |
| C/I ³ ratio | 49.5% | 36.7% | 32.8% | -3.9 |
| C/I - excluding non-recurring events | 49.5% | 37.3% | 32.8% | -4.5 |
| ROE (Net profit / average equity) | 4.3% | 3.1% | 3.5% | 0.4 |
| ROE, excluding non-recurring events | 5.0% | 3.0% | 3.5% | 0.5 |
| ROA (net profit / average assets) | 0.7% | 0.4% | 0.6% | 0.2 |
| ROA, excluding non-recurring events | 0.8% | 0.4% | 0.6% | 0.2 |
| Interest margin ⁴ | 1.0% | 0.9% | 0.8% | -0.1 |
| Solvency ratio ⁵ | 31,3% | 30,1% | 38,0% | 7,9 |

¹Own funds - share capital, supplementary capital, reserve capital, general banking risk reserve, revaluation reserve, prior year profit and net profit

²Carrying amounts for the period of 13 months (e.g. December 2016 - December 2017) were used as average balances used to calculate the measures

³C/I (cost to income ratio) = (operating expenses + amortization and depreciation) / net banking income

⁴Interest margin = net interest income / average interest-bearing assets

⁵Excluding cash flow funds

The Bank closed the year 2017 with a balance sheet total of PLN 74.3 bn. It went up by PLN 7.4 bn, i.e. 11.2%, compared to the figure at the end of 2016. The said increase was mainly attributable to:

- a capital injection of PLN 6.3 bn received by BGK for the purposes of implementing new tasks in strategic industries,
- increases related to the development of lending activities by nearly PLN 1 bn and investment activities (certificates) by nearly PLN 0.7 bn,

- liquidity position management.

The increase in the capital base had the greatest impact on the increase of the balance sheet total. The said balance went up by PLN 7,240.3 mn, i.e. 56.5%, compared to the year 2016. Apart from the capital injection, the Bank recorded an increase in the revaluation reserve.

2. THE ECONOMY IN 2017

2.1 DOMESTIC ECONOMY

Faster growth rate in Poland

The year 2017 brought about a sharp increase in the economic growth rate in Poland. GDP growth rate increased from 2.8 percent in 2016 to 4.6 percent in 2017 and was the highest recorded since 2011. The annual growth rate continued to accelerate in subsequent quarters of the year, reaching the level of 5.1 percent in the last quarter, i.e. the highest level recorded since 2011. It is important to note that the high growth rate was more sustainable than in previous years. Household consumption continued to have the biggest contribution to GDP growth, with a clear rebound of investments recorded in the second half of the year. The growth in investments was the result of optimism exhibited by enterprises, high utilization of production capacities, and faster implementation of projects co-financed from EU funds. Good consumption moods were attributable to the improved condition of the labour market, which was reflected in the lowest unemployment rate since the 90s and fast real growth of the payroll fund. Household satisfaction was reflected in record high levels of leading economic indicators. Simultaneous increase in investments and faster consumption translated into a high import growth rate. At the same time, due to the improved economic situation of major counterparties, including in the Eurozone, export grew at a fast rate. The combination of these factors resulting in a neutral contribution of trade with the rest of the world to GDP growth. It is important to note the first positive annual current account balance in history, which demonstrates better balance in relations with the rest of the world. A large surplus in the trade in services was instrumental in achieving that positive result.

Strong budget results

Better balance could also be observed in public finance, despite the increase in expenditures. In 2017, the budget deficit to GDP ratio went down to approximately 1.5 percent. This was possible owing to good economic situation and improved tax collection system. Budgetary income grew at a fast rate. This was partially due to the improved economic climate, including higher consumption facilitating higher inflows from indirect taxes (VAT, excise duty). Incomes from direct taxes (PIT and CIT) also increased owing to the fast growth rate of remunerations and better financial results recorded by enterprises. In addition, as a result of the improved condition of the labour market, the needs of the Social Insurance Fund have declined. Higher inflows were also attributable to legislative changes that increased the effectiveness of tax collection. The VAT gap was significantly reduced and the effectiveness of excise duty collection has improved. The improved budgetary situation also had a significant impact on the situation on the domestic debt market. It resulted in lower borrowing needs, which in turn facilitated lower yields on bonds. The good budgetary situation allowed to make Polish debt prices resistant to turbulence on base markets.

TABLE 3: Changes in macroeconomic indicators year-on-year in real terms

| Item | Q1-Q4 | 2017 | | | |
|---|--------------|--------------|--------------|--------------|--------------|
| | | Q1 | Q2 | Q3 | Q4 |
| Gross Domestic Product | 104.6 | 104.1 | 104.0 | 104.9 | 105.1 |
| Domestic demand | 104.9 | 103.9 | 105.5 | 103.9 | 106.1 |
| Total consumption | 104.3 | 103.7 | 104.2 | 104.1 | 105.0 |
| Individual consumption | 104.8 | 104.7 | 104.9 | 104.8 | 104.9 |
| Gross capital formation | 107.5 | 105.1 | 111.6 | 103.3 | 108.8 |
| Gross fixed capital formation | 105.2 | 99.5 | 100.9 | 103.3 | 111.3 |
| Exports | 106.7 | 109.6 | 103.1 | 107.6 | 106.8 |
| Imports | 107.7 | 109.7 | 106.0 | 105.7 | 109.2 |
| Gross value added | 104.3 | 103.8 | 103.7 | 104.8 | 104.8 |
| Manufacturing | 106.2 | 107.1 | 104.0 | 105.4 | 107.8 |
| Construction | 111.5 | 104.5 | 109.8 | 119.5 | 109.8 |
| Trade and repair of motor vehicles | 106.1 | 106.4 | 105.4 | 106.4 | 106.3 |
| Transportation and warehouse management | 110.9 | 113.3 | 109.3 | 110.0 | 111.5 |

Source: data from the Chief Statistical Office of Poland

*previous quarter = 100

Reference rate stabilization

The acceleration in GDP growth rate was accompanied by the stabilization of the National Bank of Poland (NBP) reference rate at the lowest level in history (1.5 percent). Monetary authorities did not make the decision to tighten the policy, mainly due to the insufficient force of inflationary processes. Despite the fact that the CPI ratio continued to grow in recent years, it remained below the target set by the Monetary Policy Council. At the same time, NBP forecasts indicate that there is a low probability that the annual CPI will exceed the permissible range of deviations from the inflation target (1.5-3.5 percent). Thus far, the high growth rate in wages did not have a strong impact on the price pressure due to an increase in productivity. In addition, a factor to which the Monetary Policy Council may pay attention is the issue of currency exchange rates. Reference rate increases could increase the risk of excessive appreciation of Polish zloty. The national currency appreciated in the previous year due to the improved economic situation, both domestically and abroad. The appreciation of Polish zloty was significant primarily in relation to USD (over 15 percent), but lower in relation to EUR (nearly 5 percent). In effect, at the end of 2017, the EUR/PLN exchange rate amounted to 4.18, whereas the USD/PLN exchange rate amounted to 3.48.

2.2 ECONOMY ABROAD

Normalization of monetary policy in the USA

Year 2017 was a period of improvement in global economy. This also applied to the American economy, the most important macroeconomic parameters of which returned to pre-crisis levels. The labour market situation continued to be very good, stimulating internal demand that contributed to the rising inflationary pressure. In such conditions, American monetary authorities decided to normalize the monetary policy. They raised interest rates three times and made the decision to start the process of reducing the Federal Reserve (Fed) balance, which became inflated after years of quantitative easing. Looser fiscal policy of the new administration of the USA, including tax reductions, were also conducive to faster tightening of monetary policy.

Better economic situation in the eurozone

The condition of the eurozone also continued to gradually improve. It is important to note that the improved results also include eurozone's peripheral economies. The growth was based on the combination of internal demand and increasingly faster growth in employment. However, the economic recovery in the eurozone was not strong enough to be a source of concern for the ECB regarding an excessive rise in inflation. In effect, not much was done to shift away from the ultra-loose monetary policy. Caution in this regard was also encouraged by uncertainty that accompanied global economic growth. It is necessary to mention the problems of major emerging economies, including the Chinese economy, the risk associated with protectionist actions that weaken global trade and uncertainty as to the future shape of relations between EU and Great Britain after Brexit.

3. CHANGES IN THE LEGISLATIVE ENVIRONMENT

The operations of Bank Gospodarstwa Krajowego, whose mission is to support the government in the implementation of the socio-economic growth policy, are regulated by the laws in force more than the activities of other banking sector entities. The most important amendments that affect BGK's operation concerned the following legal and regulatory acts.

- Ordinance of the Minister of Development and Finance of 6 March 2017 regarding criteria and procedure for supervisory review and assessment in banks.
- Ordinance of the Minister of Development and Finance of 6 March 2017 regarding the risk management system and internal control system, remuneration policy and detailed procedure for measuring internal capital in banks.
- Announcement of the Speaker of the Sejm of the Republic of Poland of 10 March 2017 regarding the publication of the consolidated text of the Act on Interest Subsidies for Fixed-Rate Housing Loans.
- Resolution No. 141/2017 of the Polish Financial Supervision Authority of 25 April 2017 regarding the issue of Recommendation H concerning the internal control system in banks (Official Journal of the Polish Financial Supervision Authority, item 7). This recommendation is issued under Article 137 (1)(5) of the Act of 29 August 1997 – Banking Law as well as Article 11 (1) and Article 67 (2) of the Act of 21 July 2006 on Financial Market Supervision (Polish Journal of Laws of 2017, item 196, as amended) and constitutes the new Recommendation H of the Polish Financial Supervision Authority concerning the internal control system in banks.
- Announcement of the Speaker of the Sejm of the Republic of Poland of 11 May 2017 regarding the publication of the consolidated text of the Anti-Money Laundering and Terrorism Financing Act.
- Ordinance of the Minister of Development and Finance of 25 May 2017 regarding higher risk weight for exposures secured by real property mortgages. In line with the amendments, a 100% risk weight was replaced with a 150% risk weight.
- Act of 11 May 2017 on Statutory Auditors, Audit Firms and Public Supervision. The said Act introduces EU regulations specifying new rules that apply to the performance of audits. Within the same entity, the interval between audits specified in the regulations, performed by the same audit firm, cannot exceed 5 years. A key certified auditor may, however, conduct the audit once again after no less than 3 years from the end of the last audit of the relevant entity.
- Act of 7 July 2017 Amending the Act on State Aid Provided for the Purchase of the First Apartment by Young People. The amendment made it possible to submit applications for co-financing of own contribution up until the moment when the amount resulting from submitted applications with the aid disbursement date scheduled for the relevant year reaches the equivalent of 100% of the limit earmarked for disbursement in that year (previously it was 95%). Based on that amendment, in August 2017 BGK conducted a supplementary call for applications for co-financing.
- Act of 22 June 2017 Amending the Act on Certain Forms of Support for Residential Construction and Certain Other Acts. The amendment consisted in the elimination of barriers in applying for refundable financing under a government residential construction support programme related to social rental housing, identified in the practice in place thus far.
- Act of 7 July 2017 Amending the Act on Principles for the Implementation of Cohesion Policy Programmes Financed under the Financial Perspective 2014-2020 and Certain Other Acts, which entered into force on 2 September 2017. The said Act introduced a number of amendments to the implementation of programmes financed from EU funds that removed barriers related to access of beneficiaries to that type of financing.
- Announcement of the Speaker of the Sejm of the Republic of Poland of 15 September 2017 regarding the publication of the consolidated text of the Act on Bank Gospodarstwa Krajowego (published on 5 October 2017).
- 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 Other Acts. The amendment consisted in the introduction of a new systemic instrument supporting the development of SMEs that utilises sureties and guarantees for the repayment of loans, based on the National Guarantee Fund (NGF). The NGF, which pursuant to the amendment was established at BGK

as of 1 January 2018, will as of 1 July 2018 become the source of financing costs and expenses related to granted guarantees constituting state aid or de minimis aid. In accordance with the amendment, the NGF received a capital injection of PLN 900 mn made by reducing the statutory fund of BGK as of the end of January 2018.

- Act of 24 November 2017 Amending Certain Acts to Combat the Use of the Financial Sector to Commit Treasury Fraud.
- Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014. The Regulation entered into force as of 30 June 2016. Compliance with the requirements resulted in the acquisition of the WIBID and WIBOR reference rate fixing management function by GPW Benchmark S.A. from the ACI Polska Association as of 30 June 2017. The “Code of Conduct for WIBID and WIBOR Fixing Participants” (hereinafter referred to as “Code of Conduct”) developed by GPW Benchmark S.A. was consulted by GPW Benchmark S.A. with banks-participants in WIBID and WIBOR Fixing, including BGK. The Code of Conduct imposed a number of requirements on banks-participants in WIBID and WIBOR Fixing, in particular relating to the implementation of internal procedures regarding fixing. “Procedure for the participation of Bank Gospodarstwa Krajowego in WIBID and WIBOR reference rate Fixing” was introduced by way of the Resolution No. 450/2017/DS/KRE of the Management Board of BGK of 19 December 2017. This Resolution entered into force as of 1 January 2018.

Apart from the above, a number of other generally applicable laws governing the Bank’s operations to a varying degree were enacted in 2017.

4. OPERATIONS OF BANK GOSPODARSTWA KRAJOWEGO AND BGK CAPITAL GROUP

4.1 DIVISION OF OPERATIONS WITHIN BANK GOSPODARSTWA KRAJOWEGO CAPITAL GROUP

The operations of BGK Group are carried out by the Bank and a group of institutions affiliated by management to the Bank. These include primarily financial institutions or auxiliary institutions affiliated by equity and by the fact that the Bank holds supervision or has a major impact on their operations. These are either subsidiaries or affiliates who contribute to the implementation of BGK's mission. They supplement the Bank's operations by carrying out pro-growth investment activities based on equity financing and the best asset management practices.

Therefore, BGK Group's operations are comprised of:

- banking activity, in which a major role is played by lending and surety activities as well as maintenance of accounts and deposits,
- programmes support activity related to supporting the State as well as managing government programmes and EU programmes,
- investment activity, implemented to a large extent by Capital Group entities.

Bank Gospodarstwa Krajowego as a state development bank is the major institution supporting the State in the administration of socio-economic government programs aimed to promote entrepreneurship as well as infrastructure and residential investment at the national, regional and local level. Apart from strict banking activity, as part of its statutory activity BGK actively cooperates with ministries and Polish development institutions competent in specific areas of the country's growth. BGK carries out government tasks on the basis of acts and agreements with ministries, including through funds established, entrusted or assigned to the Bank for which, by virtue of law, BGK keeps separate accounting books and prepares separate financial statements.

These include:

- cash flow funds – related to the management and administration of cash flows which are not recognised on the Bank's balance sheet and profit and loss account. Tasks in the formula of cash flow funds are carried out by the National Road Fund (NRF), Railway Fund (RF), Thermal Efficiency Improvement and Repair Fund (TEIRF), Subsidy Fund (SF), Student Loan Fund (SLF) and Borrower Support Fund (BSF).
- a credit fund the exposures of which are subject to credit risk and recognised on the Bank's balance sheet and profit and loss account, i.e. the Inland Waterways Fund (IWF).

In addition, BGK also carries out operations related to supporting entrepreneurship using sureties and supporting the export of Polish enterprises through investment funds and cooperation with surety funds and KUKI S.A.

4.2 LENDING ACTIVITY OF BGK

The value of Bank Gospodarstwa Krajowego's credit exposures in 2017 exceeded PLN 41 bn. It went up by nearly PLN 2.3 bn, mainly due to increased lending in the area of financing enterprises, financing export and foreign expansion, and financing healthcare entities.

The portfolio of credit exposures broken down by business line has been presented in the table below. The presentation has been prepared for management reporting purposes in order to monitor the implementation of the Bank's strategy on a day-to-day basis.

TABLE 4: Credit exposure in nominal terms, including off balance-sheet items (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|---|-----------------|-----------------|--------------------|---------------|
| | 2016 | 2017 | in nominal terms | % |
| Credit exposure in nominal terms, including off-balance sheet items | 39,121.1 | 41,371.6 | 2,250.5 | 5.8% |
| Structured finance | 20,145.8 | 19,369.8 | -776.0 | -3.9% |
| Export and foreign expansion financing | 2,192.1 | 2,914.8 | 722.7 | 33.0% |
| Businesses and financial entities | 2,532.8 | 4,203.9 | 1,671.1 | 66.0% |
| Local government institutions and municipal companies | 7,739.3 | 7,993.6 | 254.3 | 3.3% |
| Central government entities | 33.2 | 23.6 | -9.6 | -28.9% |
| Healthcare entities | 692.2 | 1,159.0 | 466.8 | 67.4% |
| Social housing programmes including the Residential Construction Support Programme (former National Housing Fund) | 5,652.1 | 5,582.5 | -69.6 | -1.2% |
| Other | 5,433.8 | 5,146.3 | -287.5 | -5.3% |
| including bonds | 4,992.9 | 3,473.6 | -1,519.3 | -30.4% |

The Bank achieved the highest growth of nearly PLN 1.7 bn, i.e. 66% in relation to the previous year, in the area of financing enterprises. Factors that contributed to that growth include entry into about a dozen agreements for the total value of over PLN 50 mn with entities the fuel, energy, chemical, defence and production industries, among others. Financing recognised under this business line is mostly general in nature.

In the area of structured financing, BGK recorded a nearly 4% decline in the portfolio value. This was primarily attributable to the improving financial condition of mining sector entities and early repayment of their credit liabilities. BGK classified primarily financing related to the implementation of investment and infrastructure projects to that line.

As regards the financing of social housing, the scale of growth recorded by new programmes implemented by BGK exceeded PLN 200 mn, but did not manage to fully compensate repayments in the portfolio of the former National Housing Fund. The carrying amount of credit exposures in nominal terms has been presented in the table below.

TABLE 5: Credit exposure in nominal terms (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|---|-----------------|-----------------|--------------------|---------------|
| | 2016 | 2017 | in nominal terms | % |
| Credit exposure in nominal terms | 32,345.3 | 33,194.1 | 848.8 | 2.6% |
| Structured finance | 15,284.3 | 14,464.5 | -819.8 | -5.4% |
| Export and foreign expansion financing | 1,669.8 | 2,296.5 | 626.7 | 37.5% |
| Businesses and financial entities | 1,838.6 | 2,691.1 | 852.5 | 46.4% |
| Local government institutions and municipal companies | 7,329.3 | 7,506.1 | 176.8 | 2.4% |
| Central government entities | 21.4 | 18.9 | -2.5 | -11.7% |
| Healthcare entities | 558.2 | 732.3 | 174.1 | 31.2% |
| Social housing programmes including the Residential Construction Support Programme (former National Housing Fund) | 5,510.1 | 5,360.2 | -149.9 | -2.7% |
| Other | 5,378.0 | 5,114.7 | -263.2 | -4.9% |
| including bonds | 4,992.9 | 3,473.6 | -1,519.3 | -30.4% |

The total value of credit exposures grew in relation to the previous year by nearly PLN 850 mn and amounted to PLN 33.2 bn. Similarly as in the case of total balance sheet and off-balance sheet exposure, the biggest growths were recorded in the financing of enterprises, export and foreign expansion, and healthcare entities.

The structure of financing changed as well. Due to the acquisition of bonds, debt financing decreased by nearly PLN 1.5 bn, whereas the value of loans went up by nearly PLN 2.4 bn.

Loan portfolio statistics

In order to achieve comparability with market data, the loan portfolio of BGK has been presented in tables broken down by sector. Additionally, changes in lending activity broken down by sector have been presented below.

TABLE 6: Volume and composition of the loan portfolio in nominal terms (in PLN mn)

| Item | 2016 | | 2017 | | Change versus 2016 | |
|-------------------------------|-----------------|---------------|-----------------|---------------|--------------------|-------------|
| | Performance | Composition | Performance | Composition | in nominal terms | % |
| Loans in nominal terms | 27,352.4 | 100.0% | 29,720.4 | 100.0% | 2,368.1 | 8.7% |
| financial sector entities | 854.4 | 3.1% | 832.3 | 2.8% | -22.2 | -2.6% |
| non-financial sector entities | 20,913.0 | 76.5% | 22,833.6 | 76.8% | 1,920.5 | 9.2% |
| individuals | 58.4 | 0.2% | 45.7 | 0.2% | -12.7 | -21.8% |
| businesses | 20,854.6 | 76.2% | 22,787.9 | 76.7% | 1,933.3 | 9.3% |
| budget sector entities | 5,584.9 | 20.4% | 6,054.6 | 20.4% | 469.7 | 8.4% |
| central government entities | 246.6 | 0.9% | 317.5 | 1.1% | 70.9 | 28.8% |
| local government entities | 5,338.3 | 19.5% | 5,737.1 | 19.3% | 398.8 | 7.5% |

In 2017, the most considerable growth was observed in the non-financial sector. This was attributable mainly to the financing of enterprises. The volume of loans granted to public sector entities, including mainly to local government entities, grew as well.

TABLE 7: Share of BGK in the loan market

| Item | Change versus | | |
|-----------------------------|---------------|-------------|------------|
| | 2016 | 2017 | 2016 in pp |
| Loans | 2.6% | 2.7% | 0.1 |
| financial sector entities | 1.5% | 1.3% | -0.2 |
| businesses | 4.9% | 5.1% | 0.2 |
| individuals | 0.0% | 0.0% | 0.0 |
| central government entities | 25.3% | 31.8% | 6.5 |
| local government entities | 16.8% | 19.2% | 2.4 |

Source: National Bank of Poland (NBP) data and own calculations

As at the end of 2017, the Bank's market share was slightly higher than in the previous year and amounted to 2.7%. The increase was mainly driven by the implementation of the Bank's strategy with respect to the funding of investments and corporate growth. A substantial part of the Bank's financing was arranged through its participation in syndicates formed together with commercial banks. The Bank has not been granting personal loans since 2009.

The level of exposures past due by more than 90 days went down by PLN 106 mn, i.e. 31.5%, year on year, to PLN 229 mn and constituted less than 1.0% of the loan and bond portfolio.

As at the end of 2017, the total debt subject to collection or restructuring was PLN 950 mn (871 transactions), while the recoveries in 2017 totalled PLN 131 mn.

The Bank is not involved in any litigation where the unit amount of the claim represents at least 10% of its equity. The aggregate amount of claims does not exceed that threshold, either.

TABLE 8: The level and structure of amounts due that were subject to enforced collection (in PLN mn)

| Receivables by type | 31.12.2016 | | | 31.12.2017 | | |
|-----------------------------|------------|----------------|------------------|------------|----------------|------------------|
| | No. | exposure value | collateral value | No. | exposure value | collateral value |
| construction loans | 12 | 166.1 | 122.1 | 9 | 120.9 | 18.0 |
| investment loans | 14 | 15.9 | 1.0 | 13 | 17.0 | 1.0 |
| working capital loans | 10 | 24.8 | 0.0 | 11 | 23.2 | 0.6 |
| surety bonds and guarantees | 198 | 57.4 | 0.8 | 236 | 65.0 | 6.8 |
| other | 36 | 17.2 | 0.0 | 35 | 21.6 | 0.8 |
| Total | 270 | 281.4 | 123.9 | 304 | 247.7 | 27.2 |

Due to changes in legislation, banks do not issue enforcement orders.

Development and structure of lending activity within the framework of implementing BGK's mission

The development of BGK's lending activity is an important element for the implementation of the Strategy for Responsible Growth. The Bank supports the implementation of the SRD as part of priorities: knowledge-based economic growth and sustainable social and territorial development. The Bank focuses on supporting activities concerning:

- reindustrialization and promoting infrastructure investments,
- foreign expansion and export of Polish enterprises,
- financing local government projects,
- promoting equal opportunities and housing.

Support for reindustrialization and infrastructure investment financing

Within the framework of its lending activity, the Bank primarily finances investment and infrastructure projects. The bank's operations are focused on supporting strategic sectors of Polish economy. These operations are carried out mainly through structured transactions that enable large investments in the energy, fuel and chemical sectors. These investments are carried out primarily through the participation of BGK in consortia and by increasing the use of leverage in financing investments of strategic importance for the State. This allows to utilise the share of financial sector funds in addition to BGK's own funds. The share of structured financing in the exposure portfolio was 46.7% as at the end of 2017, which represented total balance sheet and off-balance sheet exposure of PLN 19.4 bn.

Revolving loans and medium-value investment loans that do not require structured financing represented a smaller share in the structure of BGK's portfolio. The aforesaid types of loans are granted through BGK's regional network. In 2017, BGK significantly increased the value of financing provided to enterprises by nearly PLN 1.7 bn in response to the financial needs of Polish enterprises.

As regards infrastructure investment financing, the Bank also carries out government programmes support activities within the framework of the National Road Fund and the Railway Fund as well as through investment funds managed in cooperation with PFR SA (affiliates).

Export and foreign expansion financing

One of the objectives of the Responsible Development Strategy is to internationalize the Polish economy. A special emphasis has been placed on the development of business relationships with non EU member states (including higher risk ones), in addition to more sophisticated forms of international cooperation.

A central role in the implementation of the Responsible Development Strategy in respect of the provision of Polish business entities with solutions that would enable them to compete effectively on international markets, is played by BGK. Year by year, BGK has been increasing its exposure to export credit granted both under the "Finansowe Wspieranie Eksportu" (Financial Support for Exports) Programme and as part of the Bank's own activities. In 2017, BGK continued to intensify its activity which is not only aimed to support exports but also foreign expansion through investments made by Polish business entities on international markets. This was expressed, *inter alia*, by exceeding the

threshold of 50 countries in which BGK supported the transactions/projects of Polish enterprises (52 countries on 6 continents as at the end of 2017).

“Finansowe Wsparcie Eksportu” (Financial Support for Exports) Programme

One of the BGK's objectives is to support Polish exports, including by granting export loans under the “Financial Support for Exports” Government Programme adopted by the Council of Ministers in 2009. Under the Programme, the Bank provides foreign buyers (directly or through the buyer's bank) with credit facilities to finance purchases of Polish goods and/or services. The funds are transferred directly to the bank accounts of Polish exporters, which eliminates the risk of default, as the Polish business entity receives the transfer directly from BGK.

The solutions offered under the Programme are considered particularly attractive on higher risk markets (such as Belarus), where the solutions offered by commercial banks are limited and the borrowing costs charged by local banks are high.

Since its beginning until the end of 2017, BGK granted loans amounting to PLN 2.7 bn in total as part of the Programme. The amount disbursed by the end of 2017 was PLN 2.0 bn, while the value of supported export contracts was PLN 3.4 bn.

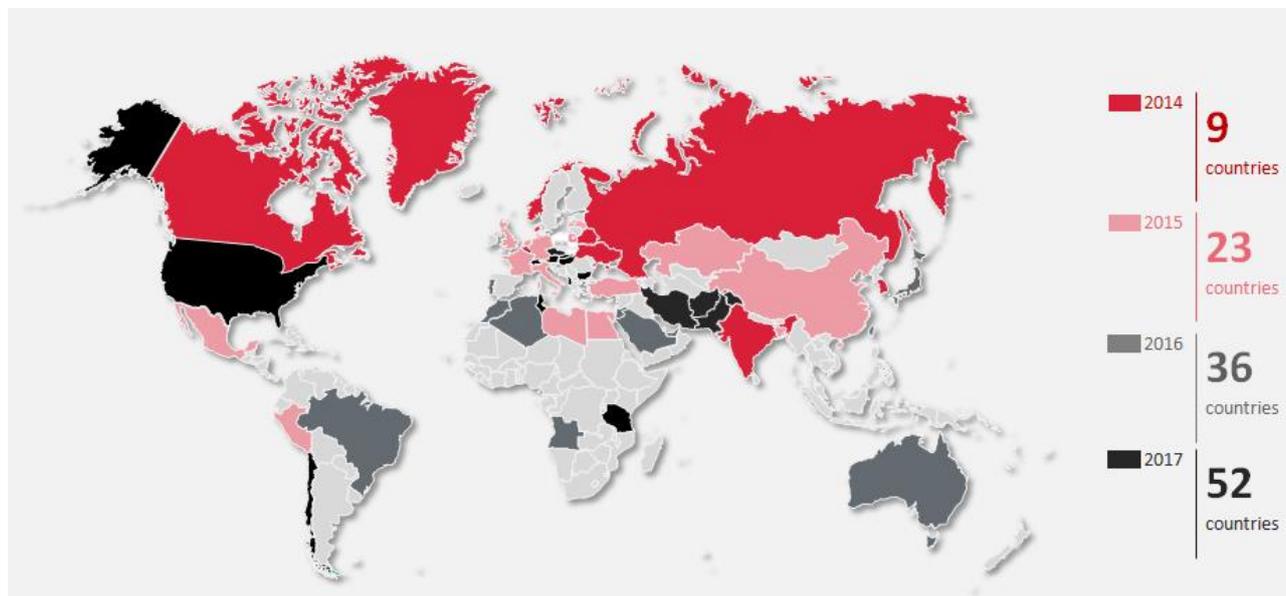
Own activities of BGK in the field of export and foreign expansion support

Since 2015, in relation to growing interest in financing expressed by Polish businesses operating on international markets, BGK expanded its product offer by loans dedicated for foreign investments of Polish enterprises. The said financial instruments is complementary to available export loan products and to products offered by other financial institutions. The above had a significant contribution to the increase in the value of loans granted in subsequent years and, at the same time, allowed BGK to enter the markets of highly developed countries through various forms of financing. The expansion of the product offer also had an impact on the geographical diversification of BGK's portfolio and enabled Polish businesses to secure attractive forms of support not only in relation to exports but also when planning expansion on foreign markets.

The amount of export and foreign expansion financing provided by BGK in 2017 (under the Financial Exports Support government programme and as part of own activities) totalled PLN 1.8 bn. It is important to note that BGK supported over 200 foreign transactions/projects of Polish enterprises, including, but not limited to, financing for: the construction of a hotel in Great Britain, a sports centre and logistics centre in Belarus, the sale of mining machinery to Russia, the sale of aircraft to Germany.

The geographical scope of transactions/projects of Polish enterprises supported by BGK in the years 2014-2017 has been presented on the figure below.

Figure 1



Financing of local government projects

The volume of balance and off-balance sheet exposures of local government units and municipal companies at the end of 2017 amounted to nearly PLN 8 bn and was PLN 0.2 bn higher compared to the previous year. On account of the effective market and competition in the banking sector, BGK maintains the volume of exposure on the same level as in previous years. Outside the area of general financing, BGK is developing its product range intended for local governments as regards the financing of projects. At the end of 2017, the value of exposures in this area amounted to approximately 10% of exposure towards the local government sector.

The Bank also finances healthcare sector entities. As at the end of 2017, the value of loans amounted to PLN 732.3 mn.

Apart from solutions to the extent of lending activity, BGK also finances local government projects by means of equity instruments through Group entities. This applies to the Municipal Fund (as of 2017 known as the Housing for Growth Fund) and the Local Government Investment Fund.

Promoting equal opportunities and housing

The area of promoting equal opportunities features a whole spectrum of BGK Capital Group instruments related to the development of housing and ensuring access to housing for young families and persons with relatively low income as well as instruments to promote social mobility and labour market balance through the development of the institutional rental housing sector.

Within the framework of its lending activity, the Bank implemented government social rental housing construction programmes and the value of its exposure as at the end of 2017 amounted to nearly PLN 5.6 bn. The value stated in the previous sentence comprises the value of the old portfolio of the former National Housing Fund amounting to PLN 5.1 bn and loans granted under the new social rental housing construction programme. In 2017, the growth in exposures related to the implementation of the new programme supplemented by the product offer prepared by the Bank amounted to nearly PLN 200 mn and was close to the value of repayments under the old portfolio. A detailed description of the implementation of government programmes can be found in sub-chapter 4.13 of the present report.

Apart from activities implemented in relation to loan products offered by the Bank, BGK supports the housing needs both through government programmes administered by the Subsidy Fund (including programmes related to social housing) and through the investment activities of funds managed by BGK Nieruchomości.

