MANAGEMENT BOARD'S REPORT ON THE ACTIVITIES OF THE CAPITAL GROUP OF BANK GOSPODARKI ŻYWNOŚCIOWEJ S.A. FOR THE FIRST HALF OF 2012

Warsaw, 7 August 2012

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1.1. MACROECONOMIC SITUATION

In the first half of 2012 the economic growth in Poland reached 3.5% y/y and it was significantly lower than in 2011 when growth rate amounted to 4.3%. The main factors decreasing the growth rate of GDP were: lower growth in private consumption (2.1% y/y in the first quarter of 2012 compared with 3.1% in the whole 2011) and gross capital expenditure (6.7% in the first quarter 2012 compared with 8.1% in 2011). The slowdown was also affected by continued negative growth in public expenditures (-1.3% y/y in the first quarter of 2012) which was a result of fiscal consolidation. As a result of the organization of the European Football Championship in the second quarter of 2012, the role of non-market services (i.e. services provided mainly by public sector) increased temporarily in creating the domestic demand, however there was no significant impact of the tournament on retail consumption.

Both weak Polish currency (zloty) and declining growth in domestic demand favored higher dynamics of exports rather than imports. In the first five months of the year these categories increased by 9.9% y/y and 7.7% y/y respectively. This relationship was reflected in the positive contribution of exports to GDP growth in the first half of 2012.

Chart 1. Growth of GDP (y/y)

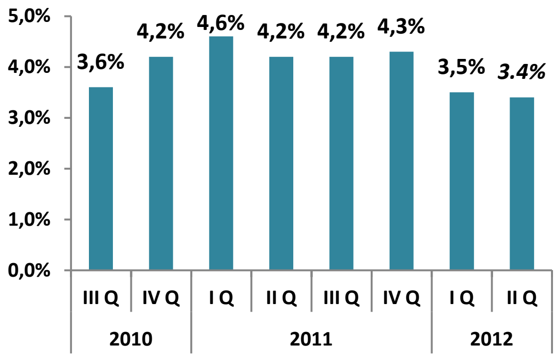
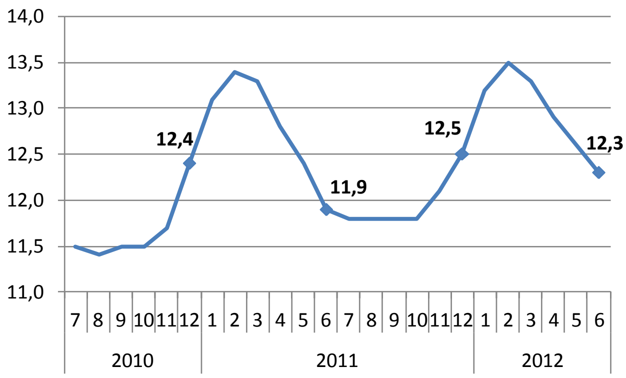


Chart 2. Registered unemployment rate



Source: GUS, own estimates

Worsening economic situation in Europe, combined with declining dynamics of domestic demand resulted in decline in industrial activity. Industrial production grew in the first half of the year at a rate of 3.8% y/y compared to 7.5% in 2011, clearly slowing down in the second quarter of 2012. Declining industrial activity combined with lower activity in the construction sector as well as slow growth in retail sales resulted in deterioration on the labor market. As a result, the employment growth in the business sector fell from 3.5% y/y in 2011 to 0.5% y/y in the first half of 2012 and the unemployment rate (seasonally unadjusted) in June 2012 equaled to 12.3% compared to 11.9% in previous year.

Despite significant deterioration on the labor market nominal wage growth y/y remained on a relatively high level, which amounted to 4.6% in the first half of the year. However, a real wage growth in the first half of the year amounted to only 0.5% y/y. It has been mainly influenced by high inflation (despite a weak demand). On average, it amounted to 4.0% y/y in the first half of the year, mainly due to significantly higher than last year fuel prices (14.3% y/y), remaining energy supplies (7.4% y/y), food (3.9% y/y) and increase in indirect taxes.

Due to high level of current and expected inflation, the Monetary Policy Council *(Rada Polityki Pieniężnej - RPP)* decided to increase interest rates by 25-base points in May. As a result, the reference rate of the Central Bank reached the level of 4.75%. RPP made this decision in spite of clear signs of slow-down and supply-side nature of prices increase. The rediscount rate – which affects the interest of preference loans for agriculture – increased to 5.00%.

Liquidity operations conducted by the European Central Bank (so called LTRO) and other actions taken by the European Union authorities to remedy the debt and banking crisis in Europe, influenced the decline in the Polish bond yields and strengthening of zloty, especially in the first quarter of 2012. However, the temporal increase in risk that Greece would leave the Euro Zone as well as risk of the outbreak of the banking crisis in Spain contributed to the maintenance of zloty at a high level in relation to the European currency. At the same time the worsening economic outlook for countries of Euro Zone contributed to the drop in the EUR/USD exchange rate. The introduction of the minimal acceptable level of the EUR/CHF exchange rate by the Swiss National Bank last year, enabled the strengthening PLN in relation to CHF in spite of perceptible escape of investors to assets denominated in Swiss Franc.

Chart 3. Inflation and interest rates

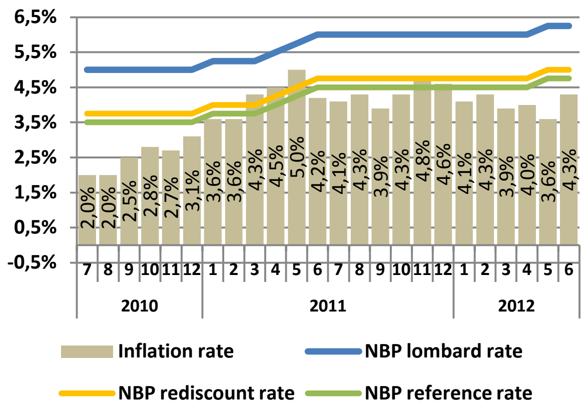
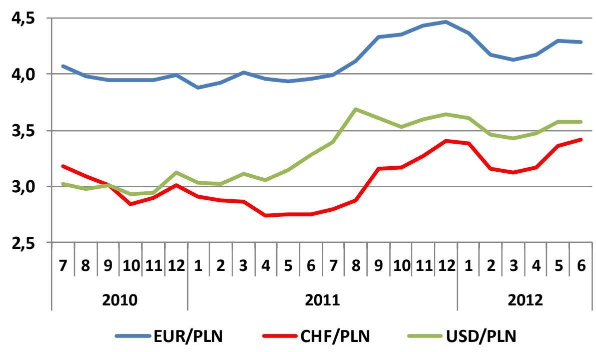


Chart 4. PLN Exchange rate



Source: GUS and NBP

1.2. BANKING SECTOR RESULTS

According to the data of Polish Financial Supervision Authority („PFSA"), in the first five months of 2012 the Polish banking sector reached a net profit of PLN 6 600 million, compared to PLN 6 200 million in the corresponding period of 2011, which means an increase by only 5.7% y/y. However, in subsequent months of 2012 the net profit growth rate gradually slowed down. The main growth factor of net profit in the sector was an increase in net interest income (+7.8% y/y) as well as trading and investing activities (+10.7%). Fluctuations of net commission income was still low and amounted to only 0.5%. The annual change of the sector's profit was negatively affected by increase in operating costs of banks (7.0% y/y) as well as increase in negative balance of impairment loss of financial assets and other provisions (13.4% y/y). Increase in depreciation balance was largely a consequence of deterioration in quality of corporate loans and mortgages to retail clients.

Table 1. Selected elements of profit and loss statement for banking sector

million PLN	I-V 2012	I-V 2011	Change y/y	
Net interest income	14 916	13 840	1 076	7.8%
Net commission income	5 932	5 900	32	0.5%
Dividend income	506	422	84	19.9%
Result on trading and investing activities	3 253	2 939	314	10.7%
Result on banking activity (total)	**24 607**	**23 101**	**1 506**	**6.5%**
Net income from other operating activities	312	73	239	327.4%
Operating expenses of banks	(11 676)	(10 916)	(760)	7.0%
Amortization/Depreciation	(1 072)	(1 045)	(27)	2.6%
Balance of provisions and allowances	(4 051)	(3 571)	(480)	13.4%
Gross profit	**8 120**	**7 642**	**478**	**6.3%**
Corporate income tax	(1 561)	(1 437)	(124)	8.6%
Net profit	**6 559**	**6 205**	**354**	**5.7%**

Source: KNF.

Capital of domestic banking sector increased in the first five months of 2012 by 8.8% against the end of 2011 to PLN 120.6 billion as a result of absorbing net profits. Overall capital requirement – with slowing lending activities and strengthening of zloty – rose by 1.8% against the end of 2011 to PLN 68.8 billion. As a result, capital adequacy ratio of the sector rose by 0.9 percentage points, compared to the end of 2011, to 14.0%.

In the first half of 2012 the banking sector's activities measured by the growth rate of deposit and loan volumes decreased. Loans to non-bank customers grew by 10.3% y/y and non-bank customer deposits by 9.8% y/y. The nominal growth rate, especially in relation to loans, was additionally reduced by zloty's appreciation.

Decline in housing loans was affected by enforcing - from the beginning of 2012 – an amended Recommendation S, which reduced availability of mortgage loans (it assumes reduction of the maximum level of ratio of expenses connected with repayment of currency mortgage loans to average net income to 42% and imposes assumption of repayment period not longer than 25 years during assessment of creditworthiness). Decline in housing loans growth (to 11.9% y/y at the end of June 2012) was caused by earlier changes in the government program "Rodzina na swoim", resulting in reduction of the program's attractiveness (lowering the maximum apartment's price, for which subsidy is applied, as well as introduction of age limit for those applying for the subsidy) and withdrawal of the loans denominated in foreign currencies from the offer of other banks. Additionally, in the analyzed period, increase of margin on housing loans' growth started, additionally strengthened by increase of the interest rate by RPP in May 2012. As far as currency structure of housing loans is concerned, according to the Polish Bank Association (ZBP), sale of housing loans denominated in zloty prevailed in the first half of 2012. Their participation in the production of new housing loans grew steadily.

According to data from the NBP and the Credit Information Bureau, the situation on the consumer loans market did not improve in the first half of 2012 as well. Debt relating to consumer loans fell in this period by 2.7% y/y. It is primarily associated with persistent, exacerbating (primarily for regulatory reasons) credit policy in this market segment, resulting inter alia in moving demand onto non-regulated market. Decrease in the volume of consumer credit on a yearly basis might have been also caused by sale of part of the "bad" loan portfolios by some of the banks.

In the first half of 2012, especially in the second quarter, there was also a decrease in growth rate of lending activity for enterprises (up to 12.1% y/y at the end of June 2012). This should be linked with observable downturn in the national economy and the weakening of investment climate. The corporate loan market was also negatively influenced by tightening of lending policy by banks, especially for the SME segment.

Table 2. Loan volume of the banking sector

PLN billion	30.06. 2012	31.12. 2011	30.06. 2011	Change y/y	
● Loans to private individuals	452.9	453.1	422.4	30.5	7.2%
○ mortgage loans	320.5	317.2	286.3	34.2	11.9%
- PLN	132.3	122.3	111.1	21.2	19.1%
- foreign currency	188.2	194.9	175.2	13.0	7.4%
○ consumer loans	132.4	135.9	136.1	(3.7)	(2.7%)
● Loans to institutional clients	444.0	432.1	390.8	53.2	13.6%
○ non – banking financial institutions	30.0	24.9	25.1	4.9	19.5%
○ non – financial entities	340.1	330.4	304.8	35.3	11.6%
- corporates	259.4	253.3	231.4	28.0	12.1%
- individual entrepreneurs	53.1	50.7	48.6	4.5	9.3%
- farmers	23.3	22.2	21.3	2.0	9.4%
- non profit organisations	4.3	4.2	3.5	0.8	22.9%
○ public sector	73.9	76.8	60.9	13.0	21.3%
Loans to non - banking customers	**896.9**	**885.2**	**813.2**	**83.7**	**10.3%**

Source: NBP. data for monetary financial institutions excluding the central bank and SKOKs. only residents.

Main source of growth of deposits in the banking sector in the first half of 2012 were still savings of individuals (increase of 13.3% y/y). The following factors were favorable: volatile conditions on the Warsaw Stock Exchange related to continuous uncertainty on the markets, last months when rules allowing for opening of deposits yielding non-taxable interest income for clients were still in force, as well as decision of RPP to increase the interest rate in May.

Significant decrease in volume of corporate deposits was observed in the first half of 2012. To some extent it was a seasonal effect and additionally it was a consequence of acquiring a Canadian mining company by one Polish mining corporation (payment was made from own company's funds). However, such strong limitation of companies' deposit activities seems to indicate a weakening economic situation in the domestic economy and deteriorating financial situation of enterprises.

Table 3. Deposit volume of the banking sector

PLN billion	30.06. 2012	31.12. 2011	30.06. 2011	Change y/y	
● **Deposits of private individuals**	452,5	435,0	399,4	53.1	13.3%
○ current	208,5	204,3	205,9	2.6	1.3%
○ term	244,0	230,7	193,5	50.5	26.1%
● **Deposits of institutional clients**	345,7	347,2	327,6	18.1	5.5%
○ non – banking financial institutions	50,4	43,3	42,9	7.5	17.5%
○ non – financial entities	228,5	252,9	221,3	7.2	3.3%
- corporates	182,9	205,0	178,8	4.1	2.3%
- individual entrepreneurs	21,7	24,9	20,4	1.3	6.4%
- farmers	7,7	7,9	7,0	0.7	10.0%
- non profit organisations	16,2	15,1	15,1	1.1	7.3%
○ public sector	66,8	51,0	63,4	3.4	5.4%
Deposits of non-banking clients	**798,2**	**782,2**	**727,0**	**71.2**	**9.8%**

Source: NBP. data for monetary financial institutions excluding the central bank and SKOKs. only residents.

1.3. STOCK EXCHANGE AND INVESTMENT TRENDS

Since August 2011 reduction in turnover on the Warsaw Stock Exchange ("WSE") is observed. WIG20 is in a horizontal trend, with lower limit around 2 010 points and upper limit around 2 400 points. The situation is slightly better in case of indices: mWIG40 and sWIG80 – in their case limited growth trends can be observed. Due to horizontal trend mentioned above, in the first quarter of 2012 there was increase of indexes, when WIG20 rose by 6.6% whereas mWIG40 and sWIG80 increased by 15.2% and 20.8% respectively. The second quarter brought a reversal of the situation, which affected mostly medium and small companies (mWIG40 fell by 8.1%. and sWIG80 by 7.2%). WIG20 performed better – it fell by only 0.5%.

