

**REPORT ON THE ACTIVITIES
OF BANK GOSPODARSTWA KRAJOWEGO
IN 2016**

The above Report on the Activities of Bank Gospodarstwa Krajowego in 2016 is a translation from the original Polish version. In case of any discrepancies between the Polish and English version, the Polish version shall prevail.

23 March 2017

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1. A BRIEF OVERVIEW OF BGK

Bank Gospodarstwa Krajowego (BGK) is the only state-owned 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. 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. The Bank operates within the territory of the Republic of Poland and does not have any foreign subsidiaries.

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. In line with the strategy adopted by the Supervisory Board in 2014, the Bank places a greater emphasis on the fulfilment of its functions as a state development bank between 2014 and 2017. In particular, this means increased activity in the field of corporate finance, in addition to export support and investment funding.

The Bank joined forces with the Polish Agency for Enterprise Development, the Industrial Development Agency, the Polish Investment and Trade Agency (formerly: the Polish Information and Foreign Investment Agency) and the Export Credit Insurance Corporation to establish the Polish Development Fund Group with a view to improving the coordination of the initiatives launched under the Responsible Development Strategy. BGK plays an important role in the implementation of the key programmes under the Strategy announced in 2016:

- it provides debt and equity financing to the strategic sectors of the Polish economy;
- it provides equity financing to the “Mieszkanie Plus” programme;
- it administers the new EU financial perspective - 2014-2020;
- it implements guarantee programmes supporting growth of small and medium-sized enterprises;
- it provides financial support to Polish exports, also to higher-risk markets;
- it provides debt and equity financing for the expansion of Polish businesses on international markets.

In 2016, the Bank focused more on those of its operations which are perceived as critical to its mission, specifically on structured finance and equity investment, in addition to getting prepared for the fulfilment of such new tasks as the implementation of the “Mieszkanie Plus” programme or administration of the new EU financial perspective.

As regards residential construction support, the Bank launched the pilot “Mieszkanie Plus” programme, the scope of which includes the construction of apartments for moderately rich people at affordable rent, the title to which may ultimately be transferred onto the tenant. In collaboration with the Ministry of Development, the Bank developed a new social housing programme, which will increase the number of apartments for rent in smaller towns through preferential debt financing provided to Social Housing Associations. The Bank also continued its commercial lease projects in large cities but decided to reduce their scale and focus on the “Mieszkanie Plus” programme (equity financing), in addition to the new social housing programme (debt financing provided to Social Housing Associations).

As regards EU funding, the Bank increased the scale of its operations relative to the prior 2007-2013 perspective, in the course of which it carried out projects in six regions and by the end of 2016 entered into subsidy agreements with 10 local governments at the regional level (pomorskie, wielkopolskie, łódzkie, zachodniopomorskie, podlaskie, lubelskie, dolnośląskie, podkarpackie, opolskie and małopolskie). It is also planning to sign agreements with a further five regions (lubuskie, warmińsko-mazurskie, świętokrzyskie, kujawsko-pomorskie and mazowieckie) by the end of the first quarter of 2017.

A number of tasks are fulfilled by the Bank in partnership with international financial institutions, mainly from the group of the European Investment Bank. In 2016, some of them were also performed as part of the European Fund for Strategic

Investments (EFSI), which is the financial pillar of the Investment Plan for Europe, also known as the Juncker Plan. National development banks, such as BGK, have been identified as important partners in this initiative.

In 2016, the scope of tasks fulfilled by BGK in relation to EFSI projects included the COSME programme allocation. The Bank also conducted negotiations on individual and portfolio transactions where it acts as a provider of co-financing or a beneficiary of EIB guarantees. The first transaction of this type (in the Infrastructure and Innovations window) was the provision of funding for the purchase of rolling stock by Przewozy Regionalne S.A., where BGK was a member of a syndicate of banks which disbursed PLN 629 million for that purpose. Further transactions are planned for 2017. Additionally, BGK was actively involved in promotional and information campaigns.

In the guarantee segment, the Bank offered surety bond products to small and medium-sized enterprises through the Guarantee Fund for acceleration of innovation in the SME sector under the Operational Programme Innovative Economy, in addition to expanding its offering of guarantees with counter-guarantees of the European Investment Fund (EIF). In partnership with EIF the Bank offered portfolio guarantees to commercial banks which grant loans to small and medium-sized enterprises under the COSME programme that promotes SME competitiveness (without the state aid component).

In 2016, the Bank placed a greater focus on export financing, by increasing its exposure to investment projects carried out by Polish businesses abroad, in addition to offering the existing trade finance solutions.

It also increased the scope of its potential export and foreign investment support by defining limits for new markets, such as Croatia, Portugal, Brazil, Taiwan, Saudi Arabia or United Arab Emirates.

The Bank's activities focused also on services to public sector entities (including local governments and municipal enterprises), business entities operating in selected sectors of the economy (including structured finance) and indirectly (through a system of guarantees and surety bonds offered in partnership with commercial banks) – the SME sector.

Finally, the scope of the operations carried out by BGK includes the fulfilment of other government-delegated tasks. Typically, they take the form of special programmes and are performed under agreements signed between the delegating public authority and BGK. An example may be the continuation of the government Export Support Programme or distribution of EU funds.

The key government-delegated tasks were fulfilled by BGK mainly through the administration of funds created, entrusted or transferred to the Bank, for which separate accounting records are kept and separate financial statements are prepared by the Bank in compliance with the applicable laws.

These include:

- cash flow funds – related to the management and administration of cash flows which are not presented on the Bank's balance sheet or recognized in its profit or loss, i.e.:
 - - the National Road Fund;
 - - the Railway Fund;
 - - the Thermal Efficiency Improvement and Repair Fund;
 - - the Subsidy Fund;
 - - the Student Loan Fund;
 - - the Borrower Support Fund created by the end of 2015;
- a loan fund exposed to the credit risk, which is presented on the Bank's balance sheet and recognized in its profit or loss, i.e. the Inland Waterway Fund.

The detailed data and figures presented and referred to in this Report on the Activities of BGK may differ from the data contained in the Financial Statements of the Bank for 2016. These are only presentation differences resulting from the fact that the data in the Report on the Activities of the Bank are presented for management reporting and not for accounting purposes.

2. FINANCIAL PERFORMANCE OF BGK IN 2016

In 2016, the balance sheet total was PLN 67,258.2 million. It went up by PLN 23,839.1 million, i.e. 54.9%, year on year. The said increase was mainly attributable to:

- rises related to increased lending and investing activities (up by PLN 5,752.2 million), which were accompanied by a relevant increase in business deposits;
- a capital injection of PLN 2,893.2 million provided to the Bank for purposes of fulfilment of new strategic sector tasks;
- liquidity position management in relation to fluctuations in central government deposits with BGK at the end of the year.

An increase in the balance of customer deposits was the key factor affecting the rise in the balance sheet total of the Bank. The said balance went up by PLN 17,725.6 million (89.2%) on the preceding year. An increase was seen mainly in public sector deposits, including those made by the Ministry of Finance, and non-financial sector deposits.

On-balance sheet credit exposures (loans, municipal and commercial bonds) increased by PLN 4,470.6 million versus the end of 2015, to PLN 32,345.3 million. An increase of PLN 4,935.2 million was seen in the loan portfolio, which totalled PLN 27,352.4 million. This was mainly attributable to a rise in structured finance provided to infrastructure investments. At the same time, the Bank's exposure to municipal and commercial bonds on the market in financial instruments was reduced by PLN 464.6 million.

In 2016, the Bank reported a net profit of PLN 349.2 million, down by PLN 13.5 million as compared to the preceding year. The said drop was mainly driven by a high balance of provisions and impairment losses (up by PLN 190.6 million), which resulted from the fact that the risk assessment had been brought into line with the approach developed in the course of a project aimed to introduce International Accounting Standards (IAS) at BGK.

The profit generated in 2015 was reduced by a one-off payment of PLN 78.6 million gross (PLN 63.7 million net) to the Bank Guarantee Fund for purposes of disbursement to the depositors of Spółdzielczy Bank Rzemiosła i Rolnictwa in Wołomin (SK Bank in Wołomin). After the elimination of the effects of non-recurring items (Table 1 presents the Bank's profit excluding the effect of non-recurring items such as reclassification of a portion of the portfolio of the former National Housing Fund in 2014, a payment to the Bank Guarantee Fund to be disbursed to the customers of SK Bank in Wołomin in 2015, the effect of the accounting for the acquisition of Visa Europe Ltd. by Visa Inc., and the sale of shares in PEKAES S.A. in 2016), the adjusted net profit for 2016 was lower by PLN 89.0 million (20.9%) than in 2015.

The key efficiency ratios in 2016 were slightly lower than in 2015. ROE dropped by 0.3 p.p., ROA by 0.1 p.p. and C/I improved and diminished by 11.8 p.p. year on year. After the elimination of non-recurring items, ROE and ROA decreased and were as follows: ROE 3.5% (down by 1.1 p.p.) and ROA 0.5% (down by 0.2 p.p.), while C/I improved and reached the level of 37.2%, which means a drop by 1.3 p.p.

The key financial parameters achieved by BGK between 2014 and 2016 have been presented in Table 1.

TABLE 1: Key financial parameters of BGK

Item	Performance			Change 2016/2015
	2014	2015	2016	
Profitability				
Net banking income (in PLN million)	792.1	790.6	853.2	7.9%
Net banking income (in PLN million) excluding non-recurring events	763.0	790.6	838.6	6.1%
Operating expenses, depreciation and amortization (in PLN million)	267.5	382.8	311.9	-18.5%
Operating expenses, depreciation and amortization (in PLN million) excluding non-recurring events	267.5	304.2	311.9	2.5%
Difference in provisions and allowances (in PLN million)	70.5	0.9	191.5	-
Gross profit (loss) (in PLN million)	472.2	413.8	353.1	-14.7%
Gross profit (loss) (in PLN million) excluding non-recurring events	432.1	492.5	338.4	-31.3%
Net profit (loss) (in PLN million)	434.6	362.7	349.2	-3.7%
Net profit (loss) (in PLN million) excluding non-recurring events	394.5	426.4	337.3	-20.9%
Scale of activity				
Gross credit exposure (in PLN million), including:	22,614.4	27,874.7	32,345.3	16.0%
Gross loans (in PLN million)	17,971.5	22,417.2	27,352.4	22.0%
Deposits from customers (in PLN million)	30,238.0	19,874.1	37,599.7	89.2%
Own funds (in PLN million) ¹	9,546.9	9,353.4	12,481.9	33.4%
Balance sheet total (in PLN million)	51,231.4	43,419.1	67,258.2	54.9%
Operating performance²				
C/I ³	33.8%	48.4%	36.6%	p.p. -11.8
C/I excluding non-recurring events	35.1%	38.5%	37.2%	-1.3
ROE (net profit / average equity)	5.2%	3.9%	3.6%	-0.3
ROE excluding non-recurring events	4.7%	4.6%	3.5%	-1.1
ROA (net profit / average total assets)	0.7%	0.6%	0.5%	-0.1
ROA excluding non-recurring events	0.6%	0.7%	0.5%	-0.2
Interest margin ⁴	1.0%	1.0%	0.9%	-0.1
Solvency ratio ⁵	38.2%	32.3%	30.6%	-1.7

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

² Carrying amounts for the period of 13 months (e.g. December 2015 and December 2016) were used as average balances used to calculate the measures

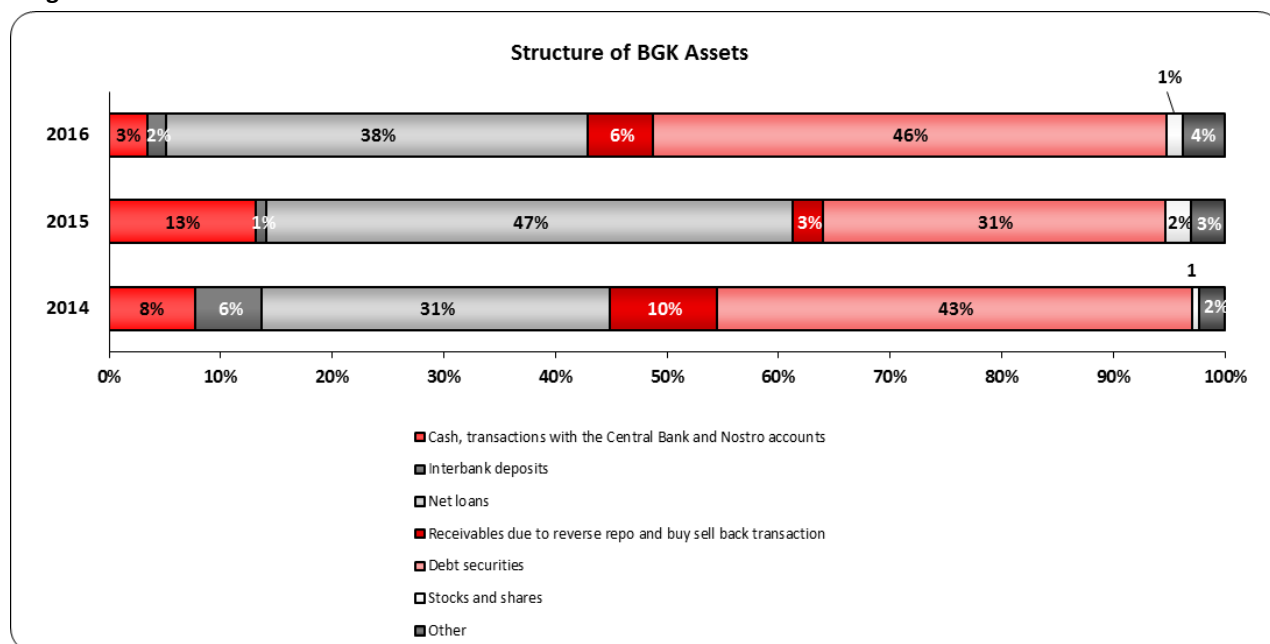
³ C/I (cost to income ratio) = (operating expenses + amortization and depreciation) / net banking income

⁴ Interest margin = net interest expense / average interest assets

⁵ Excluding cash flow funds

BALANCE SHEET STRUCTURE – ASSETS

Changes in the structure of assets of BGK have been presented on Diagram 1.

Diagram 1**Cash in nostro accounts (except cash deposited with the National Bank of Poland)**

As at the end of 2016, cash in current accounts totalled PLN 1,662.7 million, up by PLN 820.1 versus the end of 2015, which was attributable to an increase in central government deposits in foreign currencies.

Interbank deposits, Treasury securities and NBP money bills

As at the end of 2016, the portfolio of Treasury bonds measured at cost totalled PLN 8,556.5 million, which means an increase by PLN 2,754.9 million (47.5%) year on year. NBP money bills amounted to PLN 15,803.1 million, up by PLN 15,566.1 million as compared to the preceding year. The balance of interbank deposits as at the end of 2016 was PLN 1,103.0 million, which means an increase of PLN 729.0 million on the preceding year. Changes in the balances of these items were the effect of an increase in the value of the Bank's equity and liabilities.

Loan portfolio and commercial debt securities

The gross loan balance as at the end of 2016 was PLN 27,352.4 million, which means a rise of PLN 4,935.2 million (22.0%) versus the end of 2015. The highest increase in nominal terms, by PLN 5,354.5 million (34.5%) was seen in non-financial sector loans. The Bank's total gross credit exposure included also bonds issued by local government entities (PLN 1,014.2 million) as well as commercial bonds issued under project finance programmes (PLN 3,978.8 million). The total credit exposure in 2016 was PLN 32,345.3 million and it went up by 16.0% as compared to the preceding year. A detailed description of the loan portfolio and commercial debt securities, along with their changes, has been provided in Section 5.2.

Reverse repo and buy-sell-back transactions

Receivables due to reverse repo and buy-sell-back transactions totalled PLN 3,946.9 million as at the end of 2016 and were higher by PLN 2,773.2 million (236.3%) than at the end of 2015. Affected by liquidity management transactions, their level was determined by a higher balance of deposits as at the end of 2016.

Shares and investment certificates

The value of the portfolio of shares measured at carrying amount decreased in 2016 by PLN 5.9 million on the preceding year.

In 2016, the Bank's exposure was higher as a result of an increase in the share capitals of its subsidiaries, TFI BGK S.A. and BGK Nieruchomości S.A., by PLN 8.0 million and PLN 4.0 million, respectively.

The Bank's exposure to Krajowy Fundusz Kapitałowy S.A. went up by PLN 10.0 million, to PLN 43.8 million. In 2016, estimates were made of the net assets of KFK S.A., which resulted in the recognition of an impairment loss of PLN 43.8 million (an increase of PLN 10 million).

BGK Nieruchomości S.A. manages the assets of Fundusz Sektora Mieszkań na Wynajem FIZAN (Dwelling for Rent Sector Closed-End Investment Private Equity Fund). The net asset value as at the end of 2016 was PLN 722.5 million.

In 2016, the Bank held in its portfolio investment certificates of PLN 545.8 million, issued by the following funds established by Towarzystwo Funduszy Inwestycyjnych BGK S.A.:

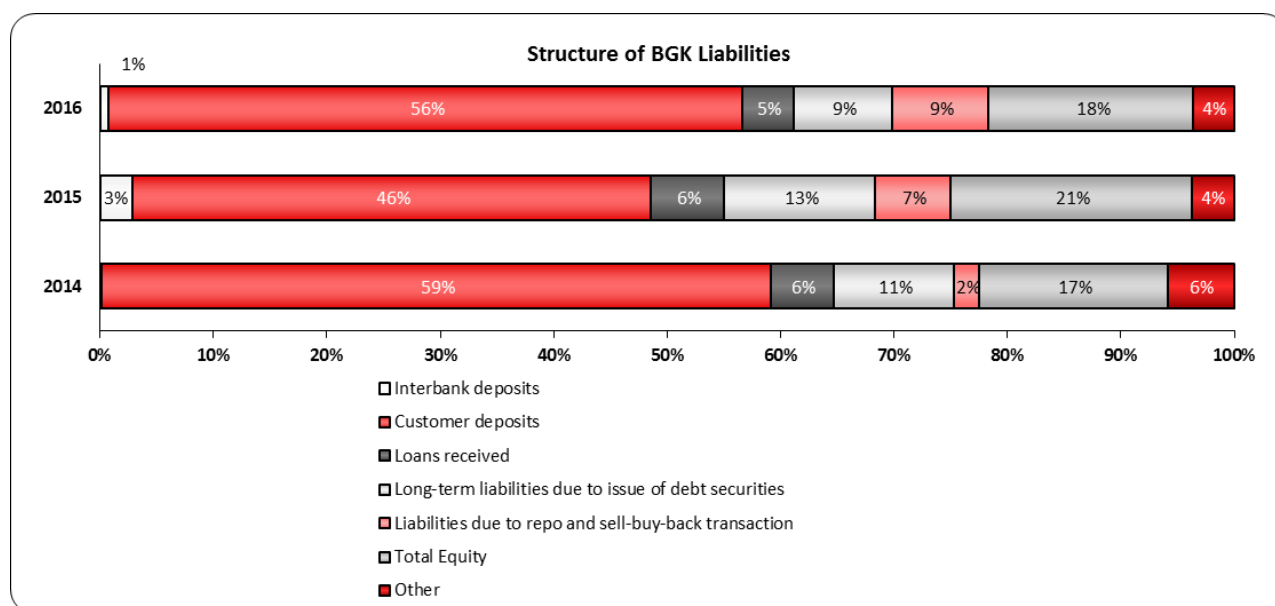
- Fundusz Ekspansji Zagranicznej (Foreign Expansion Closed-End Investment Private Equity Fund);
- Fundusz Inwestycji Samorządowych FIZAN (Municipal Investments Closed-End Investment Private Equity Fund);
- Fundusz Inwestycji Polskich Przedsiębiorstw FIZAN (Polish Enterprises Investments Closed-End Investment Private Equity Fund);
- Fundusz Inwestycji Infrastrukturalnych – Kapitałowy FIZAN (Infrastructure Investments Capital Closed-End Investment Private Equity Fund);
- Fundusz Inwestycji Infrastrukturalnych – Dłużny FIZAN (Infrastructure Investments Debenture Closed-End Investment Private Equity Fund);
- Fundusz Municipalny FIZAN (Municipal Closed-End Investment Private Equity Fund).

A detailed description of each fund has been provided in Section 5.6 Share portfolio.

BALANCE SHEET STRUCTURE – EQUITY AND LIABILITIES

Within a horizon of three years, one may 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 Diagram 2.

Diagram 2



Deposit base

In 2016, the Bank's deposit base increased by PLN 17,725.6 million (89.2%) year on year, which was mainly attributable to a considerably higher balance of central government deposits, which went up by PLN 8,224.9 million (73.0%). They still accounted for the major part of the deposit portfolio of the Bank and amounted to PLN 19,485.1 million as at the end of 2016. Their share in total deposits was 51.8% versus 56.7% a year before. The rise in non-financial sector deposits was commensurate with the increase in the credit exposure. Detailed information concerning the portfolio structure has been provided in Section 5.3.

Repo and sell-buy-back transactions

Liabilities due to repo and sell-buy-back transactions totalled PLN 5,752.2 million as at the end of 2016 and were higher by PLN 2,868.4 million than at the end of 2015. 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 2016, the balance of loans received from international financial institutions was PLN 3,029.0 million, which means an increase of PLN 250.7 million (9.0%) year on year.

In March 2016, BGK entered into a new Multi-Beneficiary Intermediated Loan V finance contract with EIB, where the loan amount was EUR 125 million. It will be used for purposes of funding investment projects implemented by local government entities, SMEs as well as mid-caps. The first loan tranche, being the equivalent of EUR 65 million, was made in September 2016.

In December 2015, the Bank entered into another loan agreement with EIB with the loan amount of PLN 800 million, with a view to financing investment and construction projects under a new government programme launched to support residential construction effective from 2016. The first loan tranche of PLN 240.0 million was made in December 2016.

In 2016, following loan repayments, the balance of funds obtained from EIB to be disbursed in the form of loans under the regional development support programme decreased by PLN 122.3 million and the balance of funds obtained from EIB and from the Council of Europe Development Bank to finance the residential construction support programme decreased by PLN 157.1 million.

Long term liabilities due to issue of debt securities

With a view to securing stable sources of funding for its operations, the Bank continued its bond issue programme.

In 2016, one issue of 3-year bonds of PLN 500 million took place. The said bonds are based on a floating interest rate determined by reference to WIBOR 6M plus a mark-up. At the same time, the Bank redeemed bonds of PLN 500 million in 2016.

The bonds issued by BGK and traded on the CATALYST market as at 31 December 2016 have been presented in Table 2.

TABLE 2: Bonds issued by the Bank as at 31 December 2016 (in PLN million)

Own bonds	Issued on	Maturing on	Amount in PLN million	Interest rate
BGK0219	19/02/2015	19/02/2019	1,392	WIBOR6M+30 b.p.
BGK0118	20/11/2012	25/01/2018	1,000	WIBOR6M+44 b.p.
BGK0517	19/05/2014	19/05/2017	1,370	WIBOR6M+30 b.p.

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 2016, its total equity (including current and prior year profit) was PLN 12,481.9 million. It went up by PLN 3,128.5 million (33.4%) year on year. This was attributable to an increase in the Bank's equity following the receipt of Treasury bonds with the par value of PLN 3,000.0 million (carrying amount of PLN 2,893.2 million) from the State Treasury as well as distribution of profit for 2015 in the amount of PLN 36.3 million. The share capital of the Bank totalled PLN 11,339.1 million, up by PLN 2,929.6 million as compared to the end of 2015.

The value and structure of the equity of BGK have been presented in Table 3.

