# MANAGEMENT BOARD'S REPORT ON THE ACTIVITIES OF THE BANK GOSPODARKI ŻYWNOŚCIOWEJ S.A. FOR 2012

Warsaw, 4 March 2013

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# 1. EXTERNAL CONDITIONS FOR THE FUNCTIONING OF THE BGŻ S.A. CAPITAL GROUP

## 1.1. MACROECONOMIC SITUATION

In 2012, the Polish economy slowed down, and the slowdown intensified particularly in Q2. As a result, the GDP dynamics systematically decreased. In Q1 2012, the GDP growth was 3.6% y/y, whilst in Q3 2012 – 1.4% y/y, and in Q4 2012 – according to the Bank's estimates – approximately by 1.0% y/y. The main factor behind the economy slowdown was shrinking internal demand. Its dynamics fell from 2.5% y/y in Q1 2012 to -0.7% y/y in Q3 2012 and was caused by the rapidly slowing pace of individual consumption (from 1.7% y/y in Q1 2012 to 0.1% y/y in Q3 2012) and a slump in the dynamics of gross capital expenditure, from growth of 6.0% y/y in Q1 2012 to a 1.5% y/y decrease in Q3 2012.The weakening pace of individual consumption was slightly offset by an increase in public spending (respectively, from -0.8% y/y in Q1 2012 to 0.5% in Q2 2012 and to 0.2% y/y in Q3 2012). Despite that, the dynamics of total consumption fell from 1.2% in Q1 2012 to 0.1% in Q3 2012. On the other hand, the weakening dynamics of domestic demand was conducive to the improvement of exports – imports ratio, which facilitated a higher contribution of the GDP to the foreign trade balance, from 1.1 pp. in Q1 2012 to 2.1 pp. in Q3 2012.

On an annual basis, the pace of economic growth decreased from 4.3% y/y in 2011 to 2.0% y/y in 2012. This was caused by a decrease in the following: total consumption from 1.5% y/y to 0.4% y/y, individual consumption from 2.5% y/y to 0.5% y/y, gross accumulation from 10.5% y/y to - 1.0% y/y, and domestic demand from 3.4% y/y to 0.1% y/y.

**Chart 1. Growth of GDP (y/y)**

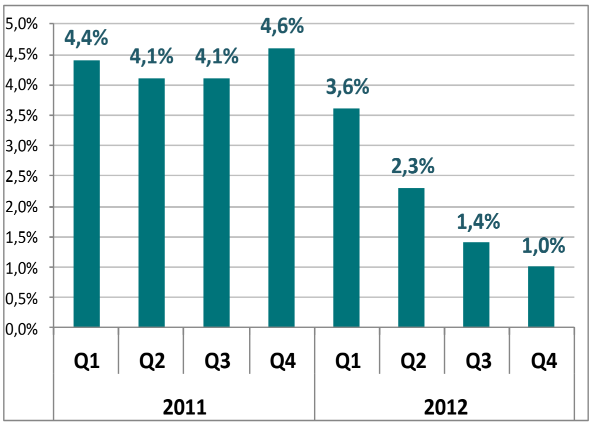
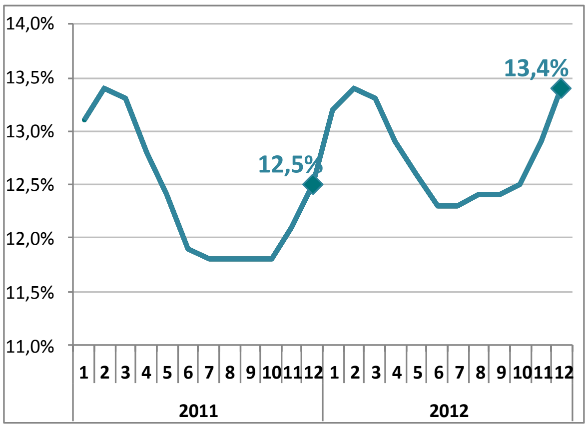



**Chart 2. Registered unemployment rate**




*Source: GUS, own estimation*

The deterioration of economic conditions in Europe coupled with weakening dynamics in internal demand translated into a slowdown in production sector activities. Industrial production grew in 2012 at a pace of 1.4% y/y, compared to 7.0% in 2011, and visibly slowed down in the second half of 2012. Falling activity in the industrial sector, together with lower activity in the construction sector, translated into a deterioration of the labour market situation. As a result, employment dynamics in the enterprise sector fell from 3.3% y/y in 2011 to 0.2% y/y in 2012 and reached a negative value of -0.5% y/y by year's end. The unemployment rate (with no seasonal adjustment) in December 2012 was 13.4% compared to 11.8% in the previous year.

Despite a significant deterioration in the labour market, the annual salary dynamics remained moderate and in 2012 was 3.5% y/y (compared to 4.8% y/y in the previous year). However, the real salary dynamics in 2012 was -0.2% y/y, compared to 0.5% y/y in the previous year. This was caused by the inflation rate being high, despite weak demand.The average inflation rate in 2012 was 3.7% y/y, mainly due to fuel prices being higher than in the previous year (11.1% y/y) and, in consequence, – also transport costs (7.1% y/y), prices of other energy carriers (6.7% y/y) and food (4.3% y/y).

The high level of the actual and expected inflation rate led to the Monetary Policy Council *(Rada Polityki Pieniężnej - RPP)* increasing interest rates, on a one-off basis, interest rates by 25 base-points in May 2012; following the increase, the central bank reference rate reached the level of 4.75%. This decision was taken by the MPC despite the evident economic slowdown indicators and despite supply-type price increases. Indicators of a strong slowdown at year’s end caused that the RPP adjusted its policy and reduced interest rates twice, each time by 25 base-points, thus reducing the level of NBP reference rate to 4.25% at year’s end, and the bill of exchange rediscounting rate – which is the basis for setting interest rates for agricultural preference loans – to 4.50%.

In the first half of the year, the liquidity operations (the so-called LTROs) conducted by the European Central Bank and other initiatives of the EU authorities to remedy the debt and banking crisis in Europe resulted in lower profitability of Polish bonds and in strengthening of the Polish zloty in Q1 2012. Despite that, a passing increase in risk caused by the exit of Greece from the Eurozone or by the outbreak of a banking crisis in Spain caused the return of Euro to the level of above PLN 4.20 in the mid year. In the second half of 2012, the Polish zloty appreciated against Euro and returned to the level of approximately PLN 4.10. It was partly due to the waning risk of a potential Eurozone break-up, following stabilisation of the political situation in Greece. At the same time, the deterioration of the economic outlook for the Eurozone countries resulted in a lower EUR/USD exchange rate in the first half of 2012. In the middle of the year, the EUR/USD exchange rate returned to the level of approximately 1.32, following implementation of the third phase of the loosening of monetary policy by the Fed. Implementation by the Swiss National Bank in 2011 of a minimum acceptable EUR/CHF exchange rate significantly reduced fluctuations in the CHF/PLN exchange rate, despite investors turning to Swiss franc-denominated assets in mid 2012.