The worst results were observed for the NewConnect market index, which has remained in a downward trend almost continuously since the beginning of 2011. During the first quarter – which was successful for the WSE – this index increased by only 2.3% and fell as much as 13.8% during the second quarter. In the first half of the year it fell by 11.8%.

Table 4. Value of main Stock Exchange indices

	30.06. 2012	31.12. 2011	30.06. 2011	Change in the first half of 2012	Change y/y
WIG	40 811	37 595	48 414	8.6%	(15.7%)
WIG20	2 275	2 144	2 802	6.1%	(18.8%)
mWIG40	2 300	2 174	2 851	5.8%	(19.3%)
sWIG80	9 520	8 497	12 085	12.0%	(21.2%)
NCIndex	37	42	55	(11.8%)	(32.7%)

Source: GPW

Despite increase in the value of all WSE indices (except NCIndex) and increase in number of listed companies in the first half of 2012 Stock Exchange capitalization at the end of June 2012 was approx. 15.0% lower than the last year.

Lack of clear trend on the main trading floor of the WSE lead to reduction of investor activities and resulted in decreased turnover on the stock market by 26.2%, on the futures market by 15.9%, on the options market by 41.1%, and as much as 46.1% on the NewConnect market.

Table 5. Number of companies, capitalization and turnover on the WSE

	30.06. 2012	31.12.2011	30.06. 2011	Change y/y
Number of companies	434	426	420	3.3%
Capitalization of domestic companies (PLN million)	472 690	446 151	556 230	(15.0%)
Shares turnover volume (PLN million)	102 585	268 139	139 001	(26.2%)
Catalyst turnover volume (PLN million)	586	836	652	(10.1%)
Futures contracts turnover volume per session (units)	45 446	58 203	54 052	(15.9%)
Options turnover volume per session (units)	2 401	3 577	4 097	(41.4%)
NewConnect turnover value (PLN million)	677,8	1 858,5	1 256,4	(46.1%)

Source: GPW

The Catalyst bond market continued activities started in 2009. It is operated on the WSE and BondSpot transaction platforms. Catalyst comprises of four trading platforms. Two of them are operated by WSE – a regulated market and the Over The Counter (OTC) – and they are intended for retail customers and the analogical two markets BondSpot are dedicated to wholesale customers. All platforms are designed for non-treasury debt instruments – municipal bonds, corporate bonds and mortgage bonds. The value of turnover on the Catalyst in the first half of 2012 fell by 10.1% compared to the first half of 2011.

In the first half of 2012, 10 new companies listed on the WSE (one of them was transferred from the NewConnect). For comparison purposes, in the first half of 2011, 25 new companies were listed on the WSE. The number of companies listed on the WSE increased from 426 at the end of June 2011 to 434 at the end of the first half of 2012.

From the beginning of 2012, 49 new issuers entered the NewConnect (in the same period last year, 80 new companies had their debut).

At the end of the first half of 2012, on the Catalyst market a total of 281 bond issues were traded, and the value of issues exceeded PLN 554 million in the first 6 months of 2012.

2. COMPOSITION OF THE CAPITAL GROUP AND METHODS USED FOR CONSOLIDATION OF THE FINANCIAL STATEMENTS

As of 30 June 2012, the Bank Gospodarki Żywnościowej S.A. Capital Group consisted of Bank Gospodarki Żywnościowej S.A. as the parent company and:

- Bankowy Fundusz Nieruchomościowy Actus Sp. z o.o. – subsidiary,
- BGŻ Leasing Sp. z o.o. – associated company.

Table 6. Consolidation scope

Entity name	Type of business activity	Share of BGŻ S.A. in the share capital	Consolidation/ valuation method
Bankowy Fundusz Nieruchomościowy ACTUS Sp. z o.o.	Acquisition and disposal of properties	100.0%	Full consolidation
BGŻ Leasing Sp. z o.o.	Leasing activities	49.0%	Equity method

3. IMPORTANT EVENTS IN BGŻ S.A. IN THE FIRST HALF OF 2012

21.02.2012	Moody's Investors Service rating agency decided to initiate a review of BGŻ S.A. ratings for a possible downgrade. The review of BGŻ S.A. by Moody was a part of an collective review announced on 21 February 2012 of ratings of banks from Central and Eastern Europe and Commonwealth of Independent States, which are subsidiaries of banking groups from Europe and the United States.
11.04.2012	Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. and Rabobank International Holding B.V. announced a tender offer for 100% of BGŻ shares. The offered price per one share was PLN 72.50. The calling company intended to purchase 17 262 669 shares of the Bank and has committed to purchase shares when at the end of the subscription period all subscriptions totalled at least 6 478 478 of the Bank's shares.
22.05.2012	On 22 May the calling company extended the subscription period until 30 July.
18.06.2012	Moody's Investors Service downgraded its long-term rating deposits for the Bank to Baa2 from Baa1, with stable outlook. The Bank's Financial Strength Rating („BFSR") has remained at the level „D" with stable outlook. The rating of the Bank's short-term deposits was confirmed at Prime-2. The change in the rating closed the BGŻ ratings review started by the Moody's on 21 February 2012.

4. AUTHORITIES OF THE PARENT COMPANY

The composition of the Bank's Supervisory Board during the period from 1 January and 30 June 2012 was as follows:

- Jan Alexander Pruijs – President of the Supervisory Board,
- Dariusz Filar – Vice-President of the Supervisory Board,
- Hendrik Adams – Member of the Supervisory Board,
- Roelof Dekker – Member of the Supervisory Board (resignation on 22.06.2012),
- Evert Derks Drok – Member of the Supervisory Board (appointed on 25.06.2012),
- Jarosław Iwanicki – Member of the Supervisory Board,
- Waldemar Maj – Member of the Supervisory Board,
- Monika Nachyła – Member of the Supervisory Board,
- Harry de Roo – Member of the Supervisory Board.

4.1.1. CHANGES IN THE COMPOSITION OF THE MANAGEMENT BOARD

The composition of the Bank's Management Board in the period between 1 January and 30 June 2012 was as follows:

- Jacek Bartkiewicz – President of the Management Board,
- Gerardus Cornelis Embrechts – The first Vice-President of the Management Board,
- Magdalena Legęć – Vice-President of the Management Board,
- Johannes Gerardus Beuming – Vice-President of the Management Board,
- Dariusz Odzioba – Vice-President of the Management Board,
- Witold Okarma – Vice-President of the Management Board,
- Wojciech Sass – Vice-President of the Management Board,
- Andrzej Sieradz – Vice-President of the Management Board.

The above composition of the Bank's Management Board was appointed by the Supervisory Board on 21 June 2012 with no changes in the composition for the next three-year period with effect from 25 June 2012 i.e. from the date of the General Shareholders' Meeting approving the financial statements for 2011.

5. EXTERNAL ASSESMENTS OF THE PARENT COMPANY

5.1. RATINGS

The Bank is rated by the Moody's Investors Service rating agency. On 18 June 2012, Moody's downgraded the long-term deposits rating of the Bank to Baa2 from Baa1, with stable outlook. The Bank's Financial Strength Rating („BFSR") remained at the level „D" with stable outlook. The rating of the Bank's short-term deposits was confirmed at Prime-2. The change in the rating concluded the BGŻ ratings review initiated by the Moody's agency on 21 February 2012.

In its comments on the downgrade of BGZ's long-term rating Moody's stated that the downgrade was prompted by the downgrade on 15 June 2012 of Bank's majority shareholder – Rabobank. At the same time, Moody's underlines a very high likelihood of parental support from Rabobank as long-term strategic shareholder in BGZ and was reflected in providing foreign-currency funding, and capital resources to BGZ and its long-term interest in the Polish agribusiness sector.

The agency views on parental support probability are reinforced by Rabobank's tender offer to wholly acquire its Polish subsidiary announced in April 2012. However, Moody's notes that Rabobank's plan to acquire 100% ownership would require a divestiture of the Polish government's 25% stake in BGZ, thus reducing the incentives of the Polish authorities to provide additional support in case of need. Accordingly, the current three notches of uplift in BGZ's long-term rating of Baa2 - which remains one of the highest of other Western European bank subsidiaries in the region - is driven solely by parental support assumptions. The stable outlook on BGZ's long-term rating is driven by the stable outlook on Rabobank's standalone rating.

6. SHAREHOLDERS' STRUCTURE OF THE PARENT COMPANY

6.1. BGŻ SHARE TENDER OFFER

On 11 April 2012 Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. and Rabobank International Holding B.V. announced tender offer for the sale of all outstanding shares of BGŻ with intention to obtain 100% of the shares of BGŻ. The tender offer price was set for 72.5 PLN per share. During the tender offer Rabobank intended to purchase 17.262.669 shares and has committed itself to purchase shares if at the end of subscription order acceptance period the subscription would cover at least 6 478 478 Bank's shares.

On 26 April 2012 the Management Board of the Bank published its stance towards the tender offered supported by opinion prepared by an external advisor concerning the financial conditions of the tender offer. According to the Management Board of the Bank the tender is consistent with Bank's interest. After the analysis of the opinion prepared by an external advisor and on the basis of its own assumptions, the Management Board stated that the offered price reflected the fair value of the Bank.

The tender offer was conditional and due to the fact that till 22 May 2012 the condition concerning the lapse time for the PFSA decision with objection to the purchase of shares or issuance of the decision confirming lack of objection has not been fulfilled, the subscription order acceptance period was extended till 30 July 2012.

Further information on events related to the tender offer, which took place after 30 June 2012, are presented in section "11 Significant events after the reporting date".

Table 7. BGŻ S.A. shareholders' structure

Shareholder	30.06.2012		31.12.2011		30.06.2011	
	Number of shares	Structure (%)	Number of shares	Structure (%)	Number of shares	Structure (%)
Rabobank International Holding B.V.*	21 298 609	49.37	21 298 609	49.37	21 298 609	49.37
Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A.*	4 303 695	9.98	4 303 695	9.98	4 303 695	9.98
State Treasury	11 015 937	25.54	11 015 937	25.54	11 016 231	25.54
Other shareholders	6 518 523	15.11	6 518 523	15.11	6 518 229	15.11
TOTAL	**43 136 764**	**100.00**	**43 136 764**	**100.00**	**43 136 764**	**100.00**

***** Rabobank Group

7. FINANCIAL POSITION OF THE BGŻ S.A. CAPITAL GROUP

7.1. FINANCIAL POSITION IN THE FIRST HALF OF 2012 COMPARED WITH THE FIRST HALF OF 2012

In the first half of 2012 the Group generated a net profit of PLN 39 456 thousand compared with PLN 60 282 thousand in the first half of 2011. The main decrease factor of PLN 20 826 thousand in net profit, i.e. 34.5% was an increase in net impairment of loans and advances.

Table 8. Consolidated income statement

PLN thousand	2 quarters 2012	2 quarters 20121	Change	
			PLN thousand	
Net interest income	502 261	369 779	132 482	35.8%
Net fee and commission income	148 182	132 252	15 930	12.0%
Dividend income	3 396	3 554	(158)	(4.4%)
Result on trading activities	39 992	53 967	(13 975)	(25.9%)
Result on investing activities	17 545	(926)	18 471	(1 994.7%)
Other operating income	33 968	31 706	2 262	7.1%
Net impairment losses on loans and advances	(157 681)	(53 648)	(104 033)	193.9%
General administrative expenses	(459 236)	(410 049)	(49 187)	12.0%
Other operating expenses	(73 940)	(54 577)	(19 363)	35.5%
Operating Result	**54 487**	**72 058**	**(17 571)**	**(24.4%)**
Share in profit (loss) of associates	(892)	2 009	(2 901)	(144.4%)
Gross profit (loss)	**53 595**	**74 067**	**(20 472)**	**(27.6%)**
Corporate income tax	(14 139)	(13 785)	(354)	2.6%
Net profit (loss)	**39 456**	**60 282**	**(20 826)**	**(34.5%)**

Net interest income

In the first half of 2012 net interest income increased by PLN 132 482 thousand, i.e. by 35.8% which was the result of increase in interest income by PLN 267 720 thousand, i.e. 35.0%, which exceeded increase in interest expense of PLN 135 238 thousand, i.e. 34.1%.

The increase in interest income was mainly affected by higher interest income on loans and advances to customers by PLN 183 553 thousand, i.e. 34.3% and on overdrafts by PLN 43 690 thousand, i.e. 40.8%. The increase in interest income was achieved through the development of credit activity mainly in the second half of 2011 and the second quarter of 2012. Moreover, due to significant share of preferential loans portfolio, increases of NBP rediscount rate in 2011 and 2012, which influences level of interest rates, were also an important growth factor. The increase in the interest income was also influenced by higher interest income on debt securities (by PLN 36 655 thousand, i.e. 34.6%), which represent higher liquidity surplus in comparison to the first quarter of 2011.

The increase in the interest expense was mainly influenced by interest expense in respect of amounts owed to customers, which grew by PLN 95 953 thousand, i.e. 27.9% following increase in clients deposits mainly through internet channel, i.e. BGŻOptima and gathered to fund credit activity growth of the Group. The other factor of the cost interest expense increase is higher cost of amounts due to other banks by PLN 39 285 thousand (76.0%) in comparison to the first half of 2011. It is a result of obtaining credit facility in CHF from the Bank's majority shareholder and another EUR loan from European Bank for Reconstruction and Development in 2011. This funding enabled the Group to partially replace funding in local currency (with a higher interest rate), particularly high-value wholesale deposits from corporate and public sector institutions.

Table 9. Net interest income

PLN thousand	**2 quarters 2012**	**2 quarters 2011**	**Change**	
			PLN thousand	
Amounts due from banks	21 061	17 239	3 822	22.2%
Amounts due from customers under overdraft facilities	150 851	107 161	43 690	40.8%
Loans and advances to customers, after considering reversal of loans interests discount on impairment losses	719 195	535 642	183 553	34.3%
Debt securities from all portfolios	142 502	105 847	36 655	34.6%
Interest income	**1 033 609**	**765 889**	**267 720**	**35.0%**
Amounts owed to banks	90 975	51 690	39 285	76.0%
Amounts owed to customers	440 373	344 420	95 953	27.9%
Interest expense	531 348	396 110	135 238	34.1%
Net interest income	**502 261**	**369 779**	**132 482**	**35.8%**
Supplementary information:				
Result on swap points*	12 132	54 213	(42 081)	(77.6%)
Net interest and swap points income, total	**514 393**	**423 992**	**90 401**	**21.3%**

* *Source: BGŻ S.A. management information*

Net fee and commission income

Net fee and commission income in the first half of 2012 increased by PLN 15 930 thousand, i.e. 12.0% compared to the prior year comparable period due to increase in fee and commission income by PLN 23 860 thousand (15.9%) which was accompanied by an increase in the fee and commission expense by PLN 7 930 thousand, i.e. 44.0%.