TABLE 3: Value and structure of the Bank's equity (in PLN million)

Item	2015		2016		Change versus 2015	
	Performance	Structure	Performance	Structure	in nominal terms	%
Own funds	9,353.4	100.0%	12,481.9	100.0%	3,128.5	33.4%
Share capital	8,409.5	89.9%	11,339.1	90.8%	2,929.6	34.8%
Supplementary capital	614.4	6.6%	643.5	5.2%	29.1	4.7%
Reserve capital	76.8	0.8%	76.8	0.6%	0.0	0.0%
General banking risk reserve	155.5	1.7%	155.5	1.2%	0.0	0.0%
Revaluation reserve	-13.5	-	-82.3	-0.7%	-68.8	-
Appropriations of net profit in the financial year*	-252.1	-	0.0	0.0%	252.1	-
Net profit (loss)	362.7	3.9%	349.2	2.8%	-13.5	-3.7%

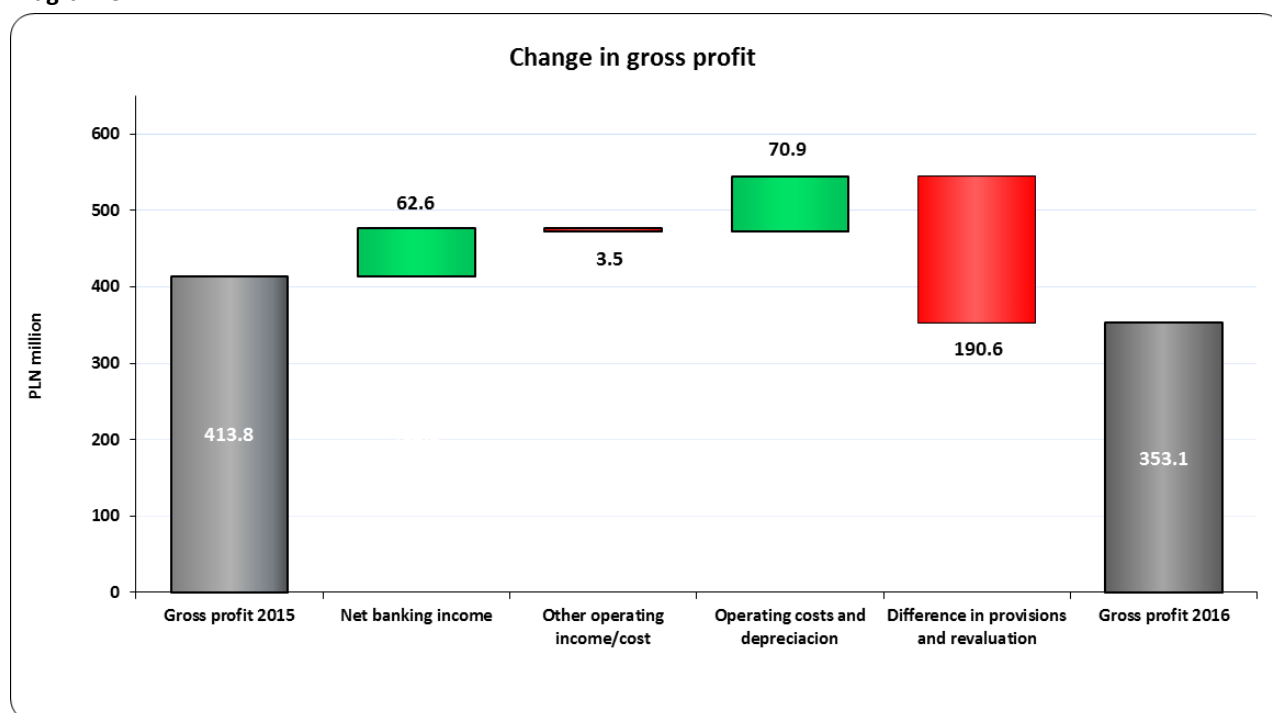
*in 2015 the Bank made an advance payment to the State budget

PROFIT AND LOSS ACCOUNT

The Bank's gross profit was PLN 353.1 million, down by PLN 60.8 million (14.7%) year on year. The net profit totalled PLN 349.2 million, which means a decrease of PLN 13.5 million (3.7%) on the preceding year.

Detailed reasons for the said changes in the Bank's gross profit for 2016 versus 2015 have been presented on Diagram 3.

Diagram 3



Net banking income

As at the end of 2016, the net banking income was PLN 853.2 million, up by PLN 62.6 million (7.9%) versus the end of 2015. The increase was mainly attributable to a larger scale of lending and deposit activities as well as margins

on foreign exchange derivatives, the volume of which was considerably higher. Furthermore, the Bank recognized a gain on sale of securities (Peakes) and income on the accounting for the acquisition of Visa Europe Ltd. by Visa Inc.

The net interest income was higher by PLN 27.1 million than in the preceding year. The Bank's gain on foreign exchange transactions went up by PLN 12.7 million, the gain on financial transactions by 9.1 million and the net fee income by PLN 8.7 million year on year.

Net interest income

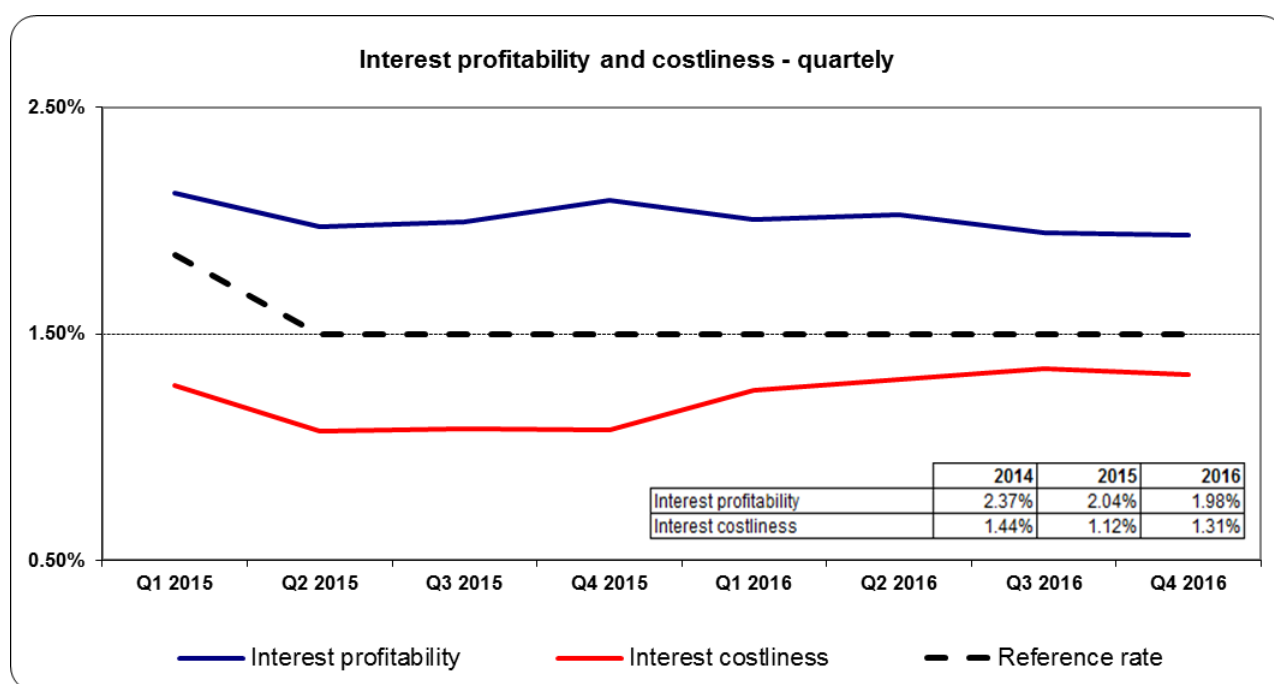
The net interest income, which totalled PLN 638.2 million as at the end of 2016 and increased by PLN 27.1 million (4.4%) on the preceding year, was the key item of the net banking income. As compared to the data presented in the Bank's Financial Statements for 2016, interest income reported herein include swap points and interests on IRS and OIS instruments.

As compared to 2015, a rise was seen both in the Bank's interest income (by PLN 162.2 million) and interest expense (by PLN 135.1 million). The said rise (in both the interest income and expense) was driven mainly by a larger scale of the Bank's lending and deposit activities.

The average level of interest-bearing assets was PLN 66.4 billion, up by PLN 11.4 billion versus 2015.

The average rate of return on assets in 2016 was 1.98%, which means a drop of 6 b.p. on the preceding year. The Bank's rate of return on assets and cost of debt have been presented on Diagram 4.

Diagram 4



The interest income on loans, which totalled PLN 839.5 million and increased by PLN 122.1 million (17.0%) year on year despite a drop in the rate of return by 17 b.p., accounted for the major part of the total interest income.

The rate of return on loans decreased by 17 b.p. (a drop from 2.93% to 2.76%) mainly as a result of a change in the portfolio structure (the prior year high-margin portfolio was being repaid and replaced with high-volume structured finance transactions) and a considerably smaller scale of reclassification of items in the loan portfolio of the former National Housing Fund as compared to the preceding years. The average balance of credit exposures went up by 24.2%, from PLN 24.5 billion in 2015 to PLN 30.4 billion in 2016.

In 2016, the average balance of debt securities was PLN 25.0 billion, up by PLN 5.4 billion (27.6%).

The average balance of other interest-bearing assets (BSB, nostro accounts and interbank deposits) in 2016 was PLN 11 billion, which means an increase of PLN 0.1 billion on the preceding year. The Bank's income on other interest-bearing assets went up by PLN 45.5 million.

In 2016, the average balance of interest-bearing liabilities was PLN 55.7 billion, up by PLN 11.6 billion (26.3%) versus the preceding year.

A rise in the interest expense was mainly driven by an increase of 19 b.p. in the cost of debt as compared to 2015, which reached the level of 1.31% in 2016. The increase was mainly the result of a change in the product structure (a higher volume of negotiated deposits) and the currency structure of deposits (a higher volume of deposits in PLN).

The average level of customer deposits in 2016 was PLN 45.5 billion and it went up by PLN 11.7 billion (34.6%) versus 2015. The interest expense on customer deposits was higher by PLN 236.1 million than in the preceding year, which was the result of a higher cost of funds.

The interest expense on liabilities arising from issues of debt securities went down by PLN 5.7 million, while the average balance of such liabilities was PLN 5.8 billion (an increase of PLN 0.1 billion on the preceding year).

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

Net commission income

The net commission income amounted to PLN 135.5 million and was higher by PLN 8.7 million than in 2015. The commission income went up by PLN 7.3 million, mainly as an effect of an increase in the fee income on letters of credit, collection, guarantees and surety bonds, which were higher by PLN 13.5 million, and on loans, which saw a rise of PLN 7.0 million. The said increase was offset by a drop of PLN 12.3 million in other commission income, which totalled PLN 55.2 million. This item included JESSICA management fees, fees for agency services provided to the Ministry of Finance as well as administration of the National Road Fund. The fee expense saw a drop of PLN 1.4 million. The structure of the net fee income has been presented in Table 4.

TABLE 4: Net fee income (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	in nominal terms	%
Net commission income	126.8	135.5	8.7	6.9%
Commission income	139.1	146.4	7.3	5.2%
- on loans and advances	43.9	50.9	7.0	15.9%
- on transactions in securities	6.8	5.9	-0.9	-13.2%
- on letters of credit, collection, guarantees and surety bonds	20.9	34.4	13.5	64.6%
- other fee income	67.5	55.2	-12.3	-18.2%
Commission expense	12.3	10.9	-1.4	-11.4%

As compared to the financial statements, the value of the fee income presented for management reporting purposes is higher by PLN 15.4 million in 2016 and by PLN 16.6 million in 2015. This is attributable to the fact that the fee income includes fees which are deferred using the effective interest method.

Income on shares

As at the end of 2016, the income on shares totalled PLN 9.7 million and increased by PLN 5.0 million (106.3%) year on year, which was mainly attributable to the accounting for the acquisition of Visa Europe Ltd. by Visa Inc. in June 2016 (PLN 6.4 million).

Gain on financial transactions

As at the end of 2016, the gain on financial transactions was PLN 24.4 million, up by PLN 9.1 million versus 2015, which was the effect of an increase of PLN 1.2 million in the gain on securities transactions and of PLN 7.9 million on derivative transactions. The items of the gain on financial transactions have been presented in Table 5.

TABLE 5: Gain on financial transactions (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	in nominal terms	%
Gain/loss on financial transactions	15.3	24.4	9.1	59.5%
in securities	12.2	13.4	1.2	9.8%
in other financial instruments	3.1	11.0	7.9	254.8%

The gain on financial transactions reported herein differs from the data contained in the Bank's Financial Statements for 2016 as it does not include the balance of interest on IRS and OIS instruments of PLN -2.9 million (PLN -4.4 million in 2015), which was presented separately as interest expense and income of PLN 4.0 million (PLN 4.4 million in 2015) and PLN 1.1 million (PLN 0.01 million in 2015), respectively.

The presentation change is aimed to disclose the interest portion of derivatives used as hedges, together with the gain/loss recognized on the hedged items.

Gain on foreign exchange transactions

As at the end of 2016, the gain on foreign exchange transactions was PLN 45.3 million, which means an increase of PLN 12.7 million on the preceding year. As compared to the data presented in the Bank's Financial Statements for 2016, the gain on foreign exchange transactions reported herein does not include swap points relating to FX swap instruments in the total amount of PLN 58.8 million (PLN - 4.2 million in 2015), which were presented separately as interest expense and income of PLN 8.7 million (PLN 34.0 million in 2015) and PLN 67.5 million (PLN 29.8 million in 2015), respectively.

The presentation change is aimed to disclose the interest portion of derivatives used as hedges, together with the gain/loss recognized on the hedged items.

Other operating revenue and expenses

As at the end of 2016, the net other operating revenue was PLN 3.3 million, down by PLN 3.6 million versus 2015. The key reason for the said difference was lower changes in the balances of provisions for disputes and sundry debtors. The structure of other operating revenue and expenses has been presented in Table 6.

TABLE 6: Other operating revenue and expenses (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	in nominal terms	%
Other operating revenue and expenses	6.9	3.3	-3.6	-52.2%
Other operating revenue	19.4	10.0	-9.4	-48.5%
Rental fees	0.4	0.3	-0.1	-25.0%
Other income	19.0	9.7	-9.3	-48.9%
Other operating expenses	12.5	6.7	-5.8	-46.4%

Operating expenses, depreciation and amortization

Operating expenses, depreciation and amortization totalled PLN 311.9 million as at the end of 2016, which means a drop of PLN 70.9 million (18.5%) year on year. Their level was reduced mainly as a result of a change in the payments

to the Bank Guarantee Fund, the Polish Financial Supervision Authority and the Financial Ombudsman by PLN 96.1 million. This was attributable to a one-off event which occurred in 2015 and was related to a payment of PLN 78.6 million to the Bank Guarantee Fund, to be disbursed to the customers of SK Bank in Wołomin in 2015, as well as changes in the regulatory environment and a reduction of the payments made by BGK to the Bank Guarantee Fund and the Polish Financial Supervision Authority in 2016. On the other hand, personnel costs went up by PLN 16.6 million, mainly as a result of changes in salaries as well as variable compensation components. This was driven by very good sales performance and extension of the scope of tasks fulfilled by the Bank, in particular its preparation for the implementation of the new EU financial perspective 2014-2020. In 2016, the depreciation and amortization expense also saw an increase of PLN 9.2 million, which was due to the fact that the Bank 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.

The structure of operating expenses has been presented in Table 7.

TABLE 7: Operating expenses, depreciation and amortization (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	in nominal terms	%
Operating expenses, depreciation and amortization	382.8	311.9	-70.9	-18.5%
Personnel expenses	171.5	188.1	16.6	9.7%
Non-personnel expense	75.2	74.7	-0.5	-0.7%
Funds' reallocated costs	-9.6	-9.7	-0.1	1.0%
Payments to Bank Guarantee Fund, Polish Financial Supervision Authority and Financial Ombudsman	126.7	30.6	-96.1	-75.8%
including payment to the Bank Guarantee Fund for SK Bank i Wołomin	78.6	0.0	-78.6	-100.0%
Depreciation and amortization	19.0	28.2	9.2	48.4%

Personnel costs differ from the cost of salaries, wages, social security and other benefits, as presented in the Bank's Financial Statements, by expenses related to training, additional medical care, employees' recreational and sports activities, OHS and mileage, which were presented within non-personnel costs 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 costs.

Net provisions and impairment losses

As at the end of 2016, the net provisions and impairment losses were PLN 191.5 million (surplus of amounts recognized over reversals) and they changed by PLN 190.6 million year on year.

The said change was mainly driven by the adoption of risk parameters which are consistent with IAS (developed in the course of a project aimed to introduce International Financial Reporting Standards at the Bank), an increase in credit exposures by PLN 4.5 billion and the related increase in the balance of provisions, where the ratio of impaired exposures to the portfolio as a whole remained at 8.9%, as well as a lower recovery rate as compared to the preceding year. At the same time, a decrease was seen in impairment losses on financial assets, mainly in relation to Krajowy Fundusz Kapitałowy S.A. In 2016, the general risk provision was reduced slightly, which was mainly attributable to improved risk parameters used for purposes of calculation of impairment losses related to the former National Housing Fund, which was accompanied by deterioration of the risk parameters in the case of large enterprises.

Detailed information concerning the quality of the loan portfolio has been presented in the "Loans" Section.

The items affecting the net provisions and impairment losses have been presented in Table 8.

TABLE 8: Net provisions and impairment losses (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	in nominal terms	%
Difference in provisions and allowances	0.9	191.5	190.6	-
provisions for receivables (specific purpose provisions)	6.7	128.8	122.1	1822%
provisions for off-balance sheet liabilities	-21.2	70.8	92.0	-
revaluation of financial assets*	22.4	11.0	-11.4	-50.9%
general risk provision	-7.0	-19.1	-12.1	-

*revaluation of shares

Income tax

The income tax for 2016 totalled PLN 3.9 million, down by PLN 47.3 million year on year. The effective tax rate was 1.1% versus 12.4% as at the end of 2015, which was attributable to a higher share of profit on non-taxable operations in the Bank's gross profit.

SUMMARY OF THE PERFORMANCE AND FINANCIAL POSITION OF BGK

The year 2016 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 5,115.7 million year on year. This was attributable to increased sales in the structured finance segment.

As at the end of 2016, the Bank's financial position was very good. Its capital adequacy and liquidity ratios were at safe, high levels.

In 2016, the net banking income was higher by PLN 62.6 million than in 2015, and after the elimination of non-recurring items (conversion of the share in Visa Europe Ltd. into shares in Visa Inc. and sale of shares in PEKAES S.A.), it would be higher by PLN 48.0 million than in the preceding year.

THE BANK'S RATING

On 1 March 2016, the Fitch rating agency maintained the long-term national rating of the Bank at the "AAA(pol)" level with stable outlook and the long-term international outlook at the "A-" level with 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)". The rating was confirmed on 21 February 2017.

3. THE ECONOMY AND THE BANKING SECTOR IN 2016

3.1 MACROECONOMIC CONDITIONS

The economy

In 2016, the real economic growth rate in Poland was 2.8%¹, lower than a year before, when GDP growth reached the level of 3.9%. Although the first three quarters of 2016 presented a negative GDP growth, clear signs of acceleration were seen in the fourth quarter, which was evidenced by the seasonal stabilization of the quarterly GDP growth.

As regards the growth structure, the key item which has lower share last year was investment. Its decline is mainly attributable to a slower rate of absorption of EU funds. The remaining components did not change so significantly. The consumption rate was growing slowly, which was accompanied by improving conditions on the labour market and social benefits. At the same time, the trade figures were very promising. Exports remained strong enough to maintain the trade surplus for the year, even despite a clear upward trend in imports. The trade surplus was attributable to a gradual recovery in the euro area as well as lower commodity prices, especially in the first half of the year.

The economic value added increased at a rate similar to the GDP growth rate. However, clear differences were seen in sectors. The value added saw a sharp drop in the construction industry, while in the remaining sectors it saw a much faster growth than GDP.

Additionally, the budget deficit became stable. According to preliminary forecasts, the central and local government deficit remained below 3.0% in 2016.

Changes in macroeconomic indicators in Poland in 2016 have been presented in Table 9.

TABLE 9: Changes in macroeconomic indicators year on year in real terms

Item	Q1 to Q4	Q1	2016		
			Q2	Q3	Q4
GDP	102.8	103.0	103.2	102.5	102.7
Domestic demand	102.8	103.9	102.2	102.9	102.4
Total consumption	103.6	103.3	103.4	104.1	103.8
Individual consumption	103.6	103.2	103.3	103.9	102.7
Gross capital formation	99.7	107.6	97.2	98.3	99.2
Gross fixed capital formation	94.5	97.8	95.0	92.3	94.2
Exports	-	106.7	111.4	106.8	108.6
Imports	-	108.7	110.0	107.8	108.5
Seasonal stabilization of GDP*	-	100.0	101.0	100.4	101.7
Gross value added	102.7	102.8	102.9	102.4	102.7
Manufacturing	103.5	103.2	105.1	103.6	102.7
Construction	88.1	87.4	90.4	83.5	90.7
Trade and repair of motor vehicles	105.4	104.3	105.5	106.0	105.8
Transportation and warehouse management	106.4	102.4	106.8	105.2	110.1

Source: Central Statistical Office *previous quarter=100

¹ The annual and quarterly GDP figures and their components are BGK estimates and may be subject to changes.

The labour market

The slowdown and the decline in investment did not have a noticeable effect on the labour market conditions. The forecast growth in consumption and increasing exports ensured that the labour demand continued. The employment growth rate was ca. 3% throughout the year. Wages also grew considerably. In the context of a low inflation rate combined with stronger fiscal support ("500 Plus" Programme), the labour market conditions translated into a strong growth of the disposable household income. Additionally, the improved labour market conditions were reflected in a clear drop in the registered unemployment rate, down to 8.3% as at the end of 2016 versus 9.7% a year before. The current unemployment levels have been the lowest since the beginning of the 1990s.

Inflation

Last year the inflation pressure remained very weak, which means that over the 2016 the inflation pressure remained very poor. For the greater part of the year, the annual CPI levels were negative, which means that they differed much from those expected by the Monetary Policy Council (the inflation target was 2.5% year on year with the acceptable divergence of +/- 1 p.p.). The CPI levels were again positive only at the end of 2016. The rising inflation rate was mainly driven by higher prices of commodities, including crude oil, on the global markets. At the same time, the inflationary impulse turned out to be stronger in the manufacturing sector. The Producer Price Index (PPI) was again positive in the third quarter of 2016. Apart from the rising commodity prices, this was due to the developments in the Chinese industrial sector, where strong deflationary impulses had already disappeared.

The interbank market

Good economic performance and the continued positive economic growth outlook were the major factors which determined that the Monetary Policy Council did not decide to modify its monetary policy in any way, even though positive CPI levels were seen only at the end of 2016. Stabilization of the reference rate at 1.5% translated into a low volatility of interbank market rates. However, a higher inflation rate at the end of the year had an effect on increases in FRA quotes.

Treasury securities

For the greater part of 2016, the prices of Polish Treasury bonds remained relatively high. The local prices reached the maximum levels in summer months, which coincided with the most serious concerns over the effects of Brexit that were caused by the June referendum. They built up expectations as to monetary policy easing by the major central banks, which pushed up bond prices on the underlying markets. However, the last months of the year brought a sudden price correction. It was driven by the measures taken by the major central banks, which did not meet the expectations of investors. At the same time, indications of acceleration of the global inflation rate became stronger. The price correction was also the result of the election of Donald Trump as the President of the United States of America. The reduction of taxes and increased spending on infrastructure projects announced in the course of the presidential campaign, which meant in fact an increase in the forecast borrowing needs of the U.S. budget and inflationary expectations, translated into a higher yield on U.S. debt instruments. Polish bonds remained sensitive to the impulses from the U.S. economy. Additionally, the yields on Polish debt instruments were pushed up by local factors, mainly concerns about a rapid growth of inflation in Poland, thus changes in the monetary policy.

The foreign exchange market

Last year the range of EUR/PLN exchange rate fluctuations increased. Depreciation of the Polish currency relative to the euro was affected by such events as S&P rating cuts, the referendum held in the United Kingdom, the election of Donald Trump as the President of the United States of America or an uncertainty about political and legislative factors, including the Act on conversion of Swiss franc mortgages. In effect, the EUR/PLN exchange rate temporarily reached the level of 4.50, that is the record high level observed at the end of 2011. This was accompanied by clear depreciation of the Polish zloty relative to the United States dollar. The U.S. currency rose sharply due to the "Trump effect" and the expectations as to faster Fed rate increases. Consequently, the USD/PLN exchange rate increased permanently to more than 4.00. However, it should be emphasized that a positive economic growth outlook for Poland

and the resulting expectations as to the maintenance of a wide spread of Polish and foreign interest rates were the key factors reducing devaluation of the Polish currency.

3.2 THE BANKING MARKET

Liabilities of the banking sector (deposits)

In 2016, the growth rate of banking sector deposits was still high. It increased to 9.4% versus 7.4% in the preceding year.

Personal deposits saw a considerable increase, which did not change as compared to the preceding year and could be attributable to a rapid growth in the disposable household income. Business deposits were also growing substantially, which was attributable to good financial performance which coincided with a limited willingness to invest. They were supported by the inflation structure and, most of all, by falling prices of fuels. What is more, a slower rate of absorption of EU funds was reflected in a marked increase in local government deposits.

Changes in the liabilities of the banking sector by customer segment have been presented in Table 10.

TABLE 10: Annual changes in the liabilities of the banking sector by customer segment

Item	2014	2015	2016
Total banking sector	9.3%	7.4%	9.4%
- individuals	10.1%	9.7%	9.5%
- businesses	9.5%	10.3%	8.9%
- financial sector	1.1%	-3.7%	-3.3%
- local government entities	-1.2%	2.0%	27.1%
- central government entities	16.2%	-28.5%	22.7%

Source: own calculations based on the data of the National Bank of Poland

Receivables of the banking sector (loans)

The year 2016 saw a lower growth rate of loan receivables of the banking sector, which went down to 4.7% in 2016 from 7.0% a year before. In nominal terms, the decrease in the growth rate was partly offset by foreign exchange effects relating to depreciation of the Polish currency relative to the euro and the Swiss franc. The key factor which affected the slower growth of lending was reduced investment needs and the diminishment of number and scale of the investments, both in the business and local government entity segment. This was driven by a decreased speed of implementation of projects supported by EU funds. The key factors affecting the personal segment were an increase in disposable income, which may have reduced the demand for consumer credit, and the raising of the prudential standards, which has had an effect on mortgage loans.