**Chart 3. Inflation and interest rates**

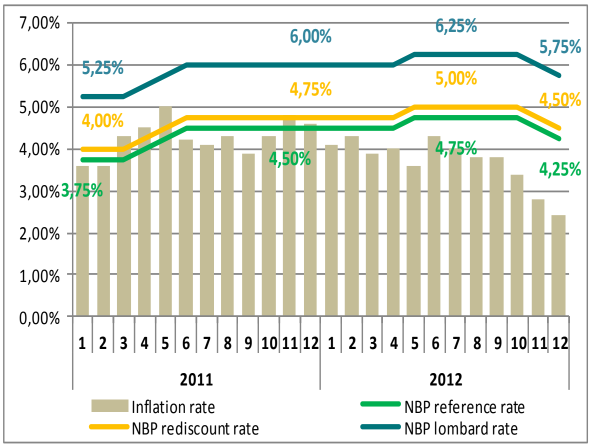
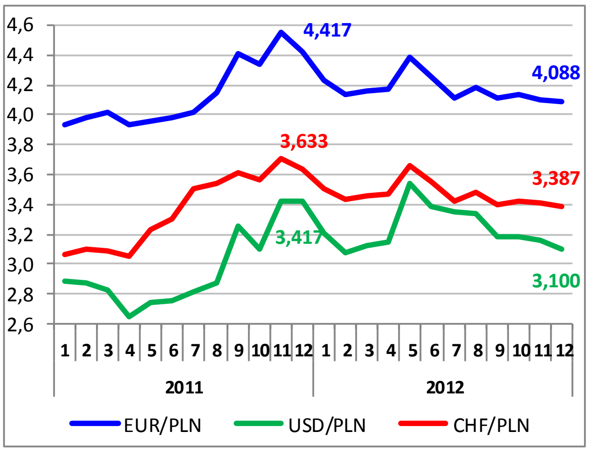



**Chart 4. Exchaneg Rate**




*Source : GUS and NBP*

## 1.2. BANKING SECTOR RESULTS

According to data from the Polish Financial Supervision Authority, in 2012 the net financial result of the Polish banking sector increased by 3.9% y/y and reached the record level of PLN 16.1 billion (compared to PLN 15.5 billion in 2011). The main growth factor in the net financial result was an increase in the so-called other items making up the result of banking activities (by 14.6% y/y), which should be associated among other things, with rise in the treasury bonds market, used by some banks to realise gains on the sale of these securities during the second half of 2012. The annual change in the net profit of the banking sector was positively affected by the following: slow, although significant in terms of volume, an increase in net interest income (by 1.5% y/y) and an increase in the results from other operating activities (by 113.2% y/y). One should note that the annual dynamics in interest result – high in the first half of 2012 – gradually decreased in the subsequent months due to, among other things, the weakening of the lending campaign and decreases in WIBOR rates preceding interest rates reductions by the MPC. The dynamics (y/y) of the commission income was merely 0.4% y/y, which - apart from the slowdown in the market of private individual loans - could have resulted from fluctuating trends in the capital market and from continuing competition in the market of personal accounts. The following had an unfavourable impact on annual change in the profits of the banking sector had the following: an increase in banks’ other operating expenses operating costs (by 4.1% y/y) and a higher negative balance in impairment write-downs against assets and other provisions (by 5.0% y/y). The increase in the balance of impairment write-downs resulted, to a large extent, from deteriorating enterprise (mainly the construction sector) and housing loans.

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

| ***billion PLN*** | **2012** | **2011** | **Change y/y** | |
|---|---|---|---|---|
| Net interest income | 35 508 | 34 979 | 529 | 1.5% |
| Net fee and commission income | 14 343 | 14 283 | 59 | 0.4% |
| Dividend income | 923 | 1 058 | (135) | (12.8%) |
| Other elements of the net income from banking activity | 8 005 | 6 984 | 1 021 | 14.6% |
| **Result on banking activity (total)** | **58 780** | **57 305** | **1 475** | **2.6%** |
| Net income from other operating activities | 860 | 404 | 457 | 113.2% |
| Operating expenses of banks | (27 768) | (26 684) | (1 084) | 4.1% |
| Amortization/Depreciation | (2 582) | (2 576) | (6) | 0.2% |
| Balance of provisions and allowances | (9 299) | (8 855) | (444) | 5.0% |
| **Gross profit** | **19 991** | **19 605** | **385** | **2.0%** |
| Corporate tax | (3 837) | (3 862) | 26 | (0.7%) |
| **Net profit** | **16 138** | **15 539** | **599** | **3.9%** |

*Source: PFSA.*

With the limited scale of dividend payments (based on the PFSA recommendations), equities of Polish banking sector (accounted for in calculating solvency ratios) increased in 2012 by 16.5%, compared to the end of 2011, to PLN 128.9 billion. However, the general capital requirement – with the slowing lending campaign and the strengthening Polish zloty, but on the other hand with increased from 75% to 100%, as of the end of June 2012, risk weight for retail exposures secured with mortgage – increased by 3.5% compared to the end of 2011 to PLN 69.9 billion. As a result, the solvency ratio increased by 1.6 pp., compared to the end of 2011, to 14.7%.

In 2012, the activity of the banking sector, measured with the pace of growth in deposit and credit volumes, significantly decreased. Loans to non-banking clients increased by 1.7% y/y (in 2011 – by 14.8% y/y), whilst deposits from non-banking clients – by 5.9% y/y (in 2011 - by 11.0% y/y). The nominal pace of growth, especially loans, was visibly restricted by the appreciation of the Polish zloty , unlike in 2011.

Debt under loans to private individuals decreased in 2012 by 0.8% y/y, whilst in 2011 – increased by 11.8% y/y. The decrease was mainly caused by the strong Polish zloty appreciation mentioned above (which reduced the nominal value of currency receivables expressed in PLN, especially from the large share of foreign currency housing loans) and by a downward trend in housing loans. This slowdown was, among other things, due to the coming into effect, as of the beginning of 2012, of the revised Recommendation S, which to an even greater extent limited the availability of housing loans (assuming a reduction in the maximum level of the ratio of currency mortgage loan servicing costs to 42% of net average salary, as well as adoption upon credit capacity assessment of a loan term of not more than 25 years). In addition, lower housing loans dynamics was also caused by earlier changes in the government-subsidised program *"Rodzina na swoim",* which resulted in the loss of attractiveness of this loan to clients (following a decrease in the limit of flat prices covered by the subsidy and implementation of restrictions on the age of subsidy applicants), and by withdrawal by other banks of foreign currency loans from their product offer. Also, in the analysed period, the process of increases in housing loan margins started. The adverse effect of that process was strengthened by an interest rate increase announced by the RPP in May 2012, and only at the end of the year, the process started to be neutralised following commencement by the MPC cycle of a moderating monetary policy. This coincided with systematic deterioration of the labour market which, on the one hand, caused further restrictions on housing loan availability for potential borrowers, and on the other – led to private individuals refraining from taking out such loans. As regards the currency structure of new housing loans, according to the Polish Banks Association, during the entire year 2012, the share of zloty housing loans, already dominant, in total housing loans, continued to increase. At the end of the analysed period, the share of foreign currency housing loans in the growth of new housing loans was insignificant.

**Table 2. Loan volume of the banking sector**

| ***billion PLN, balance at the end of the year*** | **2012** | **2011** | **2010-** | **Change** | |
|---|---|---|---|---|---|
| | | | | **2012** | **2011** |
| **Loans to private individuals** | **449.5** | **453.2** | **405.4** | **(0.8%)** | **11.8%** |
| - mortgage loans | 319.8 | 317.2 | 266.1 | 0.8% | 19.2% |
| - PLN | 144.3 | 122.3 | 99.4 | 18.0% | 23.1% |
| - foreign currency | 175.5 | 194.9 | 166.8 | (10.0%) | 16.9% |
| - consumer loans | 129.7 | 135.9 | 139.3 | (4.6%) | (2.4%) |
| **Loans to institutional clients** | **451.2** | **432.1** | **365.7** | **4.4%** | **18.2%** |
| - non – banking financial institutions | 32.1 | 24.8 | 24.9 | 29.5% | (0.5%) |
| - non – financial entities | 339.4 | 330.5 | 282.4 | 2.7% | 17.0% |
| corporates | 257.0 | 253.5 | 214.5 | 1.4% | 18,1% |
| individual entrepreneurs | 53.5 | 50.7 | 44.4 | 5.6% | 14,2% |
| farmers | 24.1 | 22.2 | 20.1 | 8.5% | 10,4% |
| non profit organisations | 4.8 | 4.2 | 3.4 | 16.0% | 22,4% |
| - loans to public sector | 79.6 | 76.8 | 58.3 | 3.7% | 31.7% |
| **Loans to non - banking customers** | **900.6** | **885.3** | **771.1** | **1.7%** | **14.8%** |