4.3 LENDING POLICY OF BGK

The purpose of the Lending Policy is to create a framework for the implementation of BGK's mission which consists in supporting social and economic growth of Poland and supporting the public finance sector in the performance of its tasks, and in particular to:

- strengthen the role of BGK as a development bank and significantly increase its current involvement in financing undertakings under the "Strategy for Responsible Growth (SRG)" by:
 - supporting existing and developing new competitive advantages and specializations of Polish economy,
 - supporting innovation and the development of high technologies,
 - supporting reindustrialization and strategic sectors from the perspective of economic growth of Poland,
 - increasing the level of investments,
 - supporting social and regional development,
- achieve and maintain the key role in the implementation of European programs, in particular in the field of repayable instruments,
- implement government social housing support programmes,
- ensure the availability of export financing and increase the scale of operation in the field of solutions that support export-related activity of enterprises, support foreign expansion of businesses and promote Polish export and Polish products,
- provide financial support to the Polish defence system,
- carry out tasks within the framework of government programmes other than those mentioned above,

while maintaining the high quality of assets (especially the loan portfolio) within a specific risk level.

The broad context specified in the Strategy for Responsible Growth and defined in the Bank's mission is implemented by BGK by prioritizing lending decisions based on evaluation criteria in 5 areas:

- the community and services provided to the public,
- the economy,
- the environment,
- the labour market,
- public finance.

Therefore, lending decisions are made not only based on the economic viability of projects and safety in terms of credit risk, but also based on the investment's impact on the country's economic growth.

4.4 DEPOSIT ACTIVITIES OF BGK

In 2017, BGK recorded a drop in the balance of deposits from PLN 37.6 bn to PLN 34.1 bn, i.e. by 9.4%. In terms of the balance amount, the most considerable drop of PLN 4.2 bn (down by 21.8%) was observed in the central government entities segment. In 2017, the value of business deposits went up in the non-financial segment (by PLN 1.2 nn, i.e. 9.6%).

TABLE 9: Volume and customer structure of the deposit base (in PLN mn)

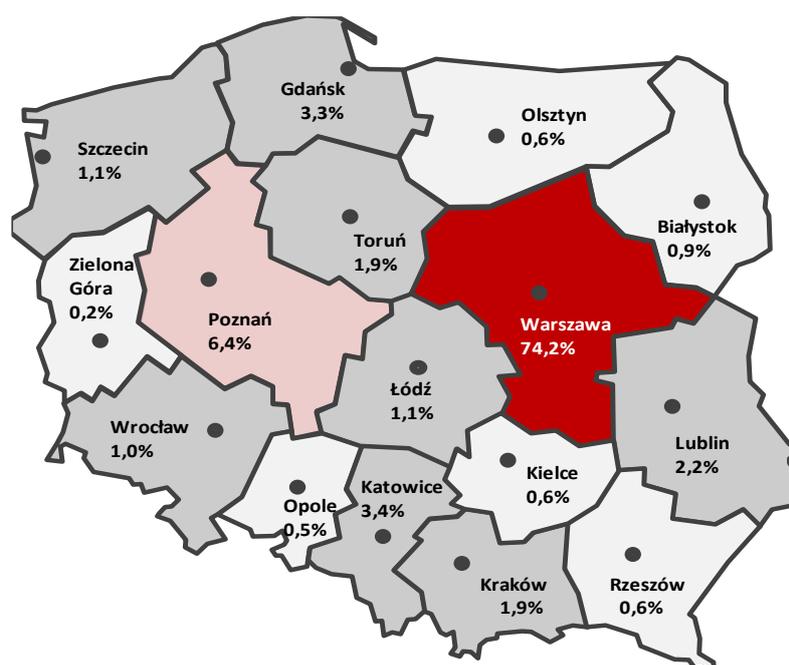
| Item | 2016 | | 2017 | | Change versus 2016 | |
|--------------------------------|-----------------|---------------|-----------------|---------------|--------------------|--------------|
| | Performance | Composition | Performance | Composition | in nominal terms | % |
| Deposits from customers | 37,599.7 | 100.0% | 34,075.0 | 100.0% | -3,524.7 | -9.4% |
| financial sector entities | 2,094.6 | 5.6% | 1,920.1 | 5.6% | -174.5 | -8.3% |
| non-financial sector entities | 12,947.8 | 34.4% | 14,184.6 | 41.6% | 1,236.8 | 9.6% |
| individuals | 34.0 | 0.1% | 37.8 | 0.1% | 3.8 | 11.2% |
| businesses | 12,913.8 | 34.3% | 14,146.8 | 41.5% | 1,233.0 | 9.5% |
| budget sector entities | 22,557.3 | 60.0% | 17,970.3 | 52.7% | -4,587.0 | -20.3% |
| central government entities | 19,485.1 | 51.8% | 15,236.1 | 44.7% | -4,249.0 | -21.8% |
| local government entities | 3,072.2 | 8.2% | 2,734.2 | 8.0% | -338.0 | -11.0% |

As at the end of December 2017, the balance of public sector deposits was considerably lower than at the end of the previous year. Due to the high volatility of this item at the end of the year, BGK has appropriately increased the value of other deposits to ensure the stable financing of assets.

The average level of deposits, excluding the deposits of central government entities, amounted to PLN 24.2 bn and was PLN 5.9 bn (32.6%) higher than in 2016. Customer deposits constitute an important source of financing due to the growing level of BGK's lending and investment activities and ensure a safe level of liquidity.

The territorial structure of deposits which constituted sources of financing for BGK's operations as at 31.12.2017 has been presented below.

Figure 2



4.5 TRANSACTION BANKING

Operating excellence is one of key tools used to implement the strategy for the years 2017-2020 adopted by BGK. The Bank adapts its initiatives and projects being implemented to the needs of its customers and changing external conditions. Operating excellence is also demonstrated in the product management method oriented towards improvement and searching for the most effective solutions.

A significant step in this direction was taken in 2017, when BGK optimised product documentation used for opening a bank account and initiating basic Cash Management products, which allowed to reduce the number of documents to be signed by the customer by nearly 50 percent.

In 2017, BGK continued to implement changes to the electronic banking system (NBE). The current objective of operations being carried out is to expand the modern electronic banking system (**bgk24**) by adding new functionalities. The cash pooling functionality, a product dedicated for the customers of BGK, was to be released in 2017. An electronic banking tool comparable to those offered by other banks has been functioning at BGK since 2016.

The next stage of bgk24 system implementation work will involve the release of development functionalities unavailable in the current electronic banking system, such as a forex buy and sell transactions platform, *light* version for mobile devices, payment card support, digitalization of systemic and product application submission processes.

In addition, in 2017 works were being carried out on the technological upgrade of the bgk24 system. The objective of the said works was to optimize the efficiency of the bgk24 system, resulting in better system response times to user

actions. An update of technology also allowed to implement new functionalities in the system, e.g. to expand filters for orders executed via bgk24, generate more comprehensive system reports as well as the simultaneous authorization and sending of numerous orders grouped into bundles.

In order to make the implementation of new electronic banking more convenient for customers, BGK carried out a number of communication and training activities, such as group training, stationary implementation at head offices of customers, phone support, creation of a dedicated knowledge base about bgk24 – www.bgk.pl/bgk24.

In response to changes in the legislative environment in 2017, measures were taken to adapt offered transaction banking products that facilitate the day-to-day handling and management of the finances of both enterprises and local government units to the amended acts (Act on the Social Insurance Institution, GDPR, VAT Act, Payment Services Act). Wide-ranging analytical works were being carried out in order to estimate the scale of changes to banking systems and applications as well as product documentation. The measures being taken will produce tangible effects as early as in 2018. During that time, a new mechanism for handling split payments from VAT invoices will be introduced and the strong authentication process of card users during the execution of online transactions – 3DSecure – will be put in place.

4.6 BGK'S ACTIVITY ON THE MONEY MARKET AND THE DEBT SECURITIES MARKET

The Bank's activities on the money market were aimed to achieve the following two objectives:

- management and stimulation of the current liquidity position (investment of excess liquidity);
- maintenance of a liquidity buffer in the longer term by holding short-term and/or highly liquid assets.

As in previous years, BGK continued to play an active role on the Polish money market, acting as the Money Market Dealer.

Current liquidity needs of BGK were fulfilled on the interbank market with basic liquidity instruments, mainly deposits, FX swaps, purchases of sell-back securities and sales of buy-back securities. In 2017, BGK's exposure to different types of financial instruments was the effect of the situation on the interbank market and the implementation of the adopted investment strategy.

As BGK allocated its liquid assets in the portfolio of Treasury debt securities on an ongoing basis, its value exceeded PLN 9.3 bn as at the end of 2017.

TABLE 10: Value and composition of the debt securities portfolio (in PLN mn)

| Item | 2016 | | 2017 | | Change versus 2016 | |
|---|-----------------|---------------|-----------------|---------------|--------------------|--------------|
| | Performance | Composition | Performance | Composition | in nominal terms | % |
| Debt securities (measured at cost) | 30,995.3 | 100.0% | 35,785.1 | 100.0% | 4,789.8 | 15.5% |
| NBP (money market) bills | 15,803.1 | 51.0% | 21,526.5 | 60.2% | 5,723.4 | 36.2% |
| treasury bonds | 8,556.5 | 27.6% | 9,311.3 | 26.0% | 754.8 | 8.8% |
| municipal bonds | 1,014.2 | 3.3% | 1,100.5 | 3.1% | 86.3 | 8.5% |
| other securities | 5,621.5 | 18.1% | 3 846.8 | 10.7% | -1,774.7 | -31.6% |

"Other securities" comprise debt securities issued by banks as well as commercial bonds. As at the end of 2017, the Bank's exposure to those securities decreased by PLN 1.8 bn.

As part of its activity on the money market and the market of debt securities, BGK cooperated with the Ministry of Finance, e.g. by investing excess liquidity of the State Treasury.

4.7 SHARE PORTFOLIO

As at 31 December 2017, BGK's total exposure to shares measured at carrying amount was PLN 1,405.5 mn, i.e. went up by PLN 442.8 mn compared to the figure as at the end of December 2016. BGK is a shareholder in 37 commercial companies. The table below presents the statement of main positions in the share portfolio.

TABLE 11: Composition of the share portfolio (in PLN mn)

| Item | 2016 | | 2017 | | Change versus 2016 carrying amount | | 2016 The percentage share of BGK in the company |
|--|--------------------|-----------------|--------------------|-----------------|------------------------------------|---------------|--|
| | Contribution value | Carrying amount | Contribution value | Carrying amount | in nominal terms | % | |
| Shares in public companies | 882.1 | 777.0 | 881.8 | 1 187.5 | 410.5 | 52.8% | - |
| PKO BP S.A. | 800.0 | 689.1 | 800.0 | 1 085.0 | 396.0 | 57.5% | 2.0% |
| PZU S.A. | 13.8 | 51.2 | 13.8 | 65.0 | 13.8 | 26.9% | 0.2% |
| POLNORD S.A. | 23.2 | 16.9 | 23.2 | 20.1 | 3.2 | 19.0% | 6.4% |
| BIOTON S.A. | 9.7 | 7.5 | 9.7 | 3.2 | -4.3 | -57.3% | 1.1% |
| Polimex Mostostal S.A. | 23.4 | 3.4 | 23.4 | 3.7 | 0.3 | 7.8% | 1.1% |
| Elektrociepłownia Będzin S.A. | 10.3 | 7.2 | 10.3 | 8.4 | 1.2 | 17.0% | 9.9% |
| Visa Inc. | 1.7 | 1.7 | 1.4 | 2.0 | 0.4 | 21.5% | < 0.1% |
| Pekaes S.A. | - | - | - | - | - | - | - |
| Shares in subsidiaries and affiliates* | 104.0 | 102.4 | 90.5 | 88.9 | -13.5 | -13.2% | - |
| BGK Nieruchomosci S.A. | 18.0 | 18.0 | 25.5 | 25.5 | 7.5 | 41.6% | 100.0% |
| Towarzystwo Funduszy Inwestycyjnych BGK S.A. | 21.0 | 21.0 | - | - | -21.0 | -100.0% | 100.0% |
| KUKE S.A. | 63.0 | 63.0 | 63.0 | 63.0 | - | 0.0% | 36.7% |
| Krajowa Grupa Poręczeniowa Sp. z o.o. | 2.0 | 0.3 | 2.0 | 0.3 | - | 0.0% | 39.3% |
| Other shares | 68.5 | 23.5 | 67.9 | 70.3 | 46.8 | 199.7% | - |
| Krajowy Fundusz Kapitałowy S.A. | 43.8 | - | 43.8 | 47.3 | 47.3 | - | 100.0% |
| Polski Fundusz Rozwoju S.A. | 15.0 | 15.0 | 15.0 | 15.0 | - | 0.0% | 1.3% |
| European Investment Fund | 8.3 | 8.3 | 7.8 | 7.8 | -0.5 | -5.7% | 0.1% |
| Metanel S.A. | 0.4 | - | 0.4 | - | - | - | 5.1% |
| Zakłady Sprzętu Instalacyjnego "Polam-Nakło" S.A. | 0.3 | - | 0.3 | - | - | - | 19.9% |
| Wałbrzyski Rynek Hurtowy S.A. | 0.3 | - | 0.3 | - | - | - | 10.7% |
| S.W.I.F.T. scrl | 0.1 | 0.1 | 0.1 | 0.1 | -0.0 | -5.7% | < 0.1% |
| Huta Jedność S.A. in liquidation | 0.1 | - | - | - | - | - | 0.6% |
| Visa Europe Ltd | - | - | - | - | - | - | - |
| Shares in investment funds | 1 297.2 | 1 268.3 | 1 960.2 | 1 960.2 | 691.9 | 54.6% | - |
| Shares in surety funds | 65.4 | 59.8 | 65.1 | 58.8 | -1.0 | -1.7% | - |
| Total | 2 417.3 | 2 231.0 | 3 065.4 | 3 365.7 | 1 134.7 | 50.9% | - |
| Total, excluding shares in investment funds | 1 120.0 | 962.7 | 1 105.3 | 1 405.5 | 442.8 | 46.0% | - |

* excluding investment funds and surety funds

In 2017, BGK held shares in 7 public companies, including 6 which are listed on the Warsaw Stock Exchange. As at 31 December 2017, BGK's total exposure to shares measured at initial value was PLN 1,105.3 mn, i.e. it went down by PLN 14.7 mn compared to the figure as at the end of 2016.

The shares in PKO BP S.A., received by BGK free of charge from the State Treasury in 2015 for the purposes of the Bank's investment activities, represent the key item of the share portfolio in terms of value. Additionally, the Bank also holds shares in 30 non-public companies, including 19 regional and local surety funds, 15 of which were classified as the affiliates of BGK and are consolidated with the Group's results using the equity method.

Portfolio of investment certificates

By investing in closed-end funds the Bank fulfils its mission, which is to support the socio-economic development of Poland. As at the end of 2017, the Bank was an investor in 7 closed-end investment private equity funds managed by PFR Towarzystwo Funduszy Inwestycyjnych S.A. The funds in which BGK had a capital involvement invest mainly in infrastructure and residential property.

TABLE 12: Information on investment funds with BGK as a shareholder

| | Fund | Investment strategy assumptions | Geographical structure | Established on |
|---|---|---|--|----------------|
| 1 | Fundusz Sektora Mieszkań na Wynajem FIZ AN (Rental Housing Fund Closed-End Private Equity Investment Fund) | The fund finances companies holding real properties for rent. | Investment projects in Poland. | 26.08.2014 |
| 2 | Fundusz Ekspansji Zagranicznej FIZAN (Foreign Expansion Fund Closed-End Private Equity Investment Fund) | The Fund carries out projects in cooperation with Polish enterprises undergoing expansion. | No geographical or industry focus. | 25.06.2015 |
| 3 | Fundusz Inwestycji Infrastrukturalnych – Dłużny FIZ AN (Infrastructure Investment Debt Fund Closed-End Private Equity Investment Fund) | The funds support investment projects primarily in the following industries: energy, hydrocarbons (crude oil and natural gas), transport and logistics. The project may cover construction and modernization of assets. | The main area of the funds' investments is the territory of Poland, with possible financing of cross-border investments. | 02.07.2015 |
| 4 | Fundusz Inwestycji Infrastrukturalnych – Kapitałowy FIZAN (Infrastructure Investment Equity Fund Closed-End Private Equity Investment Fund) | | | |
| 5 | Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprise Investments Fund Closed-End Private Equity Investment Fund) | The fund supports investments of companies, whose activity is closely connected to Polish economy. The fund focuses on manufacturing companies and companies providing services for the industry. | Manufacturing resources located or a major portion of income generated in the territory of Poland. | 02.07.2015 |
| 6 | Fundusz Inwestycji Samorządowych FIZ AN (Local Government Investments Fund Closed-End Private Equity Investment Fund) | The fund finances investment projects implemented in cooperation with local government entities in the following industries and areas: heating, waste management, regional airports, infrastructure and transportation. | No geographical focus | 02.07.2015 |
| 7 | Fundusz Sektora Mieszkań dla Rozwoju FIZ AN (Housing for Growth Fund Closed-End Private Equity Investment Fund) (formerly: Fundusz Municipalny FIZ AN (Municipal Fund Closed-End Private Equity Investment Fund)) | The fund co-finances local government investments in the real estate market, with a particular focus on the housing market. | Investment projects in Poland. | 30.12.2015 |

Compared to the figure as at the end of 2016, the total issue price of investment certificates held by the Bank increased by PLN 688.3 mn. The most considerable growths measured at issue price were recorded by Fundusz Sektora Mieszkań na Wynajem FIZ AN (Rental Housing Fund CEPEIF) and Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprise Investments Fund Closed-End Private Equity Investment Fund) and amounted to PLN 301.8 mn and PLN 259.2 mn respectively.

TABLE 13: List of investment certificates held by the Bank as at 31.12.2017

| Item | Number of investment certificates held by the Bank | Total issue price of investment certificates (in PLN mn) | | Total payments to the fund made by BGK (in PLN mn) | | Percentage share of BGK** (2017) |
|---|--|--|----------------|--|----------------|----------------------------------|
| | | 2016 | 2017 | 2016 | 2017 | |
| Fundusz Sektora Mieszkań na Wynajem FIZ AN (Rental Housing Fund Closed-End Private Equity Investment Fund) | 1,444,569 | 1,090.2 | 1,392.0 | 712.4 | 971.6 | 100.0% |
| Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprise Investments Fund Closed-End Private Equity Investment Fund)** | 604,800 | 345.6 | 604.8 | 291.1 | 474.9 | 40.3% |
| Fundusz Inwestycji Infrastrukturalnych – Kapitałowy FIZAN (Infrastructure Investment Equity Fund Closed-End Private Equity Investment Fund)** | 302,589 | 259.4 | 302.6 | 241.3 | 261.9 | 13.8% |
| Fundusz Inwestycji Samorządowych FIZ AN (Local Government Investments Fund Closed-End Private Equity Investment Fund)** | 75,000 | 25.0 | 75.0 | 24.5 | 32.0 | 12.5% |
| Fundusz Ekspansji Zagranicznej FIZAN (Foreign Expansion Fund Closed-End Private Equity Investment Fund)* | 10,000 | 44.2 | 41.7 | 10.3 | 41.7 | 100.0% |
| Fundusz Sektora Mieszkań dla Rozwoju FIZ AN (Housing for Growth Fund Closed-End Private Equity Investment Fund) (formerly: Fundusz Municipalny FIZ AN (Municipal Fund Closed-End Private Equity Investment Fund)) | 215,705 | 36.3 | 72.9 | 9.4 | 51.1 | 100.0% |
| Fundusz Inwestycji Infrastrukturalnych-Dłużny FIZ AN Infrastructure Investment Debt Fund Closed-End Private Equity Investment Fund)** | 129,681 | 129.7 | 129.7 | 8.2 | 126.9 | 5.9% |
| TOTAL | | 1,930.4 | 2,618.7 | 1,297.2 | 1,960.2 | - |

*Translated at the average EUR/PLN exchange rate of the National Bank of Poland (NBP) as at 29.12.2017

**As the scale of investments is expanded, the share of BGK increase

Major events in the share portfolio

BGK Nieruchomości S.A.

BGK Nieruchomości S.A. implements investment projects under the “Mieszkania dla Rozwoju” (Housing for Growth) government programme. Since 2014, the company has been the manager of assets owned by Fundusz Sektora Mieszkań na Wynajem FIZ AN (Rental Housing Fund CEPEIF), which by the end of 2017 issued investment certificates with the total issue price of PLN 1.4 bn. BGK is the sole investor in the fund. Since December 2017, the company has also been managing the assets of Fundusz Sektora Mieszkań dla Rozwoju FIZ AN (Housing for Growth Fund CEPEIF), in which BGK is the sole investor. In 2017, the Bank provided a capital injection of PLN 7.5 mn to BGK Nieruchomości S.A. BGK’s investment in the company amounted to PLN 25.5 mn. The Bank remained its sole shareholder.

Towarzystwo Funduszy Inwestycyjnych BGK S.A. (currently known as PFR Towarzystwo Funduszy Inwestycyjnych S.A.)

On 28 September 2017, The Bank entered into an agreement for the sale of 100% shares of Towarzystwo Funduszy Inwestycyjnych BGK S.A. to Polski Fundusz Rozwoju S.A.

Krajowy Fundusz Kapitałowy S.A.

The Bank invested PLN 43.8 mn in the company and holds 100% of shares and voting rights at the General Shareholders’ Meeting of Krajowy Fundusz Kapitałowy S.A. There was no relationship meeting the definition of control between KFK S.A. and the parent entity as at the end of 2017.

In April 2017, KFK contributed PLN 25 mn to the implementation of the 2nd component of the Swiss-Polish Cooperation Programme (SPCP) operated by BGK on the basis of the Annex signed on 30 November 2016 by the Minister of Development and Finance, BGK and the Company. BGK implements the 2nd component in the form of de minimis guarantees for the repayment of loans granted to small and medium enterprises. In October 2017, the Company’s account was credited with the excess income tax refund in the part concerning the SPCP from the Tax Office, which amounted to PLN 1.4 mn.

Huta “Jedność” S.A. in liquidation

On 1 August 2017, Huta “Jedność” S.A. in liquidation was removed from the National Court Register, thus ending the process of its liquidation.

Fundusz Poręczeń Kredytowych Sp. z o.o. in liquidation with its registered office in Jastrzębie Zdrój

On 2 March 2017, Fundusz Poręczeń Kredytowych Sp. z o.o. in liquidation with its registered office in Jastrzębie Zdrój was removed from the National Court Register, thus ending the process of its liquidation.

4.8 PROJECTS

Primary projects supporting the development of the bank’s operational efficiency were continued in 2017. The implementation of the Core Banking System will raise technological maturity, thus allowing to efficiently respond to system modification needs, including to adapt the product offer to the needs expressed by customers and stakeholders of programmes resulting from the implementation of BGK’s mission.

The project consisting in the implementation of the next stage of the expansion of the electronic banking system, the objective of which is to provide access to modern services raising the standard of service provided to strategic groups of customers, including those covered by the public finance consolidation programme, was continued as well. The delivery of a tool with a high market standard is of significant importance to public financial management and entities covered by regulations in this area.

The Bank also undertook many activities related to culture and operational capability in preparation to effectively perform its mission and multi-annual strategy. The basis for the implementation of effective communication as well as process-based and project-based management is the ongoing cultural transformation, which includes the promotion of a sense of responsibility as well as managerial and business maturity. The resulting increased involvement of BGK

employees will make it possible to effectively and efficiently implement measures defined in BGK's strategy on an operational level.

An important element of internal development is also the project to create a new branch model consisting in the transformation of BGK facilities into Regional Business Centres acting as an ambassador of the group of development institutions and a centre of knowledge regarding regional development needs.

Yet another dimension of initiatives being implemented is ensuring the bank's compliance with regulatory changes, including accounting standards. The most important projects in this area was the implementation of changes resulting from the IFRS9 standard and adaptation to MONREP and FINREP reporting requirements. As regards regulations, the bank also commenced preparations to ensure compliance with the General Data Protection Regulation (GDPR) ensuring the protection of natural persons in relation to the processing of personal data and free movement of the said data.

4.9 SURETY BONDS PROVIDED BY BGK UNDER GOVERNMENT PROGRAMMES

The Bank supports the access of SMEs to financing for development needs, including investments, as part of its surety and guarantee operations.

BGK carries out surety and guarantee operations in compliance with the Act of 8 May 1997 on Sureties and Guarantees Granted by the State Treasury and Certain Legal Persons (Polish Journal of Laws of 2017, item 2022, as amended).

In 2017, BGK performed tasks related to its surety and guarantee operations in five primary areas:

- **continued implementation of the de minimis guarantees for micro, small and medium-sized enterprises** government programme,
- **utilization of EU funds for guarantees in the SME sector** – an initiative under the Operational Programme Innovative Economy (OPIE), Operational Programme Smart Growth (OPSG) and the framework programme for the competitiveness of enterprises as well as and medium-sized enterprises (COSME) 2014-2020,
- **establishment of the National Guarantee Fund (NGF)** - implementation of the guarantee model consistent with the Strategy for Responsible Growth (SRG), i.e. an instrument of systemic strategic intervention in the SME sector that mobilizes private funds for the implementation of state policy and is based on all positive experiences from the current model,
- **management of the old portfolio of surety bonds and guarantees,**
- **cooperation with surety funds.**

Programme implementation

In 2017, BGK offered the following surety and guarantee products:

- loan repayment guarantees/surety bonds provided on a portfolio basis, including:
 - loan repayment guarantees as part of the Portfolio De Minimis Guarantee Facility (PDMGF); additionally, de minimis guarantees combined to secure loan repayment with a surety bond provided by the surety fund (PDMGF PLUS) are also granted under the PDMGF,
 - loan repayment guarantees as part of the Portfolio De Minimis Guarantee Facility (PDMGF) granted under OPIE,
 - loan repayment guarantees as part of the Portfolio Guarantee Facility with EIF counter-guarantees under the COSME Programme (PGF COSME);
 - loan repayment guarantees as part of the Guarantee Fund of OPSG (PGF-GF OPSG),
 - student loan repayment guarantees;
- guarantees/surety bonds provided on a case-by-case basis, including:
 - loan repayment guarantees and surety bonds;
 - performance bonds.

TABLE 14: Terms and conditions for granting surety bonds and guarantees (in PLN mn)

| Item | Loan amount | Maximum guarantee value | Term of guarantee | Commission charge |
|--|-------------|-------------------------|-------------------|-------------------|
| Guarantees under Portfolio De Minimis Guarantee Facility | | | | |
| working capital loan | up to 60% | up to PLN 3.5 mn | 27 months | 0.5% p.a. |
| investment loan | | | 99 months | |
| Guarantees under PGF COSME | | | | |
| working capital loan | up to 80% | up to PLN 0.6 mn | 27 months | 1.0% p.a. |
| investment loan | | | 99 months | |
| Guarantees under PGF-GF OPSG | | | | |
| working capital loan | up to 80% | up to PLN 10.0 mn | 240 months | 0.0% p.a. |
| investment loan | | | | |

As part of the PDMGF PLUS, the funds sold 275 surety bonds for the amount of PLN 12.5 mn by 31 December 2017. BGK issued guarantees under PDMGF PLUS for the amount of PLN 36.5 mn.

Portfolio guarantees and surety bonds were offered under agreements entered into by BGK with the lending banks. As at 31 December 2017, BGK had signed 45 agreements with 22 banks – BGK cooperates with the majority of lending banks in Poland, including all large banks. Facilities granted under those agreements totalled PLN 48.6 bn.

PDMGF guarantees were made available under the de minimis aid limit for a single business entity from the micro, small and medium-sized enterprise sector. According to the ordinance of the Minister of Finance, the De Minimis Guarantee scheme has been extended until the end of 30 June 2018. PDMGF does not generate credit risk for BGK and is recognized outside its books.

In addition, as at 31 December 2017 BGK had entered into 6 agreements with lending banks, which set out the terms and conditions for issuing guarantees/surety bonds on a case-by-case basis.

TABLE 15: Sales of surety bonds and guarantees (in PLN mn)

| Item | 2016 | | 2017 | |
|---|--------|---------|--------|----------|
| | Volume | Value | Volume | Value |
| Sureties and guarantees provided on a portfolio basis | 50,042 | 9,622.7 | 43,178 | 10,473.5 |
| Portfolio De Minimis Guarantee Facility | 47,820 | 9,360.5 | 39,912 | 9,913.7 |
| PGF COSME | 2,222 | 262.2 | 3,258 | 546.9 |
| PGF-GF OPSG | 0 | 0.0 | 8 | 13.0 |

Off- and on-balance sheet liabilities of the liquidated National Fund of Credit Guarantees (Krajowy Fundusz Poręczeń Kredytowych – KFPK) and the EU Guarantee Fund (Fundusz Poręczeń Unijnych – FPU)

KFPK and FPU are the former surety funds that were liquidated by BGK in 2009. On the date of their liquidation, the obligations of these funds were taken over by BGK. At the time when they were most active, the funds totalled ca. PLN 200 mn and PLN 1,000 mn, respectively. In 2017, the portfolio includes expiring or impaired items. Off-balance sheet liabilities arising from surety bonds provided as a security for the repayment of business loans from the former KFPK amounted to PLN 50.0 mn as at 31 December 2017. Off-balance sheet liabilities arising from surety bonds provided from the former FPU amounted to PLN 8.4 mn as at 31 December 2017. Gross receivables arising from KFPK surety bonds and guarantees used as at the end of 2017 totalled PLN 63.8 mn.

Development of the surety bond and guarantee system in the EU Financial Perspective 2014-2020

In 2017, BGK continued work on the establishment of the National Guarantee Fund (NGF). The establishment of the NGF will make it possible to use funds released from financial instruments of operational programmes at the central level of the current and previous financial perspective of the European Union, funds reallocated from BGK's capitals and

voluntary participation of stakeholders within any timeframe, thus diversifying the source of financing for de minimis guarantees. The state budget will play a supplementary and supporting role as the guarantor of the system's liquidity.

In 2018, it is planned to expand guarantee products offered under the Guarantee Fund of OPSG by loan interest subsidies. This will allow to raise the attractiveness of guarantees provided under the Guarantee Fund of OPSG and to achieve planned guarantee sales figures in a faster and safer way. Interest subsidies are an incentive to undertake tasks that contribute to the achievement of objective set by OPSG and a motivation for enterprises to utilise repayable EU funds as an alternative to grant instruments and other support instruments that do not utilise EU funds.

As part of developing cooperation with the EIF, work on the implementation of guarantees with the EIF counter-guarantee for the creative sector will be carried out in 2018. The implementation of the aforesaid product will make it possible to utilise the "Creative Europe" EU programme and will contribute to expanding guarantee products offered by BGK, thus diversifying guarantee risk.

In 2018, it is also planned to implement guarantees under the Operational Programme Digital Poland (OPDP), financed from the OPDP Guarantee Fund established at the Bank. The implementation of the said guarantees will allow to acquire EU funds for the next guarantee programme implemented at BGK. After the programme's end in 2023, OPDP Guarantee Fund will become a non-budgetary source of financing for the National Guarantee Fund established at BGK.

Surety funds

In accordance with the Act on Surety Bonds and Guarantees, the Bank may purchase or acquire shares in regional and local surety funds which offer surety bonds and guarantees securing the repayment of credits or loans to micro, small and medium-sized enterprises. As at 31 December 2017, BGK's exposure to 19 surety funds, measured at cost, was PLN 65.1 mn. The guarantee capital at their disposal totalled PLN 571.5 mn.

In 2017, the funds provided 6,281 surety bonds with a total value of PLN 736.0 mn. As at 31 December 2017, the active surety bond portfolio totalled PLN 1,186.0 mn.

4.10 IMPLEMENTATION OF THE EUROPEAN FUND FOR STRATEGIC INVESTMENTS (EFSI)

Year 2017 was a time of intensive action related to the implementation of EFSI, which is a financial pillar of the Investment Plan for Europe, commonly known as the Juncker Plan. The Bank was involved in both EFSI windows, implementing projects both under the "Infrastructure and Innovation" window and continuing its operations in the "SME" window.

In March, a financing agreement for the construction of the Łagiewnicka Route was signed as part of the "Infrastructure and Innovation" window. In addition, in August 2017 BGK signed a loan agreement with the European Investment Bank for the refinancing of commercial loans under a new cooperation platform dedicated to financing Social Housing Associations. Owing to the signed agreement, the potential value of the portfolio of transactions financing such undertakings may amount to even PLN 1.6 bn.