Changes in the receivables of the banking sector by customer segment between 2014 and 2016 have been presented in Table 11.

TABLE 11: Annual changes in the loan receivables of the banking sector by customer segment

Item	2014	2015	2016
Total banking sector	7.2%	7.0%	4.7%
- individuals	5.5%	7.0%	5.6%
- businesses	7.3%	7.6%	5.0%
- financial sector	29.0%	8.7%	0.7%
- local government entities	3.7%	-3.7%	-7.1%
- central government entities	-10.1%	62.7%	-14.8%

Source: own calculations based on the data of the National Bank of Poland

4. 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 key changes in this regard have been presented below.

On 29 February 2016, the Ordinance of the Minister of Infrastructure and Construction of 26 February 2016 concerning the financial support for the development of social and supervised housing as well as municipal housing other than social housing, was published in the Journal of Laws. It sets out a detailed procedure and time limits for the filing and processing of applications for financial support for the development of social and supervised housing as well as municipal housing other than social housing, by BGK.

On 22 June 2016, the Act of 10 June 2016 amending the act on export insurance guaranteed by the State Treasury and some other acts, was published in the Journal of Laws. It introduces a number of material changes applicable to the Supervisory Board and the Management Board of BGK, to include a change in the appointment procedure and the composition of those governing bodies, taking into account the role of the Minister of Economy in BGK's governance. The regulations applicable to the exercising of the powers under the BGK Act, including the adoption of the Bank's articles of association and its representation, were also amended (the Bank may not be represented by the Chairman of the Management Board acting individually).

On 8 July 2016, the Act of 10 June 2016 on the Bank Guarantee Fund, the deposit guarantee scheme and forced restructuring was published in the Journal of Laws. Under the said act, Bank Gospodarstwa Krajowego no longer falls within its scope.

On 15 September 2016, the Ordinance of the Minister of Finance of 1 September 2016 amending the regulation concerning *de minimis* aid provided by Bank Gospodarstwa Krajowego in the form of loan repayment guarantees, was published in the Journal of Laws. Under the aforesaid legal act, the term of the *de minimis* aid programme addressed to small and medium-sized enterprises in the form of BGK guarantees was extended until the end of 2017.

On 22 September 2016, the Ordinance of the Minister of Development of 16 September 2016 concerning the adoption of the articles of association of Bank Gospodarstwa Krajowego was published in the Journal of Laws. The changes made to the articles of association were mainly aimed to bring them into line with the amendments under the Act amending the act on export insurance guaranteed by the State Treasury and some other acts.

On 2 November 2016, the Announcement of the Speaker of the Sejm of the Republic of Poland of 13 October 2016 regarding the adoption of the consolidated text of the Act on Bank Gospodarstwa Krajowego was published in the Journal of Laws.

On 30 December 2016, the Act of 16 December 2016: Regulations Implementing the State Property Management Act, was published in the Journal of Laws. Under the aforesaid legal act, the number of members of the Supervisory Board of BGK was reduced from 12 to 11.

Apart from the above, a number of laws of general application which govern the operations of the Bank to a varying degree were enacted in 2016.

5. OPERATIONS OF THE BANK

5.1 THE BANK'S STRATEGY

In 2016, the Bank continued to implement the *Multi-Annual Development Programme of BGK for 2014-2017*. In January 2017, the Supervisory Board of the Bank adopted the *Tactical Action Plan for 2017*, which defines the key directions of change and the major initiatives to be implemented by BGK.

The Bank's mission to support government in implementation of the socio-economic growth of Poland and the public sector in the fulfilment of its functions has not changed.

The Bank places a particular emphasis on the provision of funding to businesses, financing foreign expansion and project finance. It also runs social equality programmes.

In 2017, the Bank began work on the formulation of its new Strategy for the 2018 – 2020 period – a document defining the role to be played by BGK in the upcoming years.

5.2 LOANS

The Bank's gross credit exposure (the portfolios of loans, commercial bonds and local government entity bonds) increased by PLN 4,470.6 million (16%) on the preceding year. It was another year when the on-balance sheet credit exposure of BGK grew much faster than the sector.

In accordance with the objectives of the Responsible Development Strategy, the Bank's operations focused on structured finance (up by PLN 4,859.3 million) addressed to the strategic sectors of the Polish economy as well as the financing of export and foreign expansion of Polish businesses (up by PLN 223.3 million).

The gross loan portfolio increased by PLN 4,935.2 million, i.e. 22.0%, in total.

The portfolio of credit exposures broken down by business line has been presented in Table 12. 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 12: Gross credit exposure (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	in nominal terms	%
Gross credit exposure	27,874.7	32,345.3	4,470.6	16.0%
Structured finance	11,161.5	16,020.8	4,859.3	43.5%
Export and foreign expansion financing	1,446.5	1,669.8	223.3	15.4%
Businesses and financial institutions	1,855.6	1,852.9	-2.7	-0.1%
Local government entities and municipal enterprises	7,000.5	6,592.8	-407.7	-5.8%
Central government entities	101.7	21.4	-80.3	-79.0%
Healthcare entities	459.4	558.2	98.8	21.5%
Residential Construction Programme (former National Housing Fund)	5,623.8	5,378.0	-245.8	-4.4%
Other	225.6	251.4	25.8	11.4%
Including bonds	5,457.5	4,992.9	-464.6	-8.5%

Structured finance

In accordance with the Responsible Development Strategy and the Bank's mission, BGK plays a central role in the provision of financial support to entities operating in the strategic sectors of the Polish economy. In 2016, the Bank focused on structured transactions which enable the implementation of major investment projects, mainly in the energy and resources as well as the transportation sector. The share of structured finance products in the Bank's whole portfolio was growing steadily to reach 49.5% as at the end of 2016 (versus 40.0% a year before). In 2016, owing to the Juncker Plan (European Fund for Strategic Investments) and its active participation in syndicates, the Bank used

the leverage mechanism to a greater extent; when financing investment projects which are of strategic importance to the State, not only did it use its own funds but also relied more heavily on debt.

As at the end of 2016, the carrying amount of credit exposures in this area was PLN 16,020.8 million, while the total exposure, including off-balance sheet liabilities, was PLN 20,945.4 million.

Local governments and other public sector entities

The volume of local government and municipal enterprise exposures as at the end of 2016 was lower than in 2015 by PLN 407.7 million and it totalled PLN 6,592.8 million. The said decrease was driven by stagnation on the procurement market related to loans to local governments – the value of invited tenders was lower by 20% as compared to 2015. In 2016, the role of cooperative banks, which pursued aggressive pricing policies to increase their share in the local government market, became more important.

In 2016, the trend related to contraction of the procurement market with respect to credit products dedicated to entities that engage in typical utility services (water, sewage, heat, and public transport), which began in the second half of 2015, continued. This was due to the announcement of the new EU perspective, as the funds are expected to support the implementation of the key projects and investments launched by municipal enterprises, as well as amendments to the public procurement law doing away with the requirement to invite tenders for funding by entities other than local government entities.

The value of loans granted to public healthcare entities went up by PLN 98.8 million to PLN 558.2 million as at the end of 2016. New transactions entered into in 2016 were mainly transactions whereby revolving credit was extended to public healthcare institutions.

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 2016, the Bank intensified its activity which is not only aimed to support exports but also foreign expansion through investments made by Polish business entities on international markets.

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

One of the Bank’s objectives is to support Polish exports, which may take the form of export credit granted under the “Finansowe Wspieranie Eksportu” 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 by the Bank under the Programme are considered particularly attractive on higher risk markets (such as Belarus), where the offering of commercial banks is limited and the borrowing costs charged by local banks are high.

The export credit extended by the Bank under the Programme by the end of 2016 totalled PLN 2,318 million (up by PLN 493 million year on year). The amount disbursed by the end of 2016 was PLN 1,765 million, while the value of the supported export contracts was PLN 3,054 million.

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

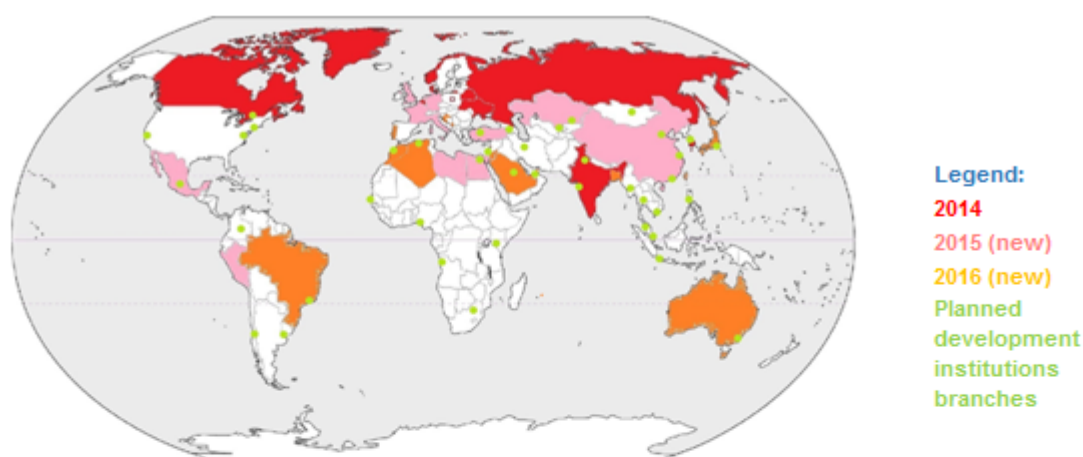
In 2015, considering a growing interest in financing, expressed by Polish businesses operating on international markets, the Bank expanded its offering of loans supporting foreign investment by Polish enterprises. This translated into a considerable increase in the value of loans granted by the Bank in 2016.

The solutions offered by BGK in connection with the “Finansowe Wspieranie Eksportu” Government Programme were complementary to those available under the Programme itself and to products offered by other financial institutions. The Bank was capable of entering markets in highly developed countries by offering various forms of financing which are not provided by commercial banks. This also ensured geographical diversification of its 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 funding provided by BGK to support exports and foreign expansion in 2016 totalled PLN 1,289 million. The said amount included PLN 627 million allocated to exports (both under the “Finansowe Wspieranie Eksportu” Government Programme and as part of the Bank’s own activities) and PLN 662 million allocated to foreign expansion (only as part of the Bank’s own activities).

Agreements signed (and letters of credit handled) by the Bank between 2014 and 2016 (under the “Finansowe Wspieranie Eksportu” Government Programme and as part of the Bank’s own activities) by geography have been presented on Diagram 5.

Diagram 5



2014	2015 (cummulatively)	2016 (cummulatively)
9 countries	22 countries	36 countries
Europe: Belgium, Belarus, Denmark, Ukraine, Russia, Norway Northern and Southern America: Canada Asia: South Korea, India	Europe: Belgium, Belarus, Denmark, Ukraine, Russia, Norway, France, the Netherlands, Germany, Great Britain, Italy Northern and Southern America: Canada, Mexico, Peru Asia: South Korea, India, China, Bangladesh, Kazakhstan, Turkey Africa: Egipt, Libia	Europe: Belgium, Belarus, Denmark, Ukraine, Russia, Norway, France, the Netherlands, Germany, Great Britain, Italy, Croatia, Montenegro, Portugal Northern and Southern America: Canada, Mexico, Peru, Brazil Asia: South Korea, India, China, Bangladesh, Kazakhstan, Turkey, Saudi Arabia, Japan, United Arab Emirates, Jordan, Lebanon, Taiwan Africa: Egipt, Libia, Algeria, Morocco, Mauritius Australia

Loans of the former National Housing Fund (Residential Construction Programme)

As at the end of 2016, the balance of loans granted from the former National Housing Fund was PLN 5,378.0 million and it decreased by PLN 245.8 million on the preceding year. The said decrease was driven by repayment of loans granted in the preceding years. In 2016, one loan of PLN 31.6 million was provided under the Programme. After closing the abovementioned fund the Bank supports social housing programmes in a different ways.

Loan portfolio statistics

For purposes of ensuring comparability with market data, Tables 13 and 14 present the loan portfolio of BGK broken down by sector. Additionally, changes in the lending activity by sector is presented in Table 13.

TABLE 13: Value and structure of the gross loan portfolio (in PLN million)

Item	2015		2016		Change versus 2015	
	Performance	Structure	Performance	Structure	in nominal terms	%
Gross loans	22,417.2	100.0%	27,352.4	100.0%	4,935.2	22.0%
- financial sector entities	888.6	4.0%	854.4	3.1%	-34.2	-3.8%
- non-financial sector entities	15,565.6	69.4%	20,913.0	76.5%	5,347.4	34.4%
- individuals	65.6	0.3%	58.4	0.2%	-7.1	-10.8%
- businesses	15,500.1	69.1%	20,854.6	76.2%	5,354.5	34.5%
- public sector entities	5,962.9	26.6%	5,584.9	20.4%	-378.0	-6.3%
- central government entities	237.1	1.1%	246.6	0.9%	9.5	4.0%
- local government entities	5,725.8	25.5%	5,338.3	19.5%	-387.5	-6.8%
- gross loan portfolio of the former National Housing Fund	5,623.8	25.1%	5,378.0	19.7%	-245.8	-4.4%

In 2016, the volume of loans granted to public sector entities fell by PLN 378.0 million, including mainly to local government entities by PLN 387.5 million. This was accompanied by the Bank's increased market share in that sector. The most considerable increase was seen in the non-financial sector and it was mainly attributable to structured finance provided to businesses.

The share of BGK in the loan market has been presented in Table 14.

TABLE 14: The share of BGK in the loan market

Item	Performance		Change versus 2015 in p.p.
	2015	2016	
Loans	2.2%	2.6%	0.4
- financial sector entities	1.6%	1.5%	-0.1
- non-financial sector entities	1.7%	2.1%	0.4
- businesses	3.9%	4.9%	1.0
- individuals	0.0%	0.0%	0.0
- public sector entities	16.8%	17.0%	0.2
- central government entities	20.8%	25.3%	4.5
- local government entities	16.7%	16.8%	0.1

Source: NBP figures and own calculations (BGK and financial sector figures have been calculated using different methodologies: banks apply IAS, while the exposures of BGK are classified in accordance with the Regulation of the Minister of Finance laying down the principles applicable to the recognition of banking risk reserves)

As at the end of 2016, the Bank's market share was 2.6%. The increase was mainly driven by the implementation of the Bank's strategy with respect to the funding of investments and corporate growth. The major part of the Bank's financing was arranged through its participation in syndicates formed together with commercial banks. It also offered funding for long-term projects. The Bank has not been granting personal loans since 2009. SMEs are mainly beneficiaries of indirect financing.

Information concerning the loan portfolio quality has been presented in Table 15.

TABLE 15: Quality structure of the loan portfolio (in PLN million)

Item	2015		2016		Change versus 2015	
	Performance	Structure	Performance	Structure	In nominal terms	%
Gross loan portfolio	22,417.2	100.0%	27,352.4	100.0%	4,935.2	22.0%
- normal	18,864.4	84.2%	23,264.6	85.1%	4,400.3	23.3%
- under observation	1,097.9	4.9%	1,211.9	4.4%	113.9	10.4%
- non performing	2,454.9	11.0%	2,875.9	10.5%	421.0	17.1%
substandard	844.0	3.8%	1,174.7	4.3%	330.7	39.2%
doubtful	1,118.2	5.0%	1,204.8	4.4%	86.5	7.7%
bad debt	492.7	2.2%	496.5	1.8%	3.8	0.8%
Specific purpose provisions	620.9	-	723.2	-	102.3	-

The volume of non-performing exposures increased by PLN 421.0 million (17.1%). However, owing to a considerably higher increase in the total gross loan portfolio, the share of non-performing loans went down from 11.0% to 10.5%. Reclassification of debt that had already been serviced to this category was the key factor driving the said increase in the value of non-performing loans. As regards the gross portfolio of credit exposures as a whole (gross loans, commercial and municipal bonds), the ratio did not change and stayed at the level of 8.9%.

The level of exposures past due by more than 90 days went up by PLN 28 million, i.e. 9.1%, year on year, to PLN 336.0 million and constituted 1.0% of the portfolio.

As at the end of 2016, the total debt subject to collection or restructuring was PLN 933.9 million (784 transactions), while the recoveries in 2016 totalled PLN 87.3 million.

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.

The level and structure of amounts due which were subject to enforced collection have been presented in Table 16.

TABLE 16: Enforcement title number and value (in PLN million)

Receivables by type	31.12.2015			31.12.2016		
	no.	exposure value	security value	no.	exposure value	security value
construction loans	12	163.8	0.7	12	166.1	122.1
investment loans	14	24.6	1.0	14	15.9	1.0
working capital loans	17	27.4	0.0	10	24.8	0.0
surety bonds and guarantees	229	64.9	0.0	198	57.4	0.8
other	62	20.0	0.3	36	17.2	0.0
Total	334	300.7	2.0	270	281.4	123.9

5.3 DEPOSITS

In 2016, BGK saw an increase in the balance of deposits from PLN 19,874.1 million to PLN 37,599.7 million, i.e. by 89.2%. In terms of value, the most considerable increase of PLN 8,224.9 million (a change by 73.0%) was seen in the central government segment. In 2016, the value of business deposits went up substantially in the non-financial segment (by PLN 6,366.4 million, i.e. 97.2%).

The value and structure of the deposit base of BGK has been presented in Table 17.

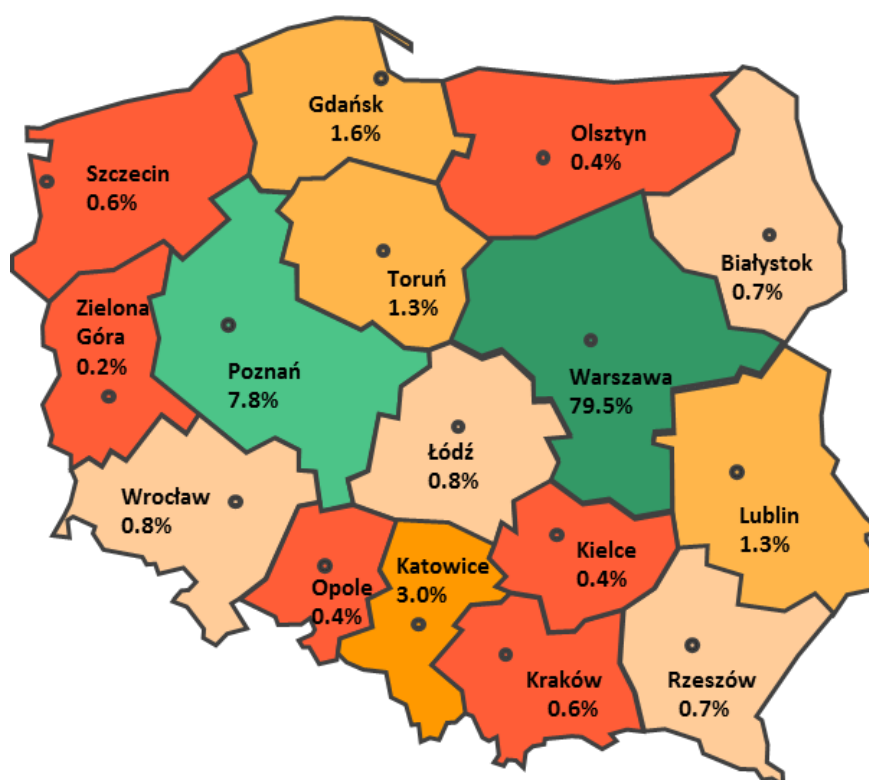
TABLE 17: Value and customer structure of the deposit base (in PLN million)

Item	2015		2016		Change versus 2015	
	Performance	Structure	Performance	Structure	In nominal terms	%
Deposits from customers	19,874.1	100.0%	37,599.7	100.0%	17,725.6	89.2%
- financial sector entities	954.4	4.8%	2,094.6	5.6%	1,140.2	119.5%
- non-financial sector entities	6,577.0	33.1%	12,947.8	34.4%	6,370.8	96.9%
- individuals	29.6	0.1%	34.0	0.1%	4.4	14.9%
- businesses	6,547.4	32.9%	12,913.8	34.3%	6,366.4	97.2%
- public sector entities	12,342.7	62.1%	22,557.3	60.0%	10,214.6	82.8%
- central government entities	11,260.2	56.7%	19,485.1	51.8%	8,224.9	73.0%
- local government entities	1,082.5	5.4%	3,072.2	8.2%	1,989.7	183.8%

The rise in the deposit base as at 31 December 2016 was affected by two factors. First, the number of sources of funding used by the Bank grew, which was accompanied by increased lending and investing activities of BGK. Second, the Bank's liquidity reached a safe level in the last quarter of the year, which typically involves considerable fluctuations in the public sector deposit volume. As at the end of December 2016, the balance of public sector deposits was considerably higher than in the preceding year.

The geographical structure of deposits which constituted the sources of funding used by the Bank has been presented on Diagram 6.

Diagram 6



5.4 THE BANK'S ACTIVITY ON THE MONEY MARKET AND THE MARKET OF DEBT SECURITIES

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 liquidity surpluses);
- maintenance of a liquidity buffer in the longer term by holding short-term and/or highly liquid assets.

The Bank continued to play an active role on the Polish money market, where it acted as the Money Market Dealer.

The Bank's day-to-day liquidity needs were satisfied on the interbank market through the use of basic liquidity instruments, mainly deposits, term deposits and FX swap transactions, in addition to purchases of securities in reverse repo and buy-sell-back transactions as well as sales of securities in repo and sell-buy-back transactions. In 2016, the Bank'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 the Bank allocated its liquid assets to the portfolio of Treasury debt securities on an ongoing basis, its value exceeded PLN 8.5 billion as at the end of 2016. The structure of the portfolio of debt securities has been presented in Table 18.

TABLE 18: Value and structure of the portfolio of debt securities (in PLN million)

Item	2015		2016		Change versus 2015	
	Performance	Structure	Performance	Structure	In nominal terms	%
Debt securities (measured at cost)	13,265.2	100.0%	30,995.3	100.0%	17,730.1	133.7%
- NBP money bills	237.0	1.8%	15,803.1	51.0%	15,566.1	6568.0%
- T-bonds	5,801.6	43.7%	8,556.5	27.6%	2,754.9	47.5%
- municipal bonds	1,072.9	8.1%	1,014.2	3.3%	-58.7	-5.5%
- other securities	6,153.7	46.4%	5,621.5	18.1%	-532.2	-8.6%

"Other securities" comprise debt securities issued by banks as well as commercial bonds. As at the end of 2016, the Bank's exposure to those securities decreased by PLN 0.5 billion.

As part of its activity on the money market and the market of debt securities, the Bank cooperated with the Ministry of Finance and invested excess liquidity of the State Treasury.

5.5 SURETY BONDS PROVIDED UNDER GOVERNMENT PROGRAMMES

BGK provides surety bonds in compliance with the Act of 8 May 1997 on surety bonds and guarantees of the State Treasury and certain legal persons (Journal of Laws of 2015, item 1052, as amended). In 2016, such facilities were offered under the "Support for entrepreneurship using surety bonds and guarantees of Bank Gospodarstwa Krajowego" Programme (the "Support for Entrepreneurship Programme").

In 2016, the activities carried out by Bank Gospodarstwa Krajowego in the field of surety bonds focused on four areas:

- continuation of the "De minimis guarantees for micro, small and medium-sized enterprises" Government Programme, where the annual value of the facilities was PLN 9.4 billion;
- use of EU funds allocated to surety bonds and guarantees in the SME sector – an initiative under the Operational Programme Innovative Economy and COSME, work on the Operational Programme Smart Growth as well as preparation of the Bank for the replacement of the *De Minimis* Guarantee Programme with programmes launched in the new 2014-2020 perspective after 2017;
- administration of the old portfolio of surety bonds and guarantees;
- cooperation with surety funds.

Support for Entrepreneurship Programme

In 2016, the Bank offered the following forms of guarantees and surety bonds:

- loan repayment guarantees/surety bonds provided on a portfolio basis, including:
 - loan repayment guarantees as part of the **Portfolio De Minimis Guarantee Facility (PDF)**; additionally the PDF includes *de minimis* guarantees combined to secure loan repayment with a surety bond provided by the surety fund (PDF PLUS);
 - loan repayment guarantees as part of the Portfolio De Minimis Guarantee Facility (PDF) offered under the Guarantee Fund of the Operational Programme Innovative Economy;
 - loan repayment guarantees as part of the Portfolio Guarantee Facility with EIF counter-guarantees under the COSME Programme (PGF COSME);
 - student loan repayment guarantees;
- guarantees/surety bonds provided on a case-by-case basis, including:
 - loan repayment guarantees and surety bonds;
 - performance bonds.