*Source: NBP, data for monetary financial institutions, excluding Central Bank and SKOK, only residents.*

The situation of the consumer loans market remained unchanged in the year 2012 despite the increase of banks' pressure to sell more cash loans (reflected in the increased marketing activity). Debt under consumer loans decreased during that period by 4.6% y/y. Apart from zloty appreciation, the decreasing trend could be related mainly to the continued and tightened (mainly for regulatory reasons) lending policy in this market segment. According to Credit Information Bureau *(Biuro Informacji Kredytowej – BIK)*, this policy led to, among other things, demand was being shifted to the over-the counter market, including shifting to non-banking lending firms (mainly with respect to small-value cash loans) or firms servicing hire-purchase agreements, controlled by banking groups and applying regulatory arbitration (as regards instalment loans). Lower volumes of consumer loans, on a yearly basis, could also result from disposal by some banks of part of their „bad" loans portfolios.

In 2012, a considerable decrease was recorded also in the development of lending a activity targeting the enterprise sector (from 18.1% at the end of 2011 to 1.4% y/y at the end of 2012). Apart from the already mentioned zloty appreciation, it could be related to an observable slump in Polish economic conditions which resulted in lower business activity of companies and in limiting the numbers of new investment projects, as well as in higher utilisation of own funds during execution of investments . The tightening of lending policy by banks could also have had an adverse impact on the market of enterprise loans , mainly towards the SMEs segment.

The main reason behind the growth in banking sector deposits in 2012 remained the savings of private individuals (increase by 8.3% y/y). Their increase was, however, smaller than in 2011, and resulted from a strong increase in the volume of term deposits. In analysing the currency structure of deposits of private individuals, one should note the insignificant, in terms of volume, but dynamic increase in currency deposits, which materialised despite a significant strengthening of zloty.

The lower dynamics in deposits of private individuals resulted from, among other things, the deteriorated labour market, which was reflected in higher unemployment and in the negative dynamics of enterprise sector gross salary, measured in real terms. The lower deposit activity of private individuals could also be related to the  rise the treasury bonds market in Poland , which resulted, among other things, in a dynamic inflow of funds to debt funds throughout 2012. Finally, the lower dynamics in deposits of private individuals could also be caused by banks withdrawing from their product offer savings accounts and term deposits with non-taxable interest. On the other hand, stock exchange uncertainty and fluctuating trends on the Warsaw Stock Exchange (WSE), the growing job loss fears of private individuals , as well as the weak results on structured products matured in 2012 could have been conducive to the turning of private individuals to bank deposits.

A significant decrease in the value of enterprise deposits took place in 2012 (by 7.5% y/y at year end). Such a considerable fall in the deposit activities of companies could be linked to, among other things, the slump in Polish economy translating into lower revenues and the deteriorating financial standing of companies. In addition, reduced deposit activities of companies contributed to better utilisation of own funds during the implementation of investment projects. A business event of particular importance was the high-value capital investment by one of the Polish mining enterprises, under which the takeover of a foreign mine was carried out.

**Table 3. Deposit volume of the banking sector**

| *(billion PLN, balance at the end of the year)* | 2012 | 2011 | 2010 | Change | |
|---|---|---|---|---|---|
| | | | | 2012 | 2011 |
| **Deposits of private individuals** | **471.0** | **435.0** | **381.8** | **8.3%** | **13.9%** |
| - current | 205.6 | 204.4 | 197.2 | 0.6% | 3.6% |
| - term | 265.4 | 230.6 | 184.6 | 15.1% | 24.9% |
| **Deposits of institutional clients** | **357.5** | **347.2** | **323.1** | **3.0%** | **7.5%** |
| - non – banking financial institutions | 56.2 | 43.1 | 39.2 | 30.4% | 10.1% |
| - non – financial entities | 239.6 | 253.0 | 229.1 | (5.3%) | 10.5% |
| Corporate customers | 189.8 | 205.1 | 182.8 | (7.5%) | 12.2% |
| Individual entrepreneurs | 25.4 | 24.8 | 23.9 | 2.3% | 4,0% |
| Individual farmers | 7.8 | 7.9 | 7.4 | (2.0%) | 7.5% |
| Non – for profit institutions | 16.6 | 15.1 | 15.0 | 9.8% | 0,6% |
| - public sector deposits | 61.7 | 51.0 | 54.9 | 20.8% | (7.0%) |
| **Deposits of non – banking clients** | **828.5** | **782.2** | **704.9** | **5.9%** | **11.0%** |

*Source: NBP, data for monetary financial institutions, excluding Central Bank and SKOK, only residents..*

## 1.3. STOCK EXCHANGE TRENDS AND INVESTMENT TRENDS

Despite numerous unfavourable political and macroeconomic events, 2012 was viewed by investors as a successful year. The WIG20, the index of 20 largest comapnies increased during the whole year by as much as 20%, and materially contributed to making up for the losses incurred in 2011, when trading in blue chips fell in the whole year by 21%. In addition, higher risk aversion contributed to a rapid growth in demand for secure financial products such as bonds. During the two-years of treasury bond bullish market, profitability of individual issues of bonds decreased by as much as 2.5 pp. It seems that this positive mood will continue in the nearest future, but this depends greatly on the monetary policy pursued by the RPP.

A recovery in the shares market was recorded after a drastic stock market correction in the second half of 2011. With the waning likelihood of the exclusion of Greece from the EU structures, the beginning of 2012 brought about sharp increases. In the subsequent months, trading responded to the series of unfavourable events such as the parliamentary elections in Greece and the financial problems of Italy and Greece. The announcement a of the third round of financial loosening in the US and the declaration of readiness by the ECB to acquire government bonds of bankruptcy-endangered Eurozone countries, were reflected by the market with even further rises, which lost their impetus only at the end of the year.

The higher risk aversion of private investors both directly and indirectly (by investing through investment institutions) had, an adverse effect on share trading results, which fell by 24% to PLN 202 billion. Similar decreases were observed for forward contracts, including futures and options. At the same time, the bonds bullish market led to a 25% growth in the trading volume in the segment.

**Table 4. Value of main Stock Exchange indices**

| Index | 31.12.2012* | 31.12.2011 | Change Y/Y |
|---|---|---|---|
| WIG | 47 461 | 37 595 | 26% |
| WIG20 | 2 583 | 2 144 | 20% |
| mWIG40 | 2 553 | 2 174 | 17% |
| sWIG80 | 10 444 | 8 497 | 23% |
| NCIndex | 33 | 42 | -21% |

**the last trading session on WSE in 2012 took place on 28.12.2012*
*Source: WSE.*

In 2012, 19 new companies joined the WSE, including Alior Bank the largest ever private company to be publically listed in Warsaw. Due to the lack of demand for risk-burdened assets, especially by private investors, the new IPOs sparked only moderate public interest. The number of WSE-listed companies increased from 426 at the end of December 2011 to 438 by the end of 2012. The Regulated NewConnect market had in 2012 - 89 new issuers (with 172 IPOs in 2011).