The increase in fee and commission income resulted mainly from higher fee and commission income on loans and advances by PLN 14 173 thousand (i.e. 29.6%) due to increased activities in granting of loans under overdraft facility, especially for farmers, SME and Micro companies as well as sale of Aviva insurance products together with cash loans for retail clients since February 2012. Another significant factor was growth of commissions on payment cards by PLN 9 932 thousand achieved mainly through higher level of sales of "Konto z Premią" offered together with cards and changes of fees on payment cards in December 2011.

The decrease in fee and commission income on account services by PLN 2 691 thousand (5.2%) resulted mainly from the fact, that the Group incurred additional costs relating to "Konto z Premią" offer, where the clients receive a 1% premium calculated on inflows on account, subject to strict conditions. These premiums were accounted for as a decrease of account service income.

The increase in fee and commission income results from higher settlement costs with cards' operators due to higher volume of card transactions carried out by the customers as well as costs of insurance premiums paid on Aviva insurance products, sold together with cash loans, which has been offered since February 2012.

Table 10. Net fee and commission income

PLN thousand	2 quarters 2012	2 quarters 2011	Change	
			PLN thousand	%
Fee and commission income from banks	8 132	6 954	1 178	16.9%
Fee and commission income from customers	166 001	143 319	22 682	15.8%
- on loans and advances	61 997	47 824	14 173	29.6%
- on domestic settlements	437	548	(111)	(20.3%)
- on foreign settlements	2 146	2 386	(240)	(10.1%)
- on account service	49 419	52 110	(2 691)	(5.2%)
- on guarantee commitments	5 677	5 855	(178)	(3.0%)
- on brokerage operations	5 598	7 069	(1 471)	(20.8%)
- on payment cards	35 769	25 837	9 932	38.4%
- other	4 958	1 690	3 268	193.4%
Fee and commission income	**174 133**	**150 273**	**23 860**	**15.9%**
Fee and commission expense from banks	1 307	2 064	(757)	(36.7%)
Fee and commission expense from customers	24 644	15 957	8 687	54.4%
Fee and commission expense	**25 951**	**18 021**	**7 930**	**44.0%**
Net fee and commission income	**148 182**	**132 252**	**15 930**	**12.0%**

Dividend income

In the first half of 2012 dividend income increased by PLN 158 thousand, i.e. 4.4%. The increase compromises of dividends on shares of the Bank in National Clearing House SA (KIR), The Credit Information Bureau SA (BIK) from the profits of these companies for 2011 approved by their General Assemblies. The decrease resulted mainly from lower dividend income from BIK (compared with the first half of 2011) and lack of dividend from the Warsaw Stock Exchange (GPW), which was postponed for the third quarter of 2012.

Result on trading activities and result on investing activities

Result on trading activities decreased by PLN 13 975 thousand, i.e. 25.9% due to change of external financing resulting form obtaining the loan in CHF during 2011. With direct funding in CHF, the Group reduced the level of swap transactions, which hedge the currency risk and interest rate risk for so-called old portfolio mortgage loans for retail customers, which were granted till April 2009. As a result, there was a decrease in the income from so-called swap points, recognized in the result on trading activities, accompanied by the growth of the net interest income due to replacement of higher interest-bearing PLN funding with lower interest-bearing CHF funding. The result on trading activities includes also margin income on currency transactions and financial instruments carried out with clients. The volume of these transactions increased significantly in comparison to the previous year.

The result on investing activities increased by PLN 18 471 thousand in comparison to negative result in the amount of PLN 926 thousand in the first half of 2011. The main component of the result were the proceeds realized on the available-for-sale portfolio achieved due to favourable market conditions.

Other operating income

Other operating income increased by PLN 2 262 thousand in the first half of 2012, i.e. 7.1% as compared to the first half of 2011, mainly due to the increase in other operating income by PLN 2 696 thousand and increase in reversal of impairment allowances for fixed assets by PLN 2 509 thousand resulting from revaluation of market value of properties taken as collateral. Additionally, the increase in other operating income was influenced by the growth in income from recovered statute barred receivables, written off or bad debts and repayments of written off receivables by PLN 1 872 thousand, which was achieved due to debt collection activities.

Decrease of income connected with the reversal of non utilized provision for non – personnel costs by PLN 2 409 thousand resulted from lower value of reversal of provisions for rewards and bonuses for the previous year in the second quarter of 2012. The revenue from PARP expenditures compensation decreased by PLN 1 464 thousand due to diminishing number of trainings within this program.

Table 11. Other operating income

PLN thousand	2 quarters 2012	2 quarters 2011	Change	
			PLN thousand	%
From management of third-party properties	351	946	(595)	(62.9%)
From sale or liquidation of property, plant and equipment, intangible assets and assets held-for-sale	481	1 314	(833)	(63.4%)
From recovered statute –barred receivables, written off or bad debts, repayments of derecognized receivables	4 239	2 367	1 872	79.1%
Sales of goods and services	4 685	4 818	(133)	(2.8%)
Reversal of provisions for other receivables (excluding loan receivables)	343	335	8	2.4%
Reversal of impairment allowances for fixed assets	2 516	7	2 509	35 842.9%
Reversal of provisions for liabilities	7 569	7 255	314	4.3%
From recovery of costs incurred	1 202	905	297	32.8%
Revenue from PARP expenditures compensation	678	2 142	(1 464)	(68.3%)
Reversal of not utilized provision for non – personnel costs	2 105	4 514	(2 409)	(53.4%)
Other operating income	9 799	7 103	2 696	38.0%
Total other operating income	**33 968**	**31 706**	**2 262**	**7.1%**

Net impairment losses on loans and advances

Net impairment losses on loans and advances increased by PLN 104 033 thousand, i.e. 193.9%. It was mainly result of higher impairment allowances for the corporate loans, including construction sector (containing exposure toward a single client from large corporate segment, which filed for bankruptcy) and for retail mortgages. On the other hand there was a decrease in net impairment allowances for cash loans, which was caused by a better repayment of loans granted in the period of 2011-2012, i.e. after strengthening of risk assessment criteria for this portfolio.

General administrative expenses

General administrative expenses rose in the first half of 2012 by PLN 49 187 thousand, i.e. 12,0% when compared to the first half of 2011 mainly due to higher staff expenses, other non-personnel costs and costs of premiums and contributions to the Bank Guarantee Fund (BFG) and PFSA.

The increase in staff expenses by PLN 26 411 thousand, i.e. 12.1% resulted from the increasing number of the Bank's branches (according to the Bank's strategy) leading to employment growth. At the end of the first half of 2012 the number of branches amounted to 396 and was higher by 26 (7.0%) than in the previous period. The employment increased respectively from the level of 5 432 posts at the end of the first half of 2011 to 5 711 posts at the end of the first half of 2012, i.e. by 5.1%. Apart from the expansion of the Bank's branch network, the reason for the increase of employment costs was also strengthening of the sale coordination function in regions' centres and Central Credit Platform responsible for processing of mortgage loans applications.

Additionally, the increase in staff expenses resulted also from growth of expenses for individual premiums and employees bonuses as compared to 2011 and an increase in disability insurance contribution by 2 p.p. starting from February 2012.

The increase in other non-personnel expenses by PLN 19 731 thousand, i.e. 29.4% was caused by the growth in promotional and marketing costs (advertisements of the Bank's products in media – personal accounts, mortgage loans, BGŻOptima products, Agro products, promotion of insurance for farmers and bank deposits), higher costs of lease and renovations, purchase of additional security tokens necessary for the growing activities of BGŻOptima and higher costs of cash processing as a consequence of branch network expansion.

The increase in costs of premiums and contributions to BFG and PFSA by PLN 2 817 thousand, i.e. 21.6% resulted from the growth of the Banks' balance sheet assets, which are the basis for calculating payments to PFSA and from the increase in the total value of capital requirements, which are the basis for calculating annual payment for BFG.

Table 12. General administrative expenses

PLN thousand	2 quarters 2012	2 quarters 2011	Change	
			PLN thousand	%
Employee benefit costs, of which:	244 051	217 640	26 411	12.1%
- Payroll	200 964	178 601	22 363	12.5%
- Including: retirement pay	134	61	73	119.7%
- Social security	30 927	25 275	5 652	22.4%
- Other	12 160	13 764	(1 604)	(11.7%)
Materials and energy	16 163	16 443	(280)	(1.7%)
External services	93 313	92 504	809	0.9%
Other non-personnel costs	86 841	67 110	19 731	29.4%
Taxes and charges	3 006	3 307	(301)	(9.1%)
Contributions and amounts transferred to the Bank Guarantee Fund (BFG) and PFSA	15 862	13 045	2 817	21.6%
General administrative expenses, total	**459 236**	**410 049**	**49 187**	**12.0%**
Amortization and depreciation (1)	45 425	38 206	7 219	18.9%
Total costs (2)	**504 661**	**448 255**	**56 406**	**12.6%**

(1) In the financial statements presented in other operating costs
(2) Total costs used in the calculation of the Cost/Income ratio

Other operating costs

In the first half of 2012 other operating costs increased by PLN 19 363 thousand, i.e. 35.5% in comparison to the comparable period of the previous year, which was caused mainly by increase in costs of provisions for liabilities and other receivables (other than loans) as well as higher depreciation charges.

Increase in costs of provisions for liabilities by PLN 7 683 thousand resulted from recognition of provisions for court cases and unused holiday accrual. The growth in costs of provisions for other receivables (other than loans) by PLN 5 076 thousand was caused by recognition of provision for cash shortage in one of the branches. The increase in depreciation charges of PLN 7 219 thousand resulted from the above-described expansion of the Bank's branches network, continuation of investments in IT area and launching of BGŻOptima.

Table 13. Other operating costs

PLN thousand	2 quarters 2012	2 quarters 2011	Change	
			PLN thousand	%
Due to the management of third-party assets	528	551	(23)	(4.2%)
Due to the sale or liquidation of property, plant and equipment, intangible assets and assets or sale	592	742	(150)	(20.2%)
Due to recognized provisions for other receivables (other than loans and advances)	5 331	255	5 076	1 990.6%
Due to recognized provisions for liabilities	16 928	9 245	7 683	83.1%
Due to debt recovery	3 327	3 278	49	1.5%
Donations	1 380	1 365	15	1.1%
Depreciation	45 425	38 206	7 219	18.9%
Other operating costs	429	935	(506)	(54.1%)
Other operating costs, total	**73 940**	**54 577**	**19 363**	**35.5%**

Total comprehensive income

In the first half of 2012 the Group's total comprehensive income increased by PLN 7 259 thousand, i.e 9.0%, due to the positive valuation of available-for-sale financial assets amounted to PLN 54 735 thousand presented in the other capital, compared to PLN 25 312 thousand in the first half of 2011. The above result related to the long-term portfolio of the treasury bonds. Another factor in the growth of total complrehensive income were the effects of hedge of future cash flows amounting to PLN 5 250 thousand, which occurred due to commencement of hedge accounting in the second quarter of 2012. In particular, the Bank concluded IRS float-to-fix transactions maruting in April 2014 to protect the interest rate risk due to future movements in interest from preferential loans dependant on NBP rediscount rate (with a multiplier of 1.5 or 1.6).

Assets

At the end of the first half of 2012 the total Group's assets amounted to PLN 35 069 762 thousand and were PLN 6 716 422 thousand (23.7%) higher than in the prior year. The main growth factor were loans and advances to clients, which increased by PLN 4 222 907 thousand, i.e. 20.1%, mainly due to increase in overdrafts facilities of enterprises and farmers, investment loans of enterprises preference loans of farmers and mortgage loans of retail clients. Another growth factor was the increase in held for trading securities, mainly due to allocation of higher liquidity surplus and purchase of securities necessary for the transactions with clients.

The increase in cash and balances with the Central Bank of PLN 388 141 thousand, i.e. 34.8%, was mainly influenced by the settlement of NBP obligatory reserve.

The growth in intangible assets of PLN 50 339 thousand, i.e. 55.9%, resulted mainly from capitalization costs related to IT system implemented for BGŻOptima and investment in current development in the Bank's IT infrastructure.

The increase in investments in subsidiaries and associates by PLN 12 049 thousand, i.e. 36.0%, was caused by the recapitalization of the Bank's affiliate – BGŻ Leasing

Table 14. Assets

PLN thousand	30.06.2012	31.12.2011	30.06.2011	Change y/y	
				PLN thousand	%
Cash and balances with the Central Bank	1 502 744	1 383 321	1 114 603	388 141	34.8%
Amounts due from other banks	273 397	221 071	213 575	59 822	28.0%
Receivables arising from reverse repo transactions	662 417	366 343	255 391	407 026	159.4%
Held-for-trading securities	2 262 776	1 632 434	812 238	1 450 538	178.6%
Derivative financial instruments	351 899	883 109	200 599	151 300	75.4%
Loans and advances to customers	25 270 400	24 222 391	21 047 493	4 222 907	20.1%
Securities available for sale	3 663 762	3 624 750	3 603 734	60 028	1.7%
Other debt securities	-	-	55 700	(55 700)	(100.0%)
Investment property	63 401	63 401	63 900	(499)	(0.8%)
Investments in subsidiaries and associates	45 563	46 245	33 514	12 049	36.0%
Intangible assets	140 420	146 443	90 081	50 339	55.9%
Property, plant and equipment	472 029	485 943	462 190	9 839	2.1%
Deferred tax asset	182 559	207 794	213 814	(31 255)	(14.6%)
Current tax asset	46 242	-	44 800	1 442	3.2%
Other assets	132 153	123 968	141 708	(9 555)	(6.7%)
TOTAL ASSETS	**35 069 762**	**33 407 213**	**28 353 340**	**6 716 422**	**23.7%**

Liabilities and equity

At the end of the first half of 2012, total Group's liabilities amounted to PLN 32 343 856 thousand and were PLN 6 566 318 thousand i.e. 25.5% higher compared to the prior year. The main growth factor were amounts owed to customers which increased by PLN 4 575 596 thousand i.e. 23.4%, mainly due to deposits gathered through BGŻOptima and corporate deposits.

The second growth factor was increase in liabilities arising from repo transactions with a balance of PLN 1 393 391 thousand at the end of June 2012, whereas at the end of previous year the balance did not occur in the Group's balance sheet. The scale of these operations reflects the activity of the Group's institutional clients – particularly non-banking financial institutions.

Since 30 June 2011 the Group has also increased the nominal value of issued Certificates of Deposit (increase by PLN 532 786 thousand, i.e. 37.1%), which are flexible and less expensive source of financing.