Portfolio guarantees and surety bonds were offered under agreements entered into by BGK with the lending banks. As at 31 December 2016, BGK was a party to 34 agreements with 21 banks,

whereby facilities were provided in the total amount of PLN 39,859.2 million, including:

- PDF – 22 agreements of PLN 39,002.7 million;
- PDF PLUS – 1 agreement of PLN 76.5 million;
- PGF COSME – 11 agreements of PLN 780.0 million.

PDF guarantees were made available under the *de minimis* aid limit for one business entity from the micro, small and medium-sized enterprise sector. Under a Ordinance of the Minister of Finance, the term of the *De Minimis* Guarantee Programme was extended until the end of 2017. PDF does not generate any credit risk for BGK and is not recognized in the accounting records of the Bank.

De minimis guarantees may be used for purposes of securing the repayment of both revolving credit and investment loans, up to the maximum limit of 60% of the loan amount. The maximum guarantee amount may not exceed PLN 3.5 million. A guarantee may be issued for a term of 27 months in the case of revolving credit and for a term of 99 months for investment loans. The commission charge is 0.5% p.a. and it is payable in advance for a period of one year.

The PGF COSME guarantee may be used for purposes of securing the repayment of new revolving credit and investment loans up to the maximum amount of PLN 600,000. It may be issued for a term of 27 months in the case of revolving credit and for a term of 99 months for investment loans. The commission charge on the guarantee is 1% p.a. and it is payable in advance for a period of one year. The guarantee may not represent more than 80% of the loan amount.

Additionally, as at 31 December 2016, BGK was a party to 6 agreements with lending banks, which set out the terms and conditions of issuing guarantees/surety bonds on a case-by-case basis.

Sales of surety bonds and guarantees in 2016 have been presented in Table 19.

TABLE 19: Sales of surety bonds and guarantees in 2016 (in PLN million)

Item	2016	
	Volume	Value
Surety bonds and guarantees provided on a portfolio basis	50,042	9,622.7
Portfolio De Minimis Guarantee Facility	47,820	9,360.5
PGF COSME	2,222	262.2
TOTAL	50,042	9,622.7

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 guarantee funds which were taken over by BGK in 2009. At the time when they were most active, the funds totalled ca. PLN 200 million and PLN 1,000 million, respectively. Currently, the portfolio includes expiring or impaired items. Off-balance sheet liabilities arising from surety bonds provided as a security for repayment of business loans from the former KFPK amounted to PLN 66.8 million as at 31 December 2016. Off-balance sheet liabilities arising from surety bonds provided from the former FPU amounted to PLN 10.4 million as at 31 December 2016. Gross receivables arising from KFPK surety bonds and guarantees used as at the end of 2016 totalled PLN 52.2 million.

Diversification of the sources of funding and work on a surety bond and guarantee system in the 2014-2020 EU Perspective

In 2016, BGK continued work on the concept of the *de minimis* guarantee programme after 2017. The said concept is based on the assumption of diversification of the sources of funding for the costs and payments under the said guarantees so that they are not covered only from the government budget but also by EU funds released from the financial engineering instruments available in the existing and new EU financial perspective, including funds settled under the Operational Programme Innovative Economy and the Operational Programme Smart Growth.

On 29 November 2016, BGK entered into an agreement with the State Treasury to create and supply capital to a Guarantee Fund for innovative enterprises from the funds available under the Operational Programme Smart Growth for the years 2014-2020 (OP SG GF). The total financial contribution of the EU is PLN 525 million. Under the said agreement, the financial contribution made by the EU (less the amount allocated to management fees, which represents 10% of the contribution itself) will be sufficient to issue guarantees in the total amount of PLN 1.4 billion.

In 2016, a pilot system project was launched as part of measure 4.7 of OP IE, where the Bank offers free-of-charge guarantees securing the repayment of loans to business entities that satisfy the innovation criteria. The increased sales activity of BGK and the lending banks resulted in the use of the total allocation amount of PLN 250 million. With the approval of the OP IE Intermediate Body, sales transactions were entered into until 25 January 2017. Owing to the guarantees, business entities obtained loans totalling PLN 457.1 million. The commission charge for a guarantee was 0%. The management fees were covered by OP IE GF and the guarantees will be paid from the fund.

On 30 November 2016, an agreement was entered into by BGK, the Ministry of Development and Krajowy Fundusz Kapitałowy, whereby issued guarantees may be financed under the Swiss-Polish Cooperation Programme. In December 2016, BGK received the first disbursement of the Swiss funds in the amount of PLN 17.4 million, which were used for purposes of issuing guarantees of PLN 87.1 million (with a multiplier of 5). Decisions concerning further disbursements of funds will be taken following the subsequent reviews of Krajowy Fundusz Kapitałowy.

In the first quarter of 2017, the measures taken to receive proceeds from interest on the principal allocated to financial engineering instruments under the Operational Programme Innovative Economy 2007-2013 (OP IE), which began in the first half of 2016 and were aimed to finance the issue of *de minimis* guarantees (PDF), will be completed. To this end, BGK entered into a separate agreement with the Minister of Development and Finance in February 2017, whereby proceeds from interest on the principal allocated to financial engineering instruments under OP IE will be transferred to a separate bank account maintained by BGK. The estimated amount of the proceeds is PLN 85 million. The said proceeds, including bank interest due, will be used for purposes of issuing guarantees by 15 March 2017. That enabled the provision of new loans of ca. PLN 140 million in total and avoiding the necessity to refund the interest on the principal allocated to financial engineering instruments under OP IE 2007-2013 to the budget of the European Union.

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 loans to micro, small and

medium-sized enterprises. As at 31 December 2016, the Bank's exposure to 19 surety funds, measured at cost, was PLN 65.4 million. Their capital allocated to surety bonds totalled PLN 652.4 million.

In 2016, the funds provided 5,599 surety bonds of PLN 727.4 million. As at 31 December 2016, the active surety bond portfolio totalled PLN 1,201.0 million.

The surety funds and BGK offer the PDF PLUS facility, which is aimed to facilitate cooperation between the said funds and banks. In relation to that product, BGK issues portfolio *de minimis* guarantees (on the PDF terms) to secure the repayment of revolving credit offered by commercial banks to SMEs, which represent 60% of its amount, while the surety funds also provide a portfolio guarantee for the repayment of 20% of the principal on commercial terms. In whole, the facility secures the repayment of 80% of the principal amount of the loan, which may not exceed PLN 1 million.

As part of the PDF PLUS facility, the funds sold 199 surety bonds of PLN 10.0 million by 31 December 2016. The Bank issued PDF PLUS guarantees of PLN 30.1 million.

5.6 PORTFOLIO OF SHARES

As at 31 December 2016, the Bank's total exposure to shares measured at carrying amount was PLN 962.7 million and it decreased by PLN 5.9 million on the preceding year. BGK is the shareholder of 39 commercial companies. The structure of the portfolio of shares held by BGK has been presented in Table 20.

TABLE 20: Composition and structure of the portfolio of shares at contribution value/cost (in PLN million)

Item	2015		2016		Change YoY		2016 Share of BGK in the share capital
	Contributed value	Carrying amount	Contributed value	Carrying amount	in nominal terms	%	
Shares in public companies	889.3	787.8	882.1	777.0	-10.7	-1.4%	-
PKO BP S.A.	800.0	669.2	800.0	689.1	19.8	3.0%	2.0%
PZU S.A.	13.8	52.5	13.8	51.2	-1.2	-2.4%	0.2%
POLNORD S.A.	23.2	30.0	23.2	16.9	-13.1	-43.6%	6.4%
BIOTON S.A.	9.7	11.0	9.7	7.5	-3.5	-31.5%	1.1%
Polimex Mostostal S.A.	23.4	5.3	23.4	3.4	-1.9	-35.1%	1.1%
Elektrociepłownia Będzin S.A.	10.3	4.6	10.3	7.2	2.6	55.4%	9.9%
Visa Inc.	-	-	1.7	1.7	1.7	-	<0,1%
Pekaes S.A.	8.9	15.2	-	-	-15.2	-100.0%	-
Shares in subsidiaries and associates*	92.0	90.5	104.0	102.4	12.0	13.2%	-
BGK Nieruchomości S.A.	14.0	14.0	18.0	18.0	4.0	28.5%	100.0%
Towarzystwo Funduszy Inwestycyjnych BGK S.A.	13.0	13.0	21.0	21.0	8.0	61.5%	100.0%
KUKE S.A.	63.0	63.0	63.0	63.0	-	0.0%	36.7%
Krajowa Grupa Poręczeń Sp. z o.o.	2.0	0.4	2.0	0.3	-0.0	-9.3%	39.3%
Minority interests	58.2	28.5	68.5	23.5	-5.1	-17.8%	-
Krajowy Fundusz Kapitałowy S.A.	33.8	-	43.8	-	-	-	100.0%
Polski Fundusz Rozwoju S.A.	15.0	15.0	15.0	15.0	-	0.0%	1.3%
Europejski Fundusz Inwestycyjny	8.0	8.0	8.3	8.3	0.3	3.8%	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. scr1	0.1	0.1	0.1	0.1	0.0	3.8%	<0,1%
Huta Jedność S.A. w likwidacji	0.1	-	0.1	-	-	-	0.6%
Visa Europe Ltd	0.0	5.4	-	-	-5.4	-100.0%	-
Shares in surety funds	67.1	61.9	65.4	59.8	-2.1	-3.4%	-
Total	1,106.5	968.6	1,120.0	962.7	-5.9	-0.6%	-

* excluding surety funds

BGK held shares in 7 public companies, including 6 which are listed on the Warsaw Stock Exchange. As at 31 December 2016, the Bank's total exposure to shares measured at initial value was PLN 1,120.0 million and it increased by PLN 13.5 million on the preceding year. The shares in PKO BP S.A. received by BGK free of charge from the State Treasury in 2015 for purposes of the Bank's investing activities, represent the key item of the portfolio of shares in terms of value. Additionally, the Bank holds shares in 32 non-public companies, including 20 regional and local surety funds.

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. An overview of each fund has been presented in the table below. The Bank was an investor in 7 closed-end non-public investment funds managed by Towarzystwo Funduszy Inwestycyjnych BGK S.A. Those funds invest mainly in infrastructure and residential property.

An overview of each fund has been presented below.

TABLE 21: Investment funds with BGK as an investor

Fund	Investment strategy assumptions	Geographical structure	Established on
Fundusz Ekspansji Zagranicznej FIZAN (Foreign Expansion Closed-end Investment Private Equity Fund)	The fund carries out projects in cooperation with Polish enterprises undergoing expansion.	No geographical or industry focus.	25.06.2015
Fundusz Inwestycji Infrastrukturalnych - Dłużny FIZAN (Infrastructure Investments Debenture Closed-end Investment Private Equity Fund)	The funds support investment projects in the following industries: energy, oil and gas, transportation and logistics. The projects may cover construction and modernization of assets.	The funds' investments focus on Polish and, additionally, on crossborder projects.	02.07.2015
Fundusz Inwestycji Infrastrukturalnych - Kapitałowy FIZAN (Infrastructure Investments Capital Closed-end Investment Private Equity Fund)	The fund supports investments of companies strongly related with the Polish economy. It focuses on manufacturing companies and entities providing services to the manufacturing industry.	Production assets located and key revenue generated in Poland.	02.07.2015
Fundusz Inwestycji Samorządowych FIZAN (Municipal Investments Closed-end Investment Private Equity Fund)	The fund supports investment projects carried out in cooperation with local government entities in the following industries: heat engineering, waste management, regional airports, infrastructure and transportation.	No geographical focus.	02.07.2015
Fundusz Muncypalny FIZAN (Municipal Closed-end Investment Private Equity Fund)	The fund co-finances local government investments in the real property market with a particular focus on the housing market.	It carries out investment projects in cooperation with local government entities countrywide.	30.12.2015
Fundusz Sektora Mieszkań na Wynajem FIZAN (Dwelling for Rent Sector Closed-end Investment Private Equity Fund)	The fund finances companies holding real properties for rent.	Investment projects in Poland.	26.08.2014

A list of investment certificates held by the Bank as at 31 December 2016 has been presented in Table 22.

TABLE 22: List of investment certificates held by the Bank as at 31 December 2016

Item	Number of investment certificates held by the Bank	Total issue price of investment certificates (in PLN million)	Total payments to the fund made by BGK (in PLN million)	Value of investment certificates recognized in the Bank's accounting records (in PLN million)		Percentage share of BGK** (2016r.)
				2016	2015	
Fundusz Sektora Mieszkań na Wynajem FIZAN (Dwelling for Rent Sector Closed-end Investment Private Equity Fund)	1,103,946	1,090.2	712.4	722.5	247.3	100.0%
Fundusz Inwestycji Polskich Przedsiębiorstw FIZAN (Polish Enterprises Investments Closed-end Investment Private Equity Fund)	345,600	345.6	291.1	273.1	3.2	23.0%
Fundusz Inwestycji Infrastrukturalnych - Kapitałowy FIZAN (Infrastructure Investments Capital Closed-end Investment Private Equity Fund)	259,362	259.4	241.3	231.3	173.5	11.8%
Fundusz Inwestycji Samorządowych FIZAN (Municipal Investments Closed-end Investment Private Equity Fund)	25,000	25.0	24.5	22.2	22.5	4.2%
Fundusz Ekspansji Zagranicznej FIZAN (Foreign Expansion Closed-end Investment Private Equity Fund)*	10,000	44.2	10.3	9.8	4.4	100.0%
Fundusz Muncypalny FIZAN (Municipal Closed-end Investment Private Equity Fund)	88,696	36.3	9.4	9.0	0.1	100.0%
Fundusz Inwestycji Infrastrukturalnych - Dłużny FIZAN (Infrastructure Investments Debenture Closed-end Investment Private Equity Fund)	129,681	129.7	8.2	0.3	4.4	5.9%
TOTAL		1,930.4	1,297.2	1,268.3	455.4	-

*translated at the average EUR/PLN exchange rate of the National Bank of Poland as at 31.12.2016

Compared to the data as of 31 December 2015 the total initial value of the investment certificates possessed by the Bank increased more than twice by PLN 1,048.7 million. The largest growths refers to Fundusz Sektora Mieszkań na Wynajem FIZ AN (Dwelling for Rent Sector Closed-end Investment Private Equity Fund) and Fundusz Inwestycji Polskich Przedsiębiorstw FIZAN (Polish Enterprises Investments Closed-end Investment Private Equity Fund) amounting to PLN 535.9 million and PLN 302.4 million respectively.

Major events in the portfolio of shares

PEKAES S.A.

In 2016, the Bank sold 1,132,363 shares in PEKAES S.A. in response to a tender offer made by the related parties of Innova Capital sp. z o.o., an investment company. The Bank's proceeds from the transaction were PLN 17.1 million.

Visa Inc.

In 2016, the Bank was a party to a transaction involving conversion of one share in Visa Europe Ltd. into 369 preference shares in Visa Inc., which may be converted into ordinary shares. As a result of the transaction, BGK received also a payment of EUR 1.0 million and was granted the right of earn-out.

BGK Nieruchomości S.A.

At the turn of 2016 and 2017, BGK Nieruchomości S.A. launched a pilot investment project under the "Mieszkanie Plus" Government Programme. Since 2014, the company has been the manager of the assets of Fundusz Sektora Mieszkań na Wynajem FIZAN (Dwelling for Rent Sector Closed-End Investment Private Equity Fund), which issued investment certificates with the total issue price of PLN 1.1 billion by the end of 2016 (BGK is the only investor in the fund). In 2016, BGK provided a capital injection of PLN 4 million to BGK Nieruchomości S.A. Thus far, the Bank has invested PLN 18 million in that company and is its sole shareholder.

Towarzystwo Funduszy Inwestycyjnych BGK S.A.

The company is the manager of 7 investment funds where BGK is an investor. In 2016, the Bank provided a capital injection of PLN 8 million to Towarzystwo Funduszy Inwestycyjnych BGK S.A. so that the company could satisfy its capital requirements. The amount invested in the company thus far is PLN 21 million. BGK is the sole shareholder of the company.

Krajowy Fundusz Kapitałowy S.A.

At the turn of 2016 and 2017, the Management Board of the company held an open competition, as a result of which it entered into finance contracts with two *venture capital* funds.

In 2016, Krajowy Fundusz Kapitałowy S.A. received a confirmation from the Ministry of Development that the funds remaining after the settlement of a grant from the Ministry of Economy of PLN 16.1 million had been classified as the company's own funds. Additionally, last year the company received a refund of overpaid income tax on interest income on the OP IE grant held in an escrow account, in the amount of PLN 12.8 million.

In 2016, an increase in the company's share capital by PLN 10 million to PLN 43.8 million was recorded in the National Court Register. The Bank holds 100% of shares and 100% of voting rights at the General Shareholders' Meeting of Krajowy Fundusz Kapitałowy S.A. As of 31 December 2016 there is no relationship meeting the definition of control between KFK S.A. and the parent.

Bielski Fundusz Poręczeń Kredytowych sp. z o.o.

Last year, the Bank sold 960 shares in Bielski Fundusz Poręczeń Kredytowych sp. z o.o. totalling PLN 960,000 to the Municipality of Bielsko-Biała.

Fundusz Poręczeń Kredytowych Sp. z o.o. in liquidation

In 2016, the Bank received a payment of PLN 718,000 following the distribution of the assets of the liquidated surety fund with its registered office in Jastrzębie Zdrój.

5.7 RELATED-PARTY TRANSACTIONS

Detailed information concerning transactions entered into by the Bank and parties related to it by capital or organization has been presented in Section 8.20 of the Financial Statements of BGK.

5.8 CONSOLIDATION OF PUBLIC FINANCES

In accordance with the Public Finance Act of 27 August 2009 (with subsequent amendments), 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.

Under the Agreement of 19 December 2014 between the Minister of Finance and the Bank (with subsequent amendments), BGK is responsible for:

- carrying out operations related to the acceptance of cash surpluses of public sector entities as deposits or under management;
- refunding the amounts paid to the Minister of Finance, including interest, to the bank accounts of those entities;
- maintaining bank accounts for the Ministry of Finance for purposes of accepting amounts from those entities and their refund, in addition to transferring interest accrued on such amounts;
- processing credit 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 the Bank (with subsequent amendments), 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 purposes of accepting amounts from the deposit accounts of the Ministry of Finance as overnight deposits and their refund, 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.

Consolidation

As at 31 December 2016, BGK consolidated 2,179 bank accounts where public funds were deposited. In 2016, the number of transactions whereby term deposits were made or funds were placed under management was 7,604. As at 31 December 2016, the value of transactions whereby term deposits were made or funds were placed under management by public sector entities was PLN 26.9 billion. The remaining funds of the said entities were transferred to overnight deposits/placed under overnight management to the account of the Ministry of Finance. As at 31 December 2016, the value of transactions whereby overnight deposits were made or funds were placed under overnight management was PLN 8.7 billion.

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 to deposits placed under the control of the court for each court of general jurisdiction and each military court. As from 1 January 2015, each such deposit has been kept in the bank account of the Minister of Finance. As at 31 December 2016, BGK maintained deposit accounts for the Ministry of Finance, dedicated to the provision of services to 295 courts of general jurisdiction and military courts. Five summary accounts were opened for each court

in PLN/EUR/USD/GBP/CHF in addition to 6 auxiliary accounts to handle cash transactions. As at 31 December 2016, the consolidated amount of deposits placed under the control of the court was PLN 4.1 billion.

5.9 COOPERATION WITH INTERNATIONAL PUBLIC INSTITUTIONS

Internationally, the Bank cooperates regularly with three groups of public entities, namely international financial institutions, international associations and foreign development banks.

COOPERATION WITH INTERNATIONAL FINANCIAL INSTITUTIONS (IFI)

European Investment Bank (EIB)

The European Investment Bank is the major foreign partner of BGK as regards the securing of funding for purposes of the programmes, funds and own activities of the Bank.

In 2016:

- BGK continued the allocation of funds under the EIB Global Loan IV finance contract of December 2013 (EUR 125 million) and entered into a new Multi-Beneficiary Intermediated Loan V finance contract, where the loan amount was EUR 125 million. The funds secured under the global EIB loans are used for purposes of funding investment projects implemented by local government entities, SMEs as well as mid-caps;
- a new finance contract of EUR 270 million was entered into with EIB for the benefit of the National Road Fund, with a view to supporting investment in road infrastructure (S7 road from Gdańsk to Elbląg);
- an agreement was signed with EIB to cooperate as part of the European Investment Advisory Hub (EIAH).

In addition, in 2016 the Bank and EIB were parties to several transactions, including the provision of funding for the investment programme of Przewozy Regionalne as part of the European Investment Plan (EFIS). Finally, the Bank cooperates with EIB in the implementation of the JESSICA initiative.

European Investment Fund (EIF)

In 2016, the Bank joined forces with the European Investment Fund mainly to issue guarantees for the SME sector under the COSME Programme and with regard to the Polish Growth Fund of Funds.

BGK issued 2,222 guarantees with EIF counter-guarantees of ca. PLN 262 million to SMEs. The total value of commercial bank loans the repayment of which was secured by those guarantees was PLN 327.8 million.

In partnership with EIF, the Bank established the Polish Growth Fund of Funds of EUR 90 million, which is managed by EIF.

The Fund invests in investment funds which provide funding to business entities that are growing or expanding their operations.

Three agreements totalling EUR 35 million were entered into with investment funds in Poland by the end of 2016. Further investments are expected to be made in the first half of 2017.

The Bank has been cooperating with EIF since 2013. BGK holds 5 shares in EIF and is its only Polish shareholder.

Other IFI

In 2016, BGK regularly exchanged information on potential areas of cooperation also with other international financial institutions – the Council of Europe Development Bank (CEB), the World Bank (WB) or the European Bank for Reconstruction and Development (EBRD). The World Bank joined the regular conference organized by BGK for local government entities as a partner. The Bank is also conducting negotiations with the Council of Europe Development Bank over a global loan to finance a new social housing programme.

COOPERATION WITH INTERNATIONAL TRADE ASSOCIATIONS AND ORGANIZATIONS

In 2016, BGK was a member of 10 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);
- Long-Term Investors Club (LTIC);
- International Project Finance Association (IPFA).

As a member of these associations, BGK is informed of EU regulations which 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.

BILATERAL COOPERATION WITH FOREIGN PUBLIC FINANCIAL INSTITUTIONS

BGK 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, the Bank has direct access to information concerning their operations, may exchange know-how and establish business relationships in selected areas.

In 2016, bilateral relations were further strengthened, in particular with the largest European development banks – KfW in Germany, CDC in France, CDP in Italy and ICO in Spain. In cooperation with CDP, the Bank launched a pilot short-term staff exchange project. It also continued the allocation of a global loan obtained from KfW to provide funding to SMEs (EUR 100 million).

5.10 TRANSACTION BANKING

The Bank offers a comprehensive range of transaction banking products that facilitate the day-to-day handling and management of the finances of both enterprises and local government entities. In 2016, the Bank launched initiatives with a view to granting its customers access to world-class deposit and TB products, through appropriate system solutions, optimum product documentation and specialist support provided by Cash Management Experts. Having improved the process of customer onboarding and the handling of cash management products, the Bank reduced the volume of documents to be signed by the customer by ca. 50%, while a revision of the Price List enabled BGK to bring its offering into line with the market conditions.

New Electronic Banking System – *bgk24*

In 2016, the Bank continued its strategic project of implementation of a new electronic banking system. The objective of the project is to launch an innovative electronic banking system (**bgk24**), which will fulfil the expectations of the Bank's customers by making new functionalities available or extending the existing ones.

The implementation has been divided into three phases:

- Phase 1 consisted in the provision of key functionalities of the electronic banking system with a view to launching a pilot project for a selected customer group. The limited functionality pilot was aimed to verify whether the system works as appropriate and is properly integrated with the banking systems.
- Phase 2 consisted in the provision of those functionalities which are available in the existing version of the electronic banking system.
- Phase 3 (the last one) will consist in the provision of deposit management and additional functionalities which are not available in the existing version of the electronic banking system but are expected by customers.

Phase 2 of the project went live in 2016. It was preceded by a number of functional, efficiency and security tests to ensure that the system works properly. This allowed the Bank to begin a process whereby **bgk24** will be made available to a large number of customers that have been identified for migration during Phase 1. The scope of activation work included stationary implementations at customer headquarters in addition to phone support.

In order to facilitate the process of implementation of the new electronic banking system for its customers, the Bank has also organized user training sessions.

5.11 SOCIAL HOUSING PROGRAMMES

With a view to supporting Social Housing Programmes, the Bank provided funding and administers the following government programmes:

- a new Social Housing Programme (SHP) – through the provision of loans and issue of bonds in order to finance the construction of affordable rent apartments;
- the Residential Construction Programme (RCP) implemented as part of the fulfilment of the obligations of the liquidated National Housing Fund – through the provision of loans for investment and construction projects (ICP loan) from the assets of the National Housing Fund and the Bank's own funds for purposes of construction of apartments for rent.

In addition to the provision of funding for the construction of residential property for rent under the available government programmes, the Bank offered construction loans on commercial terms or the arrangement of bond issues for Social Housing Associations or municipal enterprises.