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

| | 31.12.2012 | 31.12.2011 | Change Y/Y |
|---|---|---|---|
| Number of companies | 438 | 426 | 2.82% |
| Capitalization of domestic companies (million PLN) | 523 390 | 446 151 | 17.31% |
| Shares turnover volume (million PLN) | 202 880 | 268 139 | -24.34% |
| Bonds turnover volume (million PLN) | 1 043 | 836 | 24.76% |
| Futures turnover volume per session (units) | 42 540 | 58 203 | -26.91% |
| Options turnover volume per session (units) | 2 873 | 3 577 | -19.68% |

*Source: WSE*

At the end of 2012, the Catalyst Bond market recorded a total of 361 bond issues with the value of issues exceeding PLN 567.4 million.

## 2. IMPORTANT EVENTS IN BGŻ S.A. 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 a 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. |
| 30.07.2012 -1.08.2012 | As a result of the tender offer, RIH acquired 16,371,351 shares of the Bank. The total shareholding of the RIH in BGŻ S.A. amounted to 37,941,751 shares representing 87.95% of the share capital of the Bank and allowing the right to exercise the same number of votes at the general meeting. Both Rabobank Group entities as a result of the tender offer acquired a total of 97.93% of the share capital of the Bank. |
| 28.08.2012 | Extraordinary General Meeting adopted a resolution increasing the share capital by PLN 8 000 000 (to PLN 51 136 764) through the issuance of 8 000 000 G series shares (nominal value PLN 1) at issue price of PLN 62.50. The issue was offered in a private placement to RIH. |
| 14.09.2012 | Registration of the increase of the share capital of the Bank by the District Court for the Capital City Warsaw, XII Commercial Division of the National Court Register. After the increase, the share capital is PLN 51 136 764.00. As a result of acquiring the issue of shares of series G RIH increased its total shareholding to 89.84% of the share capital of BGŻ S.A. Rabobank Group's total shareholding in BGŻ S.A. after the acquisition of G series shares was 98.26%. |
| 19.12.2012 | The Bank has been notified by strategic shareholders - Coöperatieve Centrale Raiffeisen-Boerenleenbank BA and its subsidiary – Rabobank International Holding - |

| | |
|---|---|
| | on the intention to merge of BGŻ S.A. with Rabobank Polska S.A. Rabobank informed the Bank that Rabobank, together with RIH, will use its best efforts to register a merger between BGZ and Rabobank Polska S.A. before the end of 2013 and no later than mid 2014.<br>The decision on the merger of both banks is in line with the obligations undertaken by Rabobank towards the Polish Financial Supervision Authority ("PFSA") back in 2008 in relation to the approval of exceeding by Rabobank 50% of votes in the Bank BGŻ S.A. |
| 19.12.2012 | Rabobank in accordance with the obligations to the PFSA informed about the intention to reduce its involvement in BGŻ SA from the current 98% to 75% no later than mid-2016. At the same time the number of shares traded on the Warsaw Stock Exchange will be at a 25% level |

# 3. AUTHORITIES OF THE BGŻ BANK S.A.

## 3.1. CHANGES IN THE COMPOSITION OF THE SUPERVISORY BOARD

The composition of the Supervisory Board in the period between 1 January and 31 December 2012 was following:

- Jan Alexander Pruijs – President of the Supervisory Board,
- Dariusz Filar – Vice-President of the Supervisory Board,
- Monika Nachyła – Member of the Supervisory Board,
- Hendrik Adams – Member of the Supervisory Board (resignation on 28.08.2012),
- Roelof Dekker – Member of the Supervisory Board (resignation on m 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 (resignation on 22.08.2012),
- Harry de Roo – Member of the Supervisory Board,
- Andrzej Zdebski – Member of the Supervisory Board (resignation on 28.08.2012).

## 3.2. CHANGES IN THE COMPOSITION OF THE MANAGEMENT BOARD

The composition of the Bank's Management Board in the period between 1 January and 31 December 2012 was following:

- 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 Management Board was appointed by the Supervisory Board on 21 June 2012, for another three-year term, with effect from 25 June 2012, i.e. the date of the General Meeting approving the financial statements for 2011

# 4. EXTERNAL RATING OF THE BANK

## 4.1. 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 S.A. 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 of Bank's majority shareholder – Rabobank on 15 June 2012. 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 that was 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 required Accordingly, the current three notches uplift in BGZ's long-term rating of Baa2 - which remains one of the highest among 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 stable outlook on Rabobank's standalone rating.

# 5. SHAREHOLDERS' STRUCTURE OF THE BANK

## 5.1. 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 72.50 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 statement on the tender offer 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.

As a result of the tender offer, RIH acquired 16,371,351 shares of the Bank. The total shareholding of the RIH in BGŻ S.A. amounted to 37,941,751 shares representing 87.95% of the share capital of the Bank and giving the right to exercise the same number of votes at the general meeting. Both Rabobank Group entities as a result of the tender offer acquired a total of 97.93% of the share capital of the Bank.

At the same time the Treasury reduced its involvement in BGŻ S.A. to 0.02% of the Bank's share capital.

## 5.2. SHARE CAPITAL INCREASE AND ISSUE OF G SERIES SHARES

Due to the need for additional capital in order to facilitate the current and planned activities of the Bank while maintaining economic security, and to raise funds in order to meet the Bank's increased capital adequacy requirements under Basel II (the so-called Basel II), as well as the recommendations of the Polish Financial Supervisory Authority the Bank raised its share capital through the issue of G series shares.

On 28 August 2012, the Extraordinary General Meeting adopted a resolution to increase the Bank's share capital by the amount of 8,000,000 to PLN 51,136,764 through the issue of 8,000,000 shares of G series, with nominal value of PLN 1 each and issue price of PLN 62.50. The whole issue of shares of G series was offered to RIH in a private placement . On 14 September the share capital increase of the Bank was registered by the District Court for the Capital City Warsaw, XII Commercial Division of the National Court Register..

As a result of the acquisition by RIH of all shares of G series shares, its holding increased to 45 941 751 shares BGŻ SA representing 89.84% of the Bank's share capital and entitling to execute the same number of votes at the General Meeting. Rabobank Group's total exposure in BGŻ S.A. amounted to 98.26%.

**Table 6. BGŻ S.A. shareholding structure**

| Shareholder | 31.12.2012 | | 31.12.2011 | |
|---|---|---|---|---|
| | Number of shares | Structure (%) | Number of shares | Structure (%) |
| Rabobank International Holding B.V. | 45 941 751 | 89.84 | 21 298 609 | 49.37 |
| Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. | 4 303 695 | 8.42 | 4 303 695 | 9.98 |
| State Treasury | - | - | 11 015 937 | 25.54 |
| Other shareholders | 891 318 | 1.74 | 6 518 523 | 15.11 |
| **TOTAL** | **51 136 764** | **100.00** | **43 136 764** | **100.00** |

# 6. FINANCIAL POSITION OF THE BGŻ S.A.

## 6.1. FINANCIAL POSITION IN 2012 COMPARED WITH 2011

In 2012 the Bank generated a net profit of PLN 134 343 thousand compared with PLN 126 060 thousand in 2011. The main increase factor in net profit was an increase in net interest income, net fee and commission income and investing activities.