Within the framework of the so-called "small window", i.e. support for the SME sector, BGK continued its involvement in the implementation of the COSME programme in the form of a portfolio of guarantees to be used by commercial banks to secure loans granted to enterprises from the SME sector. In August 2017, BGK signed an annex to the COSME agreement with the European Investment Fund, in line with which the maximum volume of the guarantee portfolio was raised from PLN 0.8 bn to PLN 1.6 bn. This will allow to secure lending activity for the SME sector up to PLN 2 bn. In cooperation with 13 commercial banks, BGK granted 3,258 guarantees totalling PLN 546.9 mn in 2017.

4.11 COOPERATION WITH INTERNATIONAL PUBLIC INSTITUTIONS

Internationally, in 2017 BGK regularly cooperated with three groups of public entities, namely international financial institutions, international associations and foreign development banks.

Cooperation with International Financial Institutions

European Investment Bank (EIB)

The EIB remains BGK's main foreign partner in the acquisition of funding for programs, funds and own activities. Bilateral cooperation was additionally reinforced through regular meetings of experts from both institutions, initiated in 2017.

In 2017, BGK continued the allocation of funds under the EIB Global Loan IV finance contract of December 2013 (EUR 125 mn), the allocation of which was completed in December. BGK also continued the allocation of funds amounting to EUR 125 mn under the Multi-Beneficiary Intermediated Loan V contract from 2016. The funds secured under global EIB loans are used for the purposes of funding investment projects implemented by local governments, SMEs as well as mid-caps.

In addition, the Bank and EIB were parties to several transactions, including the supply of funding for the construction of the Łagiewnicka Route from the European Fund for Strategic Investments (EFSI). Cooperation with the EIB also included a loan repayment guarantee provided to the EIB and continuous cooperation related to the financing of the National Road Fund.

European Investment Fund (EIF)

In 2017, BGK joined forces with the European Investment Fund mainly to the extent of guarantees for the SME sector under the COSME Programme and the Polish Growth Fund of Funds.

BGK also continued its activities within the framework of the Polish Growth Fund of Funds established together with the EIF, the value of which amounts to EUR 90 mn. The Fund invests in investment funds which provide funding to business entities that are growing or expanding their operations.

Cooperation with the EIF is also implemented in the "ownership" formula. BGK holds 5 shares in EIF and is its only Polish shareholder.

Other international financial institutions

In 2017, BGK regularly exchanged information on potential areas of cooperation with other international financial institutions, including the World Bank (WB), the European Bank for Reconstruction and Development (EBRD) and the International Monetary Fund (IMF).

Cooperation with international trade associations and organizations

In 2017, BGK was a member of 9 international associations, including:

- European Association of Public Banks (EAPB);
- Network of European Financial Institutions for SMEs (NEFI);
- European Association of Guarantee Institutions (AECM);
- European Long-Term Investors Association (ELTI);
- International Project Finance Association (IPFA).

As a member of these associations, BGK is informed of amendments to EU regulations that affect its operations. Together with other development banks it is also a partner in a dialogue with EU institutions about instruments that support the economy as well as legal solutions.

In October 2017, BGK hosted the General Assembly of ELTI that was attended by the representatives of 27 foreign institutions. As an accompanying event, BGK organized the international conference on the role of national banks and development institutions in the implementation of the Investment Plan for Europe. The conference was attended by

the representatives of major European development banks, the EIB and the European Commission. The event was very well received by invited guests and foreign partners.

Bilateral cooperation with foreign public financial institutions

The Bank was also engaged in bilateral cooperation with a number of public development banks from other countries. The group of its close partners includes both the major European public banks and minor banks located in Central Europe. By maintaining these relations, BGK has direct access to information concerning their operations, may exchange know-how and establish business relationships in selected areas.

In 2017, bilateral relations were strengthened even further, in particular with the largest European development banks – KfW in Germany, CDP in Italy and banks from the region: MFB in Hungary, EximBank in Romania and HBOR in Croatia. It resulted in a number of bilateral study visits, workshops and meetings at the management level.

The Mexican development bank – Bancomext – joined the group of BGK's partners in 2017, as BGK signed a cooperation agreement in April 2017 during an economic mission accompanying the official visit of the President of the Republic of Poland, Andrzej Duda, to Mexico. The agreement will make it easier to obtain financing for projects implemented by Polish enterprises on the Mexican market. In addition, both institutions have declared the will to exchange information and experiences.

4.12 PUBLIC FINANCE MANAGEMENT

In accordance with the Public Finance Act of 27 August 2009 (as amended), since 2011 the Bank has been administering the process of consolidation of public funds and since 1 January 2015 it has also been responsible for the management of deposit accounts of the Minister of Finance (MF).

Under the Agreement of 19 December 2014 between the Minister of Finance and BGK (as amended), BGK is responsible for:

- carrying out operations related to the acceptance of unallocated financial resources of public sector entities as deposits or under management;
- refunding the amounts provided to the Minister of Finance, with interest, to the bank accounts of those entities;
- maintaining bank accounts for the Ministry of Finance for the purposes of accepting amounts from those entities and refunding them, in addition to transferring interest accrued on such amounts;
- processing transfers initiated by the Ministry of Finance from the bank accounts maintained by BGK;
- preparing reports on the amounts accepted as deposits or under management for the Ministry of Finance.

Under the Agreement of 3 December 2014 between the Minister of Finance and Bank Gospodarstwa Krajowego (as amended), BGK is responsible for:

- carrying out operations related to the management of the deposit accounts of the Minister of Finance (analytical records of each deposit placed under the control of the court, held in each deposit account of the Minister of Finance, daily interest accrual and periodic capitalization of interest due on each deposit placed under the control of the court);
- maintaining bank accounts for the Ministry of Finance for the purposes of accepting amounts from the deposit accounts of the Ministry of Finance as overnight deposits and refunding them, in addition to transferring interest accrued on such amounts;
- preparing reports on deposits placed under the control of the court for the Minister of Finance;
- cooperating with the heads of courts of general jurisdiction and managers of public sector entities providing services to military courts or their field divisions with respect to the management of the deposit accounts of the Minister of Finance assigned to each court.

As at 31 December 2017, the total value of consolidated funds amounted to PLN 42.2 bn and was PLN 2.4 bn higher compared to the figure as at the end of 2016.

Consolidation of public finances

As at 31 December 2017, BGK consolidated 2,227 bank accounts where public funds were deposited. In 2017, the number of transactions whereby term deposits were opened/funds were placed under management for a fixed term was 7,607. As at 31 December 2017, the value of term deposits opened/funds placed under management for a fixed term by public sector entities totalled PLN 30.5 bn. The remaining funds of the said entities were transferred to overnight deposits/placed under overnight management. As at 31 December 2017, the value of funds transferred into overnight deposits/placed under overnight management totalled PLN 7.4 bn.

Deposits placed under the control of the court

In 2015, in accordance with Article 83a of the Public Finance Act, BGK opened deposit accounts for the Ministry of Finance, dedicated for deposits placed under the control of the court for each court of general jurisdiction and each military court. As at 31 December 2017, BGK provide services to 288 courts of general jurisdiction and military courts, for which the Bank opened 3,157 accounts dedicated for deposits placed under the control of the court. As at 31 December 2017, the consolidated amount of deposits placed under the control of the court totalled PLN 4.3 bn.

4.13 EUROPEAN PROGRAMMES

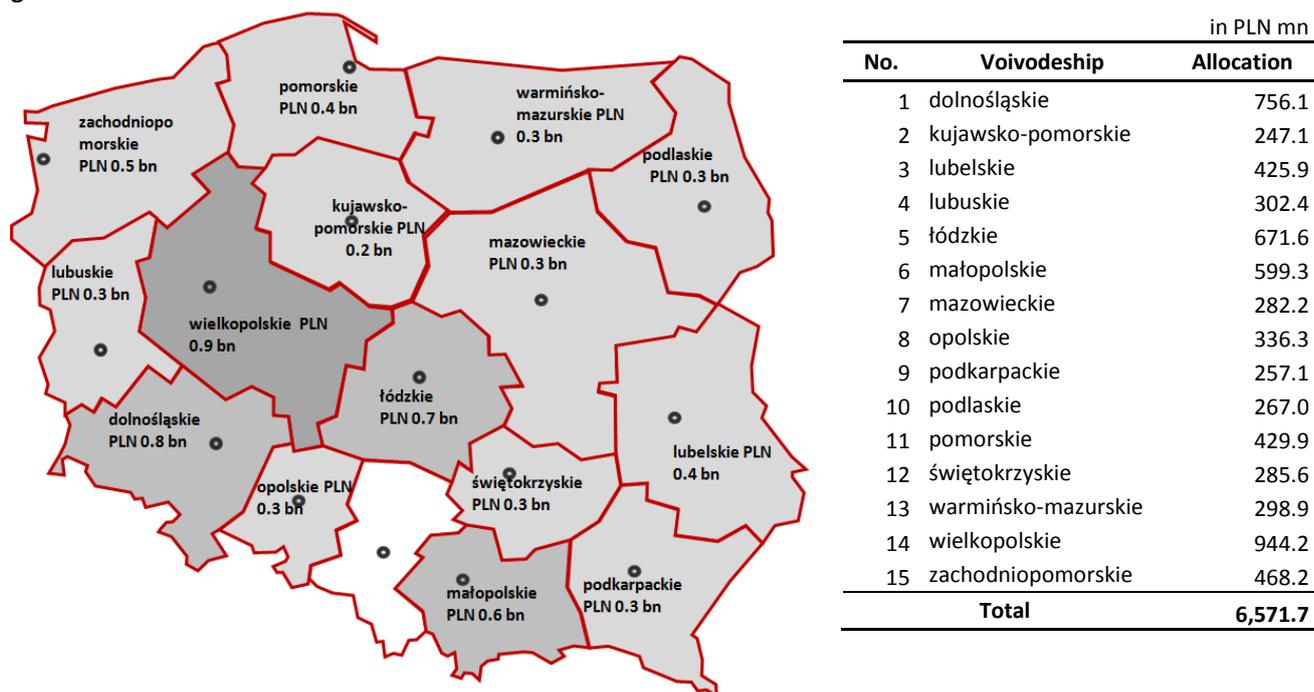
Bank Gospodarstwa Krajowego is an active partner in the implementation of European programmes. The Bank implements programmes on the national and regional level. As regards regional operational programmes, BGK expanded the scope of its operation from 6 to 15 regions in 2017. An important element in the implementation of the new perspective is innovation support.

Manager of the Mutual Fund/Fund of Funds under Regional Operational Programmes for the years 2007-2013 and 2014-2020

BGK carries out tasks related to the implementation of financial instruments under the **EU financial perspective for the years 2014-2020**, consisting in the management of funds of funds offering non-grant support for the development of micro, small and medium-sized enterprises, improving energy efficiency, regeneration and pursuit of business activity by unemployed persons. By 31 December 2017, the bank entered into financing agreements with fifteen regions (dolnośląskie, kujawsko-pomorskie, lubelskie, lubuskie, łódzkie, małopolskie, mazowieckie, opolskie, podkarpackie, podlaskie, pomorskie, świętokrzyskie, warmińsko-mazurskie, wielkopolskie and zachodniopomorskie). The amount allocated under the aforesaid agreements totalled PLN 6,571.7 mn. The funds will be distributed by BGK through a network of financial intermediaries selected in a tender procedure.

The value of projects broken down by region has been presented below.

Figure 3



In 2017, within the framework of the **EU financial perspective 2007-2013**, BGK followed the policy of exiting projects related to the management of JEREMIE mutual funds, including those offering non-grant support for entrepreneurship from public funds. As was agreed, in 2017 BGK transfer the management of the following funds to other entities: JEREMIE Mutual Fund for Wielkopolskie Voivodeship and JEREMIE Mutual Fund for Zachodniopomorskie Voivodeship. The value of projects remaining under BGK's management in Dolnośląskie, Łódzkie and Mazowieckie Voivodeships totals PLN 415.8 mn.

Implementation of equity instruments through the management of funds of funds under the Operational Programme Smart Growth 2014-2020

Equity instruments are implemented through four closed-end investment private equity funds established as part of three sub-measures and one measure under OPSG 2014-2020: sub-measure 3.1.1 *Investments in innovative start-ups – Starter*; sub-measure 3.1.2 *Business angels' group investments in SMEs – Biznest*; sub-measure 3.1.4 *CNFIF – Competitive Nationwide Fund of Innovative Funds*; measure 2.1 *Open innovation – support for technology transfer*. The implementation of each of the above four projects will be based on cooperation and the assignment of functions specified in detail in the Cooperation Agreement signed by specialized entities, i.e. Bank Gospodarstwa Krajowego (BGK), Towarzystwo Funduszy Inwestycyjnych BGK S.A. (currently: PFR TFI S.A.) and PFR Ventures Sp. z o.o. Under the concluded co-financing agreement, BGK is the beneficiary of OPSG funds and the entity responsible for accounting for those funds. PFR TFI S.A. is responsible for the establishment and management of funds. PFR Ventures Sp. z o.o. acts as the manager of investment portfolios of funds.

As the sole investor in the funds, BGK retains the rights of full control and supervision of the funds that are conferred onto the meeting of investors and the board of investors, throughout the entire project implementation period. In particular, BGK is responsible for exercising supervision over the activities carried out by the manager of the investment portfolio of the funds. The objective of the funds is to invest, through selected financial intermediaries, in SMEs using the proceeds from the Bank's acquisition of investment certificates issued by the funds and paid for using the OPSG funds. The value of OPSG projects for equity funds amounts to PLN 1 784.6 mn.

Loan for Technological Innovations

Under an agreement signed with the Minister of Development, as of 30 May 2016 BGK acts as an Intermediary Institution responsible for implementing the Loan for Technological Innovations instruments under the Operational Programme Smart Growth 2014-2020, which is the successor to the Technology Loan implemented by BGK in the EU perspective 2007-2013 (Operational Programme Innovative Economy). The instrument is a means of providing support to SMEs implementing innovative projects, provided in the form of a technological grant earmarked for the partial repayment of a loan granted by commercial banks for the implementation of aforementioned projects. Enterprises that place innovative products or services on the market may apply for a technological grant of up to PLN 6 mn.

The funds entrusted to the bank for that purpose total approximately PLN 2 bn. The role of BGK is to organize calls for applications to provide co-financing to SMEs in the form of a technological grant.

In 2017, BGK carried out and completed two calls for applications for co-financing, as part of which enterprises submitted 870 applications for the total amount of co-financing exceeding the available budget (PLN 2.8 bn). Upon evaluating these applications, 217 projects have been selected and co-financing granted totalled PLN 770 mn. Projects were selected based on the awarded number of points – the objective was to select projects that will contribute to the achievement of OPSG objectives to the greatest possible extent.

Over the year 2017, BGK also carried out tasks related to:

- entry into co-financing agreements with enterprises. Since the beginning of its implementation, a total of 363 agreements have been concluded for co-financing totalling approximately PLN 1.3 bn, including 197 agreements in 2017 for co-financing totalling approximately PLN 668 mn,
- the payment of co-financing; the amount of payments made by BGK to enterprises totalled approximately PLN 250 mn, which enabled the bank to certify eligible expenditures under projects approved for co-financing in the amount of approx. PLN 500 mn; the high level of payments made by BGK means that the projected level of certification of expenses to the European Commission (150%), adopted by the Council of Ministers, has been achieved.

Financing of regeneration and energy efficiency – 2014-2020 (Loans under JESSICA 2)

Within the framework of the financial perspective 2014-2020, BGK cooperates with regional governments and the European Investment Bank (EIB), acting as an entity granting loans for financing investments that consist in the regeneration of problem areas in voivodeships and improving the energy efficiency of buildings. Activity to that extent is the continuation of BGK's operations as the Urban Area Development Fund in the financial perspective 2007-2013, i.e. a financial intermediary granting loans under the JESSICA initiative.

By 31 December 2017, BGK launched loans in Wielkopolskie voivodeship, with which the Bank cooperates as an entity implementing a financial instrument (cooperation agreement between BGK and regional government was concluded in November 2016). Loans are granted to local governments, utilities sector entities and enterprises. First 2 loan agreements were concluded in the 3rd quarter of 2017.

Funds entrusted to BGK for loans in Wielkopolskie voivodeship amount to approx. PLN 290 mn.

In the process of granting loans for the financing of regeneration, BGK also cooperates with the European Investment Bank which – on account of representing Śląskie, Mazowieckie and Pomorskie voivodeships – announced three competitions to select the entity to grant the aforementioned loans (financial intermediary). The Bank participated in those competitions and, in consequence, was chosen to cooperate with the EIB to that extent. The value of funds that BGK will manage in the three aforementioned voivodeships totals approximately PLN 400 mn. In December 2017, an operating agreement concerning loans in Pomorskie voivodeship was concluded with the EIB (funds allocated for loans in that voivodeship amount to approx. PLN 77 mn). Agreements concerning Śląskie and Mazowieckie voivodeships were concluded in the 1st quarter of 2018.

Apart from funds entrusted to the bank for preferential loans in regions, BGK will also contribute not less than PLN 135 mn by co-financing investments (as part of its own activities). That amount will cover the following voivodeships: Wielkopolskie, Pomorskie, Mazowieckie and Śląskie.

Implementation of financial instruments under Priority Axis I “Universal Access to High-Speed Internet” of Operational Programme Digital Poland (OPDP)

In February 2017, BGK entered into a co-financing agreement with Centrum Projektów Polska Cyfrowa (Digital Poland Project Centre) whereby BGK acts as the Fund of Funds Manager responsible for the implementation of financial instruments under the **Operational Programme Digital Poland 2014-2020 (OPDP)**.

Funds amounting to PLN 996.2 mn are made available to telecommunications enterprises through the network of selected financial intermediaries, in the form of loans for the implementation of investments related to the construction, expansion and modification of broadband Internet access networks.

Thus far, BGK has selected two financial intermediaries (ALIOR Bank S.A. and TISE S.A.), who grant loans within the territory of the entire country.

The *Co-financing Agreement* provides for the implementation of the project by 31 December 2031. Its total value, including the national contributions provided by financial intermediaries, will amount to nearly PLN 1.2 bn, with the stipulation that the portion of these funds (by decision of the Managing Authority and Intermediary Institution) will be earmarked for launching the guarantee instrument in 2018.

Rural Development Programme (RDP)

In 2009, BGK began to manage loans from the State Budget for advance funding of operations carried out as part of several measures under the Rural Development Programme 2007-2013. The advance funding system allowed local government entities and local operational groups the opportunity to implement water and sewage management projects as well as projects aimed to create a system for the collection, segregation and disposal of municipal waste, generate and distribute energy from renewable sources, activate rural population, stimulate the creation of new jobs in rural areas, improve the condition of cultural and natural heritage of rural areas, and also construct, convert, renovate or furnish a permanent marketplace, in a more efficient way.

5,518 loan agreements for the amount totalling PLN 3.9 bn have been concluded under RDP 2007-2013.

Since July 2016, the advance funding mechanism has been continued under the Rural Development Programme for the years 2014-2020. Loans are granted to finance eligible costs of projects implemented by local government entities and local action groups. 436 loan agreements for the amount totalling PLN 288.6 mn were concluded in 2017.

Since RDP 2014-2020 started, 566 loan agreements for the amount totalling PLN 353.1 mn have been concluded.

Support for businesses under the Operational Programme Development of Eastern Poland (OPDEP)

In relation to Measure I.2 Financial Engineering Instruments of Operational Programme Development of Eastern Poland, BGK implemented a project titled “Counter-Guarantees and Loans as a Chance to Boost External Funding for SMEs. Surety Fund and Loan Fund Support Instruments in Eastern Poland”. The project was financed by the European Regional Development Fund with the participation of state aid. As the Project Beneficiary, BGK provided support to surety and loan funds which act as Financial Intermediaries in the Project. The ultimate beneficiaries of the support provided in the form of surety bonds securing the payment of loan liabilities and business loans were micro, small and medium-sized enterprises operating in five regions of Eastern Poland, namely lubelskie, podlaskie, podkarpackie, świętokrzyskie and warmińsko-mazurskie.

Currently, the Project is being terminated through passive management, where no new competitions are held and no new operational agreements are entered into with the Financial Intermediaries and the only task fulfilled by the Bank is the management of support provided in the past. Since 2016, BGK has been implementing the agreement signed with the Minister of Development and Finance on the re-use of funds released from the project. In accordance with the

Investment Strategy, support will be offered to micro, small and medium-sized enterprises operating in Eastern Poland in the tourism sector and the related industries. The agreement was signed for a fixed term of 10 years with an option for an extension. The value of the Project amounts to PLN 199.2 mn.

4.14 SOCIAL RENTAL HOUSING (SRH) PROGRAMMES

With a view to implement tasks related to supporting social rental housing, the Bank provided funding and managed the following government programmes:

- a new programme of repayable financing for SRH, which consists in granting loans and issuing bonds with the intention to finance the construction of affordable rental housing,
- a residential construction support programme implemented as part of fulfilling obligations of the liquidated National Housing Fund (NHF). The programme consisted in the provision of loans for investment and construction projects (ICP loan) related to the construction of rental housing.

In 2017, BGK granted loans under a new social rental housing programme. The amendment to the Act on Certain Forms of Support for Residential Construction entered into force in July 2017, whereas the amendment to the ordinance of the Council of Ministers issued in relation to that Act entered into force in December 2017. The most important changes included the removal of the obligation to allocate at least 50% of residential units for persons raising at least one child, introduction of the option to finance cooperative tenant's right to residential premises, introduction of two editions (of calls for applications) in a year, extension of the disbursement period for funds from refundable financing to 36 months, increase of the tenant's contribution amount limit to 30% of the costs of construction of residential premises and an increase of income limits for persons who made a minimum contribution of 10%. These changes had a positive impact on the attractiveness of the Programme.

In 2017, BGK participated in meetings with associations of investors in SRH (social housing associations and housing cooperatives) and the cycle of regional conferences organized for local government entities and the investors they partner with. The BGK Group organized 4 conferences for local governments (in Kielce, Toruń, Poznań and Wrocław). The topic of these conferences was the financing of local government investments in housing by the BGK Group. Over 85 meetings were also held all over the country, during which BGK employees presented repayable financing products offered by the Bank.

In September 2017, the call for applications under the third edition of the social rental housing programmes has ended. Applicants were mainly social housing associations run by local governments, which submitted 46 applications. BGK also received applications from four municipal enterprises other than Social Housing Associations and one application from a housing cooperative. After applications that did not meet statutory criteria and requirements set by the Bank have been rejected, 47 applications for financing intended for the construction of 2,155 apartments, in the amount totalling PLN 258.8 mn, were designated for further processing. BGK assumes that the vast majority of loan agreements under the 3rd edition will be signed in the 2nd quarter of 2018, whereas funds will be disbursed successively in the period from 2019 to 2021.

In 2017, BGK granted 40 loans in the amount totalling PLN 170.7 mn from funds acquired at the European Investment Bank (EIB) and own funds. They were earmarked for the implementation of investment and construction ventures in the area of social rental housing. Loans were granted for the construction of 1,631 apartments under investment and construction ventures on the basis of initial applications submitted in editions 2016-2017. 629 apartments were made available for use in 2017.

Apart from its duties related to financing the construction of rental housing arising in relation to the implementation of government programmes, BGK offers construction loans on commercial terms or the arrangement of bond issues for social housing associations (SHAs) or municipal enterprises. In 2017, BGK granted 9 construction loans totalling PLN 40 mn in relation to the construction of 548 apartments as well as organized and secured 2 bond issues in the amount of PLN 12 mn, intended to finance the construction of 134 affordable rental housing units.

Fulfilment of the obligations of the former National Housing Fund (NHF)

A major part of the Bank's operations focused on the management of the portfolio of loans granted from the liquidated National Housing Fund, in particular on amending contractual provisions to comply with legal regulations in force, updating legal security interests and monitoring credit exposures.

As at 31 December 2017, the balance sheet exposure of the former National Housing Fund was PLN 5.1 bn and was PLN 263.2 mn lower compared to the figure as at the end of 2016.

344 housing units constructed with the use of co-financing from the liquidated National Housing Fund were made available for use in 2017. Additional 283 rental housing units will be constructed as part of the investment financed from the last loan granted from the funds of the former National Housing Fund.

TABLE 16: Key figures relating to the Residential Construction Support Programme (former National Housing Fund) (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|---|-------------|---------|--------------------|---------|
| | 2016 | 2017 | in nominal terms | % |
| Carrying amount: | | | | |
| Gross loans | 5,378.0 | 5,114.7 | -263.2 | -4.9% |
| Impairment losses | 30.8 | 51.0 | 20.2 | 65.6% |
| Loans and advances received | 806.7 | 707.7 | -99.1 | -12.3% |
| Amount in the schedule of works and expenditure: | | | | |
| Loans disbursed | 33.0 | 14.3 | -18.7 | -56.7% |
| Loans committed | 31.6 | 0 | -31.6 | -100.0% |
| Number of apartments financed with loans | 283 | 0 | -283 | -100.0% |

As at the end of 2017, apart from the management of the existing loan portfolio, there was still one loan amounting to PLN 31.6 mn, intended to finance the construction of 283 housing units, remaining to be disbursed from the funds of the liquidated National Housing Fund.

The transfer of title to housing units

The provisions laid down in the Act of 19 August 2011 amending the Act on Certain Forms of Support for Residential Construction and the Act on Housing Cooperatives allowed for housing units constructed with the use of loans granted by BGK from the funds of the former National Housing Fund and own funds as part of fulfilling the fund's obligations to be converted into privately-owned housing units.

In 2017, 64 borrowers filed 257 applications for the transfer of title to housing units. A total amount of PLN 18.1 mn of debt has been repaid for 388 housing units, with additional PLN 2.7 mn repaid on account of the partial relief of a preferential loan for investment and construction ventures (the partial loan relief was a form of state aid for which borrower are eligible by implementing investments within the time limit specified in external regulations, but when the title to housing units constructed with the use of co-financing there is an obligation to return that aid to the Subsidy Fund).

4.15 INLAND WATERWAYS FUND (IWF)

The Inland Waterways Fund was created at Bank Gospodarstwa Krajowego under the Act on the Inland Waterways Fund and the Reserve Fund of 28 October 2002. The purpose of the fund is to support inland waterway transport through the provision of financial support for the modernization of the shipping fleet as well as other projects aimed to restructure inland navigation, including those implemented with a view to protect the natural environment and improve the safety of navigation. By managing the fund, the Bank manages the fund's resources from contributions made by operators of inland waterway vessels, state budget subsidies and grants from the National Fund for Environmental Protection and Water Management as well as executes disbursements from the fund's resources for granted preferential loans and to promote inland waterway transport. Preferential loans constitute de minimis aid, are granted by BGK in compliance with the terms and conditions laid down in the Commission Regulation (EU) No. 1407/2013 of 18 December 2013 on

the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid and are the only form of support for vessel operators granted from the Inland Waterways Fund.

Fulfilment of the Fund's tasks

In 2017, the proceeds of the Inland Waterways Fund totalled nearly PLN 5 mn, including PLN 1.5 mn from a grant received from the National Fund for Environmental Protection and Water Management, whereas its expenditures amounted to PLN 2.1. mn. The Bank granted a preferential loan totalling PLN 1.3 mn from the fund's resources in 2017. As part of promotional activities, BGK disbursed PLN 100 thous. from the fund's resources to co-finance the cycle of television broadcasts under the name "Temat rzeka", broadcast by Telewizja Polska S.A.

TABLE 17: Key figures relating to the Inland Waterways Fund (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|--|-------------|------|--------------------|-------|
| | 2016 | 2017 | in nominal terms | % |
| Carrying amount: | | | | |
| Balance sheet total | 45.7 | 47.8 | 1.5 | 3.3% |
| Gross loans | 5.2 | 4.5 | 0.1 | 1.9% |
| Profit or loss and amounts disclosed in the schedule: | | | | |
| Profit or loss | 0.4 | 0.4 | 0.0 | 0.0% |
| Regulatory payments made and contributions paid by shipowners less any reimbursements of unused grant from the National Fund for Environmental Protection and Water Management | -1.0 | 1.8 | 2.4 | - |
| Preferential loans committed | 2.1 | 1.3 | 1.1 | 50.5% |
| Expenditures on promotion of inland waterway transport | 0.0 | 0.1 | 0,0 | - |

As at the end of 2017, the balance sheet total of the Fund totalled PLN 47.8 mn and its gross loan portfolio amounted to PLN 4.5 mn. The Fund generated a profit of PLN 0.4 mn. Income on investing temporary cash surpluses of the Fund and interest on loans were the key sources of revenue generated by the Inland Waterways Fund.

In 2017, BGK actively participated in works on the new draft Act on the Inland Waterways Fund and the Reserve Fund, carried out at the Ministry of Maritime Economy and Inland Navigation. These works resulted in the draft of a new Act that was submitted for inter-ministerial consultations by the Ministry of Maritime Economy and Inland Navigation at the end of 2017. The draft provides for the removal of the obligation to pay contributions to the IWF imposed on vessel operators, introduction of option to apply for the partial relief of a preferential loan, addition of vessel operators carrying out passenger carriage activities and vessel operators from EU Member States to the list of entities eligible for support from the fund. The draft also provides for the financing of promotional, information and scientific activities as well as vessel operator support programmes consisting in subsidies for the purchase of equipment to ensure safe navigation from the IWF.

4.16 NATIONAL ROAD FUND

The largest cash flow fund managed by BGK is the National Road Fund (NRF). In accordance with the articles of association of BGK as well as separate legislation and other legal acts, BGK assumes responsibility for the preparation of the balance sheets and profit and loss accounts of each fund related to commissioned activities, including cash flow funds. The assets and liabilities of cash flow funds are not recognized on BGK's balance sheet as they do not meet the definition of assets and liabilities. The Bank is an organizational unit that – under relevant acts – manages the financial and operating policy of flow funds but does not control them, as the Bank does not derive economic benefits from their activities and does not bear credit risk related to those assets.

The National Road Fund (NRF), established at Bank Gospodarstwa Krajowego under the Act of 27 October 1994 on Toll Motorways and the National Road Fund, has been functioning within its structures since 2004. The purpose of the fund was to finance the construction and reconstruction of national roads, including motorways and expressways, as well as

cover any expenditures related to payments due to toll motorway operators and costs of construction and maintenance of toll collection systems on national roads. By managing the fund, the Bank manages the assets contributed to the fund (proceeds from the fuel duty on motor fuels and gaseous fuels for the propulsion of motor vehicles, refunds from EU funds, proceeds from the electronic and manual toll collection system on national roads, road charges, fines and penalties), acquires external funding through the issue of bonds and taking loans (mainly from the European Investment Bank), executes disbursements from the fund to finance road infrastructure and service the fund's debt.

The NRF is the main source of financing for national roads constructed and modernized as part of multi-annual government road programmes. Currently, the fund is involved in financing *the National Road Construction Programme for the years 2014-2023 (with an outlook to the year 2025)* – a key document for the implementation of the State transport policy. In 2017, the *Programme* was updated in connection to the adoption of a new *Strategy for Responsible Growth* by the Council of Ministers. In result of the update, the limit of expenditures to be financed by BGK from the National Road Fund (NRF) resources was raised from PLN 107 bn to PLN 135 bn.

Fulfilment of the fund's tasks

In 2017, the proceeds of the National Road Fund totalled PLN 19.3 bn. Proceeds from the key source of its funding, i.e. the fuel duty attributable to the Fund, reached the level of PLN 4.5 bn. Proceeds from the reimbursement of expenditures incurred on investment projects co-financed from EU funds from the EU budget amounted to PLN 8.1 bn. Proceeds from tranches of loans received from the EIB amounted to PLN 1 bn.