Increase in amounts owed to other banks by PLN 75 429 thousand (1.9%) was the total effect of increase in loans granted by the banks by PLN 1 021 484 thousand and decrease in the value of financial means on the current accounts and banks' term deposits. The increase in the value of loans granted by other banks resulted from release of subsequent tranches of CHF loan from the majority shareholder in the third quarter of 2011 and from the loan granted by European Bank for Reconstruction and Development (EBOiR) in August 2011. As at 30 June 2012 the total Group's liabilities related to loan in CHF from the majority shareholder amounted to PLN 3 315 326 thousand and the value of two loans granted by EBOiR amounted to 395 692 thousand (each with the value of EUR 50 million).

The growth rate of clients' deposits was higher than the growth rate of loans, which enabled the Group to increase its liquidity surplus in the described period. It was also accompanied by the increased value of issued deposit certificates and higher amounts owed to other banks.

Table 15. Liabilities and equity

PLN thousand	**30.06.2012**	**31.12.2011**	**30.06.2011**	**Change y/y**	
				PLN thousand	**%**
Amounts owed to other banks	4 050 991	4 446 716	3 975 562	75 429	1.9%
Liabilities arising from repo transactions	1 393 391	-	-	1 393 391	-
Derivative financial instruments and other liabilities held for trading	343 042	795 707	363 126	(20 084)	(5.5%)
Amounts owed to customers	24 123 812	22 941 652	19 548 216	4 575 596	23.4%
Liabilities from issued debt securities	1 967 408	2 033 267	1 434 622	532 786	37.1%
Other liabilities	383 502	474 952	380 575	2 927	0.8%
Deferred tax liability	9 719	9 719	9 814	(95)	(1.0%)
Current tax liabilities	-	-	17	(17)	(100.0%)
Provisions	42 959	41 926	40 494	2 465	6.1%
Liabilities arising from employee benefits	29 032	25 412	25 112	3 920	15.6%
TOTAL LIABILITIES	**32 343 856**	**30 769 351**	**25 777 538**	**6 566 318**	**25.5%**
Issued share capital	43 137	43 137	43 137	-	-
Reserve capital	2 458 716	2 332 656	2 332 656	126 060	5.4%
Accumulated profit/ (loss) from previous years	10 364	8 327	8 327	2 037	24.5%
Other reserves	174 233	125 645	131 400	42 833	32.6%
Undistributed profit	39 456	128 097	60 282	(20 826)	(34.5%)
EQUITY	**2 725 906**	**2 637 862**	**2 575 802**	**150 104**	**5.8%**
LIABILITIES AND EQUITY	**35 069 762**	**33 407 213**	**28 353 340**	**6 716 422**	**23.7%**

As of the end of June 2012 the total Group's shareholders' equity amounted to PLN 2 725 906 thousand and was PLN 150 104 thousand i.e. 5.8% higher than in the prior year. The increase was the result of retaining net profit for the year 2011, as well as of the increase in the revaluation reserve for available-for-sale financial assets, with the growth reasons described in the section Comprehensive income

Loan portfolio quality

The ratio of impaired receivables in gross loans and advances to customers deteriorated from the level of 6.3% at the end of June 2011 and 5.7% at the end of 2011 to 6.4% at the end of June 2012. The deterioration of the portfolio quality was a result of the growing value of impaired receivables, which was higher than the total value of gross loans and advances to customers. The situation mainly affected loans for the retail customers (especially mortgage loans) and loans for enterprises (mainly due to the bankruptcy of one of the clients from the construction sector, resulting from liquidity problems observed in June 2012). The factor, which stabilized portfolio quality was the very good and still improving situation of the farmer loans portfolio, which at the end of June 2012 accounted for 21.8% of the Group's gross credit portfolio.

Table 16. Loan portfolio quality indices

PLN thousand	30.06.2012	31.12.2011	30.06.2011	Change y/y	
				PLN thousand	%
Total gross loans and advances to customers	**26 281 469**	**25 105 296**	**21 808 089**	**4 473 380**	**20,5%**
Impairment allowances (negative value)	(1 011 069)	(882 905)	(760 596)	(250 473)	32,9%
Impairment allowances (negative value)	**25 270 400**	**24 222 391**	**21 047 493**	**4 222 907**	**20,1%**
Incurred but not reported losses					
Gross statement of financial position exposure	24 605 139	23 665 232	20 439 300	4 165 839	20.4%
Impairment allowance on exposures analyzed on the portfolio basis	(109 122)	(95 001)	(71 023)	(38 099)	53.6%
Net exposure	**24 496 017**	**23 570 231**	**20 368 277**	**4 127 740**	**20.3%**
Impaired exposures					
Gross statement of financial position exposure	1 676 330	1 440 064	1 368 789	307 541	22.5%
Impairment allowance on exposures analyzed on the portfolio and individual basis	(901 947)	(787 904)	(689 573)	(212 374)	30.8%
Net exposure	**774 383**	**652 160**	**679 216**	**95 167**	**14.0%**
Share of impaired loans in gross loan portfolio	**6.4%**	**5.7%**	**6.3%**		**0.1%**
Coverage of impaired loans with impairment allowances	**(53.8%)**	**(54.7%)**	**(50.4%)**		**(3.4%)**

Capital and capital adequacy ratio

Capital adequacy ratio decreased from the level of 11.3% at the end of June 2011 to 9.5% at the end of June 2012, exceeding the minimal level established by the Group (10%). The capital increase by PLN 68 868 thousand is mainly due to including in capital the audited net profit for the year 2011 and also due to the increase in supplementary capital arising from revaluation of available-for-sale financial assets. These factors exceeded the level of decrease of capital resulting from intangible assets due to capitalization BGŻOptima system implemented in the fourth quarter of 2011 and investment in development of the Bank's IT infrastructure.

Increase in the total capital requirements by PLN 381 256 thousand, i.e. 22.1%, corresponded with the dynamic expansion of the Group's credit activities. Another factor supporting the growth was the introduction of new rules on 30 June 2012, which increased the weight for credit risk capital requirement in the basic approach for the currency mortgage loans from 75% to 100%.

Table 17. Capital and capital adequacy ratio

PLN thousand	30.06.2012	31.12.2011	30.06.2011	Change y/y	
				PLN thousand	%
Total capital	2 508 048	2 399 781	2 439 180	68 868	2.8%
Total capital requirement	2 106 545	1 980 349	1 725 289	381 256	22.1%
Capital adequacy ratio (%)	**9.5%**	**9.7%**	**11.3%**		**(1.8%)**

Financial ratios

In the first half of 2012 the Group noted the deterioration of ROE and ROA in comparison with the first half of 2011, which resulted from the decrease in net profit due to higher net impairment losses on loans and advances.

Net interest margin (including swap points) remained stable. The increases in NBP rediscount rate improved the margin on the preferential loans and a careful deposits' price policy resulted in improving margin on the total clients' deposits, even after the promotional interest rates on BGŻOptima products.

On the other hand lower margins were characteristic for overdraft facilities and mortgage loans, which were offered with lower interest rates since second half of March 2012.

Cost/Revenues ratio improved significantly as a result of the increase in revenues exceeding the growth of expenses due to growing interest and commission income.

Increase of credit risk costs ratio corresponded with an increase of impairment losses on loans and advances which exceeded the rate of credit activities expansion.

Credits / Deposits and Credits / Total sources of finance ratios improved. It was reflected by the increase in the Group's liquidity surplus due to the growth in the value of deposits (supplemented by other sources of financing such as issued debt securities and loans from banks) greater than the increase in the loans portfolio.

Table 18. Financial ratios

	2 quarters 2012	2 quarters 2011	Change
Return on equity (1)	2.9%	4.8%	(1.9%)
Return on assets (2)	0.2%	0.4%	(0.2%)
Net interest margin (3)	2.9%	2.6%	0.3%
Net interest margin including swap points (4)	3.0%	3.0%	(0.0%)
Cost/Income (5)	70.4%	78.1%	(7.7%)
Credit risk cost (6)	(1.3%)	(0.5%)	(0.8%)
Loans/Deposit (7)	108.9%	111.6%	(2.7%)
Gross loans / Total sources of finance (8)	88.2%	92.1%	(3.9%)

(1) Relation of the net profit to average shareholders' capital based on the balances at the end of the quarters.

(2) Relation of the net profit to average assets based on the balances at the end of the quarters.

(3) Relation of the net interest income to average assets based on the balances at the end of the quarters.

(4) Relation of the net interest income including swap points to average assets based on the balances at the end of the quarters.

(5) Relation of the total of administrative costs and depreciation/ amortization to the total of result on banking on banking activities and other operating income and costs, excluding depreciation/ amortization.

(6) Relation of net impairment losses on loans and advances to the average balance of loans and advances to customers based on the balances at the end of the quarters.

(7) Relation of the carrying amount of loans and advances to customers to deposits from customers. There was a change in the comparative data in comparison with the Management Board's Report from the first half of 2011 due to the change in the methodology of calculating the ratio.

(8) Relation of the gross loans and advances to customers to the total of liabilities to customers, issued debt securities and loans from other banks. Balance at the end of the period.

8. OPERATIONS OF THE PARENT COMPANY IN THE FIRST HALF OF 2012

8.1. DISTRIBUTION CHANNELS

8.1.1. TRADITIONAL CHANNELS

Branch network

In 2012 the Bank continued to expand its network of branches, a policy started in 2008 in connection with the implementation of a growth strategy on local markets. Currently 12 branches are begin constructed in cities where the Bank branches have already existed: Białystok, Bydgoszcz, Toruń and Lublin in order to increase the Bank's share in terms of number of branches on a given micro market.

In the first half of 2012, 3 subordinated branches were opened. Based on the conducted analysis of financial results and location potential, 1 subordinated branch was relocated and 1 operational branch was transformed into subordinated branch. One subordinated branch and one Bank Shop (a branch located in a commercial center Manufaktura in Łódź) were closed.

As at 30 June 2012 the Bank had 396 branches, of which 119 were operating branches and 277 subordinated branches (compared to 120 operating branches and 274 subordinated branches as at 31

December 2011). The network of branches was supplemented by 16 external cash desks servicing cash transactions and 7 corporate centers servicing large corporations.

ATMs

At the end of June 2012, the network of ATMs available to the Bank's customers for commission-free cash withdrawals comprised of ATMs owned by BGŻ S.A. and those of Kredyt Bank, INVEST-BANK S.A., Spółdzielcza Grupa Bankowa as well as the Euronet network. At the end of June 2012 the Bank's customers could use without commission 4 772 ATMs, of which 510 were the machines operated by BGŻ S.A. Customers holding personal account as part of the "Plan Aktywny" product and the "Konto Plus" could use without commission all ATMs in Poland.

8.1.2. ALTERNATIVE CHANNELS

Internet banking

The first half of 2012 brought a continuation of dynamic growth in the number of customers using internet services eBGŻ (retail customers) and eBGŻ Firma (corporate customers) and in the number of operations performed through the Internet channel.

Table 19. Data relating to eBGŻ

		30.06.2012	31.12.2011	30.06.2011	Change y/y	
Number of customers accessing	eBGŻ	315 951	288 697	263 040	52 911	20.12%
	eBGŻ Firma	61 638	52 599	45 419	16 219	35.71%
Number of active customers logging	eBGŻ	202 892	181 440	158 511	44 381	28.00%
	eBGŻ Firma	38 310	34 340	31 197	7 113	22.80%
The average monthly number of transactions	eBGŻ	866 857	733 557	696 525	170 332	24.45%
	eBGŻ Firma	775 195	622 945	562 000	213 195	37.94%

In May 2012, the Bank enabled retail customers of eBGŻ to use SMS codes to authorize transactions, instead of one-time password cards used so far.

Moreover, the new solutions for the customers of eBGŻ Firma were introduced and included possibility to initiate debit orders, use one security token, username and password to manage many related businesses, development of administrative tools such as assigning the management of users and rights within the business to the Bank.

Phone banking

In the first half of 2012 further increase in the number of TeleBGŻ clients and the number of incoming calls to IVR and consultants were recorded.

Table 20. Data relating to Tele-banking

		30.06. 2012	31.12. 2011	30.06. 2011	Change y/y	
Number of customers with the Access to TeleBGŻ	Retail customers	354 630	326 843	301 443	53 187	17.6%
	Institutional customers	95 098	82 149	64 934	30 164	46.5%
Number of calls	Incoming from operator	69 111	63 175	62 635	6 476	10.3%
	Incoming IVR	93 348	90 039	89 251	4 097	4.6%
	Outbound to the customers	36 771	36 024	39 260	(2 490)	(6.3%)

In the first half of 2012 the Bank has worked on expansion of Communication Centre to ensure higher standard of services for a growing number of telephone service users and to enable the development of sales activities. The Bank launched a direct sale of personal accounts and credit cards using the services of courier.

To improve customer convenience and in order to provide the information on the current Bank's offer and promotions, the Bank launched a new product hotline 801 33 66 99 providing a direct connection with a consultant. The existing 801 123 456 number, connecting the area of the TeleBGŻ customers phone service and the area of Bank's product hotline, remained unchanged. The changes were also made in the IVR service (so called "the tree structure"), facilitating the use of this function for the Bank's customers.

Banking cards

The Bank issues debit cards, credit cards and cards with deferred payments by Mastercard and Visa. As at 30 June 2012 the number of issued debit cards amounted to 612.1 thousand and was 45.9 thousand (8.1%) higher than in the year earlier. This increase was achieved mainly due to debit cards issued to retail clients and corresponded with the increase in sales of product "Konto z Premią". The number of debit cards issued to corporate clients was also growing at a rapid pace (increase of 16.4% y/y). Despite the downward trend in the credit card market (the number of cards in the banking sector decreased by 20.7% y/y according to March 2012 data), BGŻ noted an increase at the level of 11.6% y/y in this segment.

Table 21. Number of banking cards issued by BGŻ SA

	30.06. 2012	31.12. 2011	30.06. 2011	Change y/y	
Retail customers debit cards	496 866	479 453	465 036	31 830	6.8%
Retail customers credit cards	54 100	48 999	48 487	5 613	11.6%
Business debit card	59 540	56 130	51 144	8 396	16.4%
Business cards with deferred payments	1 563	1 560	1 534	29	1.9%
Total number of banking cards issued	**612 069**	**586 142**	**566 201**	**45 868**	**8.1%**

Product modifications during the period included development of the offer of retail MasterCard credit cards, mainly by promoting the return of the expenses incurred by the customers. The Bank continued operations dedicated to cyclists, particularly the promotional exemptions from insurance charges and reimbursement of payments made in sport stores, fitness clubs, gyms, SPAs.

These actions resulted in awarding BGŻ's credit card Mastercard the first place in the ranking by Bankier.pl.

In May 2012, the Bank resumed issuing Visa Standard credit card.