**Table 7. Income statement**

| *PLN thousand* | 31.12.2012 r. | 31.12.2011 r. | Change | |
|---|---|---|---|---|
| | | | PLN thousand | % |
| Net interest income | 1 021 367 | 834 011 | 187 356 | 22.5% |
| Net fee and commission income | 296 177 | 269 899 | 26 278 | 9.7% |
| Dividend income | 3 416 | 3 554 | (138) | (3.9%) |
| Result on trading activities | 98 567 | 101 852 | (3 285) | (3.2%) |
| Result on investing activities | 43 329 | 5 389 | 37 940 | 704.0% |
| Result on hedge accounting | 1 233 | - | 1 233 | 100% |
| Other operating income | 64 487 | 61 987 | 2 500 | 4.0% |
| Net impairment losses on loans and advances | (269 662) | (163 913) | (105 749) | 64.5% |
| General administrative expenses | (941 203) | (854 947) | (86 256) | 10.1% |
| Other operating expenses | (139 244) | (110 208) | (29 036) | 26.3% |
| **Operating Result** | **178 467** | **147 624** | **30 843** | 20.9% |
| **Gross profit (loss)** | **178 467** | **147 624** | **30 843** | 20.9% |
| Corporate income tax | (44 124) | (21 564) | (22 560) | 104.6% |
| **Net profit (loss)** | **134 343** | **126 060** | **8 283** | **6,6%** |

**Net interest income**

In 2012, net interest income increased by PLN 187 356 thousand, i.e. 22.5%, which was due to an increase of interest income of PLN 464 327 thousand. i.e. 27.4%, which exceeded the increase in interest expense amounting to PLN 276 971 thousand i.e. by 32.3%.

The increase in interest income was mainly due to an increase in interest income from loans and advances to customers (by PLN 297 483 thousand. i.e. by 25.1%) and overdrafts (by PLN 79 180 thousand. i.e. by 32.0%). It has been achieved through the development of lending activities, especially during the second and third quarter of 2012, In addition, an important factor in the growth of an interest income, of a Bank's significant portfolio of preferential lending, was caused by NBP rediscount rate increases made during 2011 and 2012. Interest rates on these loans are linked to the level of NBP rediscount rate. Although the fact that, during the fourth quarter of 2012, the RPP cut the rediscount rate twice, the annual average level of rate in 2012 was higher than in 2011

The increase in interest income was also affected by higher income from debt securities by PLN 83 770 thousand, i.e. by 38.0%, The increase resulted from the higher investment in debt securities financed from the Bank's liquidity surplus in comparison to 2011.

The increase in interest expense was primarily due to charges on liabilities to customers, which increased by PLN 223 845 thousand i.e. by 31.2%, following the increase in customer deposits acquired to fund increased lending activities of The Bank, mainly through internet banking BGŻOptima. Another factor in the growth in interest expense were costs of liabilities to other banks which increased by PLN 41 794 thousand (by 29.8%) in comparison to 2011. To a large extent they consist of the cost of debt securities issued and loans received from other banks, including the loan from the Bank's shareholder in CHF (granted in April 2011), two loans from the European Bank for Reconstruction and Development denominated in EUR (from 2010 and August 2011) and a loan from the European Investment Bank received in the fourth quarter of 2012, to finance Small and Medium Enterprises loans. Loans from other banks are a complementary source of funding of a long-term nature.

**Table 8. Net interest income**

| *PLN thousand* | 31.12.2012 | 31.12.2011 | Change | |
|---|---|---|---|---|
| | | | PLN thousand | % |
| Amounts due from other banks | 42 890 | 38 996 | 3 894 | 10.0% |
| Amounts due from customers under overdraft facilities | 326 276 | 247 096 | 79 180 | 32.0% |
| Loans and advances to customers after considering reversal of interest on loans with impairment losses | 1 482 845 | 1 185 362 | 297 483 | 25.1% |
| Debt securities (all portfolios) | 304 467 | 220 697 | 83 770 | 38.0% |
| **Interest income** | **2 156 478** | **1 692 151** | **464 327** | **27.4%** |
| | | | | |
| Liabilities to other banks | 181 870 | 140 076 | 41 794 | 29.8% |
| - own issuance | 107 548 | 81 404 | 26 144 | 32.1% |
| Liabilities to clients | 953 241 | 718 064 | 223 845 | 31.2% |
| **Interest expense** | **1 135 111** | **858 140** | **276 971** | **32.3%** |
| | | | | |
| **Net interest income** | **1 021 367** | **834 011** | **187 356** | **22.5%** |
| ***Supplementary information:*** | | | | |
| Result on swap points* | 30 863 | 76 873 | (46 010) | (59.9%) |
| **Net interest and swap points income** | **1 052 230** | **910 884** | **141 346** | **15.5%** |

** Source: BGŻ S.A managerial data.*

**Net fee and commission income**

Net fee and commission income in 2012 increased by PLN 26 278 thousand i.e. by 9.7%, compared to the previous year, due to increase in income from fees and commissions by PLN 39 485 thousand (by 12.7%), accompanied by the increase in the costs of fees and commission income by PLN 13 207 thousand i.e. by 32.2%.

The increase of PLN 20 866 thousand in commission income was achieved mainly due to higher revenues from fees and commissions on the sales of insurance products (introduced into the Bank's offer in February 2012, AVIVA insurances on cash loans and from Concordia insurances for farmers present in the offer since 2011). Another important component of the growth was the increase in commissions on credit cards by PLN 17 734 thousand, achieved mainly as a result in the increase of the number of debit cards issued, due to higher sales of, "Konto z premią" offered together with the card and by introduced changes to the commission rates on cards introduced in December 2011. Income from commissions on loans due to the continued growth of the overdrafts, mainly for farmers, small and medium-sized and micro-enterprises rose by PLN 9 753 thousand.

The decrease in fee and commission income on account services by PLN 6 839 thousand (6.8%) was mainly related to the decrease in these sources of income by payments made to retail customers with "Konto z premią", for which Bank provides a 1% premium calculated on inflows on account, subject to strict conditions.

The increase in the fees and commissions expenses was primarily caused by higher costs of contributions from sales of insurance products sold and the costs to payment cards operators resulting from rise of amount of transactions executed by the Bank's customers.

**Table 9. Net fee and commission income**

| *PLN thousand* | 31.12.2012 | 31.12.2011 | Change | |
|---|---|---|---|---|
| | | | PLN thousand | % |
| Fee and commission income from banks | 15 995 | 14 723 | 1 272 | 8.6% |
| Fee and commission income from customers | 334 350 | 296 137 | 38 213 | 12.9% |
| –on loans and advances | 109 934 | 100 181 | 9 753 | 9.7% |
| –on domestic settlements | 824 | 1 075 | (251) | (23.3%) |
| – on foreign settlements | 4 024 | 5 065 | (1 041) | (20.6%) |
| – on account service | 93 932 | 100 771 | (6 839) | (6.8%) |
| – on guarantee commitments | 11 444 | 12 173 | (729) | (6.0%) |
| – on brokerage operations | 11 076 | 13 304 | (2 228) | (16.7%) |
| – on payment cards | 73 796 | 56 062 | 17 734 | 31.6% |
| – on sales of insurance products | 22 449 | 1 583 | 20 866 | 1 318.1% |
| – other commissions | 6 871 | 5 923 | 948 | 16.0% |
| **Fee and commission income** | **350 345** | **310 860** | **39 485** | **12.7%** |
| | | | | |
| Fee and commission expense from banks | 3 505 | 3 586 | (81) | (2.3%) |
| Fee and commission expense from customers, of which: | 50 663 | 37 375 | 13 288 | 35.6% |
| –loans and advances | 6 160 | 4 283 | 1 877 | 43.8% |
| –guarantee commitments | - | 5 | (5) | (100.0%) |
| – payment cards | 24 299 | 21 405 | 2 894 | 13.5% |
| –sales of insurance products | 14 016 | 5 775 | 8 241 | 142.7% |
| – other commissions | 6 188 | 5 907 | 281 | 4.8% |
| **Fee and commission expense** | **54 168** | **40 961** | **13 207** | **32.2%** |
| | | | | |
| **Net fee and commission income** | **296 177** | **269 899** | **26 278** | **9.7%** |

**Dividend income**

Dividend income in 2012 decreased by PLN 138 thousand to PLN 3 416 thousand. It was composed of the dividend on shares held in the Bank in the National Clearing House (KIR), Credit Information Bureau SA (BIK) and the Stock Exchange (WSE) derived from the profits of these enterprises for 2011, approved by respective General Assemblies. The decrease in revenues was mainly due to lower dividends from BIK, while the dividend has increased from KIR.