TABLE 18: Cash flows of the National Road Fund (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|---|-----------------|-----------------|--------------------|--------------|
| | 2016 | 2017 | in nominal terms | % |
| Proceeds from fuel duty | 4,873.2 | 4,470.1 | -403.1 | -8.3% |
| Proceeds from EU funds | 6,227.8 | 8,131.9 | 1,904.1 | 30.6% |
| Proceeds from loans received | 1,560.2 | 1,030.7 | -529.5 | -33.9% |
| Proceeds from bond issues | 3,511.1 | 3,174.5 | -336.6 | -9.6% |
| Proceeds from toll collection | 1,714.3 | 1,890.7 | 176.4 | 10.3% |
| Proceeds from road tolls, fines and penalties | 194.8 | 211.1 | 16.3 | 8.4% |
| Proceeds from toll motorway operators | 138.5 | 234.3 | 95.8 | 69.2% |
| Other proceeds | 215.3 | 178.2 | -37.1 | -17.2% |
| TOTAL INFLOWS | 18,435.2 | 19,321.5 | 886.3 | 4.8% |
| Payments for road projects | 12,782.9 | 11,847.5 | -935.4 | -7.3% |
| Payments for servicing loans and bonds | 2,492.0 | 2,375.8 | -116.2 | -4.7% |
| Financing of toll collection systems | 324.5 | 475.2 | 150.7 | 46.4% |
| Payments to the toll motorway operators | 1,555.3 | 1,561.3 | 6.0 | 0.4% |
| Other payments | 14.6 | 4.7 | -9.9 | -67.8% |
| TOTAL OUTFLOWS | 17,169.4 | 16,264.5 | -904.9 | -5.3% |

In 2017, BGK issued Eurobonds with a maturity of 10.5 years and a nominal value of EUR 750 mn on behalf of the NRF. The bond issue was carried out on foreign markets under the already running Euro Medium Terms Notes programme. The issued bonds will mature in April 2028 and their interest rate is fixed throughout the entire maturity period and amounts to 1.625%. This was the single biggest issue in EUR carried out thus far and one with the lowest cost of acquiring funds in relation to corresponding treasury securities.

In 2017, BGK concluded two financial loan agreements with the EIB: "Project: Expressway S7 South (Lubień - Rabka)" for the amount of EUR 200 mn, "Project: Expressways S7 and S8 II" for the amount of EUR 325 mn. Under those agreements, the NRF received loans intended to co-finance the construction of sections of expressways S7 (Lubień – Rabka section, Napierki – Płońsk section) and S8 (Wyszków – border of Mazowieckie voivodeship).

Expenditures from the National Road Fund in 2017 totalled PLN 16.3 bn, including:

- payments related to the implementation of road projects by the General Director for National Roads and Motorways, amounting to PLN 11.8 bn;
- expenditures related to the servicing of bonds and loans amounting to PLN 2.4 bn (PLN 1.2 bn for servicing bonds and PLN 1.2 bn for servicing loans);
- expenditures related to the funding of toll collection systems, amounting to PLN 0.5 bn;
- payments made to the operators of toll motorways, amounting to PLN 1.5 bn.

Balance sheet and profit and loss account

As at 31 December 2017, the balance sheet total of the Fund was PLN 57.5 bn, up by 11.2% compared to the figure as at the end of 2016. Receivables from the public sector, comprising the equivalents of payments disbursed under received loans and bonds issued for the National Road Fund, totalled PLN 52.5 bn as at the end of 2017 and were PLN 2.7 bn higher than the figure as at the end of 2016. Liabilities of PLN 53.1 bn, incurred for the purposes of the National Road Fund, went up by PLN 2.6 bn as compared to the end of 2016. Apart from liabilities arising from bonds issued by BGK for the NRF, the above item included the principal and interest accrued on EIB loans as well as a loan obtained from the Nordic Investment Bank (NIB) in the total amount of PLN 27.3 bn. In 2017, the National Road Fund reported a loss of PLN 2.0 bn.

TABLE 19: Key figures relating to the National Road Fund (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|---|-------------|----------|--------------------|-------|
| | 2016 | 2017 | in nominal terms | % |
| Balance sheet total | 51,757.2 | 57,538.8 | 5,781.6 | 11.2% |
| Receivables from the State Treasury due to settlement of amounts paid out by the National Road Fund | 49,802.7 | 52,533.4 | 2,730.7 | 5.5% |
| Liabilities incurred for the purposes of the National Road Fund | 50,531.7 | 53,149.6 | 2,617.9 | 5.2% |
| Profit or loss | -1,987.7 | -2,010.3 | -22.6 | 1.1% |

As a result of the amendment to the Act on Toll Motorways and the National Road Fund introduced in 2017 (introduced by the Act of 8 December 2017 Amending the Act on Public Roads and Certain Other Acts), the Chief Inspector for Road Transport became eligible for payments from the fund in relation to the financing of toll collection systems. As of November 2018, the Chief Inspector for Road Transport will take over duties related to toll collection on national roads from the General Director of National Roads and Motorways. The amendment also expanded the list of expenditures made from the National Road Fund resources at the request of the minister in charge of transport for financing the costs of consulting services concerning statutory duties of the minister related to the functioning and development of public road infrastructure.

4.17 RAILWAY FUND

The Railway Fund (RF), established at Bank Gospodarstwa Krajowego under the Act on the Railway Fund of 16 December 2005, has been acting since 2006. Its purpose is to finance the preparation, construction and modification of railway lines, repairs and maintenance of railway lines, liquidation of superfluous railway lines, and current expenses of PKP Polskie Linie Kolejowe S.A. (PKP PLK S.A.) connected with railway infrastructure management duties. The scope of expenditures covered by the Railway Fund includes also the financing of purchases and modernization of rolling stock used for the purposes of diagnosing, maintenance, repair or construction of railway infrastructure and to carry out rescue operations, and the purchase of shares in PKP PLK S.A. from Polskie Koleje Państwowe S.A. (PKP S.A.) by the State Treasury represented by the Minister of Transport. Until the year 2020 the fund finances the tasks of regional governments related to the purchase, modernization and repair of rolling stock used for the carriage of passengers. By managing the fund, the Bank manages assets originating from proceeds from the fuel duty on motor fuels and gaseous fuels for the propulsion of motor vehicles (in the portion attributable to the fund) and disburses the fund's resources to finance the aforementioned tasks.

The Railway Fund's involvement in financing railway infrastructure managed by PKP PLK S.A. has been specified in the government programme (updated on an annual basis) titled "National Railway Programme until 2023. Railway infrastructure managed by PKP Polskie Linie Kolejowe S.A.", which is a strategic document establishing financial frameworks as well as terms and conditions for the implementation of railway investments in Poland.

Fulfilment of the fund's tasks

Proceeds of the Railway Fund totalled PLN 1.6 bn in 2017 and were comprised primarily from proceeds from the fuel duty. Expenditures from the Railway Fund totalled PLN 2.2 bn, including:

- expenditures on the investments of PKP PLK S.A. and PKP Szybka Kolej Miejska w Trójmieście Sp. z o.o. amounting to PLN 1.1 bn,
- payments to regional governments in relation to the purchase, modernization and repair of rolling stock amounting to PLN 0.1 bn,
- current expenditures in relation to the duties of the infrastructure manager (PKP PLK S.A.) amounting to PLN 0.3 bn.

In 2017, the Railway Fund financed the purchase of shares in PKP PLK S.A. in the amount of PLN 0.7 bn by the State Treasury from PKP S.A. As a result of that transaction, the State Treasury increased its share in the share capital of PKP PLK S.A., whereas PKP S.A. received funds to raise its share capital, intended for development and financing investments under the National Railway Programme.

TABLE 20: Key figures relating to the Railway Fund (in PLN mn)

| Item | Performance | | Zmiana do 2016 | |
|---|-------------|---------|------------------|--------|
| | 2016 | 2017 | in nominal terms | % |
| Carrying amount: | | | | |
| Balance sheet total | 842.0 | 282.7 | -559.3 | -66.4% |
| Debt securities (measured at cost) | 823.7 | 260.6 | -563.1 | -68.4% |
| Profit or loss and amounts disclosed in the schedule: | | | | |
| Profit or loss | 19.3 | 20.0 | 0.7 | 3.6% |
| Inflows to the Fund: | 1,748.2 | 1,645.9 | -102.3 | -5.9% |
| Proceeds from fuel duty | 1,718.3 | 1,617.5 | -100.8 | -5.9% |
| Other inflows | 29.9 | 28.4 | -1.5 | -5.0% |
| Outflows from the Fund: | 1,453.0 | 2,205.2 | 752.2 | 51.8% |
| Payments for railway projects | 1,452.1 | 2,204.5 | 752.4 | 51.8% |
| <i>investment projects</i> | 1,036.1 | 1,048.8 | 12.7 | 1.2% |
| <i>purchase, modernization, repair of rolling stock - local governments at regional level</i> | 90.2 | 91.6 | 1.4 | 1.6% |
| <i>purchase of PKP PLK SA shares by the State Treasury</i> | 0.0 | 720.0 | 720.0 | - |
| <i>current expenditures of PKP PLK S.A.</i> | 325.8 | 344.1 | 18.3 | 5.6% |
| Other payments | 0.9 | 0.7 | -0.2 | -22.2% |

Balance sheet and profit and loss account

As at the end of 2017, the balance sheet total of the Railway Fund was PLN 0.3 bn, i.e. PLN 0.6 bn lower than the figure as at the end of 2016. In 2017, the Railway Fund reported a profit of PLN 20.0 mn.

4.18 SUBSIDY FUND

In 2017, BGK used the Subsidy Fund to finance tasks relating to the management of the following programmes:

- fixed-rate housing loan interest subsidy programme (DSS),
- programme of financial aid for families and other persons purchasing their own apartment (RnS),
- programme of financial aid for social housing (BS),
- programme of state aid for young people in purchasing their first apartment (MdM),
- programme of interest subsidies for loans granted by BGK to Social Housing Associations, hereinafter referred to as “residential construction support programme” (SRH).

Fulfilment of the Fund's tasks

Interest rate subsidies

Interest subsidies for fixed-rate housing loans are granted under the *Act of 5 December 2002 on Interest Subsidies for Fixed-Rate Housing Loans*. Under the Fixed-Rate Housing Loan Interest Subsidy Programme (DSS), BGK continued its cooperation with banks with regard to the settlement of interest subsidies and surplus interest paid by borrowers under fixed-rate loan agreements signed with lending banks between 2003 and 2005. BGK grants subsidies in periods when the contractual interest rate according to the fixed interest rate (6.5%) is lower than the statutory WIBOR3M rate increased by a fixed margin of 1.5%. If the contractual interest rate is higher, excess interest repaid by borrowers is subject to settlement.

The surplus interest on fixed-rate housing loans transferred to BGK in 2017 by the lending banks totalled PLN 0.3 mn and increased the balance of the Subsidy Fund on that account to PLN 1.9 mn.

Rodzina na Swoim (Mortgage Programme for Families)

Activities in relation to the management of the “Rodzina na Swoim” programme (mortgage programme for families) were carried out on the basis of the *Act of 8 September 2006 on the Financial Aid for Families and Other Persons Buying Their Own Apartment*. They consisted in day-to-day management of preferential loan interest subsidy agreements entered into with the lending banks, maintenance of the register of target preferential loan borrowers, payment of subsidies due as well as conducting inspections at the lending banks to verify compliance of loans and subsidies granted with the regulations in force.

As at the end of 2017, the lending banks managed 191,981 preferential loans granted between 2007 and 2013. Since the launch of the Programme until 31 December 2017, BGK transferred subsidies totalling PLN 4,014.3 mn to lending banks on account of granted preferential loans, of which PLN 361.7 mn was transferred just in 2017.

Support for social housing

Activities related to the management of the “Budownictwo Socjalne” programme (social housing programme) were carried out on the basis of the *Act of 8 December 2006 on the Financial Support for the Development of Social and Supervised Housing, Night Shelters and Housing for the Homeless* and in 2017 consisted in the entry into and management of financial support agreements for applications accepted in the 2011-2016 edition as well as two application evaluations. The amount disbursed from the programme since its launch until 31 December 2017 totalled PLN 490.2 mn, of which PLN 87.0 mn was disbursed in 2017. In the spring 2017 edition, 98 applications were considered eligible for support from the Subsidy Fund in the aggregate amount of PLN 100.9 mn. In the fall 2017 edition, 94 applications were considered eligible for support in the aggregate amount of PLN 99.6 mn.

Since the launch of the programme until 31 December 2017, 1,266 agreements were signed (excluding those which have already been terminated) for the amount of support totalling PLN 878.2 mn, including 203 agreements totalling

PLN 187.7 mn in 2017. Since the launch of the programme until 31 December 2017, investors completed and accounted for 1,030 projects, as a result of which 15,046 residential units were built and 1,003 beds were made available in night shelters and housing for the homeless, including 149 projects in 2017 resulting in 1,875 residential units and 55 beds made available.

Mieszkanie dla Młodych (Mortgage Programme for Young People)

The Bank's activities related to the management of the Mieszkanie dla Młodych (MdM) programme were carried out on the basis of the Act of 27 September 2013 on State Aid for Young People Buying Their First Apartment and in 2017 consisted in maintaining a record of buyers and their children meeting the statutory requirements to obtain the available financial support, transferring the subsidies to down-payment/partial loan repayment, settlement of the funds disbursed together with the lending banks as well as verifying compliance of the financial support provided with the statutory requirements and the terms of agreements entered into by BGK with the lending banks. Since the launch of the programme until 31 December 2017, BGK transferred financial support totalling PLN 2,230.3 mn to lending institutions as loans with a subsidy to own contribution, including PLN 761.2 mn in 2017.

Residential construction support programme

Since the launch of the programme until 31 December 2017, BGK disbursed a total amount of PLN 0.5 mn as interest subsidies for granted loans. Under the Tripartite Agreement (setting out detailed terms of interest subsidies for loans or bonds, as referred to in Article 15c.2 of the Act on Certain Forms of Support for Residential Construction), concluded on 23 May 2016 between BGK, the Ministry of Infrastructure and Construction and the Ministry of Finance, the proceeds of the Subsidy Fund from the repayment of a portion of forgiven loans were transferred to a separate account of the Subsidy Fund maintained for purposes of managing the Social Rental Housing Programme.

In accordance with amendments to the Act of 26 October 1995 on *Certain Forms of Support for Residential Construction* introduced in 2011 (Polish Journal of Laws of 2017, item 79, as amended), the title to apartments constituting resources of social housing associations and housing cooperatives, built with the use of BGK loans, may be transferred onto the tenants. Proceeds from the repayment of a portion of forgiven loans related to the aforesaid apartments and income on the Bank's investment of these funds (less disbursed interest subsidies for loans granted) increased the Subsidy Fund by PLN 2.3 mn in 2017, thus increasing the balance of these funds in the Subsidy Fund to PLN 10.7 mn.

TABLE 21: Key figures relating to the Subsidy Fund (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|---|-------------|---------|--------------------|--------|
| | 2016 | 2017 | in nominal terms | % |
| Carrying amount: | | | | |
| Balance sheet total | 407.5 | 454.7 | 47.2 | 11.6% |
| Debt securities (measured at cost) | 399.1 | 444.1 | 45.0 | 11.3% |
| Profit or loss and amounts disclosed in the schedule: | | | | |
| Profit or loss | 0.5 | 1.2 | 0.7 | 140.0% |
| Proceeds from regulatory payments | 1,223.9 | 1,234.5 | 10.6 | 0.9% |
| Payments for the programme of state aid for the purchase of the first apartment by young people | 719.2 | 761.2 | 42.0 | 5.8% |
| Payments for the Programm of financial aid for families purchasing their own apartment* | 405.0 | 355.6 | -49.4 | -12.2% |
| Payments for the social housing support programme | 57.4 | 86.8 | 29.4 | 51.2% |

* payments due from January to December 2017 (payments for December fall due in January 2018)

In 2017, the Subsidy Fund received a state budget grant of PLN 1,234.5 mn, including PLN 319.0 mn earmarked for the RnS (Family's Own Home) programme, PLN 169.5 mn to the BS (Social Housing) programme and PLN 746.0 mn to the MdM (Apartment for the Young) programme.

Balance sheet and profit and loss account

As at 31 December 2017, the balance sheet total of the Subsidy Fund was PLN 454.7 mn, up by PLN 47.2 mn as compared to the end of 2016. In 2017, the Subsidy Fund generated a profit of PLN 1.2 mn, up PLN 0.7 million versus 2016.

4.19 STUDENT LOAN FUND

The Act on Student Loans adopted in 1998 constitutes the legal basis for the operation of the Student Loan Fund, which was established within the structure of BGK on 1 October 1998. The statutory objective of the Fund is to provide wider access to tertiary education through a system of preferential student loans in the form of loan interest subsidies or in the form of partial or complete forgiveness of loans. The Fund also disburses funds for the repayment of loans with BGK guarantees, if claims under the loan guarantee may not be satisfied on legal grounds.

Fulfilment of the Fund's tasks

Since the launch of the preferential student loan system, over 395 thous. students have obtained such loans. In 2017, the fund disbursed PLN 18.5 mn in interest subsidies for student loans and a total of 362 students used the loan forgiveness option to get their loans (totalling PLN 1.6 mn) forgiven either in part or in whole.

In 2017, the Student Loan Fund received a state budget grant of PLN 21.2 mn. The said grant was sufficient to ensure continuous and timely provision of subsidies in 2017, while the amount that was not used in 2017 (PLN 0.6 mn) was returned to the Ministry of Science and Higher Education on 30 January 2018.

TABLE 22: Key figures relating to the Student Loan Fund (in PLN mn)

| Item | Performance | | Change versus 2016 in nominal terms | |
|--|-------------|------|--|--------|
| | 2016 | 2017 | | % |
| Carrying amount: | | | | |
| Balance sheet total | 0.4 | 0.6 | 0.2 | 50.0% |
| Debt securities (measured at cost) | 0.0 | 0.0 | 0.0 | - |
| Profit or loss and amounts disclosed in the schedule: | | | | |
| Profit or loss | -0.5 | -0.6 | -0.1 | 20.0% |
| Proceeds from budget payments | 21.2 | 21.2 | 0.0 | 0.0% |
| Payments from the Fund: | 23.4 | 20.1 | -3.3 | -14.1% |
| Student loan interest subsidies | 21.7 | 18.5 | -3.2 | -14.7% |
| Subsidized student loan forgiveness | 1.7 | 1.6 | -0.1 | -5.9% |

Balance sheet and profit and loss account

As at 31 December 2017, the balance sheet total of the Student Loan Fund was PLN 0.6 mn, up by PLN 0.2 mn as compared to 2016.

The Fund reported a loss of PLN 0.6 mn for 2017, similarly as in 2016.

4.20 THERMAL EFFICIENCY IMPROVEMENT AND REPAIR FUND

The objective of the Thermal Efficiency Improvement and Repair Fund is to provide state aid in the form of the thermomodernization bonus and the repair bonus to investors launching thermal efficiency improvement and repair projects capable of generating savings of energy consumed for municipal and household purposes, with the use of loans obtained from commercial banks, and the compensation bonus representing partial compensation for owners of units with rent subject to regulation between 1994 and 2005.

The thermomodernization bonuses and the repair bonuses are granted on the basis of reviewed results of energy and repair audits. They are disbursed following the completion of the investment project and may be used for purposes of repayment of a portion of loans obtained for the implementation of a thermal efficiency improvement project or a repair project, as the case may be.

Fulfilment of the Fund's tasks

In 2017, BGK granted the thermomodernization bonus, the repair bonus and the compensation bonus in partnership with 12 lending banks.

TABLE 23: Key figures relating to the Thermal Efficiency Improvement and Repaid Fund (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|--|-------------|-------|--------------------|--------|
| | 2016 | 2017 | in nominal terms | % |
| Carrying amount: | | | | |
| Balance sheet total | 318.1 | 445.3 | 127.2 | 40.0% |
| Debt securities measured at cost | 316.1 | 444.8 | 128.7 | 40.7% |
| Profit or loss and amounts disclosed in the schedule: | | | | |
| Profit or loss | 2.3 | 1.0 | -1.3 | -56.5% |
| Proceeds from regulatory payments | 50.0 | 269.0 | 219.0 | 438.0% |
| Number of bonuses awarded | 2,630 | 2,635 | 5 | 0.2% |
| Number of bonuses paid out | 2,787 | 2,480 | -307 | -11.0% |
| Value of bonuses awarded | 152.3 | 151.9 | -0.4 | -0.3% |
| Value of bonuses paid out | 147.9 | 142.7 | -5.2 | -3.5% |

The number of new applications for the thermomodernization bonus, the repair bonus and the compensation bonus received in 2017 was 2,609. The Bank granted 2,635 bonuses totalling PLN 151.9 mn. It issued 2,480 bonus decisions for the total amount of PLN 142.7 mn.

Liabilities arising from thermomodernization, repair and compensation bonuses granted but not yet disbursed amounted to PLN 172.6 mn as at the end of 2017. In 2017, the Fund received a state budget grant in the amount of PLN 269 mn.

Balance sheet and profit and loss account

As at the end of 2017, the balance sheet total of the Thermal Efficiency Improvement and Repair Fund increased by PLN 127.2 mn compared to the previous year and reached the level of PLN 445.3 mn. The Fund reported a profit of PLN 1.0 mn for 2017, down by PLN 1.3 mn compared to the profit reported for 2016.

4.21 BORROWER SUPPORT FUND

The Borrower Support Fund has been established under the Act on Support for Housing Loan Borrowers in a Difficult Financial Condition of 9 October 2015 (Polish Journal of Laws of 2015, item 1925).

The objective of the Fund is to provide refundable support to individuals in a difficult financial condition who are obliged to repay housing loans that constitute a considerable financial burden on their household budget. The funds are derived from payments made by lenders in proportion to the size of their portfolio of housing loans to households, where the delinquency in payment of the principal or interest exceeds 90 days, refunded support as well as income on invested cash surpluses of the Fund. The initial value of the Fund was PLN 598.7 mn. As at 31 December 2017, BGK has entered into agreements with 43 lenders as regards the implementation of the aforesaid legal act.

TABLE 24: Key figures relating to the Borrower Support Fund (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|------------------------------------|-------------|-------|--------------------|--------|
| | 2016 | 2017 | in nominal terms | % |
| Carrying amount: | | | | |
| Balance sheet total | 601.1 | 600.8 | -0.3 | 0.0% |
| Debt securities (measured at cost) | 600.3 | 599.5 | -0.8 | -0.1% |
| Profit or loss | 4.9 | 6.7 | 1.8 | - |
| Proceeds from regulatory payments | 0.0 | 0.0 | 0.0 | - |
| Payments for support programmes | 3.1 | 7.3 | 4.2 | 135.5% |

The Borrower Support Fund provides support under agreements concluded between the lender and the borrower. Its amount is expressed in the Polish zloty as the equivalent of the expected 18 monthly principal and interest payments under the housing loan agreement, with the proviso that if the expected monthly principal and interest payment exceeds PLN 1,500, the amount of PLN 1,500 is used as the basis for the determination of the amount of support. The support is provided on an aggregate basis in monthly instalments to the lender's bank account.

As at 31 December 2017, the Bank registered 759 support agreements for the amount of support totalling PLN 16.8 mn. As at 31 December 2017, 8,297 instalments were disbursed in the amount of PLN 10.5 mn. Expenditures from the Fund in 2017 comprised financial support disbursements and commissions.

Balance sheet and profit and loss account

As at 31 December 2017, the balance sheet total of the Borrower Support Fund was PLN 600.8 mn. The Borrower Support Fund reported a profit of PLN 6.7 mn in 2017.

4.22 OTHER PROGRAMMES AND DELEGATED TASKS

Distribution of EU funds

In accordance with the Public Finance Act of 27 August 2009 (as amended), BGK has been processing payments from EU funds to beneficiaries since January 2010. Under the aforesaid act, payments may also be made as part of state aid distributed through BGK.

Under an agreement with the Ministry of Finance as well as agreements with the Ministry of Regional Development, the Ministry of Labour and Social Policy as well as the Ministry of Health, the Bank is obliged to:

- disburse payments from EU funds and state aid;
- maintain bank accounts in the Polish zloty for purposes of payment processing;
- prepare appropriations for purposes of making payments;
- cooperate with the Ministry of Finance, administrators of each budget function as well as institutions that submit payment instructions insofar as it is necessary for their processing, including reporting, registration of refunds and preparation of the related reports.

In 2017, the Bank processed:

- 2,545 payment instructions totalling PLN 775.1 mn, including 266 payment instructions for PLN 2.6 mn with respect to state aid under the Financial Perspective 2007-2013;
- 67,281 payment instructions totalling PLN 30.5 bn, including 335 payment instructions for PLN 12.6 mn with respect to state aid under the Financial Perspective 2014-2020;

Since the launch of the service until the end of 2017, the Bank processed:

- 741,728 payment instructions totalling PLN 275.0 bn, including 12,787 payment instructions for PLN 670.3 mn with respect to state aid under the Financial Perspective 2007-2013;
- 95,803 payment instructions totalling PLN 46.5 bn, including 418 payment instructions for PLN 17.7 mn with respect to state aid under the Financial Perspective 2014-2020.

Banking services related to and the accounting for liabilities and receivables of the State Treasury

In 2017, BGK fulfilled tasks required by its cooperation with the Ministry of Finance, which consisted in the provision of banking services related to and the accounting for foreign and domestic liabilities and receivables of the State Treasury. As at the end of 2017, foreign liabilities of the State Treasury under BGK's management totalled USD 61.7 bn, and its receivables amounted to USD 1.7 bn.

Fixed-Rate Export Loan Interest Subsidy Programme

BGK manages the Fixed-Rate Export Loan Interest Subsidy Programme on behalf of the Ministry of Finance.

In 2017, BGK received one application for a commitment to enter into an agreement under the said Programme.

As at the end of 2017, the value of the export contracts supported under the Programme managed by BGK totalled EUR 306.3 mn and CAD 165.3 mn. They are financed by loans amounting to DKK 289.3 mn, NOK 1,339.3 mn and CAD 135.4 mn.

Since the launch of the Programme in 2003, BGK has made a total of 49 commitments to provide subsidies for export loans financing export contracts totalling USD 1,446 mn, EUR 901.3 mn, NOK 380 mn, CAD 165.7 mn and GBP 15.2 mn.

Programmes launched by the Minister of Family, Labour and Social Policy

In 2017, BGK managed three programmes launched by the Minister of Family, Labour and Social Policy.

Under an agreement of 25 April 2016, BGK has been offering a **refundable support instrument to Social Economy Entities (SEEs), financed by the Operational Programme Knowledge Education Development (OPKED) 2014-2020**. Assets entrusted to BGK amount to approximately PLN 158 mn. That amount will be used to provide refundable preferential financing to SEEs (loans and counter-guarantees that will be implemented over the year 2018).

The support envisioned for SEEs under OPKED is the continuation of a pilot loan programme for SEEs, i.e. a support instrument offered by BGK in the 2007-2013 perspective. The success achieved by the pilot programme was the reason and basis for the launch of a new SEE support instrument by the Ministry of Family, Labour and Social Policy, but one with a much wider scope (the amount allocated for loans is five times higher and available support solutions have been expanded by new instruments).

The Bank acts as the Fund of Funds Manager in that programme and selects financial intermediaries granting support to eligible SEEs under an open tendering procedure. Agreements with financial intermediaries have been concluded in December 2016.

Ultimately, approximately 2030 preferential loans is to be granted under the aforesaid loan instrument. On account of high demand for loans among SEEs, the 2nd tranche of OPKED funds has been released for loans.

As supplementation to loan products available to SEEs, funds from the repayment of loans granted under the pilot programme, i.e. in the 2007-2013 perspective, have been used to launch a guarantee instrument for SEEs by decision of the Ministry of Development and the Ministry of Family, Labour and Social Policy. BGK offers that instrument in partnership with banks associating co-operative banks that may grant loans secured with a BGK guarantee to SEEs.

Payment of compensations due for real property left outside the current borders of RP

Since 2006, BGK has been processing payments relating to cash compensation for real property left outside the current borders of the Republic of Poland (the so-called Bug River Area Displaced Person Act of 8 July 2005).

In 2017 alone, the Bank made over 3 thous. payments totalling PLN 210.3 mn. Since the introduction of the aforesaid compensation until the end of 2017, the Bank processed 70.3 thous. payments totalling PLN 4,283.6 mn.

First Business – Start-Up Support programme

The Bank also acted as the fund operator under the **“Pierwszy Biznes – Wsparcie w Starcie” (First Business – Start-Up Support) Programme** implemented nationwide since 2014. The purpose of the programme is to develop entrepreneurship and create new jobs as part of labour market development, counteracting unemployment and promoting employment. Under the Programme, students, graduates and the unemployed may apply for low interest loans to start their own business or create jobs for the unemployed. Additionally, those who have obtained a loan to set up a business may use free advisory and training services.

In 2017, the Ministry of Family, Labour and Social Policy together with BGK commenced work on expanding the list of target beneficiaries of the programme to include disability care workers looking for work, among others. The financial intermediaries selected by the Bank in tender procedures assume responsibility for granting loans as well as the provision of training and advisory services. By the end of 2017, 3,619 loans amounting to nearly PLN 232.0 mn were

granted to set up a business and 97 loans amounting to over PLN 2.3 mn were granted to create jobs for the unemployed.

In 2017, BGK managed a number of smaller-scale delegated programmes.

4.23 OPERATIONS OF BGK CAPITAL GROUP ENTITIES

Investment and capital activities

In carrying out the mission of supporting the economic growth of Poland, apart from banking instruments and operations under government programmes, Bank Gospodarstwa Krajowego also actively carries out operations related to capital investments. These operations are carried out by closed-end investment funds and entities established by those funds. Investment funds were established by Towarzystwo Funduszy Inwestycyjnych (Investment Fund Company) created previously by BGK (sold to Polski Fundusz Rozwoju S.A. as of September 2017) and are managed by companies dedicated to that purpose.

In the area of reindustrialization and infrastructure project financing, the managing authority is Polski Fundusz Rozwoju S.A. (Polish Development Fund) forming one of the pillars of Polish development institutions. In the area of housing, the entity specialized in managing investments on the real estate market is BGK Nieruchomości S.A. (in which BGK holds 100% of shares). In the area of supporting foreign expansion of Polish enterprises, the relevant investment fund is managed by PFR TFI S.A. In addition, the Bank also holds shares in Korporacja Ubezpieczeń Kredytów Eksportowych S.A. (Export Credit Insurance Corporation), with which the Bank cooperates on the implementation of a government export support programme and on securing debt financing transactions to the extent of foreign trade.

BGK Group entities carrying out capital investment activities as at 31 December 2017 include:

- Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprise Investments Fund Closed-End Private Equity Investment Fund),
- Fundusz Inwestycji Infrastrukturalnych – Kapitałowy FIZAN (Infrastructure Investment Equity Fund Closed-End Private Equity Investment Fund),
- Fundusz Inwestycji Infrastrukturalnych Dłużny FIZ AN (Infrastructure Investment Debt Fund Closed-End Private Equity Investment Fund),
- Fundusz Inwestycji Samorządowych FIZ AN (Local Government Investments Fund Closed-End Private Equity Investment Fund),
- Fundusz Sektora Mieszkań na Wynajem FIZ AN (Rental Housing Fund CEPEIF),
- Fundusz Sektora Mieszkań dla Rozwoju (Housing for Growth Fund CEPEIF),
- Special purpos vehicles of the Housing for Growth Fund CEPEIF,
- Special purpose vehicles of the Rental Housing Fund CEPEIF,
- Fundusz Ekspansji Zagranicznej FIZ AN (Foreign Expansion Fund Closed-End Private Equity Investment Fund),
- BGK Nieruchomości S.A.

Reindustrialization and infrastructure project financing

Equity investments in the area of reindustrialization and infrastructure project financing are made by Bank Gospodarstwa Krajowego in partnership with Polski Fundusz Rozwoju S.A. (Polish Development Fund). PFR S.A. is an entity that manages the following funds created by BGK and PFR S.A.: Polish Enterprises fund, Infrastructure Investment debt and equity funds, and Local Government Investment fund. The Bank is the main investor in those funds. The Polish Development Fund also invests a portion of its own assets agreed with BGK. Due to contractual provisions between BGK and PFR S.A., funds meet the criteria of affiliates and are consolidated with BGK Group's results using the equity method.

The Polish Enterprise Investments Fund Closed-End Private Equity Investment Fund is a fund established to support investments made by entities whose activity is strongly connected to the Polish economy. The Fund specializes in manufacturing companies and companies providing services to manufacturing companies. Its investment strategy stipulates that the fund will finance the investments of entities with the majority of their production capacity and

income located in the territory of the Republic of Poland. As at 31 December 2017, the value of issued certificates totalled PLN 604.8 mn. The Bank paid-up certificates in the amount of PLN 474.9 mn. In 2017, the value of BGK's contributions amounted to PLN 183.8 mn.