Cooperation with intermediaries and agents

Since the beginning of 2012, the Bank has implemented changes in cooperation with external partners in the area of sale of banking products for retail and institutional clients (from SMEs and micro-enterprises' sectors). The Bank focused on concluding agreements concerning acquisition of banking products (the agreements involving information and promotional services were terminated at the end of the year). Additionally, the Bank introduced a new procedure of signing cooperation agreements. The direct supervision on the conclusion of all cooperation agreements (both with network and local agents) was assigned to the Head Office. At the end of June 2012 the Bank has actively cooperated with 34 network intermediaries or agents, such as Open Finance, Notus, Money Expert. During this period, also cooperation with best local intermediaries was activated through offering them new terms of cooperation. At the end of June 2012 the Bank has cooperated with 141 local intermediaries.

8.2. RETAIL BANKING

8.2.1. Product offer development

In the area of mortgages and cash loans one of the main goals for the first half of 2012 was to implement the strategy of developing prudent lending activities. The strategy was supported by making credit procedures more efficient, which optimized the credit risk management and modernized sales model via the network of BGŻ' s branches.

One of the important objectives for the first half of 2012 was also increasing activities of depositary clients and intensifying CRM activities in the area of new retail products offered to the Bank's customers. Since the beginning of 2012 the most important acquisition product has been "Konto z premią", which is the leading market account according to rankings of Gazeta Wyborcza, Bankier.pl, Money.pl and Comperia.pl.

8.2.2. BGŻOptima

The product offer of BGŻOptima supplements the Bank's product offer in savings and investment facilities for clients, who are interested in financial services on the Internet. The offer of BGŻOptima includes deposits, saving accounts and investment funds. Since 2012 the Bank's offer has been rapidly developed in the area of deposit and investment products. In May, the Bank introduced a first structured product – endowment policy linked deposit. Consistently the investment funds offer has been developed.

As at 30 June 2012 the number of clients served by BGŻOptima amounted to 55.0 thousand. Since the beginning of the year 17.8 thousand new customers were acquired.

8.2.3. Deposit activities

The main growth factor in retail deposits were the funds raised through BGŻOptima. As at 30 June 2012 retail deposits collected through this channel amounted to PLN 2 425.4 million, which was an increase at the level of 50.8% compared to the end of 2011. The crucial fact is that 90% of the BGŻOptima deposits were obtained from the new BGŻ clients. The structure of retail deposits of BGŻOptima has changed- the share of funds located in savings accounts rose from 3.7% at the end of 2011 to 46.8% at the end of June 2012, mainly due to the withdrawal of the one-day deposits and increase in interest rates on savings accounts.

Table 22. Volume and structure of retail deposits

PLN thousand	**30.06. 2012**	**31.12. 2011**	**30.06. 2011**	**Change y/y**	
Current and savings accounts	7 780 093	6 174 921	6 633 803	1 146 290	17.3%
Term deposits	6 708 824	7 249 879	4 855 464	1 853 360	38.2%
Other liabilities	8 415	9 028	8 795	(380)	(4.3%)
Amounts owed to customers, total	**14 497 332**	**13 433 828**	**11 498 062**	**2 999 270**	**26.1%**
including: BGŻOptima	**2 425 448**	**1 597 477**	**-**	**2 425 448**	**-**

In the area of the retail deposits gathered by the branches, the value of deposits accumulated on the personal accounts increased significantly – at the end of June 2012 it was 27.0% higher than the year before. The growth corresponded with the increase in the number of accounts by 4.0% to the level of PLN 569.5 thousand, obtained mainly through selling the appealing product – "Konto z premią", of which owners fulfilling the specific requirements of the Bank, receive financial bonus from the Bank each month. The number of accounts sold in the first half of 2012 amounted to 55.7 thousand accounts and was almost 6 thousand accounts higher than during the corresponding period of the previous year. "Konto z premią" represented almost 70% of all opened current accounts. Positive sales results were also achieved through the advertising campaigns in media and simplification of current accounts opening process at branches of the Bank. "Konto z premią" account was also used as a product enabling acquisition of new clients by newly opened branches. The high appeal and quality of "Konto z premią" was confirmed by the first place in the ranking of the best personal accounts according to Money.pl in January 2011 and 2012 as well as according to the ranking of Bankier.pl in March 2012.

In the area of term deposits offered through the network of branches, the Bank offered so-called seasonal deposits with attractive interest rates, including 12-month deposit with progressive interest rate, and investment deposits.

Table 23. Number of retail deposits accounts

	30.06. 2012	31.12. 2011	30.06. 2011	Change y/y	
Number of deposits accounts in branches	**1 486.1**	**1 440.1**	**1 417.7**	**68.4**	**4.8%**
A'vista accounts, including:	1 216.7	1 152.1	1 127.4	89.3	7.9%
Personal accounts	569.5	555.6	547.4	22.1	4.0%
Max Accounts	8.7	8.9	8.7	-	-
Eskalacja savings accounts	233.5	211.7	204.4	29.1	14.2%
Term deposits accounts	269.3	288.0	290.3	(21.0)	(7.2%)
Number of deposits accounts in BGŻOptima	170.3	188.9	-	170.3	-
Savings accounts	59.6	38.5	-	59.6	-
Term deposits accounts	110.7	150.4	-	110.7	-

8.2.4. Lending activities

The first half of 2012 was a period of dynamic acceleration of key loan products sales to retail customers.

The value of mortgage loans sold during this period amounted to PLN 721.9 million and was almost tripled in comparison with the first half of 2011, when amounted to PLN 256.4 million. It was mainly a result of the product advertising campaign conducted in the media in March, price incentives and special open days with mortgage loans' promotional offers. Higher sales led to acceleration in the growth of PLN mortgage loans portfolio to 20.1% y/y as of the end of June 2012 and BGŻ increased its share in this segment of the credit market for the first time since 2009.

Table 24. Volume and structure of retail credit accounts

PLN thousand	30.06. 2012	31.12.2011	30.06.2011	Change y/y	
Current account loans	117 790	132 123	130 053	(12 263)	(9.4%)
Housing loans	7 392 994	7 118 474	6 689 794	703 200	10.5%
– in PLN	3 952 628	3 498 881	3 289 970	662 658	20.1%
– in foreign currencies	3 440 366	3 619 593	3 399 824	40 542	1.2%
Cash loans	781 264	719 466	703 960	77 304	11.0%
Other loans to retail clients	595 399	493 222	497 903	97 496	19.6%
Total loans to retail clients	**8 769 657**	**8 463 285**	**8 021 710**	**747 947**	**9.3%**

The value of cash loans sold in the first half of 2012 amounted to PLN 252.8 million compared to PLN 155.2 million in the year before (increase at the level of 62.9%) leading to the increase of portfolio by 11.0% y/y. Apart from activities aimed at acquiring new customers, the Bank also undertook to expand the sales to its own customers based on "pre-approval" campaigns. The group of selected clients were offered a credit limit, which could be used for opening one, two or three credit products from the consumer finance products, i.e. credit card, revolving credit, cash loan.

The highest increase was recorded in the credit cards portfolio, of which value increased by 41.5% y/y and amounted to PLN 61 846 thousand at the end of June 2012. Such significant increase resulted from the introduction of new Visa Standard card during the second quarter of 2012.

Table 25. Number of retail credit accounts (in thousand)

Number of items	30.06. 2012	31.12.2011	30.06.2011	Change y/y	
Number of retail credit accounts, including:	**298.4**	**297.7**	**294.7**	**3.7**	**1.3%**
Overdrafts	85.8	93.3	93.8	(8.0)	(8.5%)
Mortgage, housing and consolidation loans	51.1	48.3	47.3	3.8	8.0%
Cash loans	86.4	82.7	81.6	4.8	5.9%
Credit cards	61.3	59.5	57.2	4.1	7.2%
Other loans to retail clients	13.9	13.8	14.8	(0.9)	(6.1%)

8.2.5. Insurance

In the first half of 2012 the Bank continued cooperation with its strategic partners - Aviva General Insurance Company and Aviva Life Insurance Company. In February 2012 the offer of the Bank was enhanced by, Aviva insurance policies for cash loans, which was met with interest from clients. In June the share of loans sold with the insurance policies accounted for 56% of the total cash loans sales.

In 2012 the Bank has also offered insurance of other insurance companies. They were sold mainly together with mortgage loans and personal accounts.

Additionally, the Bank introduced to the offer for the first time insurance products in the form of group life policy – "Polisolokata" sold with cooperation with BENEFIA Life Insurance Company SA, Vienna Insurance Group (a network of branches) and Europa Life Insurance Company SA (BGŻOptima), as well as "Polisostruktura" in cooperation with Europa Life Insurance Company Europe SA.

8.3. BROKERAGE SERVICES AND DISTRIBUTION OF INVESTMENT FUND UNITS (TFI)

The Brokerage Office of BGŻ (BM BGŻ) focuses its operations on servicing retail clients and the scope of services rendered supplements the investment product offer of the Bank. BM BGŻ also provides services to selected institutional clients such as open-end pension funds (OFE) investment fund managing companies (TFI) and other entities managing the entrusted assets..

Brokerage fee in the first half of 2012 amounted to PLN 2 712 thousand compared to PLN 3 271 thousand in the first half of 2011. The decrease in comparison to the prior period was caused mainly by a general downturn in the stock market, and thus the decline in sales across the market, and change in the client structure. The Brokerage Office of BGŻ renders services mainly to domestic investors, including in particular individual investors whose share in the trading result has continually decreased in recent years. In the first half of 2012 the BM BGŻ share in the stock market turnover amounted to 0.26% in comparison with 0.22% in the first half of 2011.

At the end of first half of 2012, the Brokerage Office of BGŻ maintained 32 236 securities accounts which compared to 30 858 securities accounts at the end of 2011 represented a 4.5% increase. Increase in the number of Internet accounts maintained by the Brokerage Office in the bmBGŻ.net transaction system at the end of June 2012 was 1.46%. As at 30 June 2012, the number of internet serviced accounts was 5 419, compared to 5 341 at the end of 2011.

Table 26. Share of the BGŻ Brokerage Office in trading on the WSE

		First half of 2012		First half of 2011	
		Volume	Market share	Volume	Market share
Stock	PLN million	0.26%	514.34	0.22%	576.36
Bonds	PLN million	0.04%	0.44	1.56%	11.96
Futures	Number of contracts	0.46%	50 492	0.40%	52 501
Options	Number of contracts	0.25%	1 422	1.45%	14 093

At the end of June 2012, BM BGŻ distributed investment fund units in 54 funds managed by 4 investment - companies (Union Investment TFI, Aviva Investors Poland TFI, Skarbiec TFI, Opera TFI). The product offer of the Brokerage Office offers wide possibilities with respect to TFIs and covering the so called safe funds (bond- and cash-based funds), balanced and stable growth funds as well as funds of aggressive investing policy (share-based funds).

In the first half of 2012, revenues from the sale of investment funds participation units amounted to PLN 2 886 thousand compared to PLN 3 798 thousand in the first half of 2011. Due to worsening of financial market conditions and increase in the value of redeemed investment funds participation units, a decrease was recorded in the value of assets gathered by our Clients. As at 30 June 2012, the value of Client assets amounted to PLN 575.5 million compared to PLN 685.1 million at the end of the first half of 2011.

BM BGŻ operates as agent on the over-the-counter market organised by BondSpot S.A. Since 2007, the Brokerage Office has been the participant of the alternative trading system, NewConnect.

In the first half of 2012, BM BGŻ participated in 4 public offerings on the primary market. In the case of 2 offerings, the Brokerage Office acted as a tender and hence participated both in the preparation and execution of the offer as offer organizer at each stage.

8.4. INSTITUTIONAL BANKING

8.4.1. CLIENT SEGMENTATION

Institutional clients of the Bank were allocated to the following segments:

- Large Enterprises („LE") – with annual sales revenues of more than PLN 60 million,
- Small and Medium Sized Enterprises („SME") – with annual sales revenues being the minimum PLN equivalent of EUR 1 200 thousand to PLN 60 million,
- Microenterprises (hereinafter „Micro") – with annual sales revenues being the PLN equivalent of up to EUR 1 200 thousand.

As part of those segments, additional sub-segments were isolated for agro clients, farmers, public sector, non-profit organizations and key clients.

As at 30 June 2012 the Bank served 105.3 thousand institutional clients (+15.8% y/y), including 1.0 thousand of Large Enterprises, 22.5 thousand of Small and Medium Sized Enterprises and 81,6 thousand of Microenterprises - of which 40.1 thousand were farmers.

8.4.2. PRODUCT OFFER DEVELOPMENT

Product packages and current accounts

As of 15 March 2012 the Bank introduced to its product offer new and modified product packages: Biznes Lider and Biznes Lider Plus packages for microenterprises, Biznes Lider Aktywny and Biznes Lider Prestiż for SME clients, Społeczny Lider package for Micro Non-Profit clients, Agro Leader and Agro Leader Prestige for farmers. The new product offer replaced the existing package offer Firma Plan 2 and Firma Plan 3. Additionally, the Bank withdrew e-Plan Firma from the offer and supplemented and modified the existing package offer.

The package offer has been designed in such a way that within one agreement the client could purchase many products offered by the Bank for one price and buy other products and services at preferential prices and without additional formalities. The main products included in the packages are PLN current accounts, telephone banking, eBGŻ, deposits accounts and term deposits. The Biznes Lider Plus package enables the clients cooperating with the Bank for at least 12 months to open an overdraft amounting to PLN 10 thousand for a period of up to 36 months.

The package offer for SME customers, i.e. a Biznes Lider Akywny and Biznes Lider Prestiż packages, apart from the basic products from packages for Micro clients, includes also currency accounts, debit cards, as well as individually negotiated deposits and FX transactions (eBGŻ Treasury). The Bank introduced also the possibility of selecting a flat fee for online transfers to the other banks.

The Bank launched also a new Agro Lider Prestiż package – for farmers and food producers with higher banking requirements. The package contains, in addition to basic banking products, the ability to negotiate FX exchange rates, interest rates on deposits and to receive free of charge Agro-business information edited by the Bank's experts. At the same time, the Bank introduced to the offer for Agro-enterprises free of charge cash withdrawals from all ATMs in Poland.

The offer was also enriched by the Społeczny Lider package designed for non-profit microenterprises with attractive pricing offer and basic products included in the package.

In the period from the introduction of new offer (15 March 2012) to 30 June 2012 the Bank acquired 7 924 new customers through sale of newly introduced packages. In comparison with the corresponding period of 2011, the Bank acquired about 195 new customers.

In the first half of 2012 the offer of currency accounts was enlarged by launching currency accounts in RUB (Russian ruble) and RON (Romanian leu). The currency accounts are non-interest bearing. The accounts can be used only for non-cash settlements – no cash settlements are available.