**Result on trading activities**

Result on trading activities in 2012 decreased by PLN 3 285 thousand i.e. by 3.2%, compared with 2011, which was the result of a change in the structure of external financing as a result of CHF loan obtained in 2011. With direct funding in CHF, the Bank reduced the scale of swap transactions hedging currency risk and interest rate exposures of the old mortgage loan portfolio for retail customers, granted until April 2009. As a result there was a decreased in the income form so called swap points recognized in trading income has diminished (according to the Bank's management data it amounted to PLN 30 863 thousand in 2012, compared with PLN 76 873 thousand in 2011), in exchange for the growth in net interest income due to the replacement of the above interest-bearing financing in zloty by lower interest-bearing financing in CHF. Income on margins on from foreign exchange transactions and financial instruments concluded with customers are recognized in the result from trading activities and these reflect a significant increase in comparison to the previous year,

The result from investing activities in 2012 increased by PLN 37 940 thousand i.e. by 704.0%. The main component of this result were gains realized on the portfolio of financial assets available for sale, generated under suitable market conditions, particularly in the fourth quarter of 2012, when the markets started to strongly discount the interest rate cuts in Poland, whereas expected risk premium on investment in financial assets remained relatively low.

**Other operating income**

Other operating income in 2012 increased by PLN 2 500 thousand, i.e. by 4.0% compared to 2011, primarily due to an increase in revenues from:

- The reversal of provisions for liabilities of PLN 9 071 thousand due to reversals on provisions for court proceedings, unused holiday leave, jubilee awards, retirement benefits and future liabilities resulting from the settlement of subsidies to preferential loans.
- Reversal of unused allowances for personal expenses in 2011 of PLN 2 340 thousand
- Other operating income of PLN 3 184 thousand, which comprised, among others, of return of the excess advance on fee payments to PFSA for 2011 and the reversal of provisions related to the services provided by the Rabobank Group to BGŻ Bank.

The decrease in income from recoveries of receivables overdue, redeemed and bad loans as well as the repayment of debts excluded from the statement of financial position – of about PLN 7 571 thousand - resulted from lower portfolio of such receivables, as a result of disposal of receivables packages transactions that occurred in 2012

Income from PARP (Polish Agency for Enterprise Development) compensation expenses decreased by PLN 4 165 thousand due to significant reduction in the scope of the training conducted under this program.

**Table 10. Other operating income**

| *PLN thousand* | 31.12.2012 | 31.12.2011 | Change | |
|---|---|---|---|---|
| | | | PLN thousand | % |
| From management of third-party properties | 1 142 | 1 430 | (288) | (20.1%) |
| From sale or liquidation of property, plant and equipment, intangible assets and assets held-for-sale | 1 169 | 1 956 | (787) | (40.2%) |
| From recovered statute –barred receivables, written off or bad debts, repayments of derecognised receivables | 6 778 | 14 349 | (7 571) | (52.8%) |
| Sales of goods and services | 9 804 | 10 374 | (570) | (5.5%) |
| Reversal of provisions for other receivables (excluding loan receivables) | 875 | 847 | 28 | 3.3% |
| Reversal of fixed asset impairment write-downs | 173 | 14 | 159 | 1 135.7% |
| Reversal of provisions for future liabilities | 17 486 | 8 415 | 9 071 | 107.8% |
| From recovery of costs incurred | 2 487 | 1 903 | 584 | 30.7% |
| From compensation of PARP expenses | 1 072 | 5 237 | (4 165) | (79.5%) |
| Reversal of unused provisions for non-personnel costs | 6 303 | 6 104 | 199 | 3.3% |
| Reversal of unused provisions for personnel costs | 8 476 | 6 136 | 2 340 | 38.1% |
| Surpluses incomes | 1 204 | 888 | 316 | 35.6% |
| Other operating income | 7 518 | 4 334 | 3 184 | 73.5% |
| **Other operating income, total** | **64 487** | **61 987** | **2 500** | **4.0%** |

### Impairment losses on loans and advances

Net impairment losses on loans and advances increased in 2012 by PLN 105 749 thousand, i.e. by 64.5%, compared to 2011. The rise was an effect mainly of higher write-downs on loans to companies in the construction industry relating to the commitment towards a single client from large enterprises segment. Provisions for exposure to this client were established in the second quarter of 2012 in connection with the filling of its bankruptcy with the possibility to make an arrangement with creditors. Latter provisions were increased in the third and fourth quarter in connection with the liquidation bankruptcy. In 2012, the Bank increased net impairment losses for exposures to SME and Microenterprises (excluding farmers), which corresponded to the deteriorating macroeconomic conditions.

In comparison with 2011, the Bank recorded a decrease in net impairment losses on retail mortgage loans. Additionally write-offs for cash loans decreased, especially due to lower overdue repayments rates for loans granted in between 2011 and 2012, i.e. after the tightening of criteria in the risk assessment for this product.

In December 2012 the change was introduced to the methodology for calculating impairment allowances under collective approach the change is described in more detail in the relevant notes to the consolidated financial statements. This change resulted in reversal of impairment losses of PLN 33 million, which largely related to mortgages.

Additionally, an revenue amount of PLN 7 780 thousand was recognised in the position net impairment losses on loans and advances, due to disposals of receivables written off as a loss in the year 2012 and previous years, resulting from outstanding loans (the vast majority of cash) overdrafts and credit cards

### General administrative expenses

General administrative expenses increased in 2012 by PLN 97 775 thousand, i.e. by 11.4%, compared to 2011, which was primarily due to increased personnel costs, information technology, and marketing costs as well as due to contributions and payments made to the Bank Guaranty Fund and the PFSA.

**Table 11. General administrative expenses**

| *PLN thousand* | 31.12.2012 | 31.12.2011 | Change | |
|---|---|---|---|---|
| | | | PLN thousand | % |
| Employee benefit costs, including: | 508 337 | 456 249 | 52 088 | 11.4% |
| - remuneration costs | 406 703 | 372 543 | 34 160 | 9.2% |
| Including: retirement benefit | 192 | 206 | (14) | (6.8%) |
| - social security expenses | 57 997 | 49 124 | 8 873 | 18.1% |
| -provision for restructuring | 16 901 | - | 16 901 | 100.0% |
| - other | 26 736 | 34 582 | 7 846 | 22.7% |
| Marketing costs | 70 162 | 60 256 | 9 906 | 16.4% |
| IT costs | 79 941 | 67 935 | 12 006 | 17.7% |
| Rents | 92 677 | 89 392 | 3 285 | 3.7% |
| Other non-personnel costs | 50 889 | 48 285 | 2 604 | 5.4% |
| Other external services | 101 032 | 98 422 | 2 610 | 2.7% |
| Other administrative costs | 8 182 | 9 741 | (1 559) | (16.0%) |
| Contributions transferred to the Bank Guarantee Fund* | 24 550 | 20 253 | 4 297 | 21.2% |
| Contributions transferred to the Polish Financial Supervision Authority | 5 433 | 4 414 | 1 019 | 23.1% |
| **General administrative expenses, total** | **941 203** | **854 947** | **86 256** | **10.1%** |
| Amortisation and depreciation (1) | 94 518 | 82 999 | 11 519 | 13.9% |
| **Total Expenses (2)** | **1 035 721** | **937 946** | **97 775** | **10.4%** |

(1) In Financial Statements are presented In Other Operating Costs
(2) Total Expenses included In cost effectiveness Costs/Revenues ratio

The increase in personnel costs by PLN 52 088 thousand, i.e. by 10.4%, was associated with the rapid development of the branch network during 2011, and (to a much lesser extent) in 2012, in line with the Bank's strategy, as well as with employment growth.