Infrastructure investment debt and equity funds finance investments in the energy, oil and gas, transport and logistics industries, among others. Financing can be provided either as debt or equity financing and can be used to finance new assets or modernize existing assets. Poland is the primary territory in which the funds focus their investments is Poland, but the financing of cross-border investments is possible as well. The value of certificates issued as at 31 December 2017 totalled PLN 432.3 mn, of which PLN 302.6 mn from the equity fund and PLN 129.7 mn from the debt fund. The value of paid-up certificates totalled PLN 388.8 mn and went up compared to the previous year by PLN 139.4 mn. The increase was primarily attributable to the acquisition of investment certificates in the total amount of PLN 118.7 mn issued by the Infrastructure Investments Debt Fund.

Local Government Investments Fund Closed-End Private Equity Investment Fund finances investment projects implemented in cooperation with local government entities in the following industries and areas: heating, waste management, infrastructure and transportation. The total issue price as at the end of 2017 amounted to PLN 75 mn, of which BGK paid-up certificates in the amount of PLN 32 mn. This means an increase in the amount of paid-up certificates by PLN 7.5 mn compared to the previous year.

Housing

The financing of housing development is a major task carried out by BGK Group within the framework of supporting the Strategy for Responsible Growth adopted by the Council of Ministers. The purpose of pursued operations is to support social and territorial development and promote equal social opportunities. Apart from financing social rental housing programmes and government programmes of subsidies for the young and families, the Bank also supports housing development by constructing rental housing in cooperation with investment funds created by Towarzystwo Funduszy Inwestycyjnych BGK (Investment Fund Company of BGK). The funds are managed by BGK Nieruchomości S.A., an entity fully established by the Bank.

The area of investment funds, the Bank implements tasks related to ensuring access to housing for young families and persons with relatively low income (pilot programme Mieszkanie+ (Apartment+) and housing investments under the Municipal Fund, transformed in December 2017 into the Rental Housing Fund) as well as promoting social mobility and labour market balance through the development of the institutional rental housing sector (continuation of the Rental Housing Fund programme).

Rental Housing Fund Closed-End Private Equity Investment Fund is a fund that invests in companies building real estate intended for rental. In the years 2014-2016 investments were being implemented in large cities with the aim to establish the institutional rental market and improve access to rental housing in cities with strong labour markets. In 2017, these activities were continued and supplemented by the pilot programme Apartment+ which primarily focused on activities to promote the construction of rental housing in smaller urban areas to ensure access to housing for people with a relatively low income.

The operations of the Rental Housing Fund CEPEIF consist in investing funds collected through non-public offering of investment certificates. The Fund aims to achieve its investment objective mainly by purchasing and taking up shares and debt securities issued by special purpose vehicles. Special purpose vehicles implement construction projects related to the erection of buildings as well as purchase and sale of real estate at their own expense, and then they rent housing units in owned multi-family residential buildings. They also carry out real estate activities. Special purpose vehicles established to implement investments form part of BGK Capital Group and are subject to consolidation using the full consolidation method. As at 31 December 2017, the Fund had 15 special purpose vehicles. The detailed list of those vehicles can be found in the consolidated financial statements of BGK Group, in the sub-chapter concerning the composition of BGK Capital Group.

As at 31 December 2017, the value of issued certificates totalled PLN 1,392 mn, whereas BGK's contributions totalled PLN 971.6 mn. The value of contributions has increased by PLN 259.2 mn compared to the previous year.

Housing for Growth Fund Closed-End Private Equity Investment Fund (formerly: Municipal Fund) is a fund that invests in local government infrastructure, including residential real estate. On account of investing in residential real estate for rent in smaller urban areas together with local governments, it is characterized by low construction costs and affordable rent. In 2017, the Fund was transformed into the Housing for Growth Fund Closed-End Private Equity Investment Fund. As of December 2017, the Fund's assets are managed by BGK Nieruchomości S.A.

Due to plans to significantly increase investment activity nationwide, the Fund will be managed by utilizing experience gained in the course of implementing the pilot programme Apartment+ as well as experience gained as part of municipal investments implemented by TFI BGK. The Fund's concept is a response to the housing deficit observed in Poland and declining local government investments in the area of residential construction and social infrastructure.

The Fund's investments consist in acquiring shares or debt instruments of project companies established to implement investment projects. The Fund can also engage in real estate projects implemented under public private partnership as the financing entity. Special purpose vehicles established to implement investments also form part of BGK Capital Group and are subject to consolidation using the full consolidation method. As at 31 December 2017, the Fund managed 4 special purpose vehicles. The detailed list of those vehicles can be found in the consolidated financial statements of BGK Group, in the sub-chapter concerning the composition of BGK Capital Group.

As at the end of 2017, the value of investment certificates issued totalled PLN 72.9 mn. BGK contributed PLN 51.1 mn towards certificates since the beginning of the Fund's operation. In 2017, the value of contributions amounted to PLN 42.1 mn.

BGK Nieruchomości S.A. is a subsidiary of Bank Gospodarstwa Krajowego, in which BGK holds all shares. The entity was established to manage the Bank's investments in real estate, in particular residential real estate. BGK Nieruchomości S.A. manages the Rental Housing Fund Closed-End Private Equity Investment Fund and – since December 2017 – the Housing for Growth Fund.

In 2017, BGK acquired additional issued shares totalling PLN 7.5 mn. As at 31 December 2017, the value of capital injected into the company amounted to PLN 25.5 mn. In addition, the Bank also grants debt financing to the entity by acquiring bonds totalling PLN 10 mn.

BGK Nieruchomości S.A. is in the expansion stage. The year 2018 was a period during which the company prepared to implement investments on a much wider territorial scale under the pilot programme Apartment+. Since December 2017, the company has also been managing the investments of the Housing for Growth Fund Closed-End Private Equity Investment Fund.

Foreign expansion financing

BGK Capital Group financially supports the expansion of Polish enterprises through the Foreign Expansion Fund Closed-End Private Equity Investment Fund. The Fund invests in investment projects related to the establishment of new or acquisition of existing companies outside the borders of the Republic of Poland together with Polish partners. The Fund does not have a narrow sector focus, making investments together with Polish expansion-stage enterprises.

Foreign Expansion Fund Closed-End Private Equity Investment Fund invests proceeds from non-public offerings of investment certificates. The Fund aims to achieve its investment objective by purchasing and taking up shares in project companies. The project companies of the Fund are consolidated with the Group's results using the equity method. As at 31 December 2017, the Fund had 2 foreign entities: Esotiq Germany GMBH with its registered office in Stuttgart, Germany and UAB EMP Recycling with its registered office in Galinés, Lithuania. The first aforementioned entity carries out activities related to retail sale of textile products, whereas the second entity buys in bulk, processes and sells secondary raw materials. The share of BGK in those companies does not exceed 49%.

As at 31 December 2017, the balance sheet total of the Foreign Expansion Fund CEPEIF amounted to PLN 41.7 mn, up by PLN 31.4 mn as compared to the previous year.

Other operations of BGK Capital Group entities

BGK Capital Group also comprises entities with which the Bank cooperates in the implementation of activities supporting the export and foreign expansion of Polish enterprises: Korporacja Ubezpieczeń Kredytów Eksportowych S.A. (Export Credit Insurance Corporation) and entities pursuing local surety bond activity in cooperation with BGK as its affiliates, i.e. 15 surety funds and a special purpose vehicle: Krajowa Grupa Kapitałowa (National Capital Group). The Bank additionally holds shares in 4 lower-value funds

Korporacja Ubezpieczeń Kredytów Eksportowych SA

Korporacja Ubezpieczeń i Kredytów Eksportowych S.A. (Export Credit Insurance Corporation) is a Polish insurance company whose shareholders are the State Treasury and Bank Gospodarstwa Krajowego. BGK holds a share of 36.69%. KUKI S.A. insures commercial transactions of Polish enterprises, enabling them to safely pursue commercial trade both domestically and abroad. KUKI S.A. focuses its operations on insuring receivables from the sale of goods and services with a deferred payment date and on providing insurance guarantees.

KUKI S.A. is the only insurance company in Poland with the right to offer export insurance policies guaranteed by the State Treasury that provide security in trading on high-risk markets. KUKI insurance policies also cover long-term export investment projects financed by a loan with a repayment period longer than 2 years.

As part of its cooperation with KUKI S.A., Bank Gospodarstwa Krajowego insures the majority of debt financing provided as well as guarantee and letters of credit in the area of financing export and foreign expansion support. This applies, in particular, to the financing of transactions on high risk markets covered by State Treasury guarantees. In addition, BGK provides financing to KUKI Finance S.A. in relation to factoring activity carried out by the said subsidiary (KUKI S.A. holds 100% of shares).

Surety funds and the National Guarantee Group

In accordance with the Act on Surety Bonds and Guarantees, the Bank may purchase or acquire shares in regional and local surety funds which offer surety bonds and guarantees securing the repayment of credits or loans to micro, small and medium-sized enterprises. As at 31 December 2017, BGK had an equity interest in 19 surety funds, of which 15 formed part of BGP Group as affiliates. The guarantee capital at their disposal totalled PLN 571.5 mn. The detailed list of those funds can be found in the consolidated financial statements of BGK Group, in the sub-chapter concerning the composition of BGK Capital Group.

The Bank and surety funds entered into an arrangement with the National Guarantee Group, the purpose of which was to establish a joint action platform and ensure that surety bond activities are pursued in compliance with the best standards and practices. A special purpose vehicle under the name Krajowa Grupa Poręczeniowa Sp. z o.o. was established for that purpose.

The vehicle's objective is to take and support actions to strengthen surety funds and raise their importance as a special instrument supporting micro, small and medium-sized enterprises. Cooperation between the Bank, surety funds and the SPV resulted in the development of an IT solution aimed to streamline surety and information flow management processes.

4.24 TRANSACTIONS WITH AFFILIATES OF BGK

A detailed list of transactions with entities linked by equity or organizationally to BGK has been presented in note 38 to stand-alone financial statements of BGK.

5. STRATEGY AND DEVELOPMENT DIRECTIONS OF BGK AND BGK CAPITAL GROUP

5.1 STRATEGY OF BGK AND BGK CAPITAL GROUP

Bank Gospodarstwa Krajowego places particular focus on supporting the financing of enterprises, foreign expansion and large projects. The Bank also implements programmes promoting equal social opportunities.

A new Strategy of Bank Gospodarstwa Krajowego for the years 2017-2020 Bank, defining the role to be played by BGK in the upcoming years, has been defined in 2017. The strategy defines the role of BGK as a state development bank. It puts greater focus on its mission, i.e. to support social and economic growth of Poland and support the public finance sector in the performance of its tasks. The new Strategy of BGK is the result of new opportunities for the Polish economy defined and addressed, *inter alia*, in the Strategy for Responsible Growth (SRG) that prioritizes economic growth based on knowledge and excellence, sustainable social and territorial development and an effective State.

In the process of drafting the strategy for the years 2017-2020, BGK prepared action plans for key areas defined in the Strategy for Responsible Growth.

Figure 4



The culture of the Bank is based on professionalism, partnership, and commitment. With regard to these values, a new organizational model has been defined. It focuses on pillars such as financing development and investments, European programmes, public finance, and operating excellence.

As a state development bank, BGK focuses on initiating and implementing tasks that promote general economic growth and development of enterprises. It finances infrastructure 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, i.e. cooperation, it establishes relations with other financial institutions, taking into account the principles of partnership. One of its major aspects is the support of economic growth.

One of the elements of the Strategy of BGK for the years 2017-2020 is defining key indicators of strategy implementation and setting a projected level of their implementation by 2020.

Due to the developmental nature of the Bank, one of the basic performance indicators involves “the value of financing generated for the economy”, which reflects the ability of BGK to generate an added value for the economy. In addition, a special focus 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.

5.2 DEVELOPMENT DIRECTIONS OF BGK CAPITAL GROUP

In the coming years the development of BGK Group will be significantly affected by the involvement of BGK and BGK Group entities in supporting social and economic initiatives of the Polish government. The strategy implemented by BGK Group is compliant with the activities proposed in the Strategy for Responsible Growth adopted by the Council of Ministers. In accordance with its mission, BGK supports the socio-economic growth of Poland and the public finance sector, in particular by way of carrying out government programmes.

The development of BGK Group will follow the multi-annual plan for the years 2017-2020 adopted by the Supervisory Board. The Bank will expand its involvement in key measures set out in the Strategy for Responsible Growth, i.e. in knowledge-based economic growth, sustainable social and territorial development and an effective State.

Knowledge-based economic growth

In the area of supporting knowledge-based economic growth, BGK Group will actively engage in financing reindustrialization and infrastructure investments, supporting foreign expansion and export of Polish enterprises, ensuring systemic support for small and medium-sized enterprises and aid in innovation development.

Reindustrialization and infrastructure investment financing

The Bank plans to increase its lending activity in the upcoming years, in particular by increasing the financing of enterprises, including by mobilizing funds under agreements for financing infrastructure projects from previous years and by increasing the number of new projects in sectors of strategic and key importance to the country's development. The said lending activity will be supplemented by increasing indirect financing provided under products offered by BGK.

Activities in the area of debt and guarantee financing will be supported by utilizing knowledge and experience gained by BGK in investment project management and by ensuring the participation of high-level industry experts. The above should translate into even closer cooperation between BGK, its economic partners and other stakeholders, including those on the local government level.

In the area of equity investments, BGK will provide capital to funds managed by PFR S.A. The Bank will also create new infrastructure funds through cooperation with partners on the national and international arena.

In the area of road and railway infrastructure development (implemented by means of cash flow funds), the year 2018 will be another year of higher road and railway investment expenditures (up by nearly PLN 2 bn).

Supporting foreign expansion and export of Polish enterprises

BGK plans to dynamically increase its involvement in financing the foreign expansion and export of Polish enterprises. The Bank follows its customers, Polish enterprises, to new markets and expands its product offer, including by export letters of credit, factoring as well as hybrid guarantees and financing.

BGK Group also financially supports the foreign expansion of Polish enterprises through the Foreign Expansion Fund Closed-End Private Equity Investment Fund. The Fund invests in investment projects related to the establishment of new or acquisition of existing companies outside the borders of the Republic of Poland together with Polish partners. The Group intends to invest approximately PLN 1 bn in the Fund by 2020.

Support for small and medium-sized enterprises

In the area of SME sector support, the Bank will continue to operate the de minimis guarantee programme and utilize EU funds to reduce the competitive gap of that sector.

In 2018, it is planned to transform the de minimis guarantee programme and establish the National Guarantee Fund. The establishment of the National Guarantee Fund (NGF) is aimed to implement the instrument of systemic strategic intervention in the SME sector – compliant with the Strategy for Responsible Growth – that mobilizes public funds from EU programmes and private funds for the implementation of state policy and is based on all positive experiences gained from the De Minimis Guarantee programme.

As part of activities carried out under the EU perspective 2014-2020, the Bank intends to increase the pace of absorption of EU funds under regional operational programmes. Support will be provided through financial lending instruments (microloans, loans), surety instruments and equity investments.

Aid for innovation development

In the area of innovation development, BGK will carry out actions related to the implementation of equity instruments through the management of funds of funds under the Operational Programme Smart Growth 2014-2020. These actions include:

- *Investments in innovative start-ups – Starter;*
- *Business angels' group investments in SMEs – Biznest;*
- *Competitive Nationwide Fund of Innovative Funds;*
- *Open innovation – support for technology transfer.*

In the near future, BGK will work on the implementation of guarantees with the EIF counter-guarantee for the creative sector. The implementation of the aforesaid product will make it possible to utilise the "Creative Europe" EU programme funds.

Additionally, BGK is working on the establishment of the research and development fund in cooperation with the Ministry of Science. The projected final scale of investments will amount to PLN 500 mn.

Sustainable socio-economic growth

Within the framework of supporting the Strategy for Responsible Growth, BGK will also be actively engaging in activities implementing the key priority of that strategy - Sustainable socio-economic growth. These activities will be carried out in the area of social economy and promoting equal opportunities as well as financing local government projects.

The area of social economy and promoting equal opportunities features a whole spectrum of BGK Capital Group instruments related to the development of housing and ensuring access to housing for young families and persons with relatively low income.

The Bank will continue dedicated government programmes (cash flow fund operations and debt financing in the area of social rental housing) and carry out investment activity through funds managed by BGK Nieruchomości.

In addition, BGK will expand its activities under social economy programmes and programmes supporting professional activity on the labour market.

In the local government segment, BGK mainly plans to provide financing for local government projects supporting regional socio-economic development, so as to utilize the Bank's experiences in the fields of structured financing, including the financing of small infrastructure, regeneration projects implemented under EU programmes, and investment projects. BGK plans to double its involvement in that area in the near future. In the area of general financing, on the other hand, BGK will maintain its market share.

Effective State

On account of the specific nature of activities carried out by BGK, a major element of the Bank's development are activities specified in the "Effective State" priority. These activities include the effective implementation of EU programmes as well as public finance and commissioned government programmes management activities. It is also important for BGK and the Group to utilize the bank's potential in cooperation with Polish development institutions.

The primary objectives of projects supported under regional operational programmes are to: develop SME entrepreneurship, improve energy efficiency in the housing and public building sector and energy efficiency of SMEs, develop the labour market, finance renewable energy source and regenerate urban areas. The Bank will cooperate with local government partners on the best plan of actions co-financed from EU funds that is tailored to the specific nature of the region.

As part of activities carried out under the EU perspective 2014-2020, BGK will focus on increasing the pace of absorption of EU funds under regional operational programmes.

Effective use of EU funds and programmes

The Bank will actively engage in actions to improve the scale of financing infrastructure projects in the infrastructure and innovation window of the Investment Plan for Europe, the so-called Juncker Plan, with support from the European Fund for Strategic Investments. Cooperation will extend to many fields through bridge financing, participation of BGK in syndicated financing, acquisition of funds to finance BGK programmes or counter-guarantees for credit risk.

Ensuring effective public finance management

As regards activities oriented towards public finance sector management and distribution of EU funds, BGK will carry out actions to maintain a high standard of service and aim to achieve operating excellence.

Cooperation with Polish development institutions

In 2018, Bank Gospodarstwa Krajowego intends to expand its role in the area of regional cooperation to promote products and solutions offered by all development institutions. BGK will use its network of branches and transform them under the New Branch Model project into regional centres where, in addition to products offered by BGK, potential partners will be able to obtain support from an entire variety of products and solutions offered by Polish development institutions.

Cultural transformation

Development directions defined in that way require major investments to raise the operating efficiency and deep changes to the culture of the Bank and BGK Group. Operating excellence is one of four main pillars of the strategy of BGK adopted by the Supervisory Board for the years 2017-2020. Therefore in 2018 and following years the Bank plans to increase its efforts to raise its efficiency by optimizing and digitizing processes as well as improving staff involvement.

The plan for the year 2018 provides for increasing the number of projects from several to several dozen and a more than threefold increase of the budget for project costs and investment expenditures.

The year 2018 will be the first full year of major changes related to the transformation of organizational culture that promotes professionalism, partnership and involvement. The change of organizational culture will be a key element of implementing the strategy of BGK and enable the introduction of many necessary changes and strategic investments.

6. FINANCIAL SITUATION OF BGK AND BGK CAPITAL GROUP

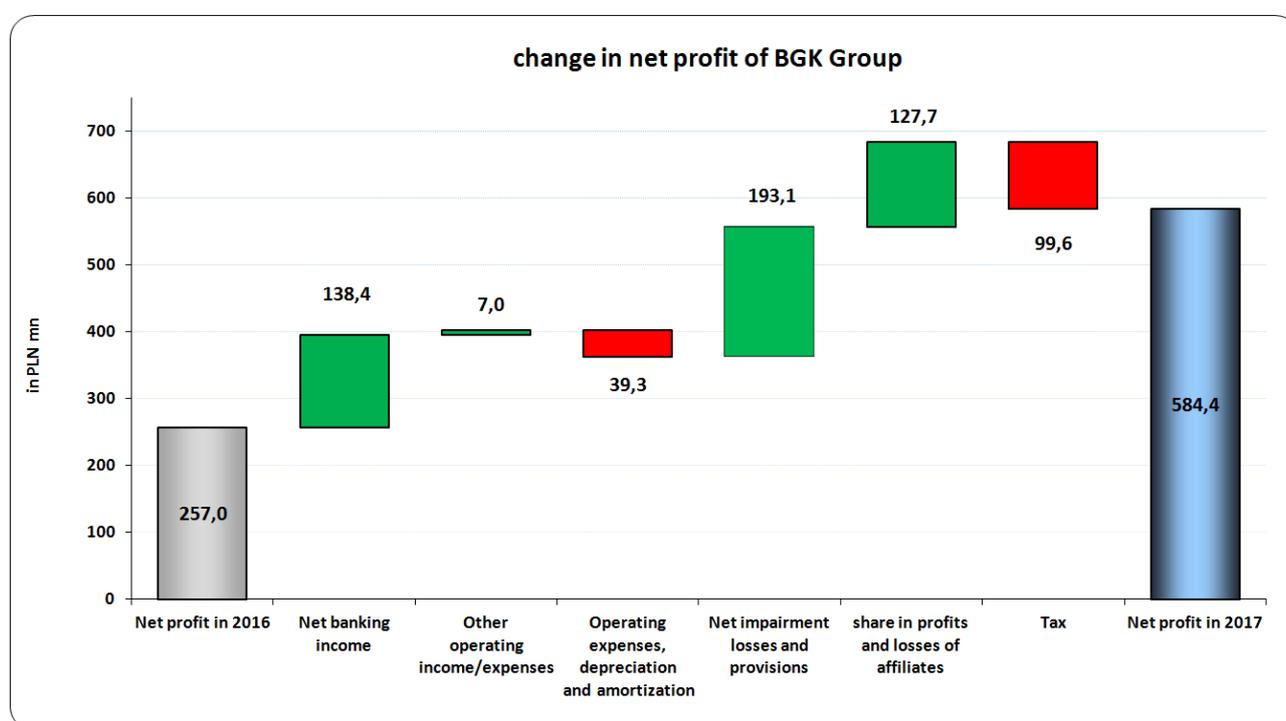
6.1 FINANCIAL RESULT OF BGK CAPITAL GROUP

BGK Group reported a net profit of PLN 584.4 mn for 2017, up by PLN 327.4 mn compared to profit reported for 2016. The increase in profit was primarily the result of the greater scale of banking activity and improved quality of BGK's loan portfolio as well as change in the valuation of investments in funds supporting the development of Polish enterprises and infrastructure investments.

The following had the greatest impact on the increase of net profit by over 127% in relation to the previous year:

- net impairment losses and provisions – cost reduced by PLN 193.1 mn,
- net banking income – increase by PLN 138.4 mn,
- share in profits and losses of affiliates – result improved by PLN 127.7 mn.

Figure 5



Profit and loss account

Net banking operations

Net banking operations for the year 2017 amounted to PLN 989.5 mn and were PLN 138.4 mn higher compared to the result achieved in 2016. That increase was primarily the result of an increase in profit of PLN 129.2 mn reported by BGK. It was attributable primarily to the increase in interest income earned by BGK amounting to PLN 118.2 mn, which was mainly the result of increased lending and deposit activities and an increase in commission income amounting to PLN 41.5 mn, while income on instruments and financial investment assets declined by PLN 30.5 mn. Net profit for Group entities subject to consolidation using the full consolidation method improved by PLN 9.2 mn. That was attributable mainly to the sales income of TFI BGK S.A. amounting to PLN 7.8 mn and an increase in interest income of nearly PLN 1.6 mn.

Other operating income and expenses

Net other operating income for the year 2017 amounted to PLN 72.6 mn and rose by PLN 7.0 mn compared to the result achieved in the previous year. The change in net other operating income was attributable to an increase in operating revenue of special purpose vehicles of the Rental Housing Fund Closed-End Private Equity Investment Fund and

revenues earned by TFI BGK S.A. and BGK Nieruchomości S.A., which resulted from the expanded scale of managed funds. The increase in income less operating expenses reported by consolidated entities amounted to PLN 31.7 mn and reached PLN 74.8 mn. That increase was compensated by the decrease in net other operating income of PLN 24.7 mn reported by BGK for the year 2017. The aforesaid decrease was attributable to the release of an operating provision at BGK amounting to PLN 17.7 mn in 2016 and PLN 2.2 mn in 2017 – in 2017 the balance was reduced by PLN 15.5 mn compared to the previous year. The Bank increased its community involvement by providing grants higher by PLN 6.1 mn for this purpose.

Operating expenses, depreciation and amortization

Operating expenses, depreciation and amortization of BGK Capital Group for the year 2017 amounted to PLN 394.0 mn and were PLN 39.3 mn higher compared to the result achieved in 2016. The increase in expenses was attributable mainly to higher operating expenses of consolidated entities, which went up by PLN 29.9 mn, especially operating expenses of BGK TFI and BGK Nieruchomości. The increase in expenses reported by those entities were related to the greater scale of activity and preparations made by companies to implement new investment projects, in particular those to be implemented in future years of housing programmes. The expenses of BGK in that period rose by PLN 9.4 mn.

Net impairment losses and provisions

Net impairment losses and provisions of BGK Capital Group for the year 2017 amounted to PLN -49.6 mn and were PLN 193.1 mn higher compared to the result achieved in 2016. That result was attributable to the core banking activity pursued by BGK. In 2017, the quality of the loan portfolio of BGK has improved, primarily due to the significant improvement in the financial condition of customers of the Bank, in particular those from the mining sector. As a result of that improvement, a portion of those exposures was repaid early and the level of impairment losses on the remaining exposures was significantly reduced. The relatively high value of net impairment losses and provisions was achieved despite the increase of credit and guarantee exposures of the Bank by PLN 8.7 bn.

Share in profits and losses of affiliates

The share in profits and losses of affiliates of BGK Capital Group for the year 2017 amounted to PLN 72.0 mn and was PLN 127.7 mn higher compared to the share reported for 2016. The change in relation to the previous year resulted from the current valuation of investments implemented by funds managed by PFR S.A. The biggest improvement was reported by the Polish Enterprise Investments Fund, in which the value of contributions made by BGK has increased by PLN 68.4 mn compared to the previous year. For the infrastructure investments equity and debt funds, BGK contributions have increased by PLN 7.5 mn in 2017. The valuation of the Local Government Investments Fund went down by PLN 2 mn.

Such significant change year-over-year is the effect of major changes in the situation on markets that affect the valuation of investments made by the fund. Valuation assumptions adopted in 2016 included a periodic minimum for industries in which the fund made two investments. As funds expand their activities and improve their industrial diversification, the volatility of the result should decline.

Gross profit/loss

Gross profit for the year 2017 amounted to PLN 690.5 mn and was PLN 427.0 mn higher compared to the profit reported for 2016. The improved result was primarily attributable to greater scale of banking activity as well as improved loan portfolio structure and quality, and higher valuation of affiliates. Gross profit for the year 2017 was also PLN 266.1 mn higher than the figure reported for 2015, which was not affected by a one-off event related to the change in the valuation of provisions.

In 2016, the ultimate method for calculating impairment losses and provisions was developed and the model value of target recovery on at-risk exposures in specific business lines was quantified as part of work carried out at the Bank under the project consisting in the implementation of IAS/IFRS. These changes resulted in a significant adjustment of impairment losses in comparison with the previous estimates. As a result of increase in impairment losses caused by a change in estimates, gross profit for the year 2016 fell by PLN 98.3 mn.

Net profit and tax

On account of adjustments to the provisions made in 2016, mainly on taxable activities, BGK Group reported a very low tax value. In 2017, the effective tax rate was 15.4% and better reflected the long-term structure of taxable and non-taxable income in the Group.

The value of tax for the year 2017 amounted to PLN 106.0 mn and was PLN 99.6 mn higher compared to the year 2016.

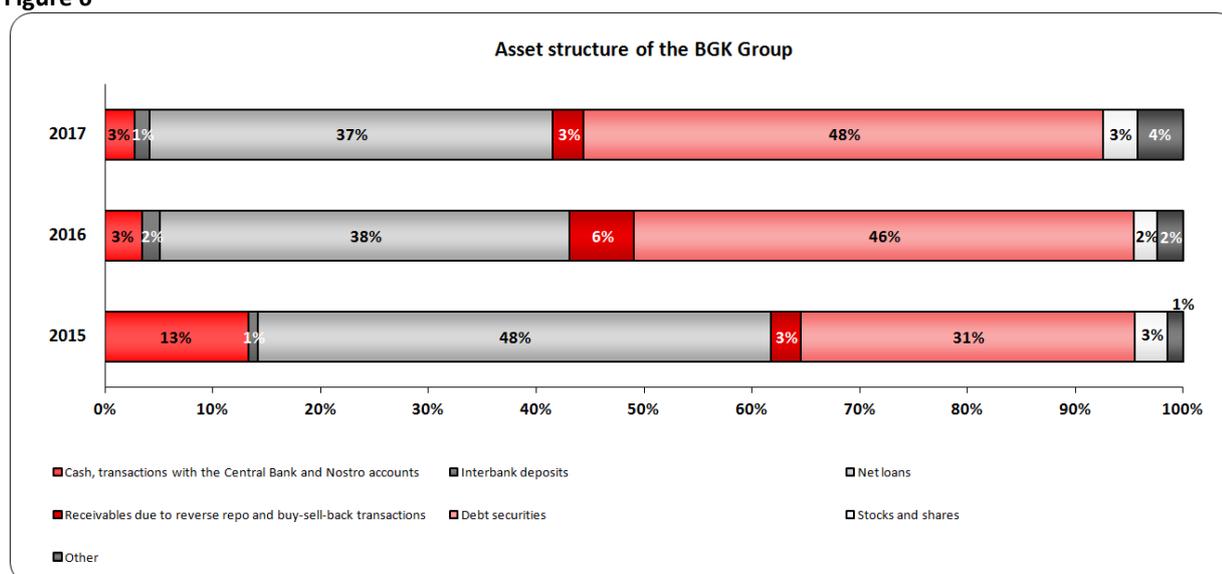
BGK Group reported a net profit of PLN 584.4 mn for 2017, up by PLN 327.4 mn compared to net profit reported for 2016.

6.2 STATEMENT OF FINANCIAL POSITION OF BGK GROUP

In 2017, the balance sheet total reported in the Statement of Financial Position as at the end of 2017 was PLN 74,314.0 mn.

Debt securities represented the biggest share in the asset structure, i.e. 48%, and their carrying amount totalled PLN 35,830.5 mn as at the end of the year. Approximately 60% of that portfolio was represented by NBP (money market) bills and nearly 26% by Treasury bonds. As compared to the previous year, the share of debt securities in the asset structure rose by 2 pp. The asset structure was characterized by high liquidity and a significant share of securities issued by the National Bank of Poland (NBP) and the State Treasury.

Figure 6



Net loans represented a 37% share in the asset structure and their carrying amount totalled PLN 27,810.0 mn as at 31 December 2017, up by PLN 2,447.0 mn compared to the previous year. Due to the increase of the balance sheet total resulting from capital injections and generated profit, the share of net loans fell by 1 pp.

The value of shares as at the end of 2017 rose by PLN 877.1 mn compared to 2016 and totalled PLN 2,333.0 mn, which represents approx. 3% of the balance sheet total. That increase was attributable primarily to an increase of PLN 420.8 mn in investments and valuation in affiliates as well as an increase of PLN 396.0 mn in the valuation of PKO BP S.A. shares.

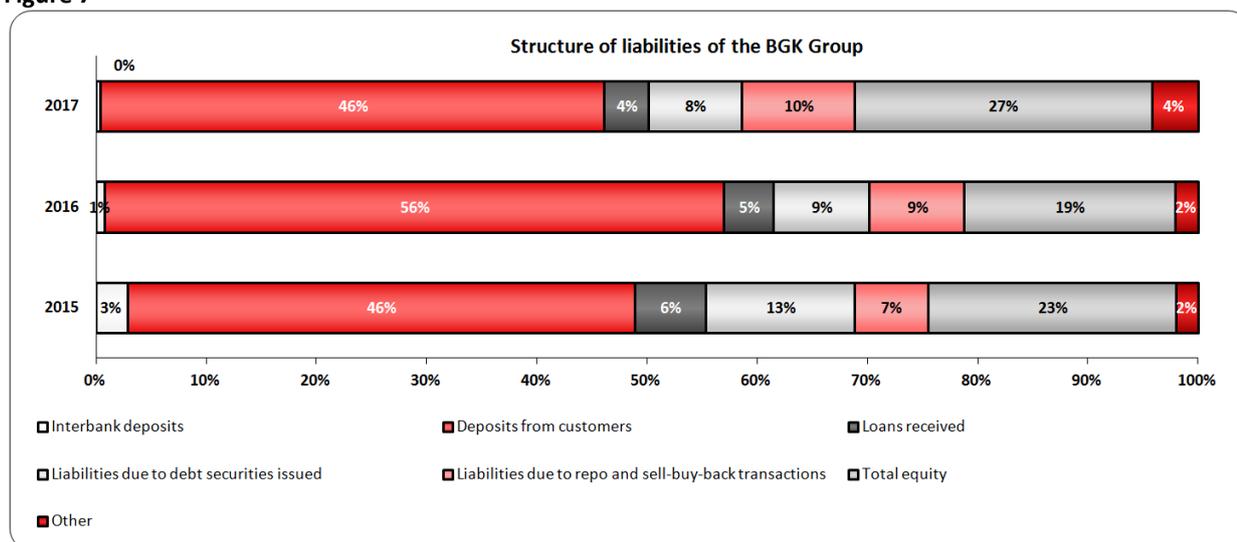
Changes in the remaining items recognised under assets of BGK Group were attributable mainly to the management of the liquidity position of BGK as well as changes in prepayments and accruals and settlements.