On 14 February 2012 the Bank has made modifications in the cash processing offer. The changes included standardization of contracts for all segments and introducing daily limits for closed payments.

In the first half of 2012 - 36 agreements were signed on rendering by the Bank the service called "Identyfikacja Płatnika" (based on the IDEN system) aimed at serving mass incoming payments. In the corresponding period of 2011, 25 such agreements were signed. In the first half of 2012 about 800 thousand transactions were processed in the IDEN, amounting to more than PLN 540 million. In the corresponding period of 2011 - 517 thousand transactions were settled amounting to PLN 358 million.

Agro-business financing

In March 2012 the Bank introduced the combined products - crop loans with recourse factoring in such a way that installments obtained under the factoring agreement constitute a source of crop loan repayment.

Since March 2012 customers have the opportunity to purchase agricultural equipment within the Polish Sustainable Energy Financing Facility (PolSEFF) Program. Acceptance of such transactions by PolSEFF engineers is realized according to the simplified procedure. Customers purchasing tractors and harvesters who wish to participate in the Facility, receive an investment bonus of 10% from the drawn credit amount.

Insurance for farmers

In the first half of 2012, according to the cooperation agreement with Concordia Polska TUW, Bank has introduced to the offer (pilot in selected branches) of the motor vehicle insurance for farmers - Concordia Auto, including civil liability insurance, Auto Casco (AC), Car Assistance, insurance agreement against accidents,, legal protection insurance and the vehicle liability insurance for environmental damages.

8.4.3. LENDING ACTIVITIES

As at 30 June 2012 gross value of the portfolio of loans to institutional clients amounted to PLN 17 511 812 thousand and was about PLN 3 725 433 thousand, i.e. 27.0% higher than in the prior year. The increase was realized in the second half of 2011 and second quarter of 2012 and was achieved in all segments: LE, SMEs and Micro.

In terms of product offer, the main driver behind the portfolio growth were investment loans to enterprises (increase of PLN 1 455 323 thousand i.e. 47.2%), granted mainly to clients from the LE and SMEs sectors. High growth (by PLN 888 812 thousand i.e. by 28.6%) was also recorded on overdraft facilities which was achieved due to good results on the Ekspres Linia product for SMEs and Agro Ekpress for farmers. At the beginning of 2011 the Bank implemented a more efficient sales process for these products.

Traditionally for the BGŻ Bank, an important factor for the development of lending activities were loans to farmers, which increased in 2011 by PLN 624 632 thousand i.e. 16.7%. However, the growth of the portfolio was reduced in the first half of 2012 in comparison to 2011 due to lower lending limits for banks imposed by The Agency for Restructuring and Modernization of Agriculture (ARMA). As a result, preferential loans were one of the slowest-growing parts of the institutional loans portfolio (10.8% y/y).

Table 27. Loans and advances to institutional customers, gross

PLN thousand	30.06.2012	31.12.2011	30.06.2011	Change y/y	
Overdraft facilities, including	3 998 089	3 276 428	3 109 277	888 812	28.6%
– businesses	2 225 948	1 814 091	1 765 389	460 559	26.1%
– individual entreprenuers	371 387	313 568	309 753	61 634	19.9%
– farmers	1 361 649	1 129 431	1 011 120	350 529	34.7%
Loans and advances to customers:	13 513 723	13 365 583	10 677 102	2 836 621	26.6%
– businesses, including:	7 547 725	7 641 938	5 676 499	1 871 226	33.0%
- investment loans	4 538 249	4 265 207	3 082 926	1 455 323	47.2%
- operating loans	1 847 477	2 366 793	1 699 190	148 287	8.7%
– individual entrepreneurs	1 206 979	1 173 698	952 727	254 252	26.7%
– farmers	4 368 846	4 146 549	3 744 214	624 632	16.7%
– public sector institutions	282 399	288 652	205 555	76 844	37.4%
– other entities	107 774	114 746	98 107	9 667	9.9%
Total	**17 511 812**	**16 642 011**	**13 786 379**	**3 725 433**	**27.0%**
of which: Preferential loans	*4 141 855*	*4 057 019*	*3 738 334*	*403 521*	*10.8%*

8.4.4. DEPOSIT ACTIVITIES

In the first half of 2012 the Bank conducted conservative policy towards institutional deposits aimed at obtaining better results on interest margins and diversifying and securing deposits stability. The flexible margin policy was offered to the best and the most loyal customers. The Bank's priority was, among others, to increase balances on current accounts as well as to secure deposits from the SMEs, microenterprises and from farmers.

As at the end of June 2012 institutional clients' deposits amounted to PLN 9 626 480 thousand and were higher than in the year before by about PLN 1 576 326 thousand (+19.6% y/y). However, almost the whole increase was realized in the second half of 2011. The most dynamic growth (37.4% y/y) was characteristic for farmers' deposits, what reflects the Bank's efforts towards achieving a more balanced participation in servicing agricultural sector. BGŻ's share in the loans to farmers is two times greater than in deposits (24.8% vs. 12.8%). In the previous year, it was respectively 22.5% and 10.2%.

Table 28. Amounts owed to institutional customers

PLN thousand	30.06.2012	31.12.2011	30.06.2011	Change y/y	
Other financial institutions:	**1 371 133**	**817 751**	**1 158 052**	**213 081**	**18.4%**
Current accounts	11 364	16 842	12 751	(1 387)	(10.9%)
Term deposits	1 359 758	800 898	1 140 977	218 781	19.2%
Other liabilities	11	11	4 324	(4 313)	(99.7%)
Corporate customers:	**7 544 918**	**7 901 418**	**6 253 020**	**1 291 898**	**20.7%**
Current accounts	2 948 990	3 442 366	3 375 233	(426 243)	(12.6%)
Term deposits	4 527 811	4 382 143	2 786 948	1 740 863	62.5%
Other liabilities	68 117	76 909	90 839	(22 722)	(25.0%)
Corporate customers, from which farmers:	**991 269**	**876 745**	**721 634**	**269 635**	**37.4%**
Current accounts	806 979	722 838	686 444	120 535	17.6%
Term deposits	178 201	149 479	26 884	151 317	562.9%
Other liabilities	6 089	4 428	8 306	(2 217)	(26.7%)
Public sector customers:	**710 429**	**788 655**	**639 082**	**71 347**	**11.2%**
Current accounts	385 069	413 291	471 758	(86 689)	(18.4%)
Term deposits	325 222	375 241	167 204	158 018	94.5%
Other liabilities	138	123	120	18	15.0%
Total	**9 626 480**	**9 507 824**	**8 050 154**	**1 576 326**	**19.6%**

8.4.5. FINANCING OF TRADING ACTIVITIES

In the first half of 2012 the Bank's factoring offer was extended by including new solutions for the Agro-business segment (LE and SMEs) involving the sale of factoring and crop loan in a package. The main objective of the new solution is to link crop loan with the recourse factoring, in such a way that installments obtained under the factoring agreement constitute a source of crop loan repayment and a collateral for the timely credit repayment.

In May 2012 the Bank has renewed terms of insurance policy for insured non recourse factoring. Additionally, the Bank's policy has been extended by including the possibility of insuring Microenterprises. The policy negotiated by the Bank will be valid until 30 September 2013.

Table 29. Factoring statistics

		30.06.2012	30.06.2011	Change y/y	
Number of factoring agreements	Number of agreements	73 items	77 items	(4)	(5%)
The value of limits	PLN million	144 021	136 460	7 561	6%
Turnover (amount of invoices purchased by the Bank)	PLN million	1 499	1 123	376	34%
Engagement	PLN thousand	444 622	323 858	120 764	37%

Bank guarantees

In the first half of 2012 BGŻ has introduced changes concerning the credit process and sealing of guarantees' payment process:

- extension of the validity period of the guarantees issued under the agreement on the guarantees' line to 3 years,
- delegation of duties related to the approval of the exceptions concerning the extension of the validity period of the guarantees issued under the agreement on the guarantees' line,
- resigning from the obligation to present the forecasts by the customers in case of guarantees valid up to 3 years.

As at the end of June 2012 the total value of guarantees issued to clients amounted to PLN 676 146 thousand compared to PLN 777 234 thousand as at the end of June 2011. The guarantee portfolio comprised 1 720 guarantees, which represents an increase of 20% compared to the corresponding period of 2011 (1431 guarantees).

Letters of credit

The Bank issues letters of credit to Polish and foreign customers, as well as services and confirms letters of credit issued by other banks and discounts receivables from letters of credit.

During the first six months of 2012, the Bank issued 128 import letters of credit amounting to PLN 38.8 million (compared to 179 letters of credit amounting to PLN 96 million in the first half of 2011) and has processed 63 export letters of credit totaling PLN 47.1 million (compared to 45 letters of the total amount of PLN 8.1 million in the first half of 2011).

8.4.6. ACTIVITIES ON DEBT SECURITIES MARET

In the first half of 2012 the Bank serviced 5 programs of issue of debt securities (one of the programs was terminated in February 2012), of which 3 related to the issuance of securities of local government units (municipal bonds). In the first half of 2012 the Bank did not act as organizer of new issues of debts securities.

8.5. ACTIVITIES ON MONEY AND FOREIGN EXCHANGE MARKETS

During the first half of 2012, the activities of the Bank on money and foreign exchange markets were significantly influenced by the following factors:

- significant appreciation of zloty in Q1 2012 (related to Long Term Refinancing Operations) and increased hedging activity among Polish exporters,
- following depreciation of zloty in Q2 (triggered particularly by a political stalemate in Greece) prompted hedging operations among importers,
- expected slowdown in the Polish economy (as infrastructural investments faded) and relatively positive situation in public finance caused increased demand for Polish bonds and currency,
- slowdown in domestic economy and economies of Polish key trade partners caused a deceleration of both import and export volume in Q1 and Q2,
- deteriorated credit capacity of many developed countries and banks operating on global financial markets,
- high demand for liquidity in the banking sector in the first half of 2011, which translates into high costs of obtaining finance from Bank's clients,
- high interest on the side of foreign investors in Polish debt instruments despite turbulence in global financial markets.

Activities on own account

FX market

The activity of Bank BGZ on FX interbank market in the first half of 2012 was focused on PLN and G7 currencies. The trading result was over 80% higher than in the respective period of the previous year. The increase resulted from both higher volume of FX transactions concluded with clients and more effective management of Bank's own currency position. The largest FX volumes were recorded on EUR/PLN currency pair followed by USD/PLN and GBP/PLN pairs. Bank BGZ also substantially increased activity on FX options market however high growth rate is mainly result of low-base effect for previous years.

Interest rate market

Bank BGZ recorded in the first half of 2012 outstanding result on the interest rate trading activity on the interbank market. The profit was generated mainly on Treasury floating- and fixed-rate bonds. The activity of Bank BGZ was focused on PLN yield curve. Bank as a Treasury Securities Dealers was an active participant of local interbank market. Minor activity was observed on EUR and USD yield curves. The product range in the interest rates area has been widened in the first half of 2012 by Cap and Floor options.

Short-term liquidity management

The lasting restricted liquidity of the interbank market and restrictive liquidity requirements of KNF associated with the recommendation Basel 3 and internal risk measures contributed to the situation that the deposits transactions with banks were concluded only to manage spot and short-term liquidity. The main instrument for placing short-term liquidity surplus were NBP money bills and short- and medium-term (with a maturity date up to 2 years) liquid Treasury bonds. The Bank did not treat neither the interbank market nor resources of non-bank financial institutions as the source of financing for credit activities. The market risk of a short-term liquidity management and instruments offered to Clients was actively managed by such a transaction as: OISs, FRAs, IRS and FX Swaps.

Assets and liabilities management

As far as assets and liabilities management is concerned, the Bank conducted financial operations in order to manage structural exposure of the Bank to interest rate, foreign currency and liquidity risk by way of, among others, setting hedging transactions against the interest rate and foreign currency risk, investing the surplus of available finance sources, gaining long-term finance and issuance of debt securities.

Hedging transactions

Interest rate risk arising from Clients' transactions – loans, deposits, current and savings account – was centrally managed by the Bank, taking into account expected changes of the market conditions in medium- and long-term. For this purpose, the IRS, OIS, CIRS and basis swap transactions are settled in order to reach the optimal profile from the risk (using the limits) and profitability point of view. As a result of forecast anticipating the start of interest rate cuts cycle in Poland at the end of 2012 / beginning of 2013 as well as specific design of preferential loans subsidized by ARMA, where the size of the Bank margin is related on a multiplier basis to the level of rediscount rate – the Bank additionally stabilized that margin by settling a set of 2-year IRS transactions for PLN 1,5 billion in April 2012, to which – for the first time in the Bank – mechanism of hedge accounting was applied. As a result, volatility of financial result was limited.

Long-term financing

The Bank is actively seeking to increase the share of long-term, stable funding in the balance sheet – apart from a credit facilities released in 2011 from Rabobank and two credit facilities from EBRD.

Certificates of deposit

Another tool used by the Bank in 2012 to acquire long-term funding were certificates of deposit – as at 30 June 2012 under the current program the Bank issued certificates amounting to PLN 1.55 billion with maturity date up to 1 year and certificates amounting to PLN 0.43 billion with maturity date from 2 up to 5 years. The above structure is a result of a new strategy implemented in March 2012, aiming to reach at least a 50% share of certificates with maturity longer than 1 year in the whole portfolio.

Investment portfolio

As at the end of June 2012, the nominal value of the Bank's investment portfolio amounted to PLN 2.49 billion. The entire portfolio was composed of liquid treasury bonds with maturity date falling between 2 and 10 years, which were classified as available-for-sale i.e. with changes in fair value taken to equity. In the first half of 2012 the portfolio generated income of PLN 94.6 million, of which PLN 18.1 million from the sale of bonds before maturity date - in order to adjust the duration of the portfolio to growing balance sheet assets, the Bank decided to sell short-term securities and purchased long-term securities thus keeping the nominal value of the portfolio in the target range of PLN 2.4 – 2.6 billion.

Sale of treasury products to clients

In the first half of 2012 compared to 2011 Treasury Sales Activities increased significantly in all customer segments (Micro & SME, Large Corporates, and non-banking Financial Institutions). The main key-success drivers were the high volatility on the Financial Markets, the new Treasury Sales model that brought more focus on respective customer segments, and the increased focus on deep-selling BGZ's client portfolio with hedging solutions..

The most important income drivers remain FX Spot, and FX Forward transactions, supported by BGZ's eBGZ Treasury electronic channel. The hedging solutions in the first half of 2012 are more diversified than in 2011; more customers are hedging their IR-risk, and a few customers using FX Options to hedge their FX risk.