Fulfilment of the obligations of the former National Housing Fund

The major part of the Bank's operations relating to the administration of the Residential Construction Programme focused on the management of the portfolio of loans granted from the liquidated National Housing Fund, in particular on the issue of bringing the contract clauses into line with the legal regulations in force, in addition to updating the legal security for the repayment and credit exposure monitoring.

As at 31 December 2016, the on-balance sheet exposure of the former National Housing Fund was PLN 5,378.0 million and it went down by PLN 245.8 million versus the end of 2015.

Under the projects financed from the liquidated National Housing Fund, 124 apartments were made available for use in 2016.

In relation to the Residential Construction Programme (RCP) run by the government, in 2016 the Bank granted one loan for investment and construction projects (ICP loan) of PLN 31.6 million to finance the construction of 283 apartments for rent.

The key figures relating to the portfolio of the former National Housing Fund have been presented in Table 23.

TABLE 23: Key figures relating to the Residential Construction Programme (formerly: National Housing Fund) (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	In nominal terms	%
Carrying amount				
Gross loans	5,623.8	5,378.0	-245.8	-4.4%
Specific purpose provisions	40.9	30.8	-10.0	-24.4%
Loans and advances taken	963.9	806.7	-157.1	-16.3%
Amount in the schedule of works and expenditure				
Loans disbursed	32.9	33.0	0.1	0.3%
Loans committed	30.4	31.6	1.2	3.9%
Number of apartments financed with loans	362	283	-79	-21.8%

As at the end of 2016, in relation to the liquidated National Housing Fund, the Bank managed not only the existing loan portfolio but also liabilities arising from a credit commitment of up to PLN 9.2 million to finance a project involving the construction of 121 apartments for rent and disbursement of loans of up to PLN 46.7 million in relation to investment projects covering 894 apartments under construction.

Transfer of the title to apartments

Under the Act of 19 August 2011 amending the act on certain forms of support for residential construction and the act on housing cooperatives, it is possible to transfer the title to apartments built with the use of BGK loans.

In 2016, in the course of the aforesaid procedure:

- 62 borrowers filed 225 applications for the transfer of title to apartments financed with the use of 145 loans;
- 55 borrowers paid liabilities relating to 354 apartments financed with the use of 122 loan agreements, including:
 - PLN 19.1 million – loan repayment;
 - PLN 2.4 million – forgiven loan repayment (transferred to the Subsidy Fund in accordance with the act).

New social housing programme

In 2016, the Bank focused on the launch of a new social housing programme.

The amended act introducing the new programme and a regulation of the Council of Ministers laying down its rules entered into force in October 2015. The government programme provides for the construction of at least 30,000 affordable apartments for rent for people who cannot afford to purchase their own apartment or to rent one on commercial terms. Preferential interest rate funding (WIBOR 3M without a mark-up) may take the form of a long-term loan or the arrangement of an issue of bonds underwritten by BGK. The Bank provides funding of PLN 4.5 billion, divided into disbursements of PLN 450 million for each of the ten annual editions of the programme, effective from 2016.

The first loans were granted and agreements signed in the fourth quarter of 2016. By the end of 2016, 9 loan agreements were entered into in the total amount of PLN 54.8 million to finance the construction of 473 apartments.

In 2016, the Bank launched initiatives aimed to promote the new social housing programme. It attended meetings with associations of SHP investors (Social Housing Associations and housing cooperatives) as well as conferences organized for local government entities and the investors they partner with. Additionally, the Bank promoted the programme at conferences held by organizations of Social Housing Associations.

The Bank participated actively in projects aimed at modification of the programme. The Ministry of Infrastructure and Construction discusses the draft legislation and implementing regulations with BGK with a view to making the programme more attractive for investors. The Bank provided the Ministry with numerous recommendations, the majority of which have been accepted and should be implemented before the launch of the 3rd edition of the programme. Additionally, BGK supported the Ministry of Infrastructure and Construction in ensuring that the issue of state aid under the community housing programme is properly regulated. After its modification, it will be possible to combine non-refundable aid provided to municipalities thereunder with preferential refundable aid related to the social housing programme.

In 2017, the programme will be promoted further through the organization of a series of conferences for local government entities, addressing the issue of residential construction funding. The purpose of the conferences will be to present the objectives of the programme as well as the planned changes prior to the call for applications in the third edition. It is also important to ensure the right positioning of the programme in the offering of the Capital Group of the Bank Gospodarstwa Krajowego, in particular the broadly defined "Mieszkanie Plus" package. Additionally, meetings are planned to be held in city councils which are the owners of the potential applicants (Social Housing Associations, municipal enterprises).

As part of its own activities, in 2016 the Bank granted two construction loans in the total amount of PLN 3.4 million to finance the construction of 68 apartments for rent, in addition to arranging six issues of bonds totalling PLN 28.4 million to finance the construction of 318 apartments.

5.12 INLAND WATERWAY FUND

The Inland Waterway Fund was created under the Act on the Inland Waterway Fund and the Reserve Fund of 28 October 2002. It is intended to support inland waterway transport through the provision of financial support for purposes of modernization of shipping as well as other projects aimed to restructure inland navigation, including those implemented with a view to protecting the natural environment and improving the safety of navigation. Under the act, disbursements from the Inland Waterway Fund may be made to shipowners on the following basis:

- preferential loans;
- subsidies to commercial loans and their forgiveness;
- interest-bearing and zero interest loans;
- consideration for permanent decommissioning of ships (ship breaking).

Preferential loans are the only form of support available to shipowners at present. In line with the guidelines of the Ministry of Infrastructure and Development, disbursements on any other basis have been suspended as they have been regarded by the European Commission as unacceptable forms of state aid.

Fulfilment of the Fund's tasks

In 2016, the total proceeds of the Inland Waterway Fund were PLN 2.6 million and its payments amounted to PLN 4.1 million. The Fund granted 3 preferential loans totalling PLN 2.1 million in 2016.

Key figures relating to the Inland Waterway Fund in 2016 have been presented in Table 24.

TABLE 24: Key figures relating to the Inland Waterway Fund (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	In nominal terms	%
Carrying amount				
Balance sheet total	46.3	45.7	-1.0	-2.2%
Gross loans	4.4	5.2	-0.3	-6.8%
Profit or loss and amount disclosed in the schedule				
Profit or loss	0.4	0.4	-0.8	-200.0%
Regulatory payments made and premiums paid by shipowners less any reimbursements of unused grant of the National Fund for Environmental	-0.6	-1.0	-4.9	-
Loans and grants committed	0.2	2.1	1.1	444.1%

As at the end of 2016, the balance sheet total of the Fund was PLN 45.7 million and its gross loan portfolio amounted to PLN 5.2 million.

The Fund generated a profit of PLN 0.4 million. Income on investing temporary cash surpluses and interest on loans were the key sources of revenue generated by the Inland Waterway Fund.

5.13 OTHER PROGRAMMES AND DELEGATED TASKS

DISTRIBUTION OF EU FUNDS

In accordance with the Public Finance Act of 27 August 2009 (with subsequent amendments), the Bank 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:

- make payments from EU funds as well as 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 2016, the Bank processed:

- 19,599 payment instructions totalling PLN 13.3 billion, including 700 payment instructions of PLN 17.8 million with respect to state aid in the 2007-2013 Financial Perspective;
- 17,565 payment instructions totalling PLN 13.8 billion, including 83 payment instructions of PLN 5.0 million with respect to state aid in the 2014-2020 Financial Perspective.

From the launch of the service to the end of 2016, the Bank processed:

- 739,183 payment instructions totalling PLN 274.2 billion, including 12,520 payment instructions of PLN 667.7 million with respect to state aid in the 2007-2013 Financial Perspective;
- 28,522 payment instructions totalling PLN 15.9 billion, including 83 payment instructions of PLN 5.0 million with respect to state aid in the 2014-2020 Financial Perspective.

BANKING SERVICES RELATED TO AND THE ACCOUNTING FOR LIABILITIES AND RECEIVABLES OF THE STATE TREASURY

In 2016, 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 2016, foreign liabilities of the State Treasury which were administered by BGK totalled USD 57.8 billion, and its receivables amounted to USD 1.6 billion.

RURAL DEVELOPMENT PROGRAMME

In 2009, BGK began to administer loans from the State Budget for advance funding for projects carried out as part of several measures under the Rural Development Programme 2007-2013. The advance funding system allows local government entities and local action groups to increase the efficiency of projects implemented in the area of water and sewage management, creation of a system of municipal waste collection, sorting and disposal, generation or distribution of renewable energy, rural community activation, stimulation of the creation of new jobs in rural areas, improvement of the condition of the rural cultural and natural heritage as well as construction, reconstruction, renovation or equipment of permanent marketplaces.

Since July 2016, the advance funding mechanism has been continued under the Rural Development Programme 2014-2020. Loans are granted to finance eligible costs of projects implemented by local government entities and local action groups. In 2016, 130 loan agreements were entered into in the total amount of PLN 68 million.

Since the launch of the programme, 5,518 loan agreements have been concluded in the total amount of PLN 3.8 billion.

SUBSIDIZED INTEREST ON FIXED RATE EXPORT LOANS

On behalf of the Ministry of Finance, the Bank administers the Subsidized Interest on Export Loans Programme.

In 2016, BGK received two applications for a commitment to enter into agreements under the said Programme.

As at the end of 2016, the total value of the export contracts supported under the Programme administered by BGK was EUR 306.3 million and CAD 165.3 million. They were supported by loans of DKK 289.3 million, NOK 1,339.3 million and CAD 135.4 million.

Since the launch of the Programme in 2003, BGK has made the total of 49 commitments to provide export loans for purposes of financing export contracts totalling USD 1,446 million, EUR 901.3 million, NOK 380 million, CAD 165.7 million and GBP 15.7 million.

“FINANSOWE WSPIERANIE EKSPORTU” (FINANCIAL SUPPORT FOR EXPORTS) PROGRAMME

Under the “Finansowe Wspieranie Eksportu” government programme adopted by the Council of Ministers on 28 July 2009 (with subsequent amendments), BGK grants loans to foreign buyers (directly or through the buyer’s bank) to finance purchases of Polish goods and/or services, in addition to providing export pre-financing loans as well as refinancing supplier credit. From the launch of the Programme to the end of 2016, the Bank granted loans totalling PLN 2,318 million. The value of the supported export contracts was PLN 3,054 million. As at the end of 2016, its on-balance sheet exposure was PLN 1,068.1 million.

PAYMENT OF COMPENSATION FOR LEAVING REAL PROPERTY OUTSIDE THE PRESENT BORDERS OF THE REPUBLIC OF POLAND

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

In 2016 itself, the Bank made more than 4,000 payments of PLN 354.7 million. From the introduction of the compensation to the end of 2016, the Bank processed 66,900 payments of PLN 4,073.3 million.

TECHNOLOGY CREDIT FUND – SPECIAL PURPOSE STATE FUND

Under an agreement entered into with the Minister of Development, since 30 May 2016, Bank Gospodarstwa Krajowego (BGK) has been acting as an Intermediate Body in relation to the implementation of sub-measure 3.2.2 Technology Innovation Credit under the Operational Programme Smart Growth 2014-2020 (OP SG). The funds for the provision of the instrument in the new EU perspective are derived from the Operational Programme Smart Growth 2014-2020. It is the second largest programme for the years 2014-2020 in terms of the budgeted funds and the largest among EU programmes which provide financing for research, development and innovations. The funds entrusted to BGK by the Ministry of Development for that purpose total PLN 1.7 billion.

The technology credit and the technological grant are made available under the Act of 30 May 2008 on certain forms of support for innovations (Journal of Laws No. 116, item 730, as amended).

The Technology Innovation Credit (formerly: the technology credit) is a non-refundable financial support instrument dedicated to micro, small and medium-sized enterprises which are planning the implementation of technology innovations, thus increase their competitive advantage on the market. The support provided by BGK takes the form of a technological grant, which means partial repayment of a loan obtained from a commercial bank with a view to carrying out a technology investment project.

Currently, BGK assumes in particular responsibility for the call for applications for the technological grant including its evaluation, performed by the experts who are not the Bank employees, the entry into agreements with the beneficiaries and the payment of the support.

In 2016, the Bank entered into 164 technological grant agreements with business entities to finance the implementation of technology projects eligible to receive support in the first call for applications (of ca. PLN 611 million) and closed the second call for applications. The total of 947 applications were filed by SMEs with the total amount of PLN 3.2 billion, which is almost twice the total programme budget allocated to that instrument. On 14 February 2017, decisions were made with respect to the second call for applications. Ca. 140 projects were regarded as eligible for support awarded by the Bank in the total amount of ca. PLN 512 million. Another call for applications has already been announced and the call for applications is closed on 6 April 2017.

JESSICA INITIATIVE

The **JESSICA Initiative 2007-2013** (Joint European Support for Sustainable Investment in City Areas) is a mechanism assuming the use of refundable instruments, i.e. EU funds allocated under Regional Operational Programmes for the years 2007-2013 to urban development projects. The JESSICA Initiative is implemented by BGK in three regions: wielkopolskie, pomorskie (in partnership with Agencja Rozwoju Pomorza S.A.) and mazowieckie (in partnership

with Agencja Rozwoju Mazowsza S.A. and Mazowiecka Agencja Energetyczna Sp. z o.o.). BGK manages the total amount of more than PLN 700 million, which accounts for nearly 70% of the funds allocated to the implementation of the JESSICA Initiative in Poland.

In 2016, 5 loans were provided in the total amount of PLN 16.5 million. The call for applications was closed on 30 April 2016 thus the amount allocated for the support was closed. The Bank will administer the loans granted, monitor the realization of the projects and the repayment of the granted loans until 2035 (the repayment date of the last granted loans).

From the launch of the initiative to the end of 2016, BGK received 223 applications in the total amount of PLN 2,007.4 million and the Bank granted 108 loans totalling PLN 719.7 million.

JESSICA II – the 2014-2020 perspective

Over the current financial framework for the period 2014 – 2020 the Boards of the regions in its Operational Programmes assumed the changes in the JESSICA Initiative financing rules. JESSICA II is a refundable instrument financing redevelopment and energy efficiency projects. The funds for its implementation are derived from the Operational Programme Greater Poland 2014-2020. Under an agreement with the Greater Poland Board of 28 November 2016, BGK manages the amount of ca. PLN 250 million to be disbursed in the form of preferential loans, in particular to local government entities, business entities, housing communities, Social Housing Associations and housing cooperatives. The Bank will be performing the role of an entity implementing an instrument. As regards energy efficiency, BGK will provide financial support to projects consisting in comprehensive energy efficient modernization of public buildings and multi-family residential buildings with a view to achieving the highest possible savings in energy consumption and reducing losses. Financing provided for redevelopment projects on preferential terms is expected to facilitate redevelopment of degraded urban and rural areas, in addition to solving problems faced by local communities and reducing the scale of poverty.

JEREMIE FUNDS

BGK has begun to fulfil the tasks relating to the implementation of financial engineering instruments in the **2014-2020 financial perspective**, which continue the Bank's prior activity in the field of non-grant support for entrepreneurship from public funds.

In the 2014-2020 financial perspective, the Bank intends to build partnerships with all regions with a view to carrying out projects which will involve the implementation of financial engineering instruments available under the Regional Operational Programmes.

By 31 December 2016, support agreements had been entered into with ten regions (pomorskie: the allocation of PLN 430 million, wielkopolskie: the allocation of PLN 608 million, łódzkie: the allocation of 672 million, zachodniopomorskie: the allocation of PLN 469 million, podlaskie: the allocation of PLN 267 million, dolnośląskie: the allocation of PLN 756 million, lubelskie: the allocation of PLN 426 million, podkarpackie: the allocation of PLN 257 million, opolskie: the allocation of PLN 336 million, małopolskie: the allocation of PLN 599 million). The total amount allocated under the aforesaid agreements was PLN 4,820 million. In 2017, agreements are planned to be signed with further regions, namely warmińsko-mazurskie, kujawsko-pomorskie, świętokrzyskie, lubuskie and mazowieckie.

In 2016, BGK continued to fulfil tasks relating to the implementation of financial engineering instruments with the use of EU funds available in the **2007-2013 financial perspective**. SMEs were offered a wide range of non-grant products, such as loans, guarantees or equity investments.

Acting as the Manager of the JEREMIE Funds, the Bank has been implementing the initiative in six regions (dolnośląskie, łódzkie, pomorskie, wielkopolskie and zachodniopomorskie – effective from fall 2009 and mazowieckie – effective from December 2012).

At present, JEREMIE projects are being terminated. The process of termination of the related agreements depends on the individual arrangements made with the local governments at the regional level. In the case of several projects, the funds have already been partly repaid to the Managing Authority.

The progress of project implementation by region has been presented in Table 25.

TABLE 25 Project implementation progress by region

Voivodeship / region	Funds entrusted to BGK (in PLN million)	Value of agreements with financial intermediaries* (in PLN million)	Funds made available to financial intermediaries (%) [3/2]	Number of agreements with financial intermediaries	Support granted to SMEs from Regional Operational Programmes (in PLN million)	Share of Regional Operational Programme funds used by SMEs (%) [6/2]	Number of participating SMEs
dolnośląskie	406	612	151%	60	612	151%	5,894
łódzkie	219	369	169%	45	350	160%	2,854
mazowieckie	66	112	169%	18	112	169%	1,562
pomorskie	287	515	179%	58	486	169%	5,797
wielkopolskie	501	1,319	263%	75	1,253	250%	9,559
zachodniopomorskie	280	628	224%	72	557	199%	5,764
Total	1,759	3,556	202%	328	3,370	192%	31,430

* As the leverage cap was applied (payments under surety bonds were made up to a certain amount) and the amount of funds released grew following repayments made by SMEs, it has been possible to enter into new agreements with financial intermediaries for the total amount exceeding the original allocation to an operational programme.

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 non-public investment funds established as part of three sub-measures and one measure under OP SG 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 detailed in the Cooperation Agreement signed by specialized entities, i.e. Bank Gospodarstwa Krajowego (BGK), Towarzystwo Funduszy Inwestycyjnych BGK S.A. (TFI BGK) and PFR Ventures Sp. z o.o.

Under the support agreement, BGK is the beneficiary of the OP SG funds and the entity responsible for the accounting for the OP SG funds. Responsibility for the creation and management of the funds rests with TFI BGK. PFR Ventures Sp. z o.o. acts as the manager of the investment portfolios of the funds.

As the only investor in the funds, the Bank retains the rights of full control and supervision of the funds, which are conferred on the investor meeting and the board of investors, throughout the entire project implementation period. In particular, BGK is responsible for exercising supervision of the activities of the manager of the investment portfolio of the funds.

The funds are to invest, through selected financial intermediaries, in SMEs using the proceeds from the Bank's acquisition of the investment certificates issued by the funds and paid for using the OP SG funds.

The funds have at their disposal OP SG funds of: Starter Fund: PLN 778 million, Biznest Fund: PLN 251 million, CNFIF Fund: PLN 315 million, Open Innovation Fund: PLN 409 million.

The first support (cooperation) agreement related to the Starter Fund was entered into on 28 November 2016. A further three agreements related to the Biznest Fund, the CNFIF Fund and the Open Innovation Fund were signed on 13 December 2016.

SUPPORT FOR BUSINESSES UNDER THE OPERATIONAL PROGRAMME EASTERN POLAND (OP EP)

In relation to Measure I.2 Financial Engineering Instruments of Operational Programme Eastern Poland, the Bank implemented a project entitled "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 on 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 administration of the support provided in the past.

On 22 December 2016, BGK entered into a new agreement with the Minister of Development and Finance to reuse the 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 term is ten years and it may be extended.

FINANCIAL ENGINEERING INSTRUMENTS SUPPORTING LABOUR MARKET DEVELOPMENT UNDER REGIONAL OPERATIONAL PROGRAMMES 2014-2020

Under the financial perspective 2014-2020 the Bank has been entrusted funds to support projects aimed to develop the labour market through the use of refundable instruments in the form of preferential loans to individuals who intend to become sole traders in eight regions (łódzkie, zachodniopomorskie, podlaskie, dolnośląskie, lubelskie, podkarpackie, opolskie and małopolskie). The total of PLN 318 million has been allocated to that purpose. The funds will be distributed by BGK through a network of financial intermediaries selected in a tender procedure.

PROGRAMMES LAUNCHED BY THE MINISTER OF FAMILY, LABOUR AND SOCIAL POLICY

In 2016, BGK administered 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, financed by the Operational Programme Knowledge Education Development 2014-2020**. The funds entrusted to BGK amount to ca. PLN 158 million and will be spent on preferential loans to social economy entities as well as a counter-guarantee instrument to be developed and implemented in 2017. On 29 December 2016, BGK entered into agreements with TISE (Social and Economic Investment Company) and Fundusz Regionu Wałbrzyskiego (Wałbrzych Region Fund), which act as financial intermediaries for the loan instruments offered to social economy entities.

Under the Operational Programme Human Capital 2007-2013 the Bank was performing a **pilot project involving refundable financial support in the form of preferential loans to social economy entities**. The pilot project was launched on a nationwide basis and loans were granted (until the end of 2016) by Towarzystwo Inwestycji Społeczno-Ekonomicznych S.A., which acted as the financial intermediary selected by BGK in an open tender procedure. The amount allocated to loans totalled ca. PLN 38 million, a portion of which was derived from the repayment of loans which had been granted before. The remaining proceeds from loan repayment will be used for purposes of the Bank's creation of a portfolio guarantee facility for social economy entities in 2017.

The Bank acts as the fund operator under the **"Pierwszy Biznes – Wsparcie w Starcie" (First Business, Start-Up Support)** Programme launched nationwide in 2014 (the pilot Programme had been launched before, in 2013, in three regions, and loans have no longer been granted thereunder since the fourth quarter of 2016). 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 fee-free advisory and training services.

The financial intermediaries selected by the Bank in tender procedures assume responsibility for loan granting as well as the provision of training and advisory services. Their activity is monitored by BGK throughout the Programme implementation period. By the end of 2016, 2,774 loans were granted to set up a business and 578 loans to create jobs for the unemployed.

IMPLEMENTATION OF FINANCIAL ENGINEERING INSTRUMENTS UNDER PRIORITY AXIS I "COMMON ACCESS TO HIGH-SPEED INTERNET", UNDER OPERATIONAL PROGRAMME DIGITAL POLAND (OP DP)

On 6 February 2017, Bank Gospodarstwa Krajowego entered into an 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 engineering instruments with the use of the support available under the **Operational Programme Digital Poland 2014-2020**.

Funds of PLN 996.2 million will be allocated to projects consisting in the development, expansion and reconstruction of the telecommunications network to provide access to high-capacity broadband Internet (30 Mb/s and more). Projects may be implemented both in areas considered to be blank spots with no broadband infrastructure available and in those regarded as grey or black spots (where broadband infrastructure already exists).

In order to use the allocated funds, BGK will select financial intermediaries responsible for granting preferential loans to the ultimate beneficiaries of the support, i.e. telecom companies. At a later implementation phase, any income generated on the Programme contribution and refunded amounts will be reused by the Bank in line with the investment strategy, which will increase the efficiency of use of EU funds as compared to grants.

In accordance with the support agreement, the project will be carried out until 31 December 2031 and its total value, including the national contribution made by the financial intermediaries, will be nearly PLN 1.2 billion.

In 2016, BGK administered a number of smaller-scale delegated programmes.

6. CASH FLOW FUND ACTIVITY AND FINANCIAL PERFORMANCE

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 the Bank's delegated activities, including cash flow funds.

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

6.1 NATIONAL ROAD FUND

The National Road Fund was created under the amended Act on Toll Motorways and the National Road Fund of 27 October 1994 as a special purpose fund which provides financial support for road projects under the National Road Construction Programme launched by the government. The Fund was established primarily with a view to collecting and disbursing funds to support the construction and reconstruction of motorways, expressways and other national roads, including projects which receive support from EU funds. It is also aimed to finance expenditures under regulations applicable to public roads and road transport, in addition to payments to entities responsible for the construction and operation of toll motorways. Furthermore, it provides funding for the introduction, development and operation of toll collection systems on national roads and covers the costs of advisory services related to the construction and reconstruction of national roads.

Fulfilment of the Fund's tasks

In 2016, the proceeds of the National Road Fund totalled PLN 18,435.2 million. Proceeds from the key source of its funding, the fuel duty attributable to the Fund, reached the level of PLN 4,873.2 million.

Proceeds from the refund of expenditures incurred on investment projects with the financial support from the EU budget amounted to PLN 6,227.8 million. In the 2007-2013 EU perspective the Fund received proceeds from refunds from the Operational Programme Infrastructure and Environment [OP I&E] in the amount of PLN 268.8 million and from the Operational Programme Eastern Poland [OP EP] in the amount of PLN 73.0 million. In the 2014-2020 perspective, proceeds from the Operational Programme Infrastructure and Environment II [OP I&E II] totalled PLN 5,886.0 million. In 2016, proceeds from loans amounted to PLN 1,560.2 million. The following disbursements were received under EIB loans:

- "S7 Expressway (Gdańsk – Warsaw – Kraków)" Project – two disbursements totalling PLN 432 million;
- "Modernization of Roads in Poland III" Project – of PLN 320 million;
- "S3 Expressway" Project – of PLN 217 million;
- "S5 Expressway (Bydgoszcz – Wrocław)" Project – of PLN 145 million;
- "S8 Expressway (Warsaw access sections)" Project – of PLN 108.5 million;
- "A1 Stryków – Pyrzowice – A (A1 Stryków – Tuszyn)" Project – of PLN 60 million (last disbursement);
- "A1 Toruń – Stryków – B" Project – of PLN 169.7 million (last disbursement);
- "A1 (Pyrzowice – Częstochowa)" Project – of PLN 108 million.