In other assets of the Group, the value of investment real estate rose in relation to the previous year by PLN 246.7 mn to PLN 834.4 mn. The asset structure of BGK Group over the years 2015-2017 has been presented on the figure below.

Customer deposits had the biggest share in the structure of equity and liabilities of BGK Capital Group, i.e. 46% as at 31 December 2017. The value of deposits as at the end of the year totalled PLN 33,959.3 mn, i.e. went down by PLN 3,532.8 mn in relation to the previous year. The decrease in the share of deposits in the structure of equity and liabilities by 10 pp resulted from the lower value of deposits and higher balance sheet total of BGK Group.

The higher balance sheet total was attributable primarily to the capital injection of PLN 6,290.4 mn received by Bank Gospodarstwa Krajowego and profit of PLN 584.4 mn achieved for the year 2017. The share of total equity of BGK Group in the structure of equity and liabilities rose by 8 pp to 27%.

Figure 7



The value of liabilities arising from the issue of securities of BGK Group amounted to PLN 6,299.3 mn as at the end of 2017, i.e. went up by PLN 497.9 mn in relation to the year 2016. The value of loans received totalling PLN 2,987.9 mn was slightly lower, i.e. it went down by PLN 41.1 mn. Together, these stable sources of financing represented 12% of the Group's liabilities.

Changes in the remaining items recognised under liabilities of BGK Group were attributable mainly to the management of the liquidity position of the Bank. With capital totalling PLN 20,068.6 mn, BGK Group has significant potential to increase its involvement in lending activity and increase its investment activity by investing funds in housing development, supporting the economic growth of Poland in such areas as reindustrialization and infrastructure investments, and supporting the foreign expansion of Polish enterprises.

Basic performance indicators of BGK Group for the year 2017 have improved compared to the previous year. ROE rose by 1.4 pp to 4.0%, whereas ROA rose by 0.2 pp to 0.6%. The C/I ratio improved, i.e. went down by 1.9 pp YOY to 39.8%.

6.3 FINANCIAL RESULT OF BANK GOSPODARSTWA KRAJOWEGO

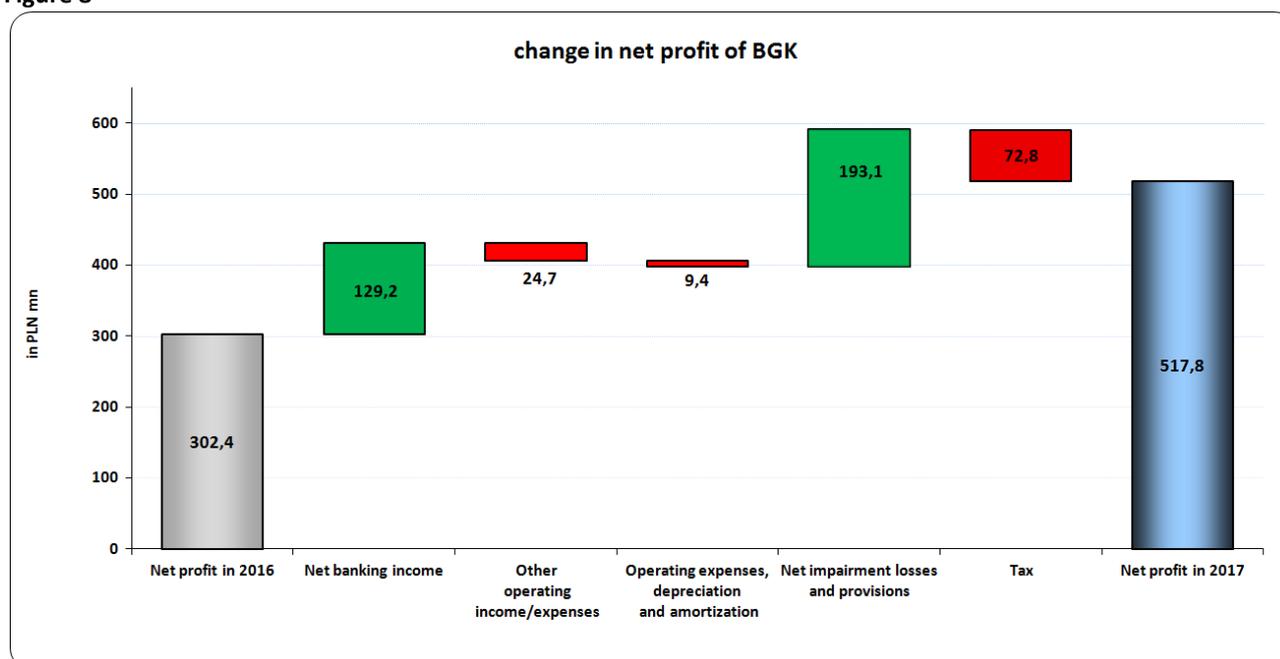
BGK reported a net profit of PLN 517.8 mn for 2017, which means an increase of PLN 215.4 mn as compared to the previous year. The increase in profit was primarily attributable to the greater scale of banking activity and improved quality of BGK's loan portfolio.

The following had the greatest impact on the increase of net profit by 71.2% in relation to the previous year:

- net impairment losses and provisions – cost reduced by PLN 193.1 mn,
- net banking income – increase by PLN 129.2 mn.

Gross profit amounted to PLN 606.2 mn, i.e. went up by PLN 288.2 mn (90.7%) in relation to the previous year. The Bank reported a net profit of PLN 517.8 mn, which means an increase of PLN 215.4 mn (71.2%) compared to net profit reported for the year 2016.

Figure 8



Net banking income

As at the end of 2017, net banking income amounted to PLN 978.9 mn, i.e. went up by PLN 129.2 mn (15.2%) compared to the result achieved as at the end of 2016. The increase in net banking income was attributable primarily to the higher interest income and higher commission income.

Net interest income

Net interest income, which totalled PLN 752.9 mn as at the end of 2017 and went up by PLN 118.2 million (18.6%) compared to the previous year, was the key component of net banking income.

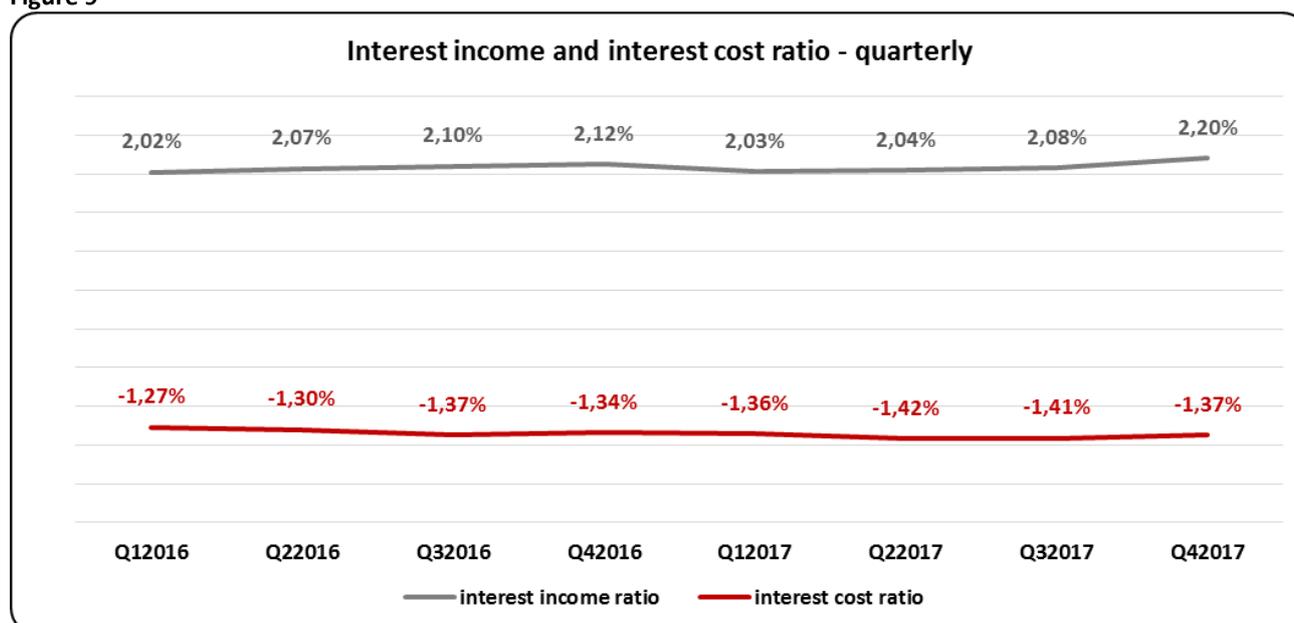
The increase in interest income was primarily attributable to the greater scale of lending and deposit activities and capital injections received by BGK.

Compared to 2016, both interest income and expenses have increased – by PLN 310.2 mn and PLN 192.1 mn, respectively.

The average level of interest-bearing assets was PLN 80.4 bn, i.e. went up by PLN 14.0 bn in relation to the year 2016.

The average rate of return on assets in 2017 was similar to the one achieved in 2016 and amounted to 2.09% (as compared to 2.08% in 2016). The rate of return on interest-bearing assets and cost of debt have been presented on the figure below.

Figure 9



Income on credit exposures represented the biggest component of interest income and amounted to PLN 991.0 mn, down PLN 87.4 mn (9.7%) compared to the previous year. Interest income ratio on that portfolio was 3.08%, compared to 2.96% for the year 2016 (increased size and rate of return of the high-volume transactions portfolio within the framework of structured financing). The average balance of credit exposures went up by 5.5%, from PLN 30.4 bn in 2016 to PLN 32.2 bn in 2017.

The second biggest component of interest income is income on debt securities that totalled PLN 626.7 mn, i.e. went up by PLN 178.3 mn (39.8%) in relation to the previous year. In 2017, the average balance of debt securities was PLN 36.7 bn, up by PLN 11.6 bn (45.9%).

The average balance of other interest-bearing assets (BSB, nostro accounts and interbank deposits) in 2017 was PLN 11.6 bn, which means an increase of PLN 0.6 bn compared to the previous year. Income on other interest-bearing assets went up by PLN 4.5 mn.

In 2017, the average balance of interest-bearing liabilities was PLN 66.4 bn, up by PLN 10.4 bn (18.7%) in relation to the previous year.

An increase in interest expenses was mainly driven by an increase of 7 bp in the cost of debt as compared to 2016, up to 1.39% in 2017. That increase was attributable primarily to change in the product structure (volume of negotiated deposits went up by PLN 2 bn).

Customer deposits represented the biggest component of interest-bearing liabilities. The average level of customer deposits in 2017 was PLN 55.0 bn, i.e. it went up by PLN 9.0 bn (19.7%) compared to 2016. Interest expenses totalled PLN 805.6 mn, i.e. they went up by PLN 129.3 mn in relation to the previous year.

Interest expenses on liabilities arising from debt securities issued and loans received went up by PLN 12.1 mn, while the average balance of such liabilities was PLN 9.2 bn, up by PLN 0.7 bn than average balance for the year 2016.

The average excess of interest-bearing assets over interest-bearing liabilities was PLN 3.3 bn higher as compared to the year 2016.

The net interest income reported herein also includes interest income and expense relating to transactions hedging the currency structure of interest-bearing assets and liabilities.

Commissions settled using the ESP method are recognised in commission income.

Net commission income

Net commission income amounted to PLN 176.9 mn and was PLN 41.5 mn higher than the result achieved in 2016. Commission income went up by PLN 41.8 mn. That was attributable mainly to the effects of having converted the reimbursements of expenses under programmes in the new EU perspective into commissions – up by PLN 23.4 mn. In addition, in 2017 BGK generated higher income on credit exposures under its own activities (up by PLN 19.3 mn) and higher income on commissioned guarantee activities (up by PLN 4.4 mn). Commission expenses went up by PLN 0.4 mn.

TABLE 25: Net commission income structure (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|---|--------------|--------------|--------------------|--------------|
| | 2016 | 2017 | in nominal terms | % |
| Commission income | 146.4 | 188.2 | 41.8 | 28.6% |
| Commissions from own activities | 96.1 | 113.9 | 17.7 | 18.4% |
| from credit exposures* | 50.0 | 69.3 | 19.3 | 38.7% |
| from guarantees and surety bonds | 28.6 | 28.7 | 0.1 | 0.4% |
| operating commissions | 17.5 | 15.8 | -1.7 | -9.8% |
| Commissions from commissioned activities, including: | 50.2 | 74.4 | 24.1 | 48.0% |
| surety activities | 4.7 | 9.1 | 4.4 | 95.3% |
| export support with KUKE insurance | 6.6 | 7.3 | 0.7 | 10.4% |
| National Road Fund | 4.2 | 6.4 | 2.2 | 53.0% |
| agency services | 5.8 | 4.9 | -0.9 | -15.4% |
| from EU programmes (new perspective) | 0.0 | 15.5 | 15.5 | - |
| Commission expenses | 10.9 | 11.3 | 0.4 | 3.6% |
| Net commission income | 135.5 | 176.9 | 41.4 | 30.6% |

* including income subject to amortization to interest expense

As compared to the financial statements, the value of commission income presented for management reporting purposes is higher by PLN 20.1 mn in 2017 and by PLN 15.4 mn in 2016. This is attributable to the fact that commission income includes commissions deferred using the effective interest method.

Net income on financial instruments measured at fair value through profit or loss and on financial investment assets

As at the end of 2017, income on dividends amounted to PLN 2.3 mn and was PLN 1.1 mn lower compared to the value from the previous year.

A lower income on instruments income was the result of a higher reference base in 2016, which was mainly attributable to the accounting for the acquisition of Visa Europe Ltd. by Visa Inc. in June 2016 (PLN 6.4 mn).

Foreign exchange gains amounted to PLN 25.5 mn at the end of 2017. They were PLN 19.9 mn lower than gains achieved in 2016.

TABLE 26: Net income on instruments and financial investment assets (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|--|-------------|-------------|--------------------|---------------|
| | 2016 | 2017 | in nominal terms | % |
| Net income on instruments and financial investment assets | 79.5 | 49.1 | -30.5 | -38.3% |
| Dividends | 3.3 | 2.3 | -1.1 | -31.5% |
| Foreign exchange gains or losses | 45.3 | 25.5 | -19.8 | -43.8% |
| Gain/loss on instruments | 30.8 | 21.3 | -9.6 | -31.0% |

Other operating income and expenses

As at the end of 2017, net other operating income and expenses amounted to PLN -2.2 mn. They were PLN 24.7 mn lower compared to 2016. The key reason for the said difference was lower changes in the balances of provisions for disputes and receivables from sundry debtors.

TABLE 27: Other operating income and expenses (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|--|-------------|-------------|--------------------|----------------|
| | 2016 | 2017 | in nominal terms | % |
| Other operating income/expenses, including: | 22.5 | -2.2 | -24.7 | -109.6% |
| gain/loss on the sale of investment real estate | 0.0 | 1.6 | 1.6 | - |
| balance of provisions for disputes receivables from sundry debtors | 17.7 | 2.2 | -15.5 | -87.4% |
| reimbursement of debt collection costs | 0.2 | 1.3 | 1.2 | 759.5% |
| debt collection costs incurred | -0.5 | -1.6 | -1.2 | 256.9% |
| donations | -2.0 | -8.2 | -6.1 | 302.7% |
| other | 7.1 | 2.5 | -4.6 | -65.0% |

Operating expenses, depreciation and amortization

Operating expenses, depreciation and amortization totalled PLN 320.9 mn as at the end of 2017, which means an increase of PLN 9.4 million (3.0%) in relation to the previous year.

The key reason for the higher level of general expenses was change in personnel expenses and material costs compensated by the decrease in the cost of payments to the Bank Guarantee Fund, Polish Financial Supervision Authority and amortization/depreciation.

The increase in remunerations was the result of changes in settlements for managing the new EU programme framework 2014-2020. These expenses are no longer reimbursed, similarly to expenses under the old framework in 2016, but are returned in the form of commissions. Expenses under the new framework in 2017 totalled PLN 15.5 mn. In addition, in relation to the higher number of FTEs at BGK in 2017, total payroll expenses have increased.

The biggest decrease in expenses was observed in payments to the Bank Guarantee Fund, the Polish Financial Supervision Authority and the Financial Ombudsman. This is attributable to changes in the legal environment. The depreciation and amortization expenses decreased by PLN 7.1 mn. This was due to the fact that BGK had introduced the accounting depreciation and amortization model, as a result of which the useful lives of its assets were shortened as compared to those used for purposes of tax depreciation and amortization.

Year 2017 was also the first year of significant changes to organizational culture, intensified activities to promote BGK, and the constantly expanding portfolio of development and improvement projects. All this will serve to improve the implementation of the mission of BGK.

TABLE 28: Operating expenses, depreciation and amortization (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|--|--------------|--------------|--------------------|-------------|
| | 2016 | 2017 | in nominal terms | % |
| Operating expenses, depreciation and amortization* | 311.5 | 320.9 | 9.4 | 3.0% |
| Personnel expenses | 186.1 | 216.4 | 30.3 | 16.3% |
| Material costs | 65.0 | 76.8 | 11.8 | 18.2% |
| Payments to BGF, PFSA and the Financial Ombudsman including: Contributions and payments to the Bank Guarantee Fund | 30.6 | 5.0 | -25.6 | -83.7% |
| Depreciation and amortization | 29.8 | 22.7 | -7.1 | -23.8% |

*including: costs of EU programmes (new perspective) in the year 2017 - PLN 15.5 mn

Personnel expenses differ from the cost of payroll, insurance contributions and other benefits as presented in the Financial Statements of BGK, as they include expenses related to training, additional medical care, employees' recreational and sports activities, OHS and mileage allowances, which were recognised in non-personnel expenses for management reporting purposes. The depreciation and amortization expense differs by the shared depreciation and amortization expense which constitutes an item of the reallocated fund costs reported herein within non-personnel expenses.

Net impairment losses and provisions

As at the end of 2017, net impairment losses and provisions amounted to PLN 49.6 mn and changed by PLN 193.1 mn YOY.

TABLE 29: Net impairment losses and provisions (in PLN mn)

| Item | Performance | | Change versus 2016 | |
|--|---------------|--------------|--------------------|------------|
| | 2016 | 2017 | in nominal terms | % |
| Net impairment losses and provisions | -242.7 | -49.6 | 193.1 | 80% |
| provisions for credit exposures | -197.5 | -5.0 | 192.4 | 97% |
| provisions for off balance sheet liabilities | -34.3 | -36.7 | -2.5 | -7.2% |
| impairment losses* | -11.0 | -7.9 | 3.1 | 28.3% |

* revaluation of shares

The balance of impairment losses and provisions as at the end of 2017 was PLN 193.1 mn lower than the balance as at the end of 2016 due to several factors. One of them was the transition of the Bank to International Accounting Standards as of 1 January 2017, which meant a transition to the method of measuring impairment losses based on such risk parameters as PD and LGD as well as on an individual assessment in the case of individually relevant credit exposures. Other important elements are the higher total value of the loan portfolio and improved economic situation in Poland, which translated into a better financial condition of customers of BGK. That improvement was especially visible in the mining sector. This resulted in the general improvement of loan portfolio quality and was reflected in a low increase in the balance of impairment losses on credit exposures. The increase of PLN 5.0 mn in the balance of impairment losses on credit exposures was attributable primarily to the aforementioned increase in total exposure, in particular in the enterprise segment.

A derivative of active operation of BGK in the area of supporting Polish economy is the provision of guarantees for loan portfolios of other financial institutions. In consequence of providing guarantees totalling approx. PLN 4.5 bn for the loan portfolio of one of the Polish banks, the increase in the balance of impairment losses on off-balance sheet liabilities amounted to PLN 36.7 mn as at the end of 2017.

Income tax

Income tax for the year 2017 totalled PLN 88.4 mn, down by PLN 72.8 mn YOY. The effective tax rate was 14.6% versus 4.9% as at the end of 2016, which was attributable to a higher share of net income on taxable operations in the Bank's gross profit. For that reason, the increase in net income (71.2%) was lower than the increase in gross income (90.7%).

6.4 STATEMENT OF FINANCIAL POSITION OF BANK GOSPODARSTWA KRAJOWEGO

In 2017, the balance sheet total reported by the Bank was PLN 74,334.2 mn. It went up by PLN 7,472.3 mn, i.e. 11.2%, year-on-year. The said increase was mainly attributable to:

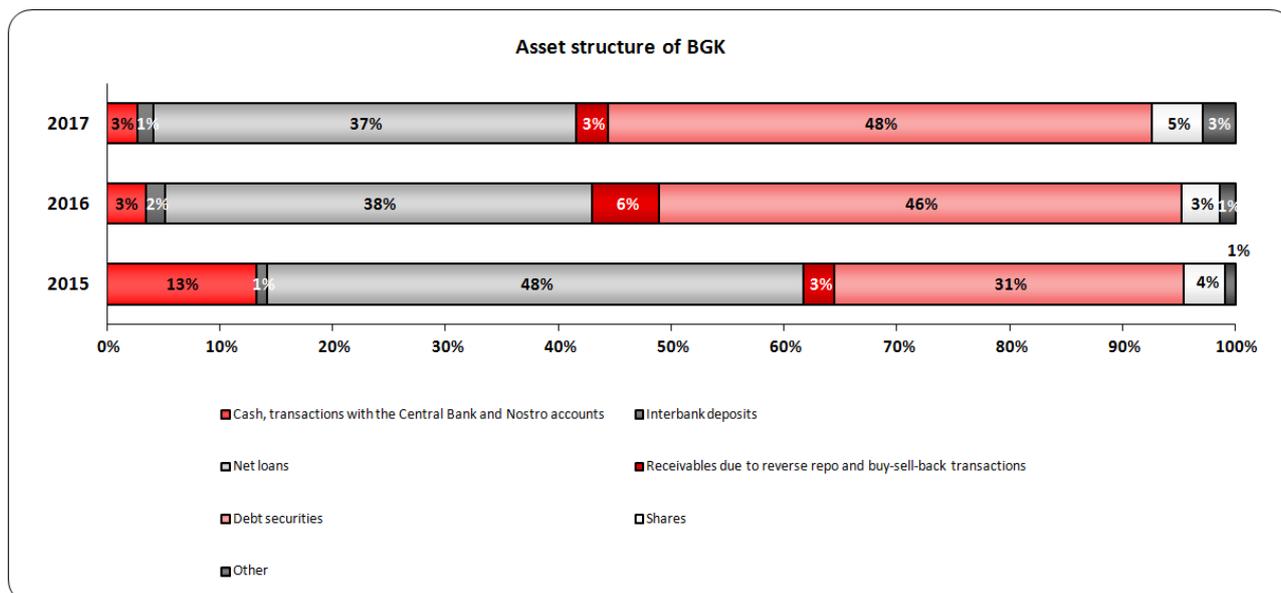
- a capital injection of PLN 6.3 bn received by BGK for the purposes of implementing new tasks in strategic industries,
- increases related to the development of lending and investment activities,
- liquidity position management in relation to fluctuations in central government deposits with BGK at the end of the year.

The increase in the capital base had the greatest impact on the increase of the balance sheet total. The said item went up by PLN 7,240.3 mn, i.e. 56.5%, compared to the year 2016, including the recorded increase of the revaluation reserve by PLN 432.3 mn.

Balance sheet credit exposures (loans, municipal and commercial bonds) increased by PLN 848.8 mn versus the end of 2016. The loan portfolio grew by PLN 2,368.1 mn. That growth was mainly attributable to the development of enterprise

financing. At the same time, the exposure of BGK to municipal and commercial bonds on the market in financial instruments was reduced by PLN 1,519.3 mn.

Figure 10



Cash in nostro accounts (except cash deposited with the National Bank of Poland)

At the end of 2017, the balance of nostro accounts totalled PLN 1,222.1 mn, i.e. went down by PLN 440.7 mn versus the end of 2016.

Interbank deposits, Treasury securities and NBP money bills

As at the end of 2017, the portfolio of Treasury debt securities measured at cost totalled PLN 9,311.3 mn, i.e. went up by PLN 754.8 mn compared to its value as at the end of 2016. NBP money bills amounted to PLN 21,526.5 mn, i.e. went up by PLN 5,723.4 mn as compared to the previous year. The balance of interbank deposits as at the end of 2017 was PLN 1,022.1 mn, which means an increase of PLN 80.9 mn year-on-year. Changes in the balances of these items were the effect of an increase in the value of liabilities of BGK.

Loan portfolio and commercial debt securities portfolio

Loan balance in nominal terms as at the end of 2017 was PLN 29,720.4 mn, i.e. went up by PLN 2,368.1 mn in relation to the balance as at the end of 2016. The highest increase in nominal terms, i.e. by PLN 852.5 mn, was observed in corporate and financial sector loans. The total gross credit exposure of BGK included also bonds issued by local government entities as well as commercial bonds issued under project finance programmes. The total credit exposure in 2017 was PLN 33,194.1 mn, i.e. it went up by 2.6% as compared to the portfolio from the previous year.

Reverse repo and buy-sell-back transactions

Receivables due to reverse repo and buy-sell-back transactions totalled PLN 2,105.5 mn as at the end of 2017 and were PLN 1,841.3 mn lower than at the end of 2016. The balance of those receivables is related to liquidity operations.

Shares and investment certificates

The value of the share portfolio measured at carrying amount grew in 2017 by PLN 1,105.7 mn year-on-year.

In 2017, the share held by BGK in its subsidiary, BGK Nieruchomości S.A., has increased in connection with raising its equity by PLN 7.5 mn.

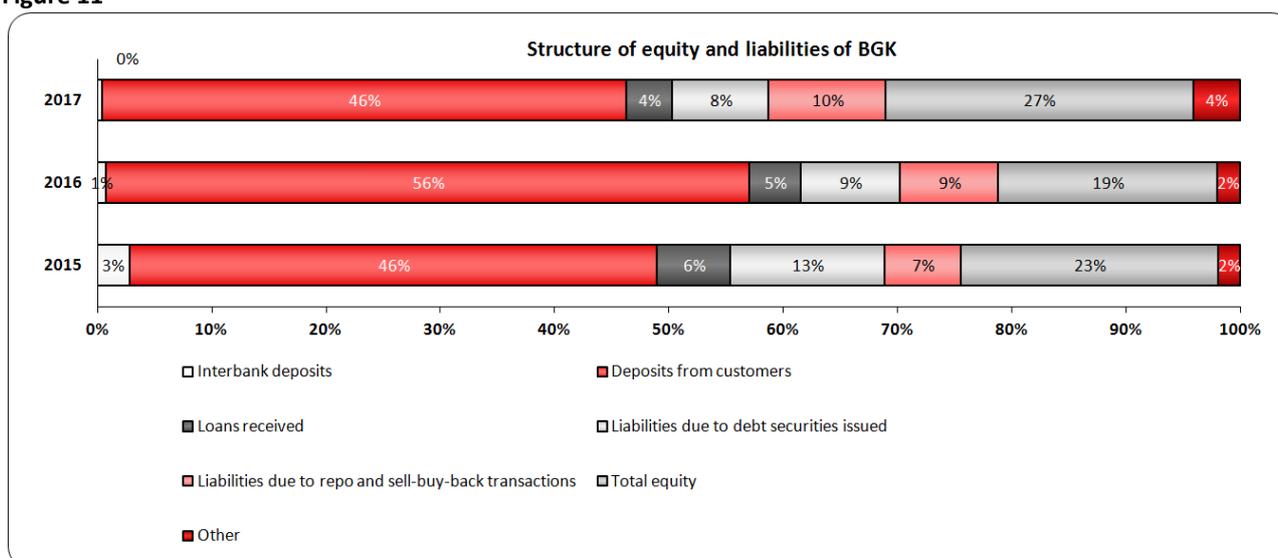
In September 2017, BGK sold 100% of shares in TFI BGK S.A. valued at PLN 21.0 mn to Polski Fundusz Rozwoju S.A. (Polish Development Fund) for PLN 21.7 mn.

BGK Nieruchomości S.A. manages the assets of the Rental Housing Fund Closed-End Private Equity Investment Fund. The value of the Fund's assets as at the end of 2017 amounted to PLN 971.6 mn and grew by PLN 259.2 mn year-on-year.

In 2017, BGK held investment certificates with a total value of PLN 988.6 mn in its portfolio, issued by funds established by Towarzystwo Funduszy Inwestycyjnych BGK S.A. The value of contributions made by BGK to each fund in 2017 is as follows:

- PLN 183.8 mn - Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprises Investments Closed-End Private Equity Investment Fund),
- PLN 118.7 mn - Fundusz Inwestycji Infrastrukturalnych Dłużny FIZ AN (Infrastructure Investment Debt Fund Closed-End Private Equity Investment Fund),
- PLN 41.7 mn - Fundusz Sektora Mieszkań dla Rozwoju FIZ AN (Housing for Growth Fund CEPEIF) (formerly: Fundusz Muncypalny FIZ AN (Municipal Fund CEPEIF))
- PLN 31.4 mn - Fundusz Ekspansji Zagranicznej FIZ AN (Foreign Expansion Fund Closed-End Private Equity Investment Fund),
- PLN 20.6 mn - Fundusz Inwestycji Infrastrukturalnych – Kapitałowy FIZ AN (Infrastructure Investment Equity Fund Closed-End Private Equity Investment Fund),
- PLN 7.5 mn - Fundusz Inwestycji Samorządowych FIZ AN (Local Government Investments Closed-End Private Equity Investment Fund),

Figure 11



Within a horizon of three years, it is possible to observe a secure and high level of equity enabling the Bank to increase its lending and investing activities. Changes in the structure of equity and liabilities of BGK have been presented on the figure above.

Deposit base

In 2017, the Bank's deposit base decreased by PLN 3,524.8 mn (9.4%) year on year, which was mainly attributable to a lower value of funds acquired from central government deposits, the balance of which went down by PLN 4,249.0 mn (21.8%). They still accounted for the major part of the deposit portfolio of the Bank and amounted to PLN 15,236.1 mn as at the end of 2017. Their share in total deposits was 45.0% versus 51.8% a year before.

Repo and sell-buy-back transactions

Liabilities due to repo and sell-buy-back transactions totalled PLN 7,573.8 mn as at the end of 2017 and were PLN 1,821.6 mn higher than at the end of 2016. A higher balance of those liabilities as at the end of 2016 was driven by

a change in the structure of the Bank's equity and liabilities as a result of liquidity management and customer transactions.

Loans received

As at the end of 2017, the balance of loans received from international financial institutions was PLN 2,987.9 mn, i.e. went down by PLN 41.1 mn (1.4%) year-on-year.

In 2017, BGK signed the "Poland Social Housing FL – B" agreement with the European Investment Bank. The value of the agreement amounts to PLN 400.0 mn, however funds can be disbursed in both PLN and EUR. The loan interest rate is floating, based on WIBOR/EURIBOR 3M, 6M or 12M + spread determined individually for each tranche. The last loan tranche must be repaid by 01.12.2049. That loan was not disbursed in 2017.

Long term liabilities due to issue of debt securities

With a view to securing stable sources of funding for its operations, BGK continued its bond issue programme. In 2017, three issues of 3-year and 4-year bonds for the total amount of PLN 2,859 mn took place. The said bonds are based on a floating interest rate determined by reference to WIBOR 6M plus a mark-up. The mark-up rates obtained were the lowest compared to corresponding treasury securities. In 2017, the Bank also redeemed bonds worth PLN 2,370 mn. All series of bonds issued by BGK in 2017 have been admitted to trading on the CATALYST market in the first quarter of 2018.