In the first half of 2012, the Bank has expanded the range of treasury products offered to clients used to hedge interest rate risk – by introducing the interest rate options – and hedge against the change of commodity prices – by introducing the commodity options and swaps.

8.6. COLLABORATION WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

Correspondent banking and money orders

During the first half of 2012, the Bank maintained correspondence contacts with approx. 700 financial business entities and at the end of June 2012, the Bank had 25 Nostro accounts in 15 main currencies in foreign banks.

In the first half of 2012, the Bank operated 39 Loro accounts in 6 currencies for 21 foreign banks, 2 domestic banks and 4 foreign non-banking financial institutions. The Loro accounts maintained in BGŻ S.A. books of account and represent external source of securing working capital funds at no cost, which serve to satisfy operating needs of the Bank. Using these accounts, the Bank executes primarily client transfers and bank-to-bank transfers. Functioning of the Loro accounts are subject to periodic analysis in terms of their cost-effectiveness and usefulness for BGŻ S.A. and therefore number of is adjusted.

In the first half of 2012, BGŻ has collaborated with four foreign non- banking financial institutions offering cheap and swift electronic money orders: MoneyGram (USA), Doma International Transfers (USA), Vigo Remittance Corporation (USA) and OneMoneyMail (Great Britain). The subject of collaboration are both money orders as well as transfers to bank accounts. In the case of MoneyGram, transactions were executed in both directions i.e. to and from Poland.

In the first half of 2012 the Bank also continued collaboration with other domestic and foreign financial institutions, mainly with investment funds, insurers, pension funds and brokers and with banks. This collaboration enabled the Bank to offer a wide range of treasury and deposit transactions. The Bank has entered into many agreements (with new and already collaborating partners from those segments), which enable the Bank to settle transactions for the new products, such as structured deposits.

Financing foreign trade operations

The product offer dedicated to financing foreign trade operations of the Bank comprises: export and import letters of credit, export and import documentary collection, letter of credit discount, nostro and loro guarantees, avals and guarantees, factoring and payment orders. At the end of 2011, the Bank withdrew from providing cheque transactions in foreign trade.

In the first half of 2012 there was a significant increase in foreign trade transactions transfers. One of the factors contributing to such situation was a high turnover in the export of food. Participation of the SEPA Credit Transfer in the number of import and export transfers increased significantly during the first half of 2012 and amounted 44% and 56% respectively.

Table 30. Statistics of operations handled by BGŻ

Type of transaction	Quantity/value	Two quarters 2012	Two quarters 2011	Change y/y
Transactions using the nostro accounts (commercial banks and NBP)	Number of transactions	327 545	223 779	46.4%
	Value in PLN billion	1 468	1 473	(0.3%)
Transactions using the loro accounts	Number of transactions	60 606	53 303	13.7%
	Value in PLN billion	364	485	(24.9%)
Export transfers	Number of transfers	205 524	153 901	33.5%
	Value in PLN million	10 138	7 039	44.0%
including: transfers of SEPA Credit Transfer	Number of transfers	114 936	62 063	85.2%
	Value in PLN million	2 844	1 363	108.7%
Import transfers	Number of transfers	84 825	62 695	35.3%
	Value in PLN million	6 990	4 394	59.1%
including: transfers of SEPA Credit Transfer	Number of transfers	37 531	23 817	57.6%
	Value in PLN million	1 917	1 196	60.3%
Own letters of credit and own documentary collection (newly opened)	Number	146	221	(33.9%)
	Value in PLN million	40	87	(54.0%)
Guarantees and own promissory notes granted	Number	814	575	41.6%
	Value in PLN million	171	515	(66.8%)
Third party letters of credit and third party guarantees	Number	274	248	10.5%
	Value in PLN million	103	40	157.5%

8.7. BANK'S ORGANIZATION AND PERSONNEL DEPARTMENT

8.7.1. CHANGES IN ORGANIZATIONAL STRUCTURE

In January 2012 reorganization of the Risk Area in the Head Office was completed. This reorganization focused on optimizing risk analysis and control of processes within the Bank.

8.7.2. HUMAN RESOURCES DEPARTMENT

Employment levels

At the end of June 2012 BGŻ S.A. had 5 775 employees i.e. 5.6% more than in the year before. At the Head Office the number of employees increased by 2.8% y/y, which was mainly the result of changes in the organizational structure of the Bank's network, strengthening the of risk management and of the Central Credit Platform. The employment level in the entire Bank's network increased by 5.6% y/y as a result of continued development of the Bank's network. The increase in the employment was also attributed the launch of the Internet branch BGŻOptima.

The largest number of employees are persons with higher education (79.3%), which means an increase by 2.1 pp. compared to June 2011.

Table 31. Bank's employment in employees and FTEs

	30.06.2012	31.12.2011	30.06.2011	Change y/y	
Network	4 163	4 027	3 942	221	5.6%
Headquarters	1 499	1 453	1 458	41	2.8%
Brokerage Office	36	36	36	-	-
BGŻOptima	43	43		43	-
Holiday resorts	30	30	31	(1)	(3.2%)
Trade unions	4	3	4	-	-
Total (employees)	**5 775**	**5 592**	**5 471**	**304**	**5.6%**
Network	4 130.12	3 992.82	3 908.32	221.80	5.7%
Headquarters	1 488.94	1 447.98	1 452.72	36.22	2.5%
Brokerage Office	36.00	36.00	36.00	-	-
BGŻOptima	22.39	21.45	-	22.39	-
Holiday resorts	29.50	29.50	30.50	(1.00)	(3.3%)
Trade unions	4.00	3.00	4.00	-	-
Total (FTEs)	**5 710.95**	**5 530.75**	**5 431.54**	**279.41**	**5.1%**

Salaries

According to the PFSA Resolution No. 258/2011, the Bank introduced the Remuneration Policy for Bank's Management Board Members including employees on managerial positions, who have a significant impact on the risk profile of the Bank.

Table 32. Payroll

PLN thousand	**Two quarters 2012 r.**	**Two quarters 2011 r.**	**Change**	
			PLN thousand	**%**
Payroll costs. including:	200 880	178 517	22 363	12.5%
- base remuneration	165 198	149 936	15 262	10.2%
- other components of salaries and wages	1 922	1 339	583	43.5%
- awards and bonuses	32 111	26 039	6 072	23.3%
- non-employment contracts	1 649	1 203	446	37.1%
Social security costs	30 917	25 266	5 651	22.4%
Other	12 159	13 764	(1 605)	(11.7%)
Total payroll	**243 956**	**217 547**	26 409	12.1%
Awards and bonuses as % of base remuneration	***19.4%***	***17.4%***		***2.1%***

The increase in basic salaries at the Bank during the first half of 2012 compared to corresponding period of 2011 amounted to 10.2%. This was caused mainly by the development of the network of the Bank's operating units and launching the Internet branch BGŻOptima. Awards and bonuses costs (resulting from implemented modification of the motivation system) as well as social security costs (in connection with increase of the disability insurance contribution since February 2012) grew faster than the basic salaries.

8.8. IT DEPARTMENT

During the first half of 2012, the Bank spent 16.87 million on investments in the area of IT. During this period 13 projects were completed (at the end of June 2012 there were 32 projects in progress).

The most significant investment projects were as follows:

- Completing the Migration of the main transaction system (Eurobank) to the 3-layer architecture.

- Completion of the main works in the area of building CRM system – preparation for pilot implementation
- Development and implementation of new products for the Internet bank BGŻOptima (joint project of BGŻ and Rabobank International Direct Banking)
- Implementation of the Client transaction authorization in the electronic banking system by means of unique SMS codes.
- Providing the Bank Clients with the first Visa / BGZ PayPass cards.
- Implementation of solutions supporting the soft collection.
- Optimization in preparing the managements board's reports in the MIS system
- Implementation of workflow solutions supporting the credit process service
- Implementation of workflow solutions supporting the Clients inquiries service
- Migration to a new version of the directory service system.

9. ACTIVITIES OF SUBSIDIARIES AND ASSCOCIATED COMPANIES OF THE CAPITAL GROUP OF BGŻ S.A.

9.1. BANKOWY FUNDUSZ NIERUCHOMOŚCIOWY ACTUS SP. Z O.O.

In the first half of 2012 all the supervisory action taken towards the company were concentrated on creating conditions for the sell a property located in Wroclaw – Marszowice

The company was created in 1999, with main business activities focusing on:

- acquisition and disposal of properties and limited property rights;
- conducting construction investment projects on own and third party properties;
- providing trust services in area of trading in properties and rental of premises;
- leases of properties and premises;
- rendering services: valuation of properties, property management, property advisory (activities of property servicing agency).

As at 30.06.2012 the investment portfolio was composed of one property in the form of undeveloped land with an area of 48.44 hectares. According with the applicable Local Zoning Plan, the property is intended for housing construction.

Table 33. Key financial data of Bankowy Fundusz Nieruchomościowy Actus Sp. z o.o

PLN thousand	30.06.2012	31.12.2011	30.06.2011
Total assets	63 574.0	63 598.3	64 058.0
Long-term investment	63 401.0	63 401.0	63 900.0
Equity	20 899.4	21 930.8	23 356.7
including: net profit	(1 109.8)	(2 712.6)	(1 122.0)

9.2. BGŻ LEASING SP. Z O.O.

The company was created in April 2007 as a subsidiary of De Lage Landen International B.V. (the Rabobank Group). The company provides leasing services focusing on equipment, cars, and other fixed assets it also provides loans. In the first half of 2012, 951 agreements were launched amounting to PLN 321.6 million (of which 500 agreements were launched in the second quarter amounting to PLN 161.7 million), compared to 803 agreements amounting to PLN 270.5 million signed in the first half of 2011.

Table 34. Key financial data of BGŻ Leasing Sp. z o.o. (in PLN thousand)

PLN thousand	30.06.2012	31.12.2011	30.06.2011
Total assets	1 059 156.8	1 013 920.3	786 817.5
Long-term investment	941 847.6	869 209.9	709 246.8
Equity	92 985.2	94 806.0	68 394.6
including: net profit	(1 820.7)	5 468.7	4 100.3

In the first half of 2012 the company achieved negative net financial result, which was a result of an impairment on receivables from customers in the large enterprises segment including the construction sector.

10. RISK MANAGEMENT

10.1. CREDIT RISK

Credit risk management

Credit risk is defined as the risk of default of financial liabilities by debtor, being – in particular – the risk of non - payment of loan liabilities as well as the risk of worsening of the financial situation of debtor, which both affect valuation and quality of the Bank's assets.

For the purpose of managing credit risk, the Bank' Management Board implemented policies determining the maximum credit risk exposure (credit risk appetite statement), the Bank is ready to accept in connection with its business strategy.

In the process of credit risk management, the Bank executes activities based on current analyses of the macroeconomic environment and conducts internal analyses of credit portfolios. The applied approach facilitates taking up swift remedial measures where unfavourable trends appear in the external environment or in the quality or structure of the credit portfolio. Active credit risk management is executed by the Bank, by way of, among others:

- regular adjustment of credit policy and the methods and tools for risk assessment and measurement to changing market conditions;
- tight supervision over the portfolio of existing credit exposures.

The most significant tasks realised by the Bank in the first half of 2012 were as follows:

- development of the new supervision rules, which apply to the loans granted for the Micro-entrepreneurs;
- review and development of the guidelines concerning modifications of Micro-entrepreneurs' and farmers' creditworthiness assessment rules;
- implementation of a new farmers' creditworthiness assessment model, centralization of the process of valuation of the properties, which serve as collateral to the retail loan transactions, conducted in cooperation with an external entity.

Quality and structure of credit portfolio

The Bank's credit portfolio has relatively safe structure with high share of loans and borrowings with more favourable risk profile i.e. housing loans (accounting for 28.1% of the gross value of credit portfolio at the end of June 2012) and loans to farmers (21.8% of the gross value of credit portfolio).

Table 35. Structure of credit portfolio

PLN thousand	30.06.2012		31.12.2011		30.06.2011	
	PLN thousand	% share	PLN thousand	% share	PLN thousand	% share
Loans and advances, gross	**26 281 469**	**100.0%**	**25 105 296**	**100.0%**	**21 808 089**	**100.0%**
Mortgage loans	7 392 994	28.1%	7 118 474	28.4%	6 689 794	30.7%
– in PLN	3 952 628	15.0%	3 498 881	13.9%	3 289 970	15.1%
– in foreign currencies	3 440 366	13.1%	3 619 593	14.4%	3 399 824	15.6%
Cash loans	781 264	3.0%	719 466	2.9%	703 960	3.2%
Other loans to retail clients	595 399	2.3%	493 222	2.0%	627 956	2.9%
Individual entrepreneurs	1 578 366	6.0%	1 487 266	5.9%	1 262 480	5.8%
Farmers	5 730 495	21.8%	5 275 980	21.0%	4 755 334	21.8%
Corporates	9 773 673	37.2%	9 456 029	37.7%	7 441 888	34.1%
Public sector	289 919	1.1%	289 919	1.2%	213 206	1.0%
Other receivables	139 359	0.5%	264 940	1.1%	113 471	0.5%

Foreign currency loans account for about a half of the housing loans portfolio, however their share has systematically decreased when in April 2009 the Bank ceased to issue such loans. The share of cash loans with higher credit risk losses in total loans and borrowings is relatively low and amounted to 3.0%.

In the first half of 2012 the share of impaired loans in the retail loan port folio has stabilized, due to the improvement of sales and a slower growth of impaired receivables in comparison with the second half of 2011. However the share for the institutional portfolio has deteriorated significantly, which was caused mainly by the bank's involvement in the large companies' segment, including individual involvement towards clients from the building sector. A positive factor in the institutional portfolio was a constant improvement of farmer's loans quality

Table 36. Quality of the loan portfolio

PLN thousand	30.06. 2012	31.12. 2011	30.06. 2011	Change y/y	
				PLN thousand	%
Retail loans	**8 769 657**	**8 463 285**	**8 021 710**	**747 947**	**9.3%**
impaired	478 976	459 408	407 096	71 880	17.7%
% share	5.5%	5.4%	5.1%		0.4%
Institutional loans	**17 511 812**	**16 642 011**	**13 786 379**	**3 725 433**	**27.0%**
impaired	1 197 354	980 656	961 693	235 661	24.5%
% share	6.8%	5.9%	7.0%		(0.1%)
of which: farmers	**5 730 495**	**5 275 980**	**4 755 334**	**975 161**	**20.5%**
impaired	183 910	184 508	176 816	7 094	4.0%
% share	3.2%	3.5%	3.7%		(0.5%)

Restructuring and recovery of high risk debt

The policy of restructuring and recovery of high risk debt conducted in the first half of 2012 was that of continuation of activities in the area of:

- identification, negotiation and implementation of activities aimed at maximizing repayments by debtors or – where possible – implementation and monitoring of debtor corporate recovery proceedings leading to improvement of debtor financial and economic position, with the overall view to return debtors for servicing by their original sales units;
- reducing the share of high risk debt in the Banks' portfolio, e.g. through the sale of the part of retail loans portfolio;
- active monitoring of execution and bankruptcy proceedings;

- strengthening the structure of transactions through requesting additional transactions insurance, change in the repayment schedule, change in the drawing schedule, adjusting/ adding new contract clauses, changing the type of transactions;
- tax optimization of executed strategies;
- identification of early warning signals and taking appropriate actions (where possible, in collaboration with sales units) limiting the risk of potential losses;
- further integration and coordination of activities with the function of debt restructuring and recovery at the Rabobank Group (GSAM) for the largest transactions, and with sales units of the Bank for defined specific transactions;
- personnel recruitment and appropriate training so as to ensure that the Bank has appropriate human resources to manage the given portfolio;
- improvement of the Bank's organizational structure, procedures and tools to enhance the efficiency of the tasks carried out.