In the second quarter of 2016, the Bank arranged the first issue of bonds for the National Road Fund under the Euro Medium Term Notes (EMTN) Programme launched in 2014. The value of the issue is EUR 500 million and the bonds bear fixed interest of 1.75%. Following deduction of discount, the amount transferred to the Fund was EUR 495.8 million, i.e. the equivalent of PLN 2,181.6 million.

In the fourth quarter of 2016, two issues of bonds were arranged on international markets under the EMTN Programme: one on 21 October 2016 with the par value of EUR 200 million (2nd tranche as part of the 1st series of 10-year bonds maturing on 6 May 2026) and the other on 3 November 2016 with the par value of EUR 100 million (as part of the 2nd

series under the EMTN Programme, 20-year bonds maturing on 3 November 2036 were issued). As a result, the amount transferred to the Fund was EUR 307.9 million, i.e. the equivalent of PLN 1,329.5 million.

The total proceeds from the issue of bonds for the National Road Fund were PLN 3,511.1 million in 2016.

In 2016, one finance contract was signed by BGK and EIB, whereby a loan of EUR 270 million was granted to the National Road Fund in relation to the "S7 Expressway (Gdańsk – Elbląg)" Project. The first disbursement is planned in the second quarter of 2017, after the conditions necessary for the payment have been satisfied (to include the entry into the Guarantee Agreement and the Project Agreement relating to the aforesaid loan).

In 2016, the total payments from the National Road Fund amounted to PLN 17,169.4 million. In particular, they included:

- payments relating to the implementation of road projects by the General Director for National Roads and Motorways of PLN 12,782.9 million;
- payments related to the administration of bonds and loans of PLN 2,492.0 million. The said amount included PLN 1,371.3 million spent on bond repayment and PLN 1,120.7 million spent on loan administration;
- payments related to the funding of toll collection systems of PLN 324.5 million;
- payments to Companies of PLN 1,555.3 million;
- payments to subcontractors under the Act on payment of certain outstanding receivables of business entities arising from public procurement contracts, totalling PLN 6.6 million.

The structure of cash flows of the National Road Fund in 2016 has been presented in Table 26.

TABLE 26: Cash flows of the National Road Fund (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	In nominal terms	%
Proceeds from fuel duty	3,972.4	4,873.2	900.8	22.7%
Proceeds from EU Funds	2,988.0	6,227.8	3,239.8	108.4%
Proceeds from loans taken	2,170.7	1,560.2	-610.5	-28.1%
Proceeds from bond issues	0.0	3,511.1	3,511.1	-
Proceeds from toll collection	1,561.9	1,714.3	152.4	9.8%
Proceeds from road tolls, fines and penalties	181.7	194.8	13.1	7.2%
Proceeds from companies	130.0	138.5	8.5	6.5%
Public sector funds	26.9	0.0	-26.9	-100.1%
Other inflows	295.6	144.1	-151.5	-51.3%
Proceeds from amounts recovered by the General Directorate for National Roads and Motorways under the Act on payment of certain outstanding receivables of business entities arising from public procurement	13.0	34.1	21.1	161.7%
Other proceeds	87.6	37.0	-50.6	-57.8%
TOTAL INFLOWS	11,427.8	18,435.2	7,007.4	61.3%
Payments for investment projects, preparation, repair and maintenance of the road network	8,658.8	12,782.9	4,124.1	47.6%
Payments to subcontractors under the Act on payment of certain outstanding receivables of business entities arising from public procurement	71.6	6.6	-65.0	-90.8%
Payments for servicing loans and bonds	2,335.9	2,492.0	156.1	6.7%
Payments for fees for BGK	8.6	6.3	-2.3	-26.7%
Financing toll collection systems	357.7	324.5	-33.2	-9.3%
Payments to companies	1,306.2	1,555.3	249.1	19.1%
Advisory services	0.0	0.0	0.0	-
Collecting data on public roads	0.1	0.0	-0.1	-118.0%
Other payments	5.0	1.6	-3.4	-68.4%
TOTAL OUTFLOWS	12,743.9	17,169.4	4,425.5	34.7%

Balance sheet and profit and loss account

As at 31 December 2016, the balance sheet total of the Fund was PLN 51,757.2 million, up by 13.9% versus the preceding year. Receivables from the public sector, comprising the equivalents of payments made from loans obtained and bonds issued for the National Road Fund, totalled PLN 49,802.7 million as at the end of 2016, which means an increase by PLN 5,038.2 million on the preceding year. Liabilities of PLN 50,531.7 million, taken on for purposes of the National Road Fund, went up by 11.5% as compared to the end of 2015. Apart from liabilities of PLN 22,971.1 million arising from bonds issued for the Fund, 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 27,560.6 million.

In 2016, the National Road Fund reported a loss of PLN 1,987.7 million. It was affected mainly by interest income of PLN 40.7 million, interest expense related to loans and bonds issued by BGK for the Fund in the amount of PLN 2,025.2 million, and the costs of commissions for Fund management totalling PLN 4.2 million.

The key figures relating to the National Road Fund in 2016 have been presented in Table 27.

TABLE 27: Key figures relating to the National Road Fund (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	In nominal terms	%
Balance sheet total	45,443.0	51,757.2	6,314.2	13.9%
Receivables from the State Treasury due to settlements	44,764.5	49,802.7	5,038.2	11.3%
Liabilities incurred for the needs of the National	45,332.9	50,531.7	5,198.8	11.5%
Profit or loss	-1,901.3	-1,987.7	-86.4	4.5%

6.2 RAILWAY FUND

The Railway Fund was created at Bank Gospodarstwa Krajowego on 9 February 2006 under the Act on the Railway Fund of 16 December 2005 (Journal of Laws of 2015, item 2115, as amended). The Fund was established with a view to collecting funds and providing financial support for projects which consist in the preparation and completion of construction and reconstruction of railways, railway repair and maintenance, decommissioning of redundant railways and financing expenditures incurred by PKP Polskie Linie Kolejowe S.A. on a day-to-day basis in relation to railway infrastructure management. Between 2009 and 2020, the Railway Fund provides financing for purchases, modernization and repair of rolling stock used for passenger transport services delivered under public services agreements. The beneficiaries are local governments at the regional level.

Since 2009, additional appropriations have been made to the Fund apart from those required as from the date of its creation. The additional annual appropriation between 2010 and 2014 was PLN 100 million, in 2015 it amounted to PLN 500 million and between 2016 and 2019 it is PLN 400 million a year. The scope of expenditures covered by the Railway Fund includes also financing, in whole or in part, purchases and modernization of rolling stock used for purposes of diagnosing, maintenance, repair or construction of railway infrastructure and of rescue operations, and the purchase of the shares in PKP PLK S.A. from PKP S.A. by the State Treasury represented by the Minister of Transport.

Fulfilment of the Fund's tasks

In 2016, the Fund's proceeds totalled PLN 1,748.2 million and they increased by 6.7% on the preceding year. The fuel duty accounted for 1,718.3 million of those proceeds (up by 6.2%). In 2016, the Fund's payments amounted to PLN 1,453.0 million and they went up by PLN 143.8 million as compared to 2015. Payments to finance railway projects in 2016 totalled PLN 1,452.1 million (an increase of 11.0%) and included:

- payments on investment projects of PLN 1,036.1 million;
- payments on purchases, modernization and repair of rolling stock for local governments at the regional level of PLN 90.2 million;
- payments on expenditures incurred by PKP PLK S.A. in relation to infrastructure management of PLN 325.8 million.

The key figures relating to the Railway Fund in 2016 have been presented in Table 28.

TABLE 28: Key figures relating to the Railway Fund (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	In nominal terms	%
Carrying amount				
Balance sheet total	546.8	842.0	295.2	54.0%
Debt securities (measured at cost)	526.9	823.7	296.8	56.3%
Profit or loss and amounts disclosed in the schedule				
Profit or loss	11.3	19.3	8.0	70.8%
Inflows of the Fund	1,637.8	1,748.2	110.4	6.7%
Proceeds from fuel duty	1,618.1	1,718.3	100.2	6.2%
Other inflows	19.7	29.9	10.2	51.9%
Outflows of the Fund	1,309.2	1,453.0	143.8	11.0%
Payments for projects:	1,308.5	1,452.1	143.6	11.0%
<i>investment projects</i>	369.8	1,036.1	666.3	180.2%
<i>repair and maintenance</i>	224.8	0.0	-224.8	-100.0%
<i>purchase, modernization, repair of rolling stock - local governments at the regional level</i>	115.7	90.2	-25.5	-22.0%
<i>payments on expenditures incurred by PKP PLK S.A. in relation to infrastructure management</i>	598.1	325.8	-272.3	-45.5%
Other payments	0.7	0.9	0.2	27.2%

Balance sheet and profit and loss account

As at the end of 2016, the balance sheet total of the Railway Fund was PLN 842.0 million and it went up by PLN 295.2 million versus the end of 2015. In 2016, the Railway Fund reported a profit of PLN 19.3 million.

6.3 SUBSIDY FUND

In 2016, BGK used the Subsidy Fund to finance tasks relating to the administration of the following programmes:

- subsidized interest on fixed rate home loans – under *the Act of 5 December 2002 on subsidized interest on fixed rate home loans* (the Act on Subsidies);
- financial support for families and individuals in buying their own apartment (Rodzina na Swoim – Mortgage Programme for Families) – under *the Act of 8 September 2006 on financial support for families and individuals buying their own apartment* (the Act on financial support for families and individuals);
- financial support for social housing – under *the Act of 8 December 2006 on financial support for the development of social and supervised housing, night shelters and housing for the homeless* (the Act on financial support for social housing);
- state aid for young people buying their first apartment (Mieszkanie dla Młodych – Mortgage Programme for Young People) – under *the Act of 27 September 2013 on state aid for young people buying their first apartment* (the Act on state aid for young people buying their first apartment).

Fulfilment of the Fund's tasks

Subsidized interest on loans

Under the Subsidized Interest on Fixed Rate Home Loans Programme, BGK continued its cooperation with banks with regard to the settlement of subsidies relating to interest and surplus interest paid by borrowers under fixed rate loan agreements signed with the lending banks between 2003 and 2005. BGK grants subsidies during periods when the fixed interest rate specified in the agreement (6.5%) is lower than the statutory WIBOR3M rate increased by a fixed mark-up of 1.5%. Where the contractual interest rate is higher, surplus interest paid by borrowers is settled.

The surplus interest on fixed rate home loans transferred to BGK in 2016 by the lending banks totalled PLN 0.3 million and increased the balance of the Subsidy Fund on that basis to PLN 1.6 million.

“Rodzina na Swoim” (Mortgage Programme for Families)

The Bank’s activities related to the administration of the support programme for families and individuals buying their own apartment consisted in day-to-day administration of preferential loan interest subsidy agreements entered into with the lending banks, management of the register of the preferential loan target borrowers, payment of subsidies due as well as inspections at the lending banks to verify compliance of loans and subsidies granted with the regulations in force.

As at the end of 2016, the lending banks administered 191,989 preferential loans granted between 2007 and 2013. The total amount of loans for which subsidies were granted was PLN 34,888.2 million. From the launch of the programme to 31 December 2016, the total subsidies transferred to the lending banks in relation to preferential loans granted were PLN 3,652.5 million, where the subsidies provided in 2016 amounted to PLN 408.0 million.

Social Housing Support

The Bank’s activities related to the administration of the social housing programme in 2016 consisted in the entry into and administration of financial support agreements for applications accepted in the 2011-2015 edition as well as two evaluations of applications in 2016. The amount paid from the launch of the programme to 31 December 2016 totalled PLN 403.5 million and included PLN 57.4 million disbursed in 2016. In the spring 2016 edition, 85 applications were considered eligible for support from the Subsidy Fund in the aggregate amount of PLN 79.4 million. In the fall 2016 edition, 123 applications were considered eligible for support in the aggregate amount of PLN 102.4 million.

From the launch of the programme to 31 December 2016, 1,071 agreements were signed (excluding those which have already been terminated) with support totalling PLN 695.0 million, including 185 agreements of PLN 152.8 million in total in 2016. From the launch of the programme to 31 December 2016, investors completed and accounted for 881 projects, as a result of which 13,171 residential units were built and 948 beds were made available in night shelters and the housing for the homeless. In 2016, the aggregate number of projects accounted for was 127, following the completion of which 1,411 residential units and 31 beds were made available.

“Mieszkanie dla Młodych” (Mortgage Programme for Young People)

In 2016, the Bank’s activities related to the administration of the government programme of state aid for young people buying their first apartment consisted in the management of a database of buyers and their children satisfying the statutory requirements to obtain the available financial support, transferring the subsidies related 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. From the launch of the programme to 31 December 2016, BGK transferred the total of PLN 1,469.1 million as down-payment subsidies to the lending banks, including PLN 719.2 million in 2016.

Social Housing Programme (SHP)

In accordance with the Act of 26 October 1995 on *certain forms of support for residential construction*, amended in 2011 (Journal of Laws of 2013, item 255), the title to apartments at the disposal 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 such funds increased the Subsidy Fund by PLN 2.4 million in 2016 so that the aggregate amount of the said funds allocated to the Subsidy Fund reached PLN 8.4 million. Under a Tripartite Agreement (setting out detailed terms of interest subsidies related to loans or bonds, as referred to in Article 15c.2 of the Act on certain forms of support for residential construction), entered into on 23 May 2016 by BGK, the Ministry of Infrastructure and Construction and the Ministry of Finance, the proceeds from the repayment of a portion of forgiven loans were transferred to a separate account of the Subsidy Fund maintained for purposes of administering the Social Housing Programme.

The key figures relating to the Subsidy Fund in 2016 have been presented in Table 29.

TABLE 29: Key figures relating to the Subsidy Fund (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	In nominal terms	%
Carrying amount				
Balance sheet total	349.7	407.5	57.8	16.5%
Debt securities (measured at cost)	349.5	399.1	49.6	14.2%
Profit or loss and amounts disclosed in the schedule				
Profit or loss	1.1	0.5	-0.6	-54.5%
Proceeds from regulatory payments	978.1	1,223.9	245.8	25.1%
Payments for the programme of financial support to families buying their own apartment*	457.9	405.0	-52.9	-11.6%
Payments for the social housing support programme	73.4	57.4	-16.0	-21.8%
Payments for state aid programme for young people buying their first apartment	535.7	719.2	183.5	34.3%

* payments due from January to December 2016 (payment for December falls due in January 2017)

In 2016, the Subsidy Fund received a grant of PLN 1,223.9 million from the government budget, including PLN 383.5 million allocated to the financial support for families and individuals buying their own apartment (Rodzina na Swoim), PLN 136.9 million allocated to the financial support under the social housing programme and PLN 703.5 million allocated to state aid for young people buying their first apartment (Mieszkanie dla Młodych).

Balance sheet and profit and loss account

As at 31 December 2016, the balance sheet total of the Subsidy Fund was PLN 407.5 million, up by PLN 57.8 million as compared to the end of 2015. In 2016, the Subsidy Fund generated a profit of PLN 0.5 million, down by PLN 0.6 million versus 2015.

6.4 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 university education through a system of preferential student loans in the form of subsidized loan interest or in the form of partial or complete forgiveness of loans. The Fund is also used for purposes of repayment of loans with BGK guarantees where 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, 391,000 students have obtained such loans.

In 2016, the Fund disbursed PLN 21.7 million to subsidize interest on student loans. The option of partial or complete loan forgiveness was exercised by 460 students and the related amount totalled PLN 1.7 million.

In 2016, an appropriation was made to the Student Loan Fund from the government budget in the amount of PLN 21.2 million, which is PLN 6.1 million less than in 2015. The decrease was driven by a lower level of subsidies as the number of loans granted was lower than planned. The said grant was sufficient to ensure ongoing and timely provision of subsidies in 2016, while the amount which was not used in 2016 (PLN 0.3 million) was refunded to the Ministry of Science and Higher Education on 30 January 2017.

The key figures relating to the Student Loan Fund have been presented in Table 30.

TABLE 30: Key figures relating to the Student Loan Fund (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	In nominal terms	%
Carrying amount				
Balance sheet total	3.1	0.4	-2.7	-87.1%
Debt securities (measured at cost)	3.1	0.0	-3.1	-100.0%
Profit or loss and amounts disclosed in the schedule				
Profit or loss	-0.5	-0.5	0.0	0.0%
Proceeds from budget payments	27.3	21.2	-6.1	-22.3%
Payments from the Fund	29.1	23.4	-5.7	-19.6%
Co-financing interest on student loans	27.0	21.7	-5.3	-19.7%
Co-financing cancellation of student loans	2.2	1.7	-0.5	-23.1%

Balance sheet and profit and loss account

In 2016, the balance sheet total of the Student Loan Fund was PLN 0.4 million, down by PLN 2.7 million as compared to 2015.

In 2016, the Fund reported a loss of PLN 0.5 million, the same as in the preceding year.

6.5 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 represents a 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 and paid following the completion of the investment project. They may be used for purposes of repayment of a portion of loans obtained for the implementation of a thermal efficiency improvement or a repair project.

Fulfilment of the Fund's tasks

In 2016, BGK granted the thermomodernization bonus, the repair bonus and the compensation bonus in partnership with 12 lending banks.

The number of new applications for the thermomodernization bonus, the repair bonus and the compensation bonus received in 2016 was 2,811. The Bank granted 2,630 bonuses totalling PLN 152.3 million. It issued 2,787 bonus decisions in the total amount of PLN 147.9 million.

Liabilities arising from thermomodernization, repair and compensation bonuses granted but unpaid amounted to PLN 171 million as at the end of 2016.

The key figures relating to the Thermal Efficiency Improvement and Repair Fund in 2016 have been presented in Table 31.

TABLE 31: Key figures relating to the Thermal Efficiency Improvement and Repaid Fund (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	In nominal terms	%
Carrying amount				
Balance sheet total	413.5	318.1	-95.4	-23.1%
Debt securities (measured at cost)	411.7	316.1	-95.6	-23.2%
Profit or loss and amounts disclosed in the schedule				
Profit or loss	3.9	2.3	-1.6	-41.0%
Proceeds from regulatory payments	120.0	50.0	-70.0	-58.3%
Number of grants awarded	3,160	2,630	-530	-16.8%
Number of grants paid out	2,830	2,787	-43	-1.5%
Amount of grants awarded	178.2	152.3	-25.9	-14.5%
Amount of grants paid out	148.9	147.9	-1.0	-0.7%

In 2016, the amount appropriated from the government budget to the Fund totalled PLN 50.0 million.

Balance sheet and profit and loss account

The balance sheet total of the Thermal Efficiency Improvement and Repair Fund decreased by PLN 95.4 million on the preceding year and reached the level of PLN 318.1 million as at the end of 2016.

In 2016, the Fund reported a profit of PLN 2.3 million, down by PLN 1.6 million versus 2015.

6.6 BORROWER SUPPORT FUND

The Borrower Support Fund has been established under the Act on supporting home loan borrowers in a difficult financial condition of 9 October 2015 (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 home 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 home loans to households, where the delinquency in payment of the principal or interest exceeds 90 days, refunded support as well as income on investing cash surpluses of the Fund. The initial value of the Fund was PLN 598.7 million.

In 2016, BGK entered into agreements with 43 lenders under the aforesaid legal act.

Support is provided under agreements made by 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 home 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 determination of the support. The support is provided on an aggregate basis in monthly instalments to the lender's bank account.

In 2016, the Bank registered 481 support agreements totalling PLN 10.7 million. As at 31 December 2016, 2,466 instalments were paid in the amount of PLN 3.1 million. Payments from the Fund in 2016 comprised disbursement of the support as well as commissions.

The key figures relating to the Borrower Support Fund in 2016 have been presented in Table 32.

TABLE 32: Key figures relating to the Borrower Support Fund (in PLN million)

Item	Performance		Change versus 2015	
	2015	2016	In nominal terms	%
Carrying amount				
Balance sheet total	0.0	601.1	601.1	-
Debt securities (measured at cost)	0.0	600.3	600.3	-
Profit or loss	-0.2	4.9	5.1	-
Proceeds from regulatory payments	0.0	0.0	0.0	-
Payments for support programme	0.0	3.1	3.1	-

7. SOCIAL RESPONSIBILITY OF THE BANK

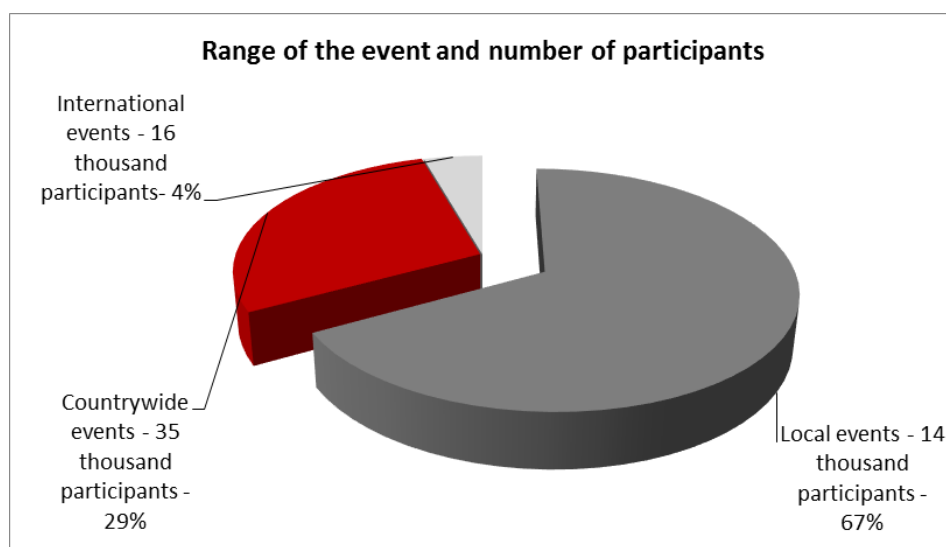
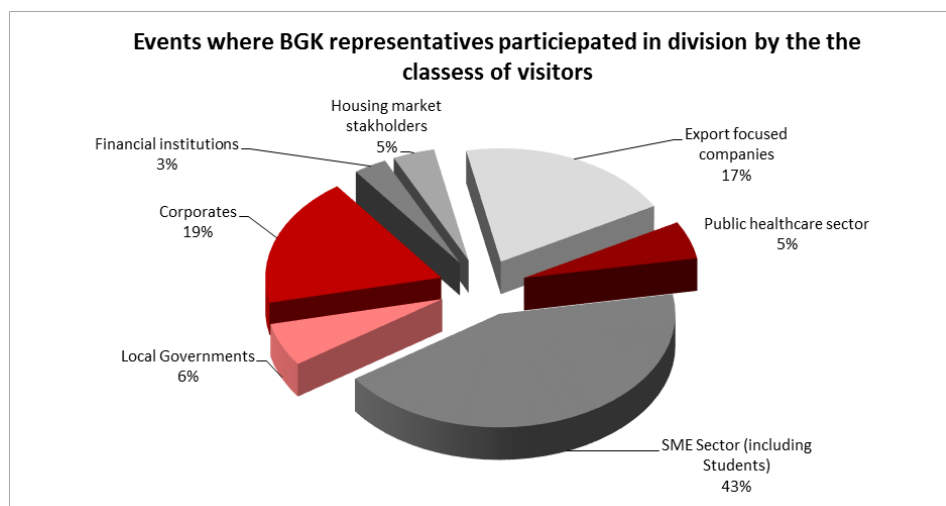
Bank Gospodarstwa Krajowego has launched a number of initiatives to support the social development of Poland. The key social responsibility activities of the Bank in 2016 included:

- BGK employee knowledge and experience sharing;
- 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 2016, the Bank’s representatives were lecturers during more than 150 events addressed to the key stakeholder groups, including private enterprises, local governments or individuals willing to set up their own businesses. What is more, BGK experts were jury members in two competitions: “Top Inwestycje Komunalne” (PTWP) and “Najlepsze Przedsiębiorstwo Społeczne Roku im. Jacka Kuronia” (The Foundation for Social and Economic Initiatives (FISE)).

Diagram 7



Social responsibility initiatives of BGK

Social responsibility programmes are run by the **BGK Foundation**. Between 2014 and 2016, the strategic focus of the Foundation is promoting equal educational opportunities for children and young people, social capital building, citizenship education as well as fostering the idea of volunteerism.

In 2016, the Bank made a donation of PLN 2 million to be used for the accomplishment of the statutory objectives of the Foundation.