TABLE 30: Bonds issued by the Bank as at 31 December 2017 (in PLN mn)

| Own bonds | Issued on | Maturing on | Amount in PLN mn | Interest rate |
|----------------|--------------|----------------|---------------------|---------------|
| BGK1019 | 05/10/2016 | 05/10/2019 | 500 | WIBOR6M+39bps |
| BGK0219 | 19/02/2015 | 19/02/2019 | 1,392 | WIBOR6M+30bps |
| BGK0118 | 20/11/2012 | 25/01/2018 | 1,000 | WIBOR6M+44bps |
| BGK0220 | 27/02/2017 | 27/02/2020 | 1,159 | WIBOR6M+40bps |
| BGK0520 | 19/05/2017 | 19/05/2020 | 1,200 | WIBOR6M+43bps |
| BGK1021 | 03/10/2017 | 03/10/2021 | 500 | WIBOR6M+42pbs |
| BGK0919 | 30/09/2014 | 30/09/2019 | 500 | 2,8% |

Total equity

Bank Gospodarstwa Krajowego is the only state-owned bank in Poland with the State Treasury as the sole owner. As at the end of 2017, its total equity (including current and prior year profit) was PLN 20.0 bn. It went up by PLN 7.2 mn (56.5%) year-on-year. The main growth factor was the injection of equity received by BGK through Treasury bonds with a nominal value of PLN 5.0 bn (carrying amount of PLN 4.8 bn) and funds totalling PLN 1.5 bn provided by the State Treasury. The revaluation reserve has also grown considerably, mainly shares of PKO BP S.A.

TABLE 31: Value and composition of the Bank's equity (in PLN mn)

| Item | 2016 | | 2017 | | Change versus 2016 | |
|------------------------------|-----------------|---------------|-----------------|---------------|--------------------|--------------|
| | Performance | Composition | Performance | Composition | in nominal terms | % |
| Total equity | 12,807.4 | 100.0% | 20,047.7 | 100.0% | 7,240.3 | 56.5% |
| Share capital | 11,339.1 | 88.5% | 17,950.6 | 89.5% | 6,611.5 | 58.3% |
| Supplementary capital | 643.5 | 5.0% | 671.4 | 3.3% | 27.9 | 4.3% |
| Reserve capital | 76.8 | 0.6% | 76.8 | 0.4% | 0.0 | 0.0% |
| General banking risk reserve | 155.5 | 1.2% | 155.5 | 0.8% | 0.0 | 0.0% |
| Revaluation reserve | -76.7 | - | 355.6 | 1.8% | 432.3 | - |
| Prior year profit (loss) | 366.7 | 2.9% | 320.0 | 1.6% | -46.7 | -12.7% |
| Net profit | 302.4 | 2.4% | 517.8 | 2.6% | 215.4 | 71.2% |

Summary of the performance and financial position of BGK

The year 2017 was a period of the Bank's intense lending activity. The total credit exposure, including commitments (gross loans, commercial and municipal bonds, off-balance sheet loan liabilities) went up by PLN 2,259.9 mn year-on-year. This was attributable to increased sales in lending to business entities.

As at the end of 2017, the Bank's financial position was very good. Its capital adequacy and liquidity ratios were at safe, high levels.

Rating of BGK

On 11 December 2017, the Fitch ratings agency upheld the national long-term rating of BGK at the "AAA(pol)" level with a stable outlook, and the international long-term rating at the "A-" level, also with a stable outlook. The said agency also confirmed the short-term foreign currency rating at the F2 level, long-term national currency rating at the A level (stable outlook), the support rating at 1 and the minimum support rating at the "A-" level. The national short-term rating was confirmed at the level of "F1+(pol)".

7. ORGANIZATIONAL STRUCTURE OF THE BANK

At the end of 2017, the Bank carried out its operations through the Head Office and the network of 16 branches located nationwide. The Bank has no branches or subsidiaries outside of Poland. Export and foreign expansion strategies in the European Union and outside are carried out by the Head Office.

8. CORPORATE SOCIAL RESPONSIBILITY OF BGK

The Bank develops its corporate social responsibility, including by paying special attention to social responsibility initiatives and taking action to improve the living conditions of the local community. The most important initiatives to support the social development of the country undertaken by the Bank in 2017 include:

- sharing knowledge and experience,
- promoting equal opportunities;
- building social capital;
- promoting volunteer projects.

BGK employees sharing their knowledge, experience and skills

As the only development bank in Poland, BGK has access to unique know-how and experience gained in the course of its operations. In 2017, bank representatives were speakers at over 100 events, conferences and seminars addressed to private enterprises, local governments and individuals planning to start a business. These events were attended by a total of over 250 thousand participants.

Social responsibility initiatives of BGK

The Bank operates social responsibility programmes through the J.K. Steczkowski Foundation. The Foundation's mission is to mobilize and support citizens at various stages of their life. Strategic operations of the Foundation in the years 2017-2019 focus on promoting equal educational opportunities, supporting individuals aged 50+, reinforcing national identity and the sense of community among young citizens. In 2017, the Foundation implemented six of its own programmes, four partnership programmes and two volunteer campaigns. The total number of project recipients exceeded 20 thousand.

Social initiatives implemented with bank employee participation

BGK enables its employees to take part in volunteer programmes. The Foundation encourages them the use of their professional skills, organizes charity events and awards grants for projects proposed by bank staff. In the 9th edition of the "Voluntary service is great!" programme, 33 projects involving the participation of 279 volunteers from the BGK Group received funding. The main beneficiaries of aid were children and youth, including children with special educational needs as well as wards in children's home and special purpose school and educational centres. Approximately 5,700 beneficiaries received aid.

In 2017, the BGK Foundation in partnership with the employees of Bank Gospodarstwa Krajowego organized 2 additional volunteer campaigns.

During the first campaign (titled "Time for School") bank employees collected school supplies for the wards of the Friends of Primary School Association "Child's Laughter" in Wielka Wieś near Kraków. Volunteer have donated over 2400 school supplies.

The second initiative was the "Small Package, Big Gesture" campaign organized at the end of October 2017. The campaign collected food and hygiene products for the wards of the St. Christopher Oncological Hospice in Warsaw. Employees donated over 1,100 products for the Hospice.

Volunteers from the BGK Group also participated in a joint project of the Polish banking sector – Bankers for Financial Education of the Young – BAKCYL, organized by the Warsaw Institute of Banking. In 2017, they conducted over 40 hours of classes for young people.

Promoting equal educational opportunities

One of the projects that has been implemented by the BGK Foundation for the past 10 years is the “Na dobry początek!” (A Good Start) grant competition. The objective of the competition is to support educational programmes addressed to children aged 2-8 residing in rural area or small towns with a population of less than 20 thousand. 4,600 children participated in the 9th edition of the competition. The coordinators of the aforesaid competition organized workshops for children, parents and grandparents. Grants were received by social organizations, sports, cultural and recreational centres, public libraries, community centres.

In 2017, the Foundation also financed the pilot programme “Małe miasto” (Small Town) addressed to families with a low socio-economic status. The objective of the project was to present children and their caregivers how small towns function. Workshops consisted in familiarizing their participants with such topics as: effective planning of expenses, earning and saving money, and how the economy functions. 123 children and 40 volunteers, local and municipal government authorities, public service officers and entrepreneurs providing support for the project participated in the “Small Town” programme.

The Foundation also launched a new programme titled “Były sobie pieniądze” (Once There Was Money) for children aged 3-9. The project aims to raise the financial knowledge of children and introducing them to the basics of finance in a way that enables them to better function in the modern society. 385 pupils and 20 teachers participated in the programme.

Promoting the sense of citizenship and patriotism

In 2017, the Foundation initiated a call for applications for the programme titled “Moja Mała Ojczyzna” (My Little Homeland). Access to the project was given to all active individuals who care about their cities/towns and have an idea how to change them. “My Little Homeland” mobilizes local communities to take actions that will integrate them, improve their quality of life, promote local patriotism, commemorate local heroes and events as well as support sports recreation and education. 509 entities have submitted their applications under the project, of which 25 received grants. Projects were implemented from March to August 2018.

The year 2018 was the 100th anniversary since Poland regained its independence. For that reason, in October 2017 the Foundation launched a pilot grant programme titled “Na 100 Niepodległa”. The competition is aimed to promote national identity, gaining more extensive knowledge about Polish history, and knowledge about historical events among young people. The programme will be implemented in the form of classes, workshops, one-time or regular events promoting patriotism. The target group are children aged 7-18. An additional advantage of the programme was building bonds between generations through the cooperation of children and young people with parents and seniors. The results will be announced in 2018.

The BGK Foundation continued its cooperation with the Centre for Citizenship Education – initiated in 2010 – under the educational programme “Młody Obywatel” (Young Citizen). The programme was addressed to adults working with young people: teachers, librarians, cultural workers, so as to engage young people in actions to the benefit of local communities through them. Participation in the programme allows pupils to learn about their community, teaches them teamwork, communication and cooperation. The “Young Citizen” programme is implemented under the honorary patronage of the Minister of National Education and the Government Plenipotentiary for Civil Society. 209 projects group from all over Poland participated in the 9th edition of the programme.

The BGK Foundation was a strategic partners of two competitions: Competition for the Best Social Enterprise of the Year and Recent History. The BGK Foundation supported the Competition for the Best Social Enterprise of the Year, organized by the Foundation for Social and Economic Initiatives, by funding the prize in “An Idea for Development” category. The award was received by Spółdzielnia Socjalna Margines (The Margin Social Cooperative) in Warsaw, which employs political and economic migrants and uses innovative work management and organization methods.

The Recent History competition was organized by the KARTA Centre Foundation. The topic of the 20th edition of the competition was “Fighting, working, surviving... People and actions for Independent Poland 1918-2018”, i.e. examining recent history which often is unknown to, forgotten by and beyond the awareness of local communities. By announcing

the competition in the period of preparations for the celebration of the 100th anniversary of Poland regaining its independence, competition organizers wanted to encourage young people to present different aspects of the fight for own country, care for its shape and sustainability, and work for its benefit.

9. HR POLICY PURSUED BY BGK

Headcount

Within the entire capital group, employment totalled 1,531 FTEs as at the end of 2017 and was higher by 127 FTEs year-on-year.

As at 31 December 2017, employment at BGK amounted to 1,444 FTEs. Compared to the end of 2016, the number of FTEs increased by 109 (i.e. by 8.2%). Growth in FTEs was observed mainly in the European Funds Division, IT Division, Finance and Markets Division, HR and Communication Division and the Product Management Division.

Remuneration system

The Bank pursues a remuneration policy compliant with the strategy and values of BGK and aiming to mitigate risks. The remuneration policy meets legal requirements, compliance principles as well as external guidelines and regulations which BGK is obligated to follow.

The primary internal regulation in the area of the remuneration policy applicable to BGK employees is the "Remuneration Regulations for Bank Gospodarstwa Krajowego Employees", which sets out the terms and conditions that govern the employee remuneration system and the granting of other work-related benefits.

BGK has adopted a remuneration system that includes base remuneration and variable remuneration components, including bonuses and performance bonuses. It is a comprehensive system of key employee remuneration tools and regulations. Additionally, BGK offers other non-cash benefits.

As a rule, the Bank maintains remunerations at a level that is comparable to remunerations in the private sector and does not constitute an incentive to take excessive risks in BGK operations.

The Bank keeps a list of persons whose professional activity has a significant impact on the risk profile of BGK. The principles that govern the award and payment of variable remuneration to those employees are regulated in the "Policy governing variable remuneration components of employees identified to have a significant impact on the risk profile of Bank Gospodarstwa Krajowego".

At the same time, the principles that govern the remuneration of persons acting in the capacity of Members of the Management Board are based on the Act of 9 June 2016 on Remuneration of the Management of Certain Entities. Fixed and variable remuneration components of those employees are determined pursuant to Article 11a of the Act of 14 March 2003 on Bank Gospodarstwa Krajowego.

Staff development

In 2017, staff development policy in the Bank was carried out in the form of large development projects, closed (external and internal) training courses, open training courses, language classes and studies. Most training and development initiatives, including all development projects, were organized as closed training courses that allowed to tailor the training programme to the Bank's needs, train a higher number of people and use funds in a more efficient way. The Bank organized professional training courses to expand knowledge in areas related to a given job and develop skills aligned with the general development strategy of the Bank. A number of training courses, in particular those for the Risk and Business Division employees, were financed from EIB grants.

In 2017, in cooperation with managers, we have built a model of managerial competencies (strategic thinking, motivation and development, business awareness, change management, communication). Managers participated in a number of development measures, i.e. GRID programme, Aware Leadership, Maxwell's Academy, Manager's Handbook, and Manager's ABCs. In addition, we have carried out a 360-degree feedback process for Management Board members and Managing Directors. We have also examined the Bank's organizational culture.

Employees on expert positions participated in a number of general development training courses, i.e. negotiations in business, assertiveness, dealing with stress, public speaking, and the 7 habits of highly effective people.

An employee satisfaction survey was also conducted to analyze employee opinions and insights on the Bank's employer brand.

Diversity management policy

The Bank follows diversity management principles in its recruitment practices and ensures equal treatment of staff. In line with the Work Regulations of BGK, Bank employees are treated equally with respect to commencing and terminating employment, employment terms, promotion, access to training and development, irrespective of their sex, age, physical identity, race, religion, nationality, political beliefs, trade union membership, ethnic identity, religion, sexual orientation or employment contract (for a limited or unlimited term, full-time and part-time contract). Employees have the right to equal remuneration for the same job or its equivalent. The Bank is working on the other solutions devoted to the support of dignity and respect in the workplace.

The Bank's staff are diverse in terms of sex, age, experience and education both at the executive and less senior levels. Statistical data as at 31 December 2017 have been presented below.

TABLE 32: BGK staff structure by sex

| | Women | Men | Total |
|--------------|------------|------------|--------------|
| Executives | 113 | 125 | 238 |
| Other staff | 824 | 435 | 1,259 |
| TOTAL | 937 | 560 | 1,497 |

Figure 12

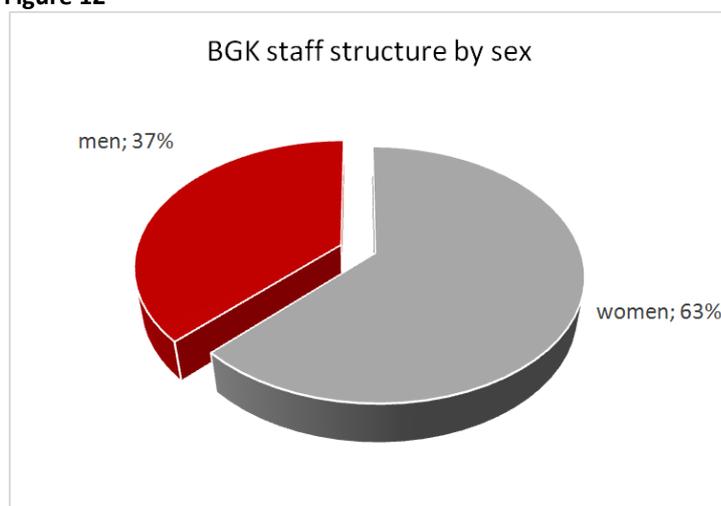


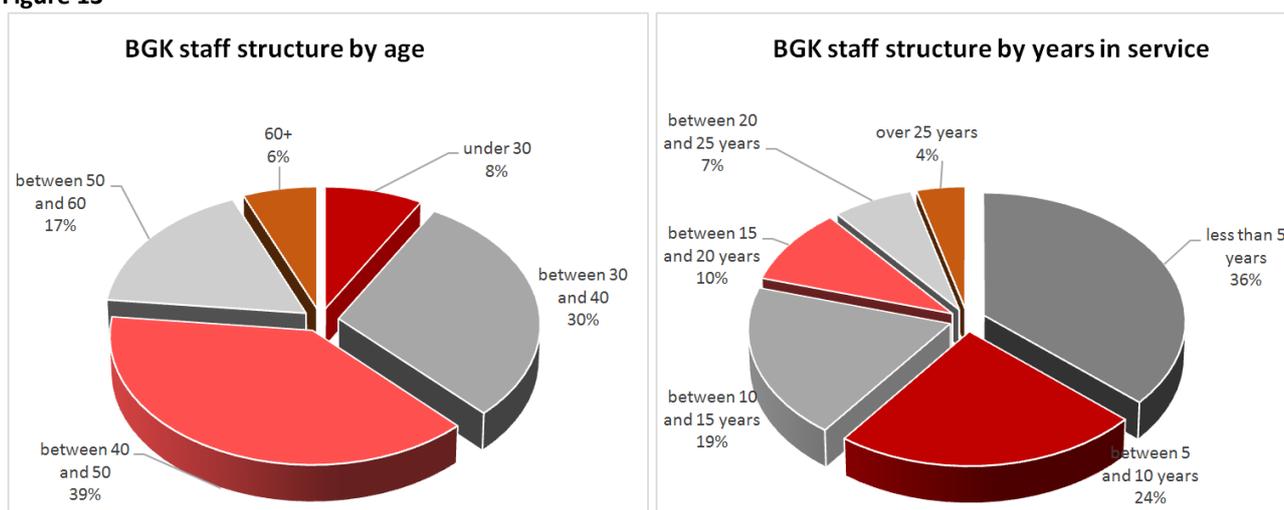
TABLE 33: BGK staff structure by age

| | under 30 | between 30 and 40 | between 40 and 50 | between 50 and 60 | 60+ |
|--------------|------------|-------------------|-------------------|-------------------|-----------|
| Executives | 2 | 45 | 127 | 50 | 14 |
| Other staff | 121 | 397 | 456 | 206 | 79 |
| TOTAL | 123 | 442 | 583 | 256 | 93 |

TABLE 34: BGK staff structure by years in service

| | less than 5 years | between 5 and 10 years | between 10 and 15 years | between 15 and 20 years | between 20 and 25 years | over 25 years |
|--------------|-------------------|------------------------|-------------------------|-------------------------|-------------------------|---------------|
| Executives | 83 | 52 | 58 | 16 | 15 | 14 |
| Other staff | 464 | 302 | 232 | 128 | 86 | 47 |
| TOTAL | 547 | 354 | 290 | 144 | 101 | 61 |

Figure 13



10. INFORMATION ON THE ENTITY AUTHORIZED TO AUDIT THE FINANCIAL STATEMENTS

Details of the audit agreement date and fees of the entity authorized to audit the financial statements have been presented in note 50 of the financial statements of Bank Gospodarstwa Krajowego for the year 2017.

11. DISCLOSURES REQUIRED UNDER BANKING LAW SUBJECT TO AUDIT BY CERTIFIED AUDITOR

Acting in accordance with Article 111.a of the Banking Law Act (Polish Journal of Laws of 2017, item 1876, as amended), BGK hereby states that:

- Bank Gospodarstwa Krajowego acts only on the territory of the Republic of Poland as the only state-owned Bank and does not have any foreign subsidiaries,
- BGK did not enter into the agreement referred to in Article 141t.1 of the Banking Law Act,
- in accordance with the financial statements for the 2017 financial year, the Bank's turnover, calculated as a sum of interest income, commission income, income on shares, other securities and other variable income financial instruments, gains on foreign exchange transactions, amounted to PLN 2,042.0 mn. The gross profit amounted to PLN 606.2 mn whereas the income tax totalled PLN 88.4 mn,
- as at the end of December 2017 employment at the Bank amounted to 1,444 FTEs,
- the Bank did not receive any financial support on the basis of the Act on Support from the State Treasury to the Financial Institutions dated 12 February 2009 (Polish Journal of Laws 2016, item 1436).

The aforementioned information were subject to the audit by the certified auditor.

12. STATEMENT OF NON-FINANCIAL INFORMATION

As an entity operating as a state bank, Bank Gospodarstwa Krajowego does not submit a statement of non-financial information as part of the financial statements, in accordance with Article 49b.1 of the Accounting Act (Dz.U.2016.1047, consolidated text, as amended).

13. STATEMENT OF COMPLIANCE WITH THE PRINCIPLES OF CORPORATE GOVERNANCE

13.1 GENERAL PRINCIPLES

Bank Gospodarstwa Krajowego complies with the “Principles of Corporate Governance for Supervised Institutions” of the Polish Financial Supervision Authority, which entered into force on 1 January 2015. They were incorporated into the “Principles of Corporate Governance at Bank Gospodarstwa Krajowego” as well as other internal regulations of the Bank. Additionally, the corporate governance framework of BGK is defined by other external legal acts:

- the Act on Bank Gospodarstwa Krajowego of 14 March 2003,
- the articles of association of Bank Gospodarstwa Krajowego, attached as an appendix to the Ordinance of the Minister of Development of 16 September 2016 on the adoption of the articles of association of Bank Gospodarstwa Krajowego,
- the Banking Law Act of 29 August 1997,
- the Ordinance of the Minister of Development and Finance of 6 March 2017 regarding the risk management system and internal control system, remuneration policy and detailed procedure for measuring internal capital in banks,
- resolution No. 141/2017 of the Polish Financial Supervision Authority of 25 April 2017 regarding the issue of Recommendation H concerning the internal control system in banks,
- resolution No. 385/2008 of the Polish Financial Supervision Authority of 17 December 2008 setting out detailed principles and the procedure for publication of qualitative and quantitative information concerning capital adequacy by banks and the scope of information to be published.

The Principles of the Polish Financial Supervision Authority and BGK were adopted having regard to the legal form of Bank Gospodarstwa Krajowego as a state bank whose sole owner is the State Treasury as well as its characteristics:

- the lack of a General Meeting of Shareholders and no candidates appointed from among minority interest;
- additional activity of members of the management and supervisory bodies, as set out in separate legislation;
- the lack of services consisting in asset management at the risk of the customer in the Bank’s offering.

The “Principles of Corporate Governance at Bank Gospodarstwa Krajowego” are adopted by the Management Board and require the approval of the Supervisory Board. They are published by the Bank on its website at: www.bgk.pl.

13.2 FUNCTIONS, SCOPE OF ACTIVITY AND ORGANIZATION OF BGK

The Act on Bank Gospodarstwa Krajowego sets out the functions, scope of activity and organization of BGK. The key priorities around which BGK is organized, as defined in the Act on Bank Gospodarstwa Krajowego and separate legislation, include supporting the economic policy of the Council of Ministers, socio-economic government programmes as well as local government and regional development programmes, specifically:

- projects financed by EU funds and international financial institutions, as defined by Article 4.1.3 of the Banking Law Act of 29 August 1997;
- infrastructure projects;
- projects related to the development of the small and medium-sized enterprise sector, including those financed with public funds.

The functions fulfilled by BGK include:

- functions specified in the Banking Law Act of 29 August 1997;
- administration of funds created, entrusted or transferred to BGK under separate legislation;

- export transaction handling with the use of export support instruments, in addition to supporting exports of Polish goods and services under separate legislation or government programmes;
- functions relating to credit institutions which were liquidated or regarded as liquidated under three acts (decrees) of 25 October 1948;
- offering, whether directly or indirectly, guarantee and/or surety bond services under government programmes or on behalf of and for the account of the State Treasury in accordance with the Act on Surety Bonds and Guarantees of the State Treasury and Certain Legal Persons of 8 May 1997, in particular to the small and medium-sized enterprise sector;
- issuing declarations which have the power of official documents and enable the deletion of entries made in Sections III and IV of Land and Mortgage Registers or document sets for:
 - credit institutions which were liquidated or regarded as liquidated under the aforesaid decrees;
 - the State Treasury in relation to:
 - purchases of land and property from the National Land Fund established by the agricultural reform decree of 6 September 1944;
 - credit facilities and loans granted between 1945 and 1990 for purposes of demolition, repair and completion of construction, superstructures, renovation and reconstruction of buildings, sale of development land and sale of single- and multi-family residential buildings by the state;
 - the State Treasury or entities whose successor is the State Treasury, made before 1 September 1939;
- supporting residential construction, in particular construction aimed to build apartments for rent, in accordance with separate legislation or under government programmes.

The Bank may also fulfil the function of an entity responsible for the implementation of a financial instrument or a fund of funds as referred to in Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006.

The articles of association of BGK are adopted, by way of an ordinance, by the Minister of Economy. In particular, the articles of association of BGK set out the internal organization and a detailed scope of the Bank's activities, detailed roles of the Supervisory Board and the Management Board as well as the Bank's own funds and its financial management principles.

The Act on Bank Gospodarstwa Krajowego and the articles of association of BGK ensure the division of duties between the Supervisory Board, which is a supervisory body, and the Management Board, which is a managing body of the Bank.

Unless otherwise provided for by the applicable laws, the activities of the Bank are governed by the Banking Law Act of 29 August 1997.

13.3 COMPOSITION AND REGULATIONS OF BGK'S GOVERNING BODIES AND COMMITTEES, REPRESENTATION AND POWERS VESTED IN THE PRESIDENT OF THE MANAGEMENT BOARD

The Management Board and the Supervisory Board are the Bank's governing bodies.

The representation method is defined by the Act on Bank Gospodarstwa Krajowego and the articles of association of BGK, whereby declarations concerning the financial rights and obligations of the Bank may be made by:

- two members of the Management Board acting jointly;
- attorneys-in-fact – within the scope of their powers of attorney, acting severally or jointly with another attorney-in-fact or a member of the Management Board.

Supervisory Board

The Supervisory Board exercises permanent supervision of the activities of BGK in all areas of its operations. The term of office of the Supervisory Board is four years. The 9th term of office of the Supervisory Board began on 1 September 2016.

In line with the Act on Bank Gospodarstwa Krajowego, the Supervisory Board is composed of 11 members, including the Chairman, appointed from among candidates having the necessary qualifications. Candidates for the Supervisory Board of BGK must be approved by the Council for Companies with State Treasury Shareholding and State Legal Persons operating at the Chancellery of the Prime Minister of Poland. In addition, the Supervisory Board is composed of members meeting the independence criterion referred to in the Act on Statutory Auditors, Audit Firms and Public Supervision of 11 May 2017. The Chairman of the Supervisory Board is appointed and removed by the President of the Council of Ministers at the request of the Minister of Economy. The remaining members of the Supervisory Board are appointed and removed by the President of the Council of Ministers at the request of the competent ministers. A member of the Supervisory Board may not be a member of the Management Board.

Information concerning the current composition of the Supervisory Board is available at www.bgk.pl.

Meetings of the Supervisory Board are held when needed but no less frequently than every quarter. Resolutions of the Supervisory Board are adopted by absolute majority of votes in the presence of at least a half of its members, including the Chairman or a member of the Supervisory Board acting as a Deputy Chairman on a permanent basis. Resolutions of the Supervisory Board are provided to the Management Board for implementation or for information purposes.

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

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

Composition of the Bank's Supervisory Board as well as information concerning the term of office and remuneration of the Supervisory Board members in 2017 have been presented below.

TABLE 35: Supervisory Board of BGK in 2017

| Full name | Term in office in the Supervisory Board | Position in the Supervisory Board | remuneration* in PLN |
|----------------------------|---|-----------------------------------|----------------------|
| Paweł Borys | 01.01.2017 – 31.12.2017 | Chairman | 87,195 |
| Witold Słowik | 01.01.2017 – 31.12.2017 | Deputy Chairman | |
| Artur Adamski | 01.01.2017 – 31.12.2017 | Member | 86,218 |
| Joanna Bęza-Bojanowska | 01.01.2017 – 24.07.2017 | Member | 49,134 |
| Beata Gorajek | 26.07.2017 – 31.12.2017 | Member | 34,287 |
| Michał Łukasz Kamiński | 01.01.2017 – 03.01.2017 | Secretary | 1,682 |
| Wojciech Kowalczyk | 01.01.2017 – 13.02.2017 | Member | |
| Jadwiga Lesisz | 01.01.2017 – 15.01.2017 | Member | 3,531 |
| Jakub Modrzejewski | 03.07.2017 – 24.09.2017 | Member | 40,389 |
| | 25.09.2017 – 31.12.2017 | Secretary | |
| Kamil Mrocza | 26.07.2017 – 31.12.2017 | Member | 34,287 |
| Jarosław Nowacki | 01.01.2017 – 31.12.2017 | Member | 85,418 |
| Jan Filip Staniłko | 01.01.2017 – 31.12.2017 | Member | 85,732 |
| Łukasz Robert Śmigasiewicz | 26.07.2017 – 31.12.2017 | Member | 35,356 |
| Jerzy Szmit | 01.01.2017 – 31.12.2017 | Member | |
| Robert Zima | 01.01.2017 – 24.07.2017 | Member | 46,900 |

* no remuneration is paid to Secretaries or Under-Secretaries of State

In 2017, the following members have resigned as members of the Supervisory Board:

- 1) Michał Łukasz Kamiński – effective 4 January 2017,
- 2) Jadwiga Lesisz – effective 16 January 2017,
- 3) Wojciech Kowalczyk – effective 13 February 2017.

President of the Council of Ministers Beata Szydło:

- 1) appointed the following members of the Supervisory Board:
 - a) Jakub Modrzejewski – effective 3 July 2017. On 25 September 2017, the Supervisory Board appointed Jakub Modrzejewski as Secretary of the Supervisory Board;
 - b) Beata Gorajek, Kamil Mroczek and Łukasz Śmigasiewicz – effective 26 July 2017.
- 2) dismissed Joanna Beza-Bojanowska and Robert Zima from the Supervisory Board – effective 25 July 2017.

Remuneration of Members of the Supervisory Board of BGK

Members of the Supervisory Board of Bank Gospodarstwa Krajowego are remunerated in accordance with Article 10.1.5 of the Act on Remuneration of the Management of Certain Entities (Polish Journal of Laws of 2016, item 1202) and the Declaration of the Minister of Development and Finance of 14 October 2016 on remuneration of Members of the Supervisory Board of Bank Gospodarstwa Krajowego.

Management Board

The basis and the scope of functions of the Management Board are set out in the Act on Bank Gospodarstwa Krajowego, the articles of association of BGK, the Banking Law Act and the Regulations of the Management Board of BGK approved by a resolution of the Supervisory Board. The Management Board has the power to decide on any matters related to the management of BGK, except those which have been assigned to the Supervisory Board and President of the Management Board. The term of office of the Management Board is five years.

In accordance with the Act on Bank Gospodarstwa Krajowego, the Management Board is composed of six members, including the President, First Vice-President and Vice-President. The President, First Vice-President and Vice-President as well as the remaining members of the Management Board are appointed and removed by the President of the Council of Ministers at the request of the competent ministers. In addition, the President of the Management Board and one member of the Management Board entrusted with the management of risk relevant to the operations pursued by BGK are appointed subject to approval by the Polish Financial Supervision Authority. The provisions of Articles 22a.2 and 22b of the Banking Law Act of 29 August 1997 apply accordingly.

The Management Board holds meetings in accordance with the schedule of Management Board meetings or as needed. The schedule of Management Board meetings is determined at the end of each year and specifies planned meeting dates. Resolutions of the Management Board are adopted at the meeting. The Management Board may adopt resolutions in writing or via remote means of communication. Resolutions adopted by the Management Board are adopted by a simple majority of votes in the presence of at least a half of its members. In the case of a tied vote, the President of the Management Board or, if absent, the First Vice-President has the deciding vote.

In 2017, there were no changes to the composition of the Management Board of BGK. The composition of the Management Board of BGK and the terms of office of its members have been presented below.

TABLE 36: Composition of the Supervisory Board of BGK in 2017

| Full name | Term in office in the Management Board | Position in the Management Board |
|--------------------------|--|--|
| Beata Daszyńska-Muzyczka | 01.01.2017 - 31.12.2017 | President of the Management Board |
| Paweł Nierada | 01.01.2017 - 31.12.2017 | First Vice-President of the Management Board |
| Włodzimierz Kocon | 01.01.2017 – 31.12.2017 | Vice-President of the Management Board |
| Przemysław Cieszyński | 01.01.2017 - 31.12.2017 | Member of the Management Board |
| Wojciech Hann | 01.01.2017 - 31.12.2017 | Member of the Management Board |
| Radosław Kwiecień | 01.01.2017 - 31.12.2017 | Member of the Management Board |

Information concerning the current composition of the Management Board is available at www.bgk.pl.