At the end of 2012, the number of branches was at 400 as compared to 394 at the end of 2011 - nevertheless in 2011, the number of branches was increasing steadily during the year by 46 outlets, which boosted network costs in 2012 in comparison to 2011.

The number of employees of the Bank increased from 5 531 FTEs at the end of 2011 to 5 588 FTEs at the end of 2012, however the level of employment has been affected by its first effects of the restructuring (-157.5 FTEs in the fourth quarter of 2012). During 2012, the Bank recorded an increase in employment, caused not only by the extension of the network but also by the strengthening of the sales coordination functions in regional sales centres, implementation of Central Credit platform responsible for processing loan applications for mortgages, TeleBGŻ, so called soft collection and an increase in BGŻOptima employment.

In addition to network expansion and employment growth, the increase in labour costs was also associated with an increase in provisions for premiums in comparison to 2011, the increase in disability insurance contributions in February 2012 by 2 percentage points and the establishment of employment restructuring provision (PLN 16 901 thousand reported in other labour costs).

An increased marketing expenses of BGŻOptima, retail banking and agro and insurance products in relation to the business objectives contributed to the increase in marketing expenses of PLN 9 906 thousand.

The increase in IT costs by PLN 12 006 thousand was the result of the first full year of BGŻOptima operation (launched in November 2011).

The increase in premiums and contributions to the PFSA and the Bank Guaranty Fund (Bankowy Fundusz Gwarancyjny - BFG)was the a consequence of the growth in balance sheet assets, which are the basis for calculating payments to the PFSA, and the growth of the Bank's total capital requirements, which are a basis for calculating the annual fee for the BFG. In November 2012 the BFG Council adopted a resolution to increase fees to BFG from 0.099% to 0.1% of 12.5 times the sum of the capital requirements. Nevertheless, the BFG decision will apply from 2013.

**Other operating costs**

Other operating costs increased in 2012 by PLN 29 036 thousand, i.e. by 26.3% compared to 2011. The increase was particular driven by:

- an increase in depreciation by PLN 11 519 thousand. i.e. by 13.9%, related to the development of the branch network of the Bank and the continuation of investment in IT, as well as with the start of BGŻOptima.
- increased costs relating to the provisions for liabilities by PLN 10 390 thousand, i.e. by 93.4%, concerning provisions established for legal proceedings, the decision of the Office of Competition and Consumer Protection (UOKiK), as well as provisions for unused annual leave.
- increased in costs relating to the provisions for other receivables (excluding loans) by PLN 5 925 thousand caused by an setting up of a provision for cash shortage in one of the branches.

**Table 12. Other operating costs**

| *PLN thousand* | 31.12.2012 | 31.12.2011 | Change | |
|---|---|---|---|---|
| | | | PLN thousand | % |
| Due to the management of third-party assets | 1 457 | 1 089 | 368 | 33.8% |
| Due to the sale or liquidation of property, plant and equipment, intangible assets and assets or sale | 2 613 | 1 873 | 740 | 39.5% |
| Due to recognized provisions for other receivables (other than loans and advances) | 7 007 | 1 082 | 5 925 | 547.6% |
| Due to provisions for liabilities | 21 516 | 11 126 | 10 390 | 93.4% |
| Due to debt recovery | 7 693 | 7 060 | 633 | 9.0% |
| Donations | 3 185 | 2 997 | 188 | 6.3% |
| Amortisation and depreciation | 94 518 | 82 999 | 11 519 | 13.9% |
| Other operating expenses | 1 255 | 1 982 | (727) | (36.7%) |
| **Other operating expenses, total** | **139 244** | **110 208** | **29 036** | **26.3%** |

**Total comprehensive income**

Total comprehensive income of the Bank increased in 2012 by PLN 198 241 thousand, i.e. by 140.8% compared to 2011, mainly due to an increase of PLN 212 660 thousand in valuation of available-for-sale financial recognised in other reserves. This result concerned the portfolio of long-term Treasury bonds.

Another factors influencing the growth of total comprehensive income were the effects of valuation of derivatives designated to cash flows hedging in the amount of PLN 21 857 thousand, which occurred due to commencement of hedge accounting in the second quarter of 2012. The Bank h concluded IRS float-to-fix transactions (with maturity in April 2014) in order to secure the interest rate risk arising on future interest cash flows from interest-bearing preferential loans granted, based on NBP rediscount rate (with a multiplier of 1.5 or 1.6).

**Assets**

The total value of the Bank's assets at the end of 2012 amounted to PLN 37 180 622 thousand and was higher than a year earlier by PLN 3 793 726 thousand, i.e. by 11.4%.

Loans and advances to customers increased by PLN 2 101 379 thousand, i.e. by 8.7%, which is significantly less than in 2011, when growth reached 21.9%. The main factors of growth in loans in 2012 were mortgages denominated in PLN (acceleration in comparison to 2011) and overdrafts granted to enterprises and farmers (similar dynamics as in 2011). Slower growth was recorded in investment loans for enterprises and preferential loans, while currency mortgage loans and working capital loans to businesses decreased.

The weakening of loan growth in 2012, was accompanied by an increase in total securities, whereby the financial assets available for sale increased by PLN 3 242 807 thousand, i.e. by 89.5%, and financial assets held for trading decreased by PLN 1 413 383 thousand, i.e. by 86.6%. The increase in share of securities in the assets of the Bank corresponded with an increase in its financial surplus due to faster growth in value of deposits than value of loans and by recapitalization. However, the shift between the financial assets held for trading and available-for-sale was associated with increased investing of surpluses in NBP bills classified as available for sale in late 2012.

The increase in cash and balances with the Central Bank of PLN 723 336 thousand. i.e. by 52.3%, was influenced by the settlement of NBP obligatory reserve (this item is subject to considerable daily fluctuations, which is a natural phenomenon).

**Table 13. Assets**

| *PLN thousand* | 31.12.2012 | 31.12.2011 | Change | |
|---|---|---|---|---|
| | | | PLN thousand | % |
| Cash and balances with the Central Bank | 2 106 657 | 1 383 321 | 723 336 | 52.3% |
| Amounts due from other banks | 104 035 | 221 071 | (117 036) | (52.9%) |
| Receivables arising from reverse repo transactions | 104 369 | 366 343 | (261 974) | (71.5%) |
| Held-for-trading | 219 051 | 1 632 434 | (1 413 383) | (86.6%) |
| Derivative financial instruments including: | 474 058 | 883 109 | (409 051) | (46.3%) |
| – Derivatives designated as hedges | 69 179 | - | 69 179 | 100% |
| Loans and advances to customers | 26 341 646 | 24 238 267 | 2 103 379 | 8.7% |
| Securities available for sale | 6 867 557 | 3 624 750 | 3 242 807 | 89.5% |
| Investment property | 15 876 | 15 105 | 771 | 5.1% |
| Investments in associates | 58 720 | 58 468 | 252 | 0.4% |
| Intangible assets | 152 674 | 146 443 | 6 231 | 4.3% |
| Property, plant and equipment | 469 098 | 485 943 | (16 845) | (3.5%) |
| Deferred tax asset | 130 818 | 207 794 | (76 976) | (37.0%) |
| Receivables from current income tax | 10 318 | - | 10 318 | 100% |
| Other assets | 125 745 | 123 848 | 1 897 | 1.5% |
| **TOTAL ASSETS** | **37 180 622** | **33 386 896** | **3 793 726** | **11.4%** |

**Liabilities and Equity**

As at the end of 2012, the total value of the liabilities of the Bank amounted to PLN 33 714 075 thousand. and was higher than a in a previous year by PLN 2 954 677 thousand, i.e. by 9.6%. The main growth factor was increase in liabilities due to customers, which raised by PLN 4 000 301 thousand, i.e. by 17.4%, mainly as a result of deposits gathered through by BGŻOptima, retail network and from other financial institutions. Due to the slower pace of growth in value of credits granted, the Bank has reduced funding by issuing debt securities and decreased its commitment by PLN 180 336 thousand. Liabilities due to other banks decreased by PLN 352 280 thousand, mainly due to the repayments made according to the loan schedule (loan denominated in CHF from Rabobank) and the strengthening of the zloty currency against CHF.