Debts recovered in the first half of 2012 services by the Institutional Debt Recovery Department, Retail Debt Recovery Bureau and Debt Restructuring Department in the amount of PLN 121 million (principal) was the result of the conducted court executive procedures, bankruptcy proceedings in progress, civil-legal agreements with debtors and compositions proceedings in process.

The number of enforceable titles issued by the Bank in the first half of 2012 amounted to 445 for corporate loans and 1 280 for retail loans.

The value of collaterals in the portfolio, which is recovered or restructured is as follows (in the context of the LTV ratio for loans secured by mortgages and for mortgages loans):

- institutional in PLN – 39,9%,
- institutional in foreign currencies – 52,9%,
- retail in PLN – 70,2%,
- retail in foreign currencies – 114,1%.

The above information means a relatively high level of collateralization with the concurrent limitation of risk of debt non-recovery. A high LTV ratio for retail loans results mainly from currency appreciation (CHF).

10.2. FINANCIAL RISK

10.2.1. Market risk

Activities of the BGŻ Bank are recorded in the trading and banking books. Fluctuations in market interest rates, currency exchange rates, prices of securities or in the implied volatility of option instruments cause changes of these books' present values. The risk of unfavourable fluctuations in value due to the above risk factors is recognised by the Bank as market risk, and due to the very different nature of these books, this risk is monitored and managed separately for each book. In addition, one should note that the activities on the stock market conducted by the Brokerage Office were practically reduced to zero.

Market risk in the banking book

Included in the banking book are – transferred for management purposes to the Bank's Head Office via Funds Transfer Prices system (TCF) – deposits and credits (loans and borrowings), items of strategic nature (long-term investments, bonds from the conversion of obligatory reserve, own debt instruments issued and loans and borrowings), liquidity-type operations of the financial market (interbank placements, liquid debt securities) as well as hedging instruments for this book (derivative financial instruments) and non-interest items (among others, equity, tangible fixed assets, intangible assets, taxes, provisions and current result).

The Bank's policy in the area of banking book continued to attain additional revenues in the above product margin without compromising stability of client deposits, equity or financial result. The Bank has met this objective by maintaining or matching natural exposure generated by the main deposit-lending activities, as part of prevailing risk limits and in accordance with expected mid- and long-term trends of the financial market..

The main measures of the market risk applied by the Bank in the banking book are:

- interest rate gap, assets and liabilities „duration";
- sensitivity measures – defining sensitivity of the financial result – valuation, interest income, net value of economic capital – to changes in risk factors;
- IaR (Interest-at-Risk – sensitivity of interest result);
- EaR (Equity-at-Risk – sensitivity of the current value of net capital).

The Bank manages the banking book risk by limiting risk measures and monitoring the risk on an ongoing basis.

Situation in the first half of 2012

At the end of the first half of 2012, the value of the „duration" measure – i.e. the weighted period to revaluation of interest rate of balance sheet assets was approx. 3.4 month (at the end of 2011 3.5 months), whilst for the balance sheet liabilities – 1.6 month (previously – 2.8 month). Almost 94% of assets and liabilities' items has revaluation deadline lower than 6 months (at the end of 2011 - 93%), however, almost 53% of assets and liabilities are to be re-valued within one month (previously - 54%).

In the area of interest risk (measured by IaR) significant changes occurred in the first half of 2012, which contributed to a significant limitation of exposure. The most important among them related to collateral with OIS and swap transactions and corrections to the IaR calculation guidelines. In the first half of 2011 interest risk for the preference loan in the ALM portfolio was hedged using the interest rate swap, amounting to 1.5 bln PLN (payments based on a fixed, 2-year interest rate, paid on the 1-month WIBOR basis). The preclusion from IaR calculation of selected items of the trade and Money Market portfolios had an impact on the observed portfolio. The basic risk of those items has a price (market) nature, and its result is presented as "Results on trading activities". Moreover the specification of guidelines for non-sensitivity of current accounts' balances to interest rates fluctuations, depending on the direction of change and client's segment, was influential for the portfolio.

Interest at Risk (IaR) at the end of the first half of 2012 were as follows (values at the end of 2011 in brackets):

- immediate growth of interest rates by 50 bps: increase of the Bank's interest income during one year by 0.7 million PLN (increase by 8.3 million PLN),
- immediate decrease of interest rates by 50 bps: decrease of the Bank's interest income during one year by 0.9 million PLN (decrease by 24.1 million PLN),
- a gradual increase of interest rates by 200 bps during one year: interest income increased by 1.2 million PLN (increase by 9.5 million PLN),
- a gradual decrease of interest rates by 200 bps during one year: interest income decreased by 1.5 million PLN (decrease by 48.0 million PLN).

Market risk in the trading book

Trading activities of the Bank are supplementary in nature and are conducted to support sales of financial products to corporate clients, financial non-banking clients (directly) and retail clients. Considering this and opening own positions by the Bank generates revenues from short-term fluctuations in price parameters (foreign currency exchange rate, interest rate, debt securities prices etc.) whilst keeping the exposure within defined risk limit The Bank does not have open position on currency options and for this reason market risk in the trading book does not exist.

The key measures for market risk used by the Bank in the trading book are:

- Value-at-Risk (VaR) – showing maximum acceptable level of loss on the given item in normal market conditions in a defined time span; can be exceeded with defined probability; BGŻ applies the parametric model with modified variance – covariance matrix and exponential weighting of historical observations; the accepted confidence level is 99%, and the period of position holding for trading book – 1 day;

- Scenario analyses and Stress Test – supplement VaR to include statistically predictable market events; historical economic and political crises, expected shortfall analyses (expected loss of value above confidence level) and max-loss (the highest possible loss based on a known history of fluctuations in market-based factors);
- BpV (basis point value) – sensitivity of price to parallel shift of profitability curve;
- Nominal measures – among others, value of currency position during a day and at day end, securities nominal value;
- Non-monetary limitations – among others, allowed types of instruments, currencies and pairs of currencies, maximum maturity dates, minimal credit rating for acquired debt securities;
- Stop – loss limits (level of the maximum loss acceptable) – for various time periods (day, month, year) at the portfolio and sub-portfolio level.

In order to limit the market exposure, based on the decisions of the Committee for Risk and Balance Sheet Management, limits are established for IR VaR and FX VaR risk appetite, stress tests, BpV sensitivity and other measures. Utilisation of all limits is monitored and controlled on a daily basis.

Situation in the first half of 2012

A review of limits in the trading book was conducted in the first half of 2012, however the basic border values (VaR, stress test) remained unchanged. The maximum possibile sensitivity level (BPV) for the individual node points (tenors) of profitabilty curves were specified, lowering the accepted risk level for the longer tenors. The risk appetite key measures were not exceeded, except for the only situation in the first half of 2012 connected with the initially unaccepted Romanian currency RON (finally accepted by the Bank's Credit and Balance Sheet Management Committee).

In the first half of 2012 the average measure of trading items exposure to the price risk, the so-called value at risk (VaR), was kept at the average level of 59% of the limit, which almost entirely resulted from interest rate exposure. VaR for interest rate risk amounted to the average level of 61% of the limit and for currency risk - 8% of the limit. The risk appetite key measures in the trading books were not exceeded.

Thanks to the beneficial market conditions and positive intraday trade results, the Financial Markets Department achieved very good results in the interest rate trading portfolio (IR Trading). It enabled a change in the risk profile in the following direction: nominally significant position on short-term debentures, with low market risk, close to nil exposure on long-term Polish bonds and speculative EUR positions (mainly German debentures' futures) and swap (mainly exposure opposite to the transaction hedging the preference loan portfolio within ALM portfolio).

Liquidity risk and assessment of finance sources stability

The Bank maintained safe level of financial liquidity. The growth of depository base, which occurred in the fourth quarter of 2011 was retained in the first half of 2012. The financial resources held allowed the Bank to discharge all its liabilities on time. The portfolio of the most liquid securities was kept at the level fully securing any potential outflow of funds by largest Bank's deposit owners. The excess of liquid assets over the minimum limit amounted to PLN 0.59 billion at the end of June 2012.

At the end of the first half of 2012, the excess of financing resources originated from non interbanking market above credit limit amounted to PLN 3.5 billion, whilst the excess of stable deposits over credit portfolio – PLN 0.41 billion.

Stability of the Bank's financing was kept at high average level of 88.5% during the period from January 2012 to June 2012, which was possible mainly due to low fluctuations of balances of retail deposits and BGŻOptima, the increase of resources placed by SMEs and microenterprises (excluding migration between individual products), sediment funds of large enterprises and state budget entities, growing balance of certificates of deposit and the secured EBRD credit facility, and in the second half of 2011 – owing to the CHF loan from Rabobank.

10.3. OPERATING RISK

In accordance with the regulations in force, the Bank defines operating risk as a possibility of suffering loss or unjustified costs caused by improper or unreliable internal processes, people, technical systems or influence of external factors. To the operating risk scope the Bank includes also the risk of the lack of compliance and legal risk.

The purpose of operating risk management is to limit losses and costs caused by this risk, ensuring that Bank renders services of the highest quality as well as security and compliance of Bank's activities with laws and regulations.

10.4. LEGAL RISK

The litigation situation in the first half of 2012 within insurance and employment claims was stable and did not generate material legal risk for the Bank.

Legal proceedings or proceedings before government administration bodies relating liabilities or debts of BGŻ S.A. with a value of at least 10% of the BGŻ S.A. equity: as at 30 June 2012 (approx. PLN 250 million) – lack of such proceedings.

Table 37. Created / reversed provisions in the first half of 2012 (with a unit value exceeding PLN 100 thousand)

Purpose	Amount of provision in PLN thou [as at 30.06.2012 or balance at the reversal date]	Creation date	Reversal date
Court proceedings initiated by the ARiMR	534	2012-04-27	--------------
Court proceedings initiated by the customer	5 556	2012-03-21	2012-06-19

11. SIGNNIFICANT EVENTS AFTER THE REPORTING DATE

11.1. BGŻ SHARE TENDER OFFER

On 27 July 2012 Polish Financial Supervision Authority has revoked the prohibition of Coöperatieve Centrale Raiffeisen Boerenleenbank BA from the Netherlands to use of 50% or more of the voting rights during the General Shareholders' Meeting of Bank BGŻ, performed directly or through Rabobank International Holding B.V. The request was submitted due to breaching in May by Rababakb International Holding BV of the threshold 50% in voting rights at the Shareholders' Meetings of BGŻ, without former notification to PFSA as required by the law.

On 30 July 2012 the Minister of the State Treasury accepted the tender offer announced by Rabobank for the sale of 10 996 531 BGŻ shares for PLN 72.5 each.

As a result of the tender Rabobank International Holding BV took 16 371 351 shares, and thus the number of shares held by the Rabobank Group increased to 42 245 446 shares, i.e. 97.93% of share capital and the voting rights at the General Meeting of Shareholders.

11.2. SIGNIFICANT CREDIT AGREEMENT

On 9 July 2012 the Bank entered into a credit agreement with one of the Bank's clients operating in the agricultural sector on the total amount of EUR 78.5 million (which gives PLN 331.1 million using NBP average exchange rate on 6 July 2012). The complete repayment of this credit facility will take place not later than 30 September 2026. Interest rate of the loan granted under the Agreement is based on EURIBOR rate plus the Bank's margin. The Bank's claim under the facility is secured among others by mortgages on lands owned by the customer's related parties, financial and registered pledges on shares in customer's related parties and by providing a surety by related parties under the provisions of civil code.

12. DEVELOPMENT PROSPECTS OF THE CAPITAL GROUP BGŻ S.A.

In the first half of 2012 the Bank has reviewed and updated its strategy for years 2010 – 2014 and extending it to 2016. The strategy was approved by the Supervisory Board on 21 June 2012.

According to the strategy, BGŻ is continue to develop its activities as a universal bank, specializing in rendering services for the agricultural and food producing segment. From the perspective of the client the Bank wants to be a Bank developing long-term relations, seen as a responsible partner and engaged in local communities defined as centres with 20 – 150 thousand residents.

According to universal banking, the strategy assumes further strengthening of the Bank's position in retail banking by expanding the product offer and attracting customers from medium class segment (including alternative distribution channels) in order to provide funding for a key segments of its activities. The Bank will continue to develop its branch network, but this will be limited compared to previous years and will be carried out in medium-sized cities, where BGŻ is already present and has a strong reputation.

The Bank is also going to concentrate on further growth of the business in providing services for small, medium and micro – businesses in local markets.

In the area of banking services for agricultural and food producing segment, the Bank intends to strengthen its leadership based on the product range and a service model tailored to the needs of this market.

A number of internal project and initiatives including inter alia the development of traditional and virtual distribution channels, optimization of internal processes and support functions for business activity will help to achieve its strategic goals. A lot of attention is paid to the development of Client Relationship Management systems, improvement of operating effectiveness and human management potential.

The strategy assumes also necessary capital injection to the Bank, as a result of which the 12% targeted capital adequacy ratio could be achieved.

Both the Management Board of Bank and its shareholders are convinced of the long-term potential of the banking sector in Poland and wish to continue their commitment in future development of BGŻ S.A.

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Jacek Bartkiewicz
President of the Management Board

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Gerardus Cornelis Embrechts
First Vice-President
of the Management Board

....
Witold Okarma
Vice-President
of the Management Board

....
Andrzej Sieradz
Vice-President
of the Management Board

....
Johannes Gerardus Beuming
Vice-President
of the Management Board

....
Dariusz Odzioba
Vice-President
of the Management Board

....
Wojciech Sass
Vice-President
of the Management Board

....
Magdalena Legęć
Vice-President
of the Management Board

Warsaw, 7 August 2012