The President of the Management Board represents the Bank in external relations, chairs Management Board meetings, organizes the activities of the Bank and ensures that resolutions of the Management Board are enforced. All BGK employees report to the President of the Management Board. The powers vested in the First Vice-President, the Vice-President and members of the Management Board have been defined in the Act on Bank Gospodarstwa Krajowego.

Remuneration of Members of the Management Board of BGK

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 (Polish 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 Resolution No. 57/2016/IX of the Supervisory Board dated 3 November 2016, as amended, and the “Policy governing variable remuneration components of BGK managers”, adopted by way of Resolution No. 58/2016/IX of the Supervisory Board of BGK dated 3 November 2016.

Remuneration of Members of the Management Board has been presented below.

TABLE 37: Remuneration of Members of the Management Board of BGK in 2017 (in PLN)

| Full name | Position held in 2017 | Base pay | Supplementary pay |
|--------------------------|---|------------------|-------------------|
| Beata Daszyńska-Muzyczka | President of the Management Board | 763,714 | |
| Paweł Nierada | Vice-President – First Vice-President of the Management Board | 624,000 | 141,067 |
| Włodzimierz Kocon | Vice-President – First Vice-President of the Management Board | 624,000 | 141,067 |
| Przemysław Cieszyński | Vice-President of the Management Board | 624,000 | 141,067 |
| Wojciech Hann | Vice-President of the Management Board | 624,000 | 141,067 |
| Radosław Kwiecień | Vice-President of the Management Board | 599,238 | |
| Total | | 3,858,952 | 564,267 |

The Supervisory Board and the Management Board of Bank Gospodarstwa Krajowego have established committees which perform control or advisory and review functions. Committees set up by the Supervisory Board:

- Audit Committee;
- Risk Committee;
- Remuneration Committee.

Within its competence, the Management Board has set up two obligatory committees: the Bank's Finance Committee and the Bank's Credit Committee, in addition to five committees in charge of specific areas of the activities pursued by BGK, namely the Operational Risk Committee, Change Committee, Architecture Committee, Expenditure Authorization Committee, Data Quality Management Committee. These Committees are collegial bodies that carry out review and decision-making functions and whose composition and duties are set out by way of a resolution of the Management Board. The aforementioned Committees operate based on Regulations adopted by the Management Board.

Audit Committee

The Audit Committee was established in December 2007 by a Resolution of the Supervisory Board of the Bank. Its members are appointed from among members of the Supervisory Board. The Committee is composed of three to five members.

In particular, the Committee's duties are:

- to supervise the organization of the internal audit function and compliance function at the Bank,
- to monitor the financial reporting process, the management reporting process and audit procedures at BGK,
- to monitor the area of internal control and risk management systems at BGK.
- to develop an audit firm selection policy, policy governing the performance of any additional non-audit services by entities related to the audit firm and by a member of the audit firm's network, and the procedure to be followed by BGK when selecting an audit firm,
- to control and monitor the independence of the audit firm and certified auditor.

A detailed scope of duties of and procedures followed by the Audit Committee have been defined in the Regulations of the Audit Committee adopted by the Supervisory Board.

Risk Committee

The Risk Committee was established in December 2015 by a Resolution of the Supervisory Board of the Bank. Its members are appointed from among members of the Supervisory Board of the Bank. The Committee is composed of three to five members.

In particular, the Committee's duties are:

- to review overall current and future readiness of BGK to accept risk,
- to review the strategy for risk management at BGK developed by the Management Board,
- to review the information provided by the Management Board on the implementation of policies governing the management of specific risks,
- to support the Supervisory Board in supervising the implementation of the strategy for management of risks inherent in the operations BGK by the senior management of the Bank,
- to review reports on the prices of assets and liabilities on a periodic basis in the context of the Bank's multi-annual development plan and the risk management model.

Remuneration Committee

The Remuneration Committee has been established by a Resolution of the Supervisory Board of the Bank. Its members are appointed from among members of the Supervisory Board of the Bank. The Committee is composed of three to five members.

In particular, the Committee's duties are:

- to monitor and review the variable remuneration policy and its implementation, including the values and types of components comprising the remuneration of the Bank's management,

- to formulate recommendations for the Management Board as to the remuneration of persons whose professional activity has a significant impact on the Bank's risk profile,
- to review and monitor variable remuneration components of the Bank's management in charge of managing the internal audit function, risk management and compliance of the Bank's activities with generally applicable laws and internal regulations,
- to assess the achievement of management goals by the Management Board and present recommendations concerning the payment of variable remuneration components to the Supervisory Board.

Finance Committee

The primary objective of the Bank's Finance Committee is to formulate the current, medium- and long-term policy for the Bank's asset and liability management policy with a view to improving the Bank's performance and the efficiency of capital allocation, while considering an appropriate level of the exposure to banking risk and the nature of tasks fulfilled by the Bank with respect to the administration of funds created, entrusted or transferred to the Bank under separate legislation or other legal acts.

Credit Committee

The scope of competence of the Bank's Credit Committee covers activities exposed to credit risk that are pursued by BGK under its own activities or under activities commissioned to BGK, in particular those that concern making decisions regarding credit applications, applications for restructuring or debt enforcement operations and the acquisition of assets that fall within the committee's competence, as well as the performance of quarterly credit portfolio reviews and making decisions regarding the classification and level of specific reserves;

Operational Risk Committee

The Operational Risk Committee has been established with a view to ensure effective operational and compliance risk management. The Committee carries out review and decision-making functions.

Change Committee

The primary objective of the Committee is to manage the portfolio of projects (including projects, programmes and initiatives) within its competence, in particular to ensure that projects are implemented in accordance with the Strategy of the Bank.

Architecture Committee

The objective of the Architecture Committee established in 2017 is to ensure effective and efficient IT infrastructure management at BGK.

Expenditure Authorization Committee

The primary objective of the Expenditure Authorization Committee is to ensure the high cost efficiency of current activities and projects supporting the implementation of the Strategy of the Bank.

Data Quality Management Committee

The Data Quality Management Committee has been established in 2017 to support the data quality management process at BGK.

13.4 INTERNAL CONTROLS, RISK AND CAPITAL MANAGEMENT AND FINANCIAL REPORTING AT THE BANK

Internal audit system

BGK has an internal control system in place, the objective of which is to ensure effective and efficient operation, reliability of its financial reporting, compliance with risk management policies as well as conformity with the applicable laws, internal regulations and market standards. The internal control system also encompasses the functioning of subsidiaries and external enterprises, to whom the Bank has entrusted the performance of banking operations and activities related to banking operations.

The internal control system at BGK is organized around three independent levels (lines of defence):

- the first level (first line of defence) comprises the management of risk in operating activities,
- the second level (second line of defence) comprises:
 - risk management by employees at positions or in organizational units established specifically for that purpose, independent from risk management under the first line of defence,
 - Compliance Department operations,
- the third level (third line of defence) comprises operations carried out by the Internal Audit Department.

The internal control system is governed by the BGK Internal Control Regulations adopted by the Management Board and then approved by the Supervisory Board. The Regulations were drafted in accordance with the Banking Law Act, the Act on Bank Gospodarstwa Krajowego, the Ordinance of the Minister of Development and Finance of 6 March 2017 regarding the risk management system and internal control system, remuneration policy and detailed procedure for measuring internal capital in banks, Resolution No. 141/2017 of the Polish Financial Supervision Authority regarding the issue of Recommendation H concerning the internal control system in banks, and international standards and good practices. BGK Internal Control Regulations are supplemented by the Principles of organizing the control function at BGK.

The Regulations define the objectives, scope and the rules applicable to the organization and functioning of internal controls in the organizational units of the head office and branches of the Bank as well as rules for monitoring the risk inherent in the operations of subsidiaries.

BGK has an internal audit function that reports directly to the President of the Management Board, in accordance with the articles of association of the Bank. Its task is to investigate and evaluate, independently and objectively, the adequacy and effectiveness of the internal audit system and the risk management system. In compliance with external requirements and best practices, all the operations of BGK are subject to audit. Subsidiaries are also subject to audit. The internal audit function at BGK follows the IIA International Standards for the Professional Practice of Internal Auditing, which is confirmed by regular independent external reviews (last such review was carried out in 2017). In line with regulatory requirements, the Bank has mechanisms in place which guarantee independence of the internal audit function, including but not limited to supervision of the internal audit function by the Supervisory Board, approval of the appointment of the internal audit head by the Supervisory Board, approval of the function's plans and reports by the Supervisory Board as well as direct communication between the internal audit head and the Chairman of the Audit Committee.

The compliance function at BGK is carried out by the Compliance Department (CD). The objective of the Compliance Department is to monitor the process of ensuring the compliance of BGK with applicable laws, internal regulations and market standards. That monitoring is carried out in particular through:

- independent monitoring and reporting of the compliance of control mechanisms, especially through continuous vertical review and vertical testing in dedicated areas,
- implementation of the compliance risk management process (identification, assessment, control, monitoring and reporting).

Powers, obligations and the scope of duties of the Compliance Departments have been set out in the Compliance Policy of BGK, Organizational Regulations of the Compliance Department, and the Internal Control Regulations of BGK. The head of the Compliance Department, i.e. Compliance Officer, and CD employees have been granted appropriate powers.

Additionally, in line with regulatory requirements, BGK has mechanisms in place which guarantee independence of the compliance function, including but not limited to the subordination of the compliance function directly to the Chairman of the Management Board, supervision of the Compliance Department's operations by the Audit Committee, approval of changes on the position of Compliance Officer by the Supervisory Board, approval of the function's plans and reports by the Supervisory Board as well as direct communication between the Compliance Officer and the Chairman of the Audit Committee.

Risk and capital management

The Bank's risk is managed in line with internal regulations (such as policies, rules, instructions and procedures) concerning risk identification, measurement, control, reporting, mitigation and hedging, such as:

- Liquidity risk management policy of BGK, defining strategic framework and liquidity risk management policies,
- Market risk management policy of BGK, defining strategic framework and market risk management policies,
- Operational risk management policy of BGK, comprising guidelines on the organization of the management system underlying operational risk management principles,
- Credit risk management policy defining key credit risk management principles of Bank Gospodarstwa Krajowego,
- Capital management policy at BGK, defining key principles of capital (equity) management in the Bank, including the roles of bodies of BGK in that process.

In line with Articles 431-455 of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (OJ L 176, 27.6.2013, p. 1 as amended) the Bank publishes information on risk management and capital adequacy status on its website at www.bgk.pl, in its Report on Risk Management and Capital Adequacy of BGK (Pillar III).

The Bank follows a procedure defining the internal capital adequacy assessment process implemented by the Management Board and approved by the Supervisory Board. In line with this procedure, ICAAP review is carried out at least once a year. ICAAP review report is presented to the Finance Committee of the Bank, which accepts it and forwards to the Management Board for approval. Then, the Management Board submits the ICAAP review report to the Supervisory Board, requesting its approval. The key elements of the ICAAP process are reflected in the Bank's strategic and operational management processes. The organizational structure of BGK ensures that organizational units in charge of executing and settling transactions and those monitoring and controlling risks are independent. The functions are also separated at the Management Board level.

BGK monitors the risk of operations carried out by subsidiaries.

The Supervisory Board plays an important role in risk management processes at BGK, as it approves risk management policies.

Preparation of the financial statements of the Bank

The financial statements of Bank Gospodarstwa Krajowego were prepared in conformity with 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 (Polish Journal of Laws of 2017, item 2342, as amended) and implementing provisions issued on the basis of that Act. The final form of the financial statements of BGK, adopted by a resolution of the Management Board, is provided by the Management Board for approval to the Supervisory Board by 31 May of the year immediately following the financial year for which the financial statements were prepared. The annual financial statements of BGK are audited by an entity authorized to audit the financial statements of BGK. That entity is selected by the Supervisory Board.

14. MANAGING AND ASSESSING CREDIT, FINANCIAL, OPERATIONAL AND OTHER RISKS

14.1 ORGANIZATION OF THE RISK MANAGEMENT PROCESS

The risk management system in place at BGK is organized on three independent levels. The first level (first line of defence) comprises the management of risk in operating activities of BGK. The second level (second line of defence) comprises risk management by employees at positions or in organizational units established specifically for that purpose (independent from risk management under the first line of defence) and the compliance function. The third level (third line of defence) comprises operations carried out by the Internal Audit Department.

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

The risk management is based on:

- Strategy for Risk Management at BGK endorsed by the Supervisory Board of the Bank,
- Capital Management and Internal Capital Assessment Policy 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 the Policy governing variable remuneration components 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 system in place at the Bank includes the following tasks:

- **risk identification**, which comprises the determination of: risk types, their sources (risk factors), significance and relationships between individual types of risk,
- **risk measurement/assessment**, which comprises the determination and enforcement of risk quantification methods and stress test performance,
- **risk control**, which comprises the determination and enforcement of risk control mechanisms (including limit systems, ensuring independence between first-level risk management and second-level risk management, insurance, risk transfer, financing plans),
- **risk monitoring**, which comprises the monitoring of risk levels, review of relevance and accuracy of the applied risk assessment methods and the evaluation of efficiency of the tools used,
- **risk reporting**, which comprises information on the risk profile, identification of possible threats, and information on the measures adopted.

In 2017, BGK expanded its risk management system and carried out work aimed to ensure compliance with regulatory requirements, including to the ordinance of the Minister of Development and Finance on risk management. The Bank adopted the "Strategy for Risk Management at BGK", which covers all identified risks to which BGK is exposed as part of its activities. The Strategy also defined the general acceptable level of risk, whereas acceptable risk levels in relation to specific risks have been specified in risk management policies applicable to those risks.

The Strategy also defined the principles of risk culture. Through its actions and conduct, the Management Board of BGK promotes the awareness about the relevance of risk in the activities pursued by BGK, the principles of assuming risk and its management, i.e. the so-called risk culture. Next, these practices cascade down to individual levels the organizational structure of BGK and to subsidiaries.

14.2 ORGANIZATION OF THE CREDIT RISK MANAGEMENT PROCESS

Credit risk is the most important element of financial risk to which the Bank is exposed in the pursuit of its activities. The Bank uses a credit risk management process that comprises risk identification, measurement and assessment, control, monitoring and reporting to identify credit risk and mitigate it to an acceptable level, and for the purposes of controlling the effectiveness of actions taken on a continuous basis.

Credit risk management is carried out at two levels:

- client risk accounting for an individual credit exposure;
- loan portfolio risk.

The Bank identifies and assesses the existing credit risk based on:

- the implementation of internal procedures enabling the assessment of creditworthiness for individual borrowers and classification of credit exposures into relevant risk groups,
- the results of control and monitoring measures taken with regard to asset items managed by the organizational units of BGK.

The Bank applies a prudential approach to the credit risk management process. Key characteristics of the current risk management system are:

- the separation of sales functions from client risk assessment at both branch and Head Office levels of BGK,
- comprehensive individual credit risk assessment for all customers and transactions, so as to assign them to a specific credit risk category,
- the application of expert and statistical methods for measuring credit risk arising from an individual transaction of customer, supporting the estimation of the probability that the customer will default on their obligation towards BGK, and when the customer has problems with repaying their debt – measuring the impairment of granted credit exposures,
- a system for measuring portfolio risk by assessing its concentration by industry, entity and type of product,
- a system of decision-making competencies,
- the regular verification of the risk of past transactions, including changes in the financial condition of borrowers and in the Bank's environment;
- diversification of industry sectors, borrowers and types of loans, within the resource exposure limits set out by the Bank,
- the determination of impairment losses and provisions for credit exposures,
- the analysis and verification of valuation principles related to loan collaterals,
- a system for monitoring exposures and their collaterals that allows for early threat identification.

The system of limits constitutes one of the basic tools for credit risk management at BGK. Limits are established at both operational and strategic levels in line with relevant responsibilities.

The following limit groups are used with respect to credit risk:

- industry limits reflecting the risk arising from the customer's core business;
- limits depending on loan types and related to the risk associated with the purpose of the loan granted;
- borrower limits determined by client types;
- product limits.

One of the most important credit risk factors is concentration risk. At BGK, it is monitored in line with the provisions of the Banking Law Act and the resolutions and recommendations of the Polish Financial Supervisory Authority in this respect, the Act on Bank Gospodarstwa Krajowego and the Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms. In accordance with the resolution of the Management Board, irrespective of statutory concentration limits, BGK has additional exposure limits applicable at the stage of making financial decisions.

The risk monitoring process consists in periodic reviews of the parameter levels which are subject to limits in addition to analyzing the utilization of those limits.

The Bank drafts regular credit risk and concentration risk reports presented to the Credit Committee of the Bank, Management Board of BGK and in semi-annual periods to the Supervisory Board.

The Bank has in place procedures that specify the rules to be followed in the event of an increased level of credit risk.

14.3 OVERVIEW OF KEY CREDIT AND CONCENTRATION RISKS

Credit risk is defined as a risk that a borrower will default on their contractual obligations, i.e. fail to repay receivables under credit exposure along with the Bank's fee, either in whole or in part, within time limits defined in the agreement.

The Bank mitigates credit risk at the micro level by assessing and monitoring individual customers and transactions, and at the macro level – for the entire portfolio – by establishing limits for the various segments and products.

Although the credit risk is uniform in nature, its basic subtypes can be distinguished.

Concentration risk

The risk of exposure concentration is an important aspect of credit risk. The Bank has adopted appropriate internal rules and procedures applicable to exposure concentration, with a particular focus on large exposures to single customers and customer groups. Portfolio concentration is monitored at the level of individual borrowers, entities with equity or organizational relationships, industries etc. The exposure concentration policies address different areas of the Bank's operations (not only lending but also investing activities or money market transactions).

Risk of partial or total default

The risk of default is a situation where a customer fails to meet the contractual repayment deadlines or no payments are made. The materialization of that risk is associated with an increase in costs by generating loss allowances which in the case of total non-payment turn into a loss incurred.

The Bank mitigates the risk of default by:

- assessing a customer's credit rating based on financial models, including predictive models based on which the customer is assigned a credit rating adequate to the level of associated risk,
- periodically monitoring a customer's economic and financial situation.

Collateral risk

Collateral risk occurs when taken collateral of a credit exposure is inadequate to the financing granted or when the value of the collateral fluctuates significantly.

Collateral risk is mitigated by:

- collateral policy adopted by a resolution of the Management Board, which sets the boundary conditions of collateral's adequacy for a particular type of exposure, customer and collateral,
- monitoring the value of collateral, in particular mortgages, through periodic verification of property valuation,
- stress tests, including simulations of changes in the value of collaterals.

Interest rate risk and foreign exchange risk

Interest rate risk and foreign exchange risk are associated with the risk of default, because the rise in the former considerably increases the probability of the latter. This risk causes increased payments due from a customer due to the increase in interest rates or negative change in currency exchange rates, which results in higher instalment commitments.

The Bank mitigates interest rate risk and foreign exchange risk by:

- applying appropriate procedures for financing in foreign currencies, in particular when verifying the repayment sources of the Bank's receivables,
- stress tests, including, but not limited to, simulations of interest rate and foreign exchange rate fluctuations and their impact on the customer's creditworthiness.

14.4 ORGANIZATION OF THE FINANCIAL RISK MANAGEMENT PROCESS

The system of financial risk measurement used at BGK includes, in particular, the following approaches and tools:

- liquidity ratios, liquidity gap, fund stability analyses and daily monitoring of the deposit base – applied to liquidity risk;
- measures of position volumes (such as foreign exchange position, interest rate gap) – applied to foreign exchange risk and interest rate risk, measures of sensitivity used for detailed analyses (BPV, duration, sensitivity of net interest income to fluctuations in interest rates) – applied to interest rate risk;
- Value at Risk (VaR) – applied to market risk;
- capital adequacy ratios – measures related to the requirements of external regulations, determining the adjustment of equity to the level and nature of risks of the Bank, including i.a. the size and structure of risk-weighted assets;
- leverage ratios – applied to excessive leverage risk;
- stress tests – applied to the financial risk.

The system of limits is the main financial risk management tool at BGK. BGK uses the following limits:

- for liquidity risk – limits and threshold values of liquidity ratios;
- for interest rate risk – sensitivity limits, position limits and loss limits;
- for foreign exchange risk – position limits and loss limits;
- for capital adequacy – capital adequacy limits and capital limits in the particular types of activity;
- for excessive leverage risk – internal limits for regulatory leverage ratio.

The risk monitoring process consists in periodic control of the limited parameter levels in addition to analysing utilization of limits. Financial risk reports are submitted to the Bank's Finance Committee, the Management Board and the Risk Committee as well as to the Bank's Supervisory Board. Procedures additionally specify the rules to be followed in the event of an increased level of financial risk.

14.5 OVERVIEW OF KEY FINANCIAL RISKS

Liquidity risk

Liquidity risk is a risk 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 purpose of liquidity risk management is 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 business continuity solutions for potential crisis.

Liquidity risk level is presented in regular liquidity reports including, in particular, information on the utilization of regulatory and internal liquidity limits, the stability of external funding and stress tests results as well as additional analyses concerning, inter alia, long-term liquidity.

Quarterly reports also present information about the assessment of the size and profile of the Bank's liquidity risk related to the operations of its subsidiaries. In 2017, cash flows generated by subsidiaries were insignificant from the perspective of the liquidity of BGK.

The Bank controls liquidity risk using a system of limits and liquidity ratio thresholds. The limit system covers current, short-term, medium-term and long-term liquidity.

In 2017, BGK developed its liquidity risk management, including by changing and adding new liquidity risk ratios. The Bank also adjusted its liquidity risk management principles to new accounting principles after the Bank has transitioned to the International Financial Reporting Standards.

In the entire year 2017, the liquidity of BGK was at a safe level. Supervisory liquidity measures defined in Resolution 386/2008 of the Polish Financial Supervision Authority of 17 December 2008 on development of the liquidity standards for banks (as amended) and in Commission Delegated Regulation (EU) 2015/61 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.

TABLE 38: Regulatory liquidity measures

| Item | limit | as at 31.12.2016 | as at 31.12.2017 | Additional information – excluding cash flow funds | |
|--|--------|---------------------|---------------------|---|------------|
| | | | | as at | as at |
| | | | | 31.12.2016 | 31.12.2017 |
| M1 – short-term liquidity gap (in PLN mn) | 0.0 | 15,503.8 | 17,524.4 | 14,464.8 | 16,468.8 |
| M2 – short-term liquidity ratio | 1.0 | 1.5 | 1.6 | 1.6 | 1.7 |
| M3 – total equity to non-liquid assets | 1.0 | 5.0 | 5.4 | 5.0 | 5.4 |
| M4 – total equity and stable external funds to non-liquid and limited-liquidity assets | 1.0 | 1.2 | 1.3 | 1.6 | 1.7 |
| LCR—liquidity coverage ratio | 80.0%* | 251.6% | 206.9% | 327.7% | 271.7% |

* the limit applicable as at 31 December 2017

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

Market risk

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

The objectives of market risk management are:

- for interest rate risk (including the price risk of debt securities) — to reduce 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 foreign exchange risk – to mitigate the risk of losses that may be incurred as a result of changes in market foreign exchange rates;
- for equity price risk – to mitigate the risk of losses that may be incurred as a result of changes in the prices of equity instruments.

In 2017, BGK expanded the method for calculating the sensitivity of the bank's economic value to changes in interest rates, introduced new stress test scenarios for estimating the risk of reduction in net interest income on the banking book that provide for multi-directional changes in interest rates, and improved the procedure for back-testing VaR.

In 2017, BGK maintained the acceptable level of market risk approved by the Supervisory Board (risk appetite).

Interest rate risk

The Bank monitored interest rate risk using:

- BPV limits for the trading book and the banking book;
- loss limits;
- limits for income risk in the banking book;
- other risk measures, such as duration and VaR.

The internal reporting system for interest rate risk includes, in particular, information on the utilization of limits and the threshold values for interest rate risk, gains/losses on interest rate movements, measures (VaR, BPV, duration, modified duration), interest rate gap analysis, interest income sensitivity and results of stress tests.

In 2017, interest income risk over a period of 12 months remained at a moderate level. The exposure to interest rate risk was limited through the ongoing management of the liquid asset portfolio.

TABLE 39: Basic interest rate risk measures (in PLN thousand)

| Item | as at | as at |
|--------------------------|------------|------------|
| | 31.12.2016 | 31.12.2017 |
| BPV (Treasury portfolio) | -902 | -1,457 |
| VAR (Treasury portfolio) | 3,931 | 5,346 |

As at the end of the reporting period, BPV, VaR and interest income risk grew as a result of a capital injection received by the bank, including in particular an increase in the value of the debt securities portfolio.

Foreign exchange risk

In 2017, BGK reported low foreign exchange risk. The risk was measured in accordance with the applicable principles, including based on measurement of foreign exchange positions, VaR and foreign exchange gains or losses. The utilization of internal limits was also constantly monitored with respect to currency position and loss.

Currency risk reports include, in particular, information on the utilization of currency risk limits, performance, VaR and results of stress tests.

The total foreign currency position as at 31 December 2017 amounted to PLN 131.1 mn, whereas VaR for that item totalled PLN 699.9 thous.

Equity price risk

In 2017, the equity price risk at BGK was moderate. Compared to the year 2016, the share portfolio value grew by PLN 411 mn (in relation to the growing price of PKO BP S.A. shares over 2017 and a high volume of those shares in the portfolio of BGK). The portfolio of investment certificates continued to grow as well.

Risk was measured in accordance with the applicable principles, mainly through measuring equity instruments portfolio and VaR. As at 31 December 2017, VaR of the equity instruments portfolio amounted to PLN 37.7 mn.

14.6 ORGANIZATION OF THE OPERATIONAL RISK MANAGEMENT PROCESS

Operational risk is inherent in all major areas of operations pursued by BGK, including any new, existing and modified products, processes and systems, and it takes account of internal factors (such as the organizational structure, business profile, IT systems used, client profile, client complaints, HR quality, organizational changes and employee turnover) and external factors (external environment of the Bank).

Operational risk management covers all branches/organizational units of the head office of BGK and subsidiaries supervised by appropriate organizational units of the Bank's head office in line with the Head Office Organizational Regulations and their responsibilities.

The Bank manages operational risk through:

- the function of Operational Risk Coordinator;
- process-based approach to the assessment of business lines, increased risk products the risk posed by branches of BGK and organizational units of its head office,
- operational risk ratios.

The Operational Risk Committee functions at the Bank to carry out review functions, make decisions and assist the Bank's Management Board in the oversight and control of the operational risk and of the effectiveness of the risk management system.

Reporting of operational risk is based on the information entered into the application Operational Risk Registry by operational risk coordinators from all branches/organizational units of the head office of BGK and transferred from subsidiaries.

14.7 OVERVIEW OF OPERATIONAL RISK

The gross loss arising from operational risk events in 2017 amounted to PLN 54 thousand. Provisions for operational risk events reached PLN 0.9 mn as at the end of 2017.

14.8 OTHER RISKS

Additionally, BGK manages hard-to-measure risks, especially compliance risk, adopting similar principles as in the case of operational risk management, and risk models adopted in accordance with relevant internal procedures.

14.9 CAPITAL ADEQUACY

The Bank monitors the level of capital adequacy using capital adequacy ratios determined in line with the Banking Law Act and CRR¹.

In 2017, BGK expanded its capital adequacy management, including by developing methods and updating principles related to capital adequacy. BGK introduced reverse stress tests, clarified methods for determining capital limits, updated principles that govern the development of a capital plan and changed selected methods for examining the relevance of risks.

In 2017, the capital adequacy standards set out in Article 128.1 of the Banking Law Act and in Article 92.1 of CRR were met (CET1 of at least 4.5%, the Tier 1 capital ratio of at least 6%, the solvency ratio of at least 8%, and the internal capital ratio of less than 100%).

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

TABLE 40: Capital adequacy ratios

| Item | as at 31.12.2016 | as at 31.12.2017 | change PLN mn / pp | Additional information – excluding cash flow funds | | |
|---------------------------------------|---------------------|---------------------|-----------------------|---|------------|------------|
| | | | | as at | as at | change PLN |
| | | | | 31.12.2016 | 31.12.2017 | mn / pp |
| Total capital requirement (in PLN mn) | 3,205.2 | 3,976.3 | 771.1 | 3,204.8 | 3,975.8 | 771.0 |
| Internal capital (in PLN mn) | 3,811.8 | 4,648.9 | 837.1 | 3,811.5 | 4,648.3 | 836.8 |
| Total equity (in PLN mn), including: | 12,257.5 | 18,864.2 | 6,606.7 | 12,257.5 | 18,864.2 | 6,606.7 |
| Tier 1 capital, including: | 12,064.1 | 18,864.2 | 6,800.1 | 12,064.1 | 18,864.2 | 6,800.1 |
| Common Equity Tier 1 | 12,064.1 | 18,864.2 | 6,800.1 | 12,064.1 | 18,864.2 | 6,800.1 |
| Tier 2 capital | 193.5 | 0.0 | -193.5 | 193.5 | 0.0 | -193.5 |
| CET1 | 30.1% | 38.0% | 7.9 | 30.1% | 38.0% | 7.9 |
| Tier1 capital ratio | 30.1% | 38.0% | 7.9 | 30.1% | 38.0% | 7.9 |
| Solvency ratio | 30.6% | 38.0% | 7.4 | 30.6% | 38.0% | 7.4 |
| Internal capital ratio | 31.1% | 24.6% | -6.5 | 31.1% | 24.6% | -6.5 |

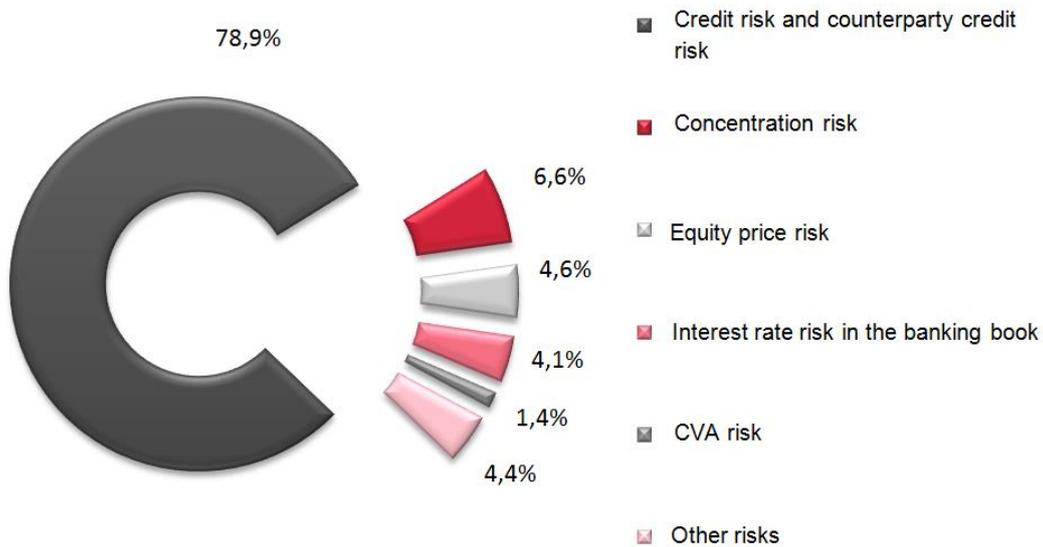
In 2017, the increase of total capital requirement and internal capital ratio was related to the expanded activity of the Bank in the area of financing enterprises and to the purchase of investment certificates of Closed-End Investment Funds.

¹ Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (OJ L 176, 27.6.2013, p. 1)

Increase in equity, on the other hand, was attributable to the fact that the statutory fund of BGK was increased by the State Treasury through the transfer of securities with a total value of PLN 4.8 bn and cash totalling PLN 1.5 bn.

Internal capital is determined in respect of the risks identified by the Bank as significant. The largest part of it is represented by internal capital for credit risk and counterparty credit risk. Internal capital structure has been presented below.

Figure 14



MANAGEMENT BOARD OF BANK GOSPODARSTWA KRAJOWEGO

President of the Management Board
Beata Daszyńska - Muzyczka

.....

First Vice-President of the Management Board
Paweł Nierada

.....

Vice President of the Management Board
Włodzimierz Kocon

.....

Member of the Management Board
Przemysław Cieszyński

.....

Member of the Management Board
Wojciech Hann

.....

Member of the Management Board
Radosław Kwiecień

.....

Warsaw, 23 April 2018