Promoting equal educational opportunities

As part of the “Na dobry początek” (A Good Start) grant competition, the BGK Foundation supports educational projects addressed to children aged 2-8, living in rural areas and towns with a population of up to 20,000. In the eighth edition of the competition (2015/2016), 50 educational projects were implemented with the involvement of 2,990 children. In the ninth edition (2016/2017), 60 initiatives were rewarded by the BGK Foundation. A grant of more than PLN 500,000 was awarded to libraries, cultural institutions and local NGOs. A workshop was held for 45 representatives of the grantees. It was dedicated to integrating group work methods as well as animation inspired by education through play.

In 2016, the BGK Foundation sponsored scholarships for 30 first-year students. The Bridge Scholarship Programme is addressed to ambitious and talented secondary school graduates from small towns, who come from low-income families and want to continue their education at university.

Building social capital and citizenship education

Under the “Młody Obywatel” (Young Citizen) citizenship education programme launched by the BGK Foundation and the Centre for Citizenship Education in 2010, young people learn teamwork skills and engage in initiatives for the benefit of their local communities. In the 2015/2016 school year, under the motto of “The Young Citizen and Sports” a number of young people groups organized charity sports events with the involvement of their local communities (“Exercise Makes Sense”), documented various forms of games and activities from the past and organized local matches (“Sports Chronicle”) or held debates with local authorities and communities over the development of sports in their neighbourhood and promoting sports among the local residents (“Discussion Relay”). In the ninth edition of the programme (2016/2017 school year), the project groups could choose from among three topics: “Neighbourhood Documentary” aimed to get to know their neighbours and presented the information collected in the course of the project in an interesting form to the general public; “The ins and outs of a local office” aimed to learn as much as possible about the operations of an institution of their choice in their town and present it to the residents; and “Work on your Future” aimed to discuss the vision of their neighbourhood in the next 5, 10 and 15 years. Thus far, 1,250 schools, 1,700 teachers and ca. 14,000 students have participated in the “Young Citizen” Programme.

Having joined forces with the Volunteering Development Foundation, the BGK Foundation launched the third edition of the “Mała ojczyzna – wspólna sprawa” (Our Local Community – A Shared Responsibility) Programme aimed to prepare secondary and post-secondary school students from small towns to take a conscious and active part in the civic life. In 2016, 185 students volunteered to organize 58 educational workshop sessions and field games for secondary and post-secondary school students from 9 regions of Poland. The project was addressed to 2,000 beneficiaries.

In partnership with the Ashoka Innovators for the Public Foundation, in 2015 and 2016 the BGK Foundation run the “Szkoły z mocą zmieniania świata” (Changemaker Schools) Programme aimed to promote valuable, practical solutions worked out at schools which recognize the importance of social skills in the education process. In 2016, six such schools were identified in Poland: Primary School in Konary (małopolskie region), School Complex in Radowo Małe (zachodniopomorskie region), Montessori Mountain School in Przyłęków (śląskie region), Secondary School No. 1 in Gdynia (pomorskie region), Primary School No. 4 in Ełk (warmińsko-mazurskie region) and No Bell School Complex in Konstancin (mazowieckie region). In March 2016, a nationwide EDUcamp changemaker conference was organized.

The BGK Foundation was a strategic partner of the Best CSR Company of the Year Competition, launched by The Foundation for Social and Economic Initiatives (FISE) and it sponsored the award in the “Idea for Growth” category. The award was bestowed on the Dalba Social Cooperative from Puck and the Cooperative Brewery it runs.

Employee volunteer programmes

BGK enables its employees to take part in volunteer programmes and encourages them to use their professional skills by organizing charity events and awarding grants to projects proposed by its staff. In the eighth edition of the “Wolontariat jest super!” (Volunteerism is Cool) Programme, the Bank provided financial support to 33 social responsibility projects, which were implemented with the participation of 406 volunteers, including 162 employees and 24 representatives of the BGK Group stakeholders. Owing to the engagement of the volunteers, ca. 5,000 beneficiaries received support under the Programme.

BGK employees taught finance classes to young people at schools participating in the “Young Citizen” Programme. They shared their knowledge of banking and taught young people how to make informed decisions when selecting banking products. In 2016, educational materials were prepared and classes taught in municipal finance. Addressed to young people, the programme consisted of more than 100 teaching hours. Bankers for Financial Education of the Young – BAKCYL is a project launched by the Polish banking sector and organized by the Warsaw Institute of Banking. In 2016, BGK volunteers taught 50 hours of classes dedicated to young people in relation to the BAKCYL Project.

Additionally, the Bank’s employees volunteered to take part in the economic experts’ work related to the Best CSR Company of the Year Competition and held two meetings for the patients of the Paediatrics Clinic of the Military Institute of Medicine.

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

Being in concordance with the Article 111.a of Banking Law, BGK hereby states that:

- Bank Gospodarstwa Krajowego acts only on the territory of the Republic of Poland as the only state-owned Bank;
- Bank do not act in the holding subject to consolidated supervision;
- In accordance with the financial statement for the 2016 financial year the Banks 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 1,711.2 million. The gross profit amounted to PLN 353.1 million whereas the income tax was equaled to PLN 3.9 million;
- As at 31 December 2016 the Bank employed 1,335 people (FTEs);
- The Bank did not receive any financial support on the basis of the Act on support from the Treasury State to the financial institutions dated 12 February 2009 (Journal of Laws 2016, item 1436).

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

9. STATEMENT OF COMPLIANCE WITH THE PRINCIPLES OF CORPORATE GOVERNANCE

9.1 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 the Bank is defined by other external legal acts:

- the Act on Bank Gospodarstwa Krajowego of 14 March 2003 (Journal of Laws of 2016, item 1787, as amended);
- 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 (Journal of Laws of 2016, item 1527);
- the Banking Law of 29 August 1997 (Journal of Laws of 2016, item 1988, as amended);
- Resolution No. 258/2011 of the Polish Financial Supervision Authority of 4 October 2011 determining detailed principles of risk management and internal control system and detailed principles of estimating internal capital by banks, reviewing the estimation and internal capital maintenance processes and the principles of developing the policy of variable compensation for top executives of the bank (Official Journal of the Polish Financial Supervision Authority No. 11, item 42);
- 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 (Official Journal of the Polish Financial Supervision Authority No. 8, item 39, as amended).

By adopting the Principles of the Polish Financial Supervision Authority, the Bank considered its legal form as a state-owned bank, whose solely owner is the State Treasury as well as the characteristics of Bank Gospodarstwa Krajowego:

- a 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;
- a 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.

9.2 THE BANK'S FUNCTIONS, SCOPE OF ACTIVITY AND ORGANIZATION

The Bank's functions, scope of activity and organization are defined by the Act on Bank Gospodarstwa Krajowego. 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 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 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 the State Treasury is, 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 engineering 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 (OJ L 347, 20.12.2013, p. 320).

The articles of association of the Bank are adopted, by an ordinance of the Minister of Economy. In particular, the articles of association of the Bank 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 Bank's articles of association ensure the division of duties between the Supervisory Board, which is a supervisory body, and the Management Board, which is a management body of the Bank.

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

9.3 COMPOSITION AND REGULATIONS OF THE BANK'S GOVERNING BODIES AND COMMITTEES, REPRESENTATION AND POWERS VESTED IN THE CHAIRMAN 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 Bank's articles of association, 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

As of 31 December 2016 the Supervisory Board exercises permanent supervision of the Bank's activities in all areas of its operations. The term of office of the Supervisory Board is four years. The ninth term of office of the Supervisory Board began on 1 September 2016.

The Supervisory Board is composed of 12 members, including the Chairman, appointed from among candidates having the necessary qualifications. 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. The Supervisory Board is composed of:

- three representatives of the minister in charge of economy;
- two representatives of the minister in charge of regional development;
- a representative of the minister in charge of financial institutions;
- a representative of the minister in charge of public finance;
- a representative of the minister in charge of State Treasury;
- a representative of the minister in charge of construction, spatial planning and development as well as housing;
- a representative of the minister in charge of transport;
- a representative of the minister in charge of energy.

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 2016:

- Paweł Borys – Chairman;
- Witold Słowik – Deputy Chairman;
- Michał Łukasz Kamiński – Secretary;
- Artur Adamski – Member;
- Joanna Bęza-Bojanowska – Member;
- Jadwiga Lesisz – Member;

- Wojciech Kowalczyk – Member;
- Jarosław Nowacki – Member;
- Jan Filip Staniłko – Member;
- Jerzy Szmit – Member;
- Adam Węgrzyn – Member;
- Robert Zima – 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 2016 have been presented in Table 33.

TABLE 33: Supervisory Board of BGK in 2016

Full name	Position in the Supervisory Board held in the period	Position in the Supervisory Board	Remuneration* in PLN
Leszek Skiba	18.01.2016 - 31.08.2016	Chairman	0
Bogdan Klimaszewski	01.01.2016 - 02.03.2016	Deputy Chairman	8,699
Grażyna Grzyb	01.01.2016 - 31.08.2016	Secretary	34,243
Joanna Bęza-	01.01.2016 - 31.12.2016	Member	60,091
Paweł Olszewski	01.01.2016 - 18.01.2016	Member	0
Ryszard Pazura	01.01.2016 - 31.08.2016	Member	34,243
Mirosław Pietrewicz	01.01.2016 - 31.08.2016	Member	34,243
Jadwiga Romaszko	01.01.2016 - 31.08.2016	Member	34,243
Tomasz Szałwiński	01.01.2016 - 31.08.2016	Member	34,243
Agnieszka Szczepaniak	01.01.2016 - 31.08.2016	Member	34,243
Piotr Koziński	18.01.2016 - 31.08.2016	Member	31,896
Jerzy Szmit	18.01.2016 - 31.12.2016	Member	0
Robert Zima	02.03.2016 - 31.08.2016	Deputy Chairman	25,544
	01.09.2016 - 31.12.2016	Member	24,841
Paweł Borys	01.09.2016 - 31.12.2016	Chairman	25,848
Witold Słowik	01.09.2016 - 31.12.2016	Deputy Chairman	0
Michał Łukasz Kamiński	01.09.2016 - 31.12.2016	Secretary	25,848
Artur Adamski	01.09.2016 - 31.12.2016	Member	24,841
Wojciech Kowalczyk	01.09.2016 - 31.12.2016	Member	0
Jadwiga Lesisz	01.09.2016 - 31.12.2016	Member	24,841
Jarosław Nowacki	01.09.2016 - 31.12.2016	Member	24,841
Jan Filip Staniłko	01.09.2016 - 31.12.2016	Member	24,841
Adam Węgrzyn	01.09.2016 - 31.12.2016	Member	24,841
Total			532,429

* no remuneration is paid to Secretaries or Undersecretaries of State

On 18 January 2016, the Minister of Finance appointed Leszek Skiba as Chairman of the Supervisory Board and Piotr Koziński and Jerzy Szmit as members of the Supervisory Board, while removing Paweł Olszewski from office. On 2 March 2016, the Minister of Finance removed Bogdan Klimaszewski from office and appointed Robert Zima as a member of the Supervisory Board. On 21 March 2016, the Supervisory Board elected Robert Zima as the person acting permanently as Deputy Chairman of the Supervisory Board.

Following the amendment to regulations governing the functions of the Supervisory Board, Beata Szydło, the President of the Council of Ministers, appointed the following individuals to the Supervisory Board of the Bank (ninth term of office) as from 1 September 2016: Paweł Borys – as Chairman of the Supervisory Board, and the following members of the Supervisory Board: Artur Adamski, Robert Zima, Joanna Bęza-Bojanowska, Michał Łukasz Kamiński, Wojciech Kowalczyk, Jadwiga Lesisz, Jarosław Nowacki, Witold Słowik, Jan Filip Staniłko, Jerzy Szmit and Adam Węgrzyn. The Supervisory Board was constituted on 20 September 2016 and: Witold Słowik became Deputy Chairman of the Supervisory Board and Michał Łukasz Kamiński became the Secretary of the Supervisory Board.

On 30 December 2016, the Act of 16 December 2016: Regulations Implementing the State Property Management Act, was published in the Journal of Laws. Under the aforesaid legal act, the number of members of the Supervisory Board of BGK was reduced from 12 to 11 effective from the 1 January 2017.

Remuneration 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 (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 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 the Bank, except those which have been assigned to the Supervisory Board and Chairman of the Management Board of the Bank. The term of office of the Management Board is five years.

The Management Board is composed of six members, including Chairman, First Deputy Chairman and Vice-Chairman. Information concerning the current composition of the Management Board is available at www.bgk.pl.

Chairman of the Management Board and one member of the Management Board are appointed by consent of the Polish Financial Supervision Authority. The provisions of Articles 22a.2 and 22b of the Banking Law of 29 August 1997 apply accordingly.

In line with the Regulations of the Management Board, meetings of the Management Board are held at least once a month.

Chairman 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 employees of the Bank report to Chairman of the Management Board.

The powers vested in the First Deputy Chairman, the Vice-Chairman and members of the Management Board have been defined in the Act on Bank Gospodarstwa Krajowego:

- the First Deputy Chairman is in charge of the financial market;
- the Vice-Chairman is in charge of transport infrastructure development;
- the member of the Management Board appointed at the request of the minister in charge of regional development is in charge of the regional policy and regional development;
- the member of the Management Board appointed at the request of the minister in charge of economy is in charge of support for the economy;
- the member of the Management Board appointed at the request of the minister in charge of public finance is in charge of revenues and expenses in the government budget.

As at 31 December 2016, the Management Board of BGK had six members:

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

On 3 March 2016, the Minister of Finance removed Dariusz Kacprzyk from the office of Chairman of the Management Board as from 7 March 2016. At its meeting on 3 March 2016, the Supervisory Board of BGK appointed Mirosław Panek

as Acting Chairman of the Management Board of BGK as from 8 March 2016. At the same time, the Supervisory Board removed Radosław Stępień from the office of Vice-Chairman – First Deputy Chairman of the Management Board as from 3 March 2016 and Andrzej Ladko from the office of Vice-Chairman of the Management Board as from 9 March 2016. On 21 March 2016, the Supervisory Board adopted a resolution to appoint Włodzimierz Kocon as Vice-Chairman – First Deputy Chairman of the Management Board as from 23 March 2016. On 17 August 2016, Adam Świrski, Vice-Chairman of the Management Board, resigned from office as from 31 August 2016.

Following the amendment to regulations governing the appointment of members of the Management Board of BGK, Beata Szydło, the President of the Council of Ministers, appointed:

- the following members of the Management Board as from 23 September 2016: Paweł Nierada as the First Deputy Chairman of the Management Board, Włodzimierz Kocon as Vice-Chairman of the Management Board, Wojciech Hann as Member of the Management Board and Przemysław Cieszyński as Member of the Management Board. The appointments were accepted by Members of the Management Board on 27 September 2016 and the new term of office of the Management Board began as from that date;
- as from 15 November 2016: Radosław Kwiecień as Member of the Management Board. The appointment was accepted by Radosław Kwiecień on 15 December 2016;
- as from 1 December 2016: Beata Daszyńska-Muzyczka as Chairman of the Management Board. The appointment was accepted by Beata Daszyńska-Muzyczka on 9 December 2016.

The composition of the Bank's Management Board and the term of office have been presented in Table 34.

TABLE 34: Composition of the Management Board of BGK in 2016

Full name	Position in the Management Board held in the period	Position in the Management Board
Dariusz Kacprzyk	01.01.2016 - 07.03.2016	Chairman of the Management Board
Radosław Stępień	01.01.2016 - 03.03.2016	Vice-Chairman – First Deputy Chairman of the Management Board
Włodzimierz Kocon	23.03.2016 - 26.09.2016	Vice-Chairman – First Deputy Chairman of the Management Board
	27.09.2016 - 31.12.2016	Vice-Chairman of the Management Board
Andrzej Ladko	01.01.2016 - 09.03.2016	Vice-Chairman of the Management Board
Piotr Puczyński	01.01.2016 - 26.09.2016	Vice-Chairman of the Management Board
Jerzy Jacek Szugajew	01.01.2016 - 26.09.2016	Vice-Chairman of the Management Board
Adam Świrski	01.01.2016 - 31.08.2016	Vice-Chairman of the Management Board
Mirosław Panek	08.03.2016 - 26.09.2016	Acting Chairman of the Management Board
Paweł Nierada	27.09.2016 - 31.12.2016	First Deputy Chairman of the Management Board
Wojciech Hann	27.09.2016 - 31.12.2016	Member of the Management Board
Przemysław	27.09.2016 - 31.12.2016	Member of the Management Board
Beata Daszyńska-Muzyczka	09.12.2016 - 31.12.2016	Chairman of the Management Board
Radosław Kwiecień	15.12.2016 - 31.12.2016	Member of the Management Board

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 (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.

Remuneration of Members of the Management Board has been presented in Table 35.

TABLE 35: Remuneration of Members of the Management Board of BGK in 2016 (in PLN)

Full name	Position held in 2016	Base pay sick pay and unused annual leave	Annual bonus	Termination benefit	Additional benefits
Dariusz Kacprzyk	Chairman of the Management Board	88,999		77,047	
Radosław Stępień	Vice-Chairman – First Deputy Chairman of the Management Board	54,867	62,182	77,047	9,144
Włodzimierz Kocon	Vice-Chairman – First Deputy Chairman of the Management Board	161,098			
	Vice-Chairman of the Management Board	108,670			
Andrzej Ladko	Vice-Chairman of the Management Board	92,557	62,182	77,047	
Piotr Puczyński	Vice-Chairman of the Management Board	243,538			27,000
Jerzy Jacek Szugajew	Vice-Chairman of the Management Board	225,738			25,682
Adam Świrski	Vice-Chairman of the Management Board	207,849	62,182		20,883
Mirosław Panek	Acting Chairman of the Management Board	183,890		77,047	22,632
Paweł Nierada	First Deputy Chairman of the Management Board	112,258			
Wojciech Hann	Member of the Management Board	112,258			
Przemysław Cieszyński	Member of the Management Board	112,258			
Beata Daszyńska-Muzyczka	Chairman of the Management Board	0			
Radosław Kwiecień	Member of the Management Board	0			
Total		1,703,980	186,546	308,188	105,341

The Supervisory Board and the Management Board of Bank Gospodarstwa Krajowego have established committees which perform control or advisory and reviewing 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 two committees in charge of specific areas of the Bank's activity, namely the Operational Risk Committee and the Change Committee.

AUDIT COMMITTEE

The Audit 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 supervise the organization of the internal audit function at the Bank;
- to monitor the financial reporting process, the management reporting process and audit procedures at the Bank;
- to monitor the area of internal control and risk management systems at the Bank.

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 the Bank's overall current and future readiness to accept risk;
- to review the information provided by the Management Board on the implementation of policies governing the management of risks, which constitute the risk management strategy;
- to support the Supervisory Board in supervision of the implementation of the strategy for management of risks inherent in the Bank's operations 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 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 the components of the remuneration of the Bank's management;
- to formulate recommendations for the Management Board as to the remuneration of the Bank's management;
- to review and monitor variable remuneration components of the Bank's management in charge of risk management and compliance of the Bank's activities with the applicable laws and internal regulations.

THE BANK'S FINANCE COMMITTEE

The Bank's Finance Committee is an obligatory collegial body which issues opinions and decisions and whose composition and duties are set out by a resolution of the Management Board. The Committee follows its Regulations adopted by the Management Board.

The primary objective of the Bank's Finance Committee is to formulate the current, medium- and long-term policy for the Bank's asset liability management with a view to improving its performance and the efficiency of capital allocation, while considering an appropriate level of the exposure to the 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.

In particular, the key duties of the Committee are:

- to monitor and manage the level of the Bank's market and liquidity risks;
- to monitor the credit (portfolio) risk and to monitor and manage the level of the settlement and pre-settlement risks of banks and insurance companies;
- to review the measures taken with respect to capital management;
- to determine the desired structure of the Bank's assets and liabilities so as to ensure an appropriate return while optimizing the level of risk assumed by the Bank.

THE BANK'S CREDIT COMMITTEE

The Bank's Credit Committee is an obligatory collegial body which issues opinions and decisions and whose composition and duties are set out by a resolution of the Management Board. The Committee follows its Regulations adopted by the Management Board.

The Committee focuses on the Bank's own and delegated activities which are exposed to the credit risk. In particular, the Committee's duties are:

- to take decisions on credit applications as well as restructuring, debt collection and asset seizure applications within the competence of the Committee;

- to express opinions on the possibility of the Bank's further participation in transactions on the proposed terms;
- to formulate recommendations for the Management Board as to decisions falling within the competence of the Board;
- to perform quarterly credit portfolio reviews and to take decisions regarding the classification and level of specific reserves;
- to perform quarterly industry reviews in line with the Polish Classification of Activities (PKD) and to take decisions regarding the assignment of appropriate investment risk categories to each industry in accordance with separate regulations which the Bank is obliged to comply with;
- to approve the criteria for classification of credit exposures to the "under observation" category, considering the risk of the region, country, industry, customer group or product group;
- to take measures aimed to manage the rating models, as defined in the internal regulations of the Bank.

OPERATIONAL RISK COMMITTEE

The Bank's Operational Risk Committee is a collegial body which issues opinions and decisions and whose composition and duties are set out by a resolution of the Management Board. The Committee follows its Regulations adopted by the Management Board.

The Committee has been established with a view to ensuring effective operational and compliance risk management. It issues opinions and decisions to enable:

- the Management Board to manage the operational and compliance risks by exercising control of the level of such risks;
- the Supervisory Board to supervise and assess the effectiveness of operational and compliance risk management.

CHANGE COMMITTEE

The Bank's Change Committee is a collegial body which issues opinions and decisions and whose composition and duties are set out by a resolution of the Management Board. The Committee follows its Regulations adopted by the Management Board.

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 Multi-Annual Development Plan of Bank Gospodarstwa Krajowego (hereinafter referred to as the Bank's Strategy).

Duties of the Change Committee:

- to manage the portfolio of projects within the competence of the Committee;
- to approve, considering the objectives defined in the Bank's Strategy, the key policies applicable to the Bank's products and services, processes, applications and the IT infrastructure.

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

INTERNAL CONTROLS

The Bank has an internal control system in place, the objective of which is to ensure effective and efficient operations of the Bank, reliability of its financial reporting, compliance with the Bank's risk management policies as well as conformity with the applicable laws and internal regulations.

The internal control system of the Bank is organized around three lines of defence against risk:

- the control function, including internal control procedures and mechanisms in the form of ex ante, ongoing and ex post control;

- risk management policies, including the audit of compliance of the Bank's operations with the applicable laws and internal regulations;
- the internal audit.

The Bank's internal control function is governed by the BGK Internal Control Regulations, which were adopted by the Management Board and approved by the Supervisory Board. The Regulations were drafted in accordance with the Banking Law, the Act on Bank Gospodarstwa Krajowego, the Bank's articles of association, Resolution No. 258/2011 of the Polish Financial Supervision Authority as well as international standards and good practices.

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, control over the risk of outsourcing banking and the related operations to third parties as well as the risk inherent in the operations of the Bank's subsidiaries.

BGK has an internal audit function which reports directly to Chairman of the Management Board in accordance with the articles of association of the Bank. It is responsible for examining and assessing, in an independent and unbiased way, the appropriateness and effectiveness of internal controls, in addition to reviewing the Bank's governance system, in particular the effectiveness of operational risk management. In compliance with external requirements and best practices, all the operations of the Bank are subject to audit. Audits are also conducted at the Bank's subsidiaries. The Bank's internal audit function follows the IIA international standards for the professional practice of internal auditing, which is confirmed by regular independent reviews. 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 Audit Committee, the Audit Committee's approval of the appointment of the internal audit head, 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.

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:

- Compliance policy of Bank Gospodarstwa Krajowego, describing basic operational procedures of Bank employees, responsibilities of individual Bank functions and key compliance risk identification processes and enabling compliance risk management at all levels of the organization;
- Liquidity risk management policy of BGK, defining strategic framework and liquidity risk management policies of the Bank;
- Market risk management policy of BGK, defining strategic framework and market risk management policies of the Bank;
- Operational risk management policy of BGK, comprising guidelines on the organization of the management system underlying operational risk management principles of the Bank;
- Credit risk management policy defining key credit risk management principles of Bank Gospodarstwa Krajowego;
- Capital risk management in BGK, defining key principles of capital (own funds) management in the Bank with the roles of the Bank's functions.

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 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 the Bank ensures that organizational units in charge of concluding and settling transactions and those monitoring and controlling risks are independent. The functions are also separated at the Management Board level.

The Bank monitors the risk of operations carried out by subsidiaries.

A Compliance Unit operates in the Head Office. The Unit manages the risk of non-compliance of the Bank's operations with the applicable laws, procedures and ethical standards, including compliance risk management standards developed by the bank supervision authorities. A Compliance Officer, in charge of compliance risk management, reports directly to the Chairman of the Management Board of the Bank.

The Supervisory Board plays an important role in the Bank's risk management processes, as it approves risk management policies.

PREPARATION OF THE FINANCIAL STATEMENTS OF THE BANK

The Bank draws up its financial statements in line with the accounting policies (principles) specified in the Accounting Act of 29 September 1994 (Journal of Laws of 2016 item 1047 as amended), and the related implementing regulations enacted on its basis, the Bank's Articles of Association and other applicable laws. The financial statements are prepared under the professional supervision of the Managing Director in charge of the Bank's finance and the final document is approved by a resolution of the Management Board and provided for approval to the Supervisory Board by 31 May of the year immediately following the financial year for which the financial statements were prepared. Annual financial statements of the Bank are audited by an entity authorized to audit financial statements of the Bank. The entity is selected by the Supervisory Board.

9.5 OTHER CORPORATE GOVERNANCE PRINCIPLES

Since 1 January 2015 Bank Gospodarstwa Krajowego has followed the "Principles of Corporate Governance for supervised institutions" issued by the Polish Financial Supervision Authority in line with the pro rata principle, having implemented these principles in the "Corporate Governance Rules of Bank Gospodarstwa Krajowego" and other internal regulations.

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 financial statements have been presented in item 1.15 of the financial statements of Bank Gospodarstwa Krajowego for 2016.

11. HR POLICY PURSUED BY BGK

Headcount

As at 31 December 2016 the Bank employed 1,335 people (in FTEs), i.e. 1% (13 FTEs) more than at the end of 2015.

The headcount grew mainly in functions carrying out commissioned activities, in particular following the increase in the number of *de minimis* guarantees, and services related to the Technology Loan Fund, where BGK act as an Intermediate Body under sub-measure 3.2.2 Technology Innovation Credit of the Operational Programme Smart Growth.

In April 2016, the Decision No. 23/2016/DZK/PRA of the Chairman of the Management Board introducing employee performance appraisal process entered into force. The program covers all Bank employees except for the Management Board and Legal Counsels. It requires that individual goals be set for every employee, monitored on a quarterly basis and assessed annually. In accordance with the regulations implemented, goal performance, employee attitude, commitment and performance were appraised before 31 January 2017, during the annual performance review.

Remuneration system

The Bank's remuneration system comprises a fixed and variable portion: base pay and bonuses. Moreover, the Bank offers additional benefits, such as: healthcare, Employee Pension Scheme and co-finances sport and leisure activities.

Staff development

In 2016 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 which enable tailoring the training programme to the Bank's needs, training a higher number of people and more efficient fund use. 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, were financed from EIB grants.

The Bank also offered a wide range of e-learning courses such as: closed training courses in operational risk management, cyber crime, anti-money laundering and counter-terrorism financing, fraud prevention, compliance risk management and reputation risk management in BGK. E-learning courses effectively complement the traditional learning offer, enable tailoring the learning pace to individual needs and capabilities and can be completed at any time convenient.

In 2016, in line with the new approach to employee development, training projects for executives (Directors and Managers) were carried out along with soft skills training for all staff.

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

Moreover, as a part of knowledge sharing initiative, a knowledge sharing process was implemented in the organization.

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 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 2016 have been presented below.

TABLE 36: BGK staff structure by sex

	Female	Male	Total
Executives	103	106	209
Other staff	757	411	1,168
TOTAL	860	517	1,377

Diagram 8

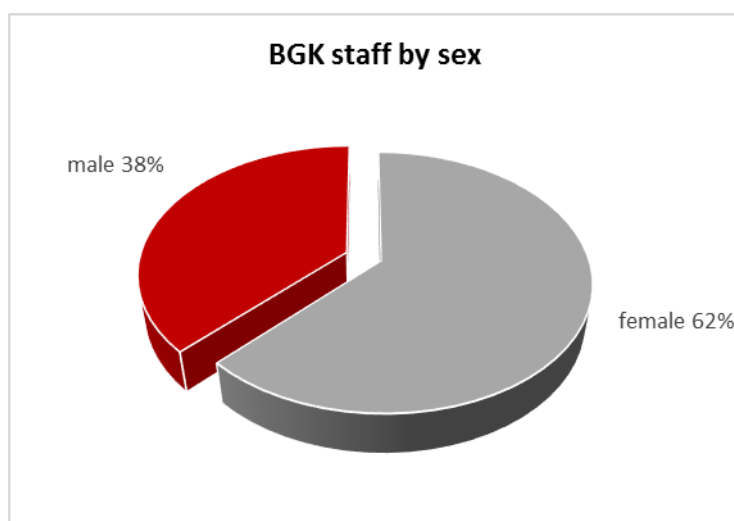


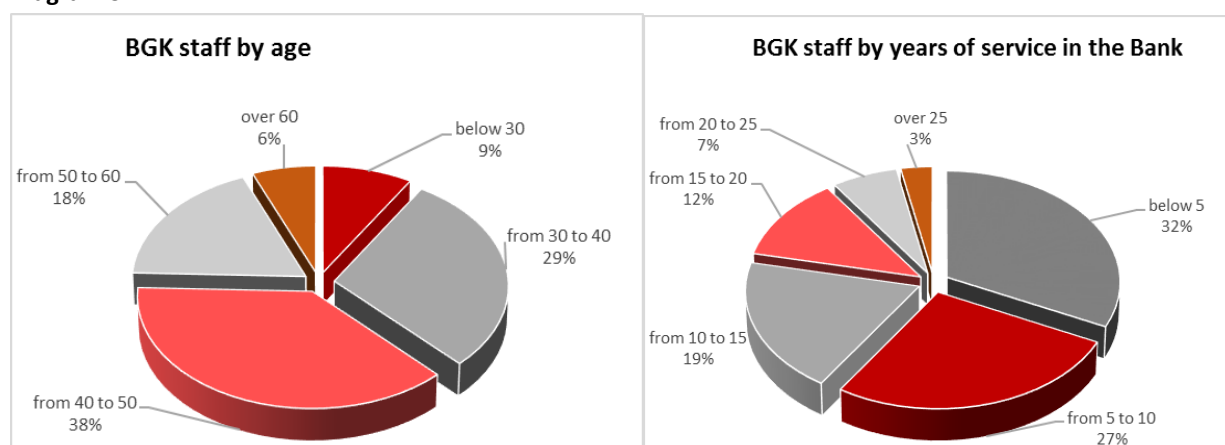
TABLE 37: BGK staff structure by age

	below 30	30 to 40	40 to 50	50 to 60	over 60
Executives	2	38	111	50	8
Other staff	118	362	409	202	77
TOTAL	120	400	520	252	85

TABLE 38: BGK staff structure by years in service

	below 5 years	from 5 to 10 years	from 10 to 15 years	from 15 to 20 years	from 20 to 25 years	over 25 years
Executives	52	66	47	23	13	8
Other staff	392	304	219	144	75	34
TOTAL	444	370	266	167	88	42

Diagram 9



12. ORGANISATION

ORGANIZATIONAL STRUCTURE OF THE BANK

At the end of 2016 the Bank carried out its operations through the Head Office and the network of 16 branches located countrywide. 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.

In 2016 the Bank continued works aimed at changing its structure to comply with the provisions of the BGK Act. At the end of 2016 the Bank's structure was assigned to the new full composition of the Management Board.

The key changes in the Bank's Head Office implemented in 2016 included organizational changes in sales and product management which led to the development of the Sales and Product Support Department. The Department was created as a result of combining the Sales Planning and Monitoring Office with the Product Management Department (excluding cash management and online banking, which were transferred to the Foreign Trade Finance Department). Moreover, a Product Management Division was created and it includes: Foreign Trade Finance Department, Surety Bond and Guarantee Centre and Structured Finance Department.

In 2016 the Bank established the Core Banking System Implementation Office in the Head Office, as a separate organizational unit responsible for the implementation of the Core Banking System. At the same time, the Bank created an IT Division comprising IT support units, such as: IT Department, IT Development Department and Core Banking System Implementation Office.

Moreover, an Equity Investment Division including Equity Investment Office and Corporate Governance Office is also supervised by the First Deputy Chairman of the Management Board.

To comply with the requirements of Recommendation W on model risk management in banks issued by the Polish Financial Supervision Authority on 21 July 2015, an independent model validation function was created in the Bank.

13. PROJECTS

Projects carried out by the Bank support performance of the Multi-Annual Development Programme of BGK, Tactical Action Plan for 2017 and changes resulting from external regulations. Most projects improve operational efficiency of the Bank through process streamlining and implementing necessary IT solutions. *Core Banking System Implementation* is a strategic project in this area.

Changes implemented in the Bank also relate to regulatory issues and application of standards, including accounting standards. In 2016 the Bank completed an initiative which was aimed at preparing the Bank to carry out financial reporting compliant with the International Financial Reporting Standards, to ensure unified accounting and financial reporting standards in a global perspective. Consequently, the Bank reduced its liquidity risk thanks to easier access to foreign markets, comparability of data with similar financial institutions and enhanced image of the Bank which complies with the same accounting principles as other banks. The Supervisory Board of BGK decided to change statutory reporting standards from the Polish Accounting Standards to the International Accounting Standards from 1 January 2017.

In 2016, the Bank pursued 14 initiatives. During the year 9 projects were completed, including those related to risk, sales, products, process management, derivative transactions (EMIR) and management reporting.

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

14.1 ORGANISATION OF THE CREDIT RISK MANAGEMENT PROCESS

Credit risk is one of the most important elements of the financial risks to which the Bank is exposed in the terms of conducted activities. The Bank uses a credit risk management process that involves risk identification, assessment, mitigation, hedging or transfer, monitoring and reporting to identify credit risk and reduce it to an acceptable level, and for the purposes of ongoing control of the effectiveness of the actions taken.

A material component of the credit risk management process is action planning, which covers the entire decision making process consisting in issuing recommendations and guidelines, modifying the Bank's range of services and developing procedures designed to ensure that credit risk exposures are within the limits set by the Bank's governing bodies.

Credit risk management at the Bank is performed at two levels:

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

The Bank identifies and assesses the existing credit risk on the basis of:

- the implementation of internal procedures enabling the assessment of creditworthiness for individual borrowers and classification of credit exposures into relevant risk groups;
- updating the risk level as a result of the inspection and monitoring of assets managed by the Bank's organizational units.

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;
- comprehensive individual credit risk assessment, taking into account individual credit exposures for all transactions giving rise to credit exposures in order to assign a credit risk category;
- applying expert credit risk measurement methods through the use of ratio analysis for risks associated with individual transactions and descriptive analysis for the purposes of credit risk assessment, and (for the portfolio risk) through the evaluation of the concentration level of the Bank's loan portfolio with respect to industry sectors, borrowers and types of loans;
- the system of decision-making authorizations depending on exposure level, involving collective responsibility for credit decisions;
- the regular verification of the risk of past transactions, including changes in the financial condition of borrowers and in the Bank's environment;
- the diversification of industry sectors, borrowers and types of loans through setting exposure limits that are acceptable to the Bank;
- the analysis and verification of valuation principles related to loan collaterals and the establishment of provisions for doubtful accounts;
- the exposure monitoring system enabling early identification of threats or early warning signals;
- the collateral monitoring and valuation system enabling the inspection of exposure security and responding to changes in security value.

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 in respect of credit risk:

- sector limits reflecting the risk arising from the client'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.

Moreover, one of the key credit risk factors is the concentration risk, which is monitored by the Bank in line with the provisions of the Banking Act and the resolutions and recommendations of the Polish Financial Supervisory Authority in this respect, the BGK Act and Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms. In accordance with the Bank's Management Board resolution, irrespective of statutory concentration limits, the Bank has additional exposure limits applicable at the stage of credit decisions.

The risk monitoring process consists in periodic reviews of the parameter levels which are subject to limits in addition to analysing utilization of the limits. The Bank draws up periodic credit risk reports, such as:

- a monthly credit risk report including information on the nature of exposures, risk structure for the entire loan portfolio and the utilization of internal and external exposure limits – for the Bank's Credit Committee and the Management Board;
- a quarterly credit risk report including expanded information on the nature of exposures, risk structure for the entire loan portfolio (including the portfolio of mortgaged exposures) and on the utilization of internal and external exposure limits – for the Bank's Credit Committee, the Finance Committee, the Management Board and the Risk Committee, and for the Bank's Supervisory Board on a semi-annual basis;
- an annual report on lending activity using own and third party funds, including mortgaged exposures – for the Bank's Credit Committee, Finance Committee, Management Board, the Risk Committee, and for the Bank's Supervisory Board.

The Bank has adequate procedures covering the rules to be followed in the event of an increased level of credit risk.

14.2 OVERVIEW OF KEY CREDIT RISKS

Credit risk is the risk of a borrower's failure to repay a loan under the agreement concluded with the Bank. Therefore, credit risk is a direct risk that the borrower fails to fulfil financial commitments and thus the bank will incur a loss on the exposure. The Bank mitigates credit risk at the micro level through assessment and monitoring of the customer and at the macro level - for the entire portfolio - by establishing limits for the various segments and products.

Although the credit risk is virtually unified 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 clients and client 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 counterparty fails to meet the contractual repayment terms or no payments are made. The materialization of the risk is associated with an increase in costs by generating additional specific provisions which, in the case of total non-payment turns into a loss incurred.

The Bank mitigates the risk of default by:

- counterparty credit rating based on financial models, including predictive models resulting in the granting counterparty credit rating adequate to the level of associated risk;
- periodic monitoring of counterparty's economic and financial situation.

Collateral risk

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

Collateral risk is minimized by:

- collateral policy adopted by resolution of the Management Board, which sets the boundary conditions of collateral's adequacy for a particular type of exposure, client and collateral;
- monitoring of collateral, in particular mortgages, through periodic verification of property valuation;
- stress tests, including simulations of changes in the collateral value and their impact on the level of specific provisions.

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 counterparty due to the increase in interest rates or negative change in currency exchange rates, which results in higher instalments commitments.

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

- the application of appropriate procedures for financing in foreign currencies, in particular the verification of repayment sources of the Bank's receivables;
- stress tests, including simulations of interest rates and currency exchange rates changes and their impact on counterparty creditworthiness and the level of specific provisions.

14.3 ORGANISATION OF THE FINANCIAL RISK MANAGEMENT PROCESS

The financial risk monitoring system functioning at the Bank supports risk management in all key areas. For each identified risk, procedures have been implemented to describe the authority and responsibilities of the Bank's individual units involved in the risk monitoring process as well as the process itself and the methodologies used.

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 own funds 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. The Bank 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. The Bank has adequate procedures covering the rules to be followed in the event of an increased level of credit risk.

14.4 OVERVIEW OF KEY FINANCIAL RISKS

Liquidity risk

Liquidity risk is the threat that the ability to meet liabilities on time will be compromised as a result of unfavourable developments in the composition of assets and liabilities, off-balance sheet transactions, maturity mismatch between current cash flows and potential losses.

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 crisis;
- 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.

The Bank controls the 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 the entire 2016, Bank's liquidity was at a secure 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 (OJEC L 11 of 17 January 2015, p. 1) and internal liquidity standards were not breached.

Bank's supervisory liquidity measures are presented in Table 39.

TABLE 39: Supervisory liquidity measures

Item	limit	as at 31.12.2015	as at 31.12.2016	Notes - figures excluding cash flow funds	
				as at	as at
				31.12.2015	31.12.2016
M1 - short-term liquidity gap (in PLN million)	0	6,095	15,504	5,481	14,465
M2 - short-term liquidity ratio	1.00	1.38	1.55	1.37	1.57
M3 – own funds to illiquid assets	1.00	5.96	5.03	5.96	5.03
M4 – own funds and stable external funds to illiquid assets and limited-liquidity assets	1.00	1.18	1.24	1.52	1.64
Liquidity Coverage Ratio	70%*	212%	252%	267%	328%

* limit binding as at 31.12.2016

The increase in liquidity measures is associated with the proportional increase in the Bank's long-term sources of funding comparing to the increase in the lending activity and the growth in the portfolio of equity instruments.

Market risk

Market risk is the risk of a decrease in the value of the portfolio of financial instruments or in the profit resulting from adverse changes in market parameters (exchange rates, interest rates, prices of debt instruments or equity instruments).

Market risk management objectives:

- for interest rate risk (including the risk of changes in prices of debt securities) – to mitigate the risk of losing a portion of interest income or incurring excessive interest expense as a result of changes in the market interest rates as well as the risk of negative changes in the market value of 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 equity instruments prices.

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 2016 the 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.

Basic interest rate risk measures are presented in Table 40.

TABLE 40: Basic interest rate risk measures (in PLN thousand)

Item	as at 31.12.2015	as at 31.12.2016
BPV (Treasury portfolio)	-774	-902
VAR (Treasury portfolio)	2,429	3,931

In the reporting period BPV and VaR grew as a result of an increase in the Bank's balance sheet total, including in particular the debt securities portfolio.

Foreign exchange risk

In 2016, the Bank reported low foreign exchange risk. The risk was measured in accordance with the applicable principles, for instance 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 currency position as at 31 December 2016 amounted to PLN 107.8 million, for VaR it was PLN 1.6 million.

Equity price risk

In 2016 the equity price risk of the Bank was moderate. The value of the share portfolio did not change considerably, while the investment certificate portfolio grew comparing to 2015.

Risk was measured in accordance with the applicable principles, mainly through measuring equity instruments portfolio and VaR. As at 31 December 2016, VaR of the equity instrument portfolio amounted to PLN 43 million.

14.5 ORGANISATION OF THE OPERATIONAL RISK MANAGEMENT PROCESS

Operational risk is inherent in all major areas of the Bank's operations, including any new, existing and modified products, processes and systems, and it takes account of internal factors (such as the 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 Bank's head office 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 Bank's affiliates and organizational units;
- operational risk ratios.

The Operational Risk Committee was created in the Bank to provide opinions, 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 Bank's head office and transferred from subsidiaries.

14.6 OVERVIEW OF OPERATIONAL RISK

The gross loss arising from operational risk events in 2016 amounted to 345 thousand. Provisions for operational risk events reached PLN 3.3 million as at 31 December 2016.

14.7 OTHER RISKS

Additionally, the Bank 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. In 2016 the Bank adjusted the model risk management process to the requirements of Recommendation W.

14.8 CAPITAL ADEQUACY

The Bank monitors the level of capital adequacy using capital adequacy ratios determined in line with the Banking Act and CRR ²

In 2016, the capital adequacy standards set out in Article 128.1 of the Banking 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%).

Capital adequacy ratios are presented in Table 41.

TABLE 41: Capital adequacy ratios

Item	as at 31.12.2015	as at 31.12.2016	change in PLN million / p.p.	Notes - figures excluding cash flow funds		
				as at 31.12.2015	as at 31.12.2016	change in PLN million / p.p.
Total capital requirement (in PLN million)	2,343.1	3,205.2	862.1	2,342.7	3,204.8	862.1
Internal capital (in PLN million)	3,008.3	3,811.8	803.5	3,007.9	3,811.5	803.6
Own funds (in PLN million), including:	9,445.8	12,257.5	2,811.7	9,445.8	12,257.5	2,811.7
Tier 1 capital, including:	9,182.5	12,064.1	2,881.6	9,182.5	12,064.1	2,881.6
Common Equity Tier 1 capital	9,182.5	12,064.1	2,881.6	9,182.5	12,064.1	2,881.6
Tier 2 capital	263.4	193.5	-69.9	263.4	193.5	-69.9
CET1	31.4%	30.1%	-1.3	31.4%	30.1%	-1.3
Tier 1 capital ratio	31.4%	30.1%	-1.3	31.4%	30.1%	-1.3
Solvency ratio	32.3%	30.6%	-1.7	32.3%	30.6%	-1.7
Internal capital ratio	31.8%	31.1%	-0.7	31.8%	31.1%	-0.7

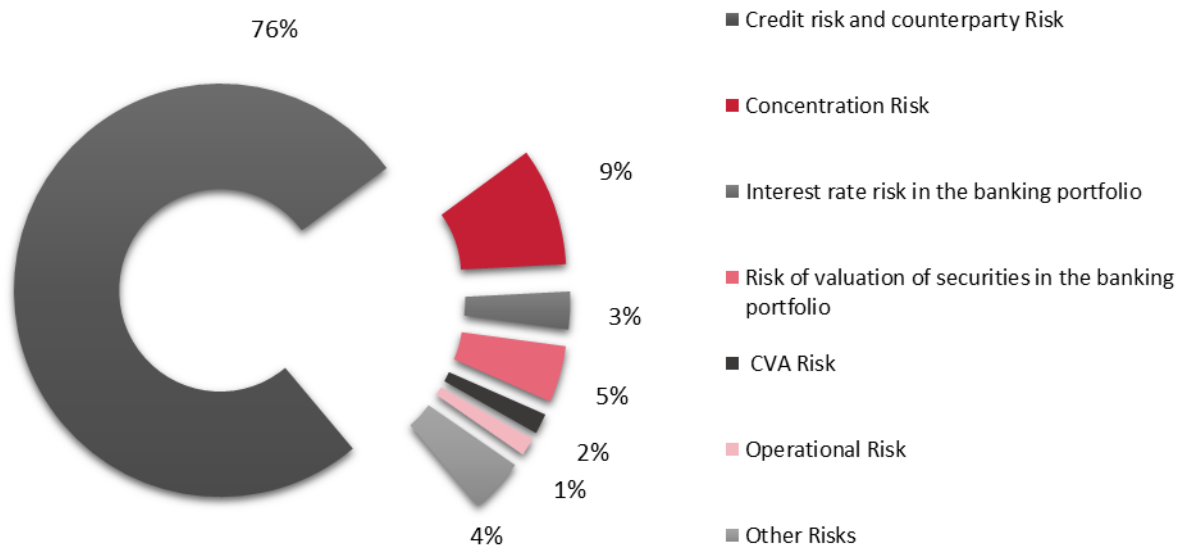
²Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (OJ L 176, 27.6.2013, p. 1)

In 2016, the increase of total capital requirement and internal capital ratio was related to the growth in the Bank's lending to businesses and purchase of investment certificates of closed-ended investment funds. The growth of own funds resulted from capital injection by the State Treasury (treasury securities).

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

Internal capital structure is presented on Diagram 10.

Diagram 10



15. BGK'S DEVELOPMENT STRATEGIES

In the coming years the Bank's development strategy will focus on supporting social and economic initiatives of the Polish government. The Bank's mission is to support the socio-economic growth of Poland and the public sector, in particular by way of carrying out government programmes. The Bank's strategy complies with the activities proposed in the Strategy for Responsible Growth adopted by the Council of Ministers. At the beginning of 2017 the Bank kicked-off works associated with the new Strategy, which will be consistent with the Strategy for Responsible Growth.

It focuses on financing reindustrialization initiatives, innovation, development, foreign expansion, supporting housing construction and social development.

The Bank will strengthen its capital base and financing through the issues of treasury shares also on foreign markets. Thanks to the changes the Bank will carry out large investment projects in the fuel, energy and chemical sector, where concentration limits apply. In medium term the capital increase will enable debt financing of investment projects of ca. PLN 6 billion and filling the debt financing gap for large enterprises of PLN 16 billion by 2020. The capital injection will improve the Bank's capacity to finance large projects and initiatives of funds managed by the TFI BGK, where the Bank acts as an investor.

Bank assumes a considerable increase in debt financing with a growth rate higher by 10 p.p. than the projection for the Polish credit market. Apart from higher structured and corporate finance, the growth of the Bank's lending activity will be based on financing exports and foreign expansion.

The second key area of the Bank's operations in 2017 and beyond will be financing investment funds managed by the TFI BGK. The amounts to be invested in funds managed by the TFI BGK (mainly in reindustrialization initiatives and infrastructure development projects carried out by local government entities) and in funds carrying out housing programmes which promote social mobility "Mieszkanie na wynajem" (Flat for rent) and attractively priced flats "Mieszkanie Plus" will exceed PLN 3 billion p.a.

In 2017 the Bank will launch European programmes under the new EU Perspective 2014-2020. These programmes will focus on innovation and growth financing. They will include credit financing (loans), surety bonds and equity financing (provided with Polski Fundusz Rozwoju (PFR), Polska Agencja Rozwoju Przedsiębiorczości (PARP), Agencja Rozwoju Przemysłu (ARP), Korporacja Ubezpieczeń Kredytów Eksportowych (KUKE), Polska Agencja Inwestycji i Handlu (PAIiH) TFI BGK S.A., BGK Nieruchomości and PFR Ventures). The Bank will expand its activities comparing to the previous perspective 2007-2013 from 6 regions to 15 regions in 2017.

Apart from projects financed from regional programmes, BGK will manage EU funds from Member State level programmes supporting SME innovation and development of broadband infrastructure. EU funds supporting economic development managed by the Bank will reach PLN 9 billion vs. PLN 2 billion in the Financial Perspective 2007-2013.

Starting from 2018 the Bank will launch a new *de minimis* aid surety programme to replace the government's De Minimis Guarantee Programme. The Bank intends to maintain the existing level of support to micro, small and medium-sized enterprises and to streamline the access of businesses and enterprises to debt financing in the banking sector.

From 2017 the Bank will report its performance in line with the International Financial Reporting Standards.

It will carry on performance of strategic initiatives, including technology projects such as the implementation of a new Core Banking System, which further streamlines provision of services to the Bank's customers.

MANAGEMENT BOARD OF BANK GOSPODARSTWA KRAJOWEGO

Chairman of the Management Board

Beata Daszyńska - Muzyczka

.....

First Deputy Chairman of the Management Board

Paweł Nierada

.....

Vice-Chairman 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 March 2017