Total equity increased in 2012 by PLN 839 049 thousand. which consisted of the following components:

- increase the share capital through the issuance of 8 million shares with a nominal value of PLN 1 and the issue price of PLN 62.50 (total amount of recapitalization: PLN 500 000 thousand);
- an increase in other reserves of PLN 204 706 thousand. due to the increase in revaluation reserve on available-for-sale financial assets (i.e. portfolio of debt securities available for sale owned by the Bank) and an increase in the revaluation reserve on hedging transactions in connection with the use of hedge accounting;
- retention of net profit for 2011 and 2012,

**Table 14. Total Liabilities and Equity**

| *PLN thousand* | 31.12.2012 | 31.12.2011 | Change | |
|---|---|---|---|---|
| | | | PLN thousand | % |
| Amounts owed to other banks | 4 094 436 | 4 446 716 | (352 280) | (7.9%) |
| Liabilities arising from repo transactions | 104 346 | - | 104 346 | 100% |
| Derivative financial instruments and other liabilities held for trading, including: | 350 621 | 795 707 | (445 086) | (55.9%) |
| - derivatives designated as hedges | - | - | - | - |
| Amounts owed to customers | 26 942 029 | 22 941 728 | 4 000 301 | 17.4% |
| Liabilities from issued debt securities | 1 852 776 | 2 033 112 | (180 336) | (8.9%) |
| Other liabilities | 292 129 | 474 912 | (182 783) | (38.5%) |
| Deferred tax liability | - | - | - | - |
| Provisions | 50 769 | 41 811 | 8 958 | 21.4% |
| Liabilities arising from employee benefits | 26 969 | 25 412 | 1 557 | 6.1% |
| **TOTAL LIABILITIES** | **33 714 075** | **30 759 398** | **2 954 677** | **9.6%** |
| | | | | |
| Issued share capital | 51 137 | 43 137 | 8 000 | 18.5% |
| Reserve capital | 2 950 716 | 2 332 656 | 618 060 | 26.5% |
| Accumulated profit/ (loss) from previous years | 330 351 | 125 645 | 204 706 | 162.9% |
| Other reserves | 134 343 | 126 060 | 8 283 | 6.6% |
| **TOTAL EQUITY** | **3 466 547** | **2 627 498** | **839 049** | **31.9%** |
| | | | | |
| **TOTAL LIABILITIES AND EQUITY** | **37 180 622** | **33 386 896** | **3 793 726** | **11.4%** |

**Loan Portfolio Quality**

The share of impaired receivables in gross amount of loans and advances to customers, worsen from 5.8% at the end of 2011 to 7.1% at the end of 2012. For retail loans, the indicator deteriorated from 5.4% to 6.6% in the period, and for institutional loans, from 5.6% to 7.4% respectively The decline of these ratios was partly a result of the changes implemented to the impairment of loans estimation model, introduced in December 2012 (chiefly by implementation of the quarantine concept for exposures exiting the "Impaired" status). In case of the retail loans, the modification in the model resulted in an increase in impairment charges by 1.4 percentage point and accordingly in case of institutional loans by 0.5 percentage point. The change resulted in a growth of the indicator by about 0.8 percentage point in the total loans portfolio (as for the end of 2011 the data was not restated for comparability with the revised model). Analyzing changes in the indicators in 2012, excluding the changes in the model, the stability in the mortgage portfolio and improvement in cash loans portfolio should be emphasized. Nevertheless, the quality of institutional loans, both large companies (mainly due to the bankruptcy of one client operating in the construction industry in June 2012 on the wave of general problems with liquidity in the sector), as well as the Small, Medium and Microenterprises segments, in the wake of the deterioration of the macroeconomic situation, have worsened.

Very good condition of loans for farmers' portfolio can be perceived as a stabilizing factor. (at the end of 2012, they accounted for 22.4% of the Bank's loan portfolio). For this portfolio, the share of impaired loans totalled at the end of 2012, at 3.6% (without change in the model: 3.2%) as compared to 3.5% at the end of 2011.

**Table 15. Credit portfolio quality ratios**

| *PLN thousand* | 31.12.2012 | 31.12.2011 | Change | |
|---|---|---|---|---|
| | | | PLN thousand | % |
| **Loans and advances to customers, gross, total** | **27 411 582** | **25 121 172** | **2 290 410** | **9.1%** |
| Impairment allowances (negative value) | (1 069 936) | (882 905) | (187 031) | 21,2% |
| **Loans and advances to customers, net, total** | **26 341 646** | **24 238 267** | **2 103 379** | **8.7%** |
| **Losses incurred but not reported (IBNR)** | | | | |
| Gross statement of financial position exposure | 25 457 786 | 23 665 232 | 1 792 554 | 7.6% |
| Impairment allowance on exposures without impairment | (77 081) | (95 001) | 17 920 | (18.9%) |
| **Net exposure** | **25 380 705** | **23 570 231** | **1 810 474** | **7.7%** |
| **Impaired exposures** | | | | |
| Gross statement of financial position exposure | 1 953 796 | 1 455 940 | 497 856 | 34.2% |
| Impairment allowance on impaired exposures analyzed on the group and individual basis | (992 855) | (787 904) | (204 951) | 26.0% |
| **Net exposure** | **960 941** | **668 036** | **292 905** | **43.8%** |
| **Ratios:** | | | | |
| **Share of Impaired exposures** | **7,1%** | **5,8%** | | **1.3%** |
| **Impairment Coverage** | **(50,8%)** | **(54,1%)** | | **3.3%** |

**Capital and Capital Adequacy Ratio:**

The capital adequacy ratio increased to 11.8% at the end of 2012, from 9.7% at the end of 2011. The increase was mainly caused by increase of equity by PLN 776 872 million, i.e. by 32.4%. The change was affected by the following factors:

- issue of 8 000 000 shares of G series with a nominal value of PLN 1 per share and the issue price of PLN 62.50, adopted on 28 August 2012, by the Extraordianry General Meeting and acquired entirely in a private placement by Rabobank International Holding BV. The increase of the share capital of the Bank was registered by the court on 14 September;
- transfer of total net profit for 2011 to reserve capital as a result of the decision of the Ordinary General Meeting dated 25 June 2012;
- inclusion of the net profit for the first half of 2012 in basic funds, following a review of the financial statements by the auditor;
- an increase in supplementary funds resulting from the revaluation of financial assets available for sale.

Simultaneously, in 2012 the total capital requirement increased by PLN 177 217 thousand. i.e. by 8.9%, which was mainly due to the growth in loans during this period, as well as the fact that on 30 June 2012 the regulations increasing the weight ratios for the mortgage loans from 75% to 100%, used in calculation of the capital requirement for credit risk according to primary method, came into force.

**Table 16. Capital and Capital Adequacy Ratio**

| *PLN thousand* | 31.12.2012 | 31.12.2011 | Change | |
|---|---|---|---|---|
| | | | PLN thousand | % |
| **Basic funds** | **3 157 310** | **2 550 189** | **607 121** | **23.8%** |
| – share capital | 51 137 | 43 137 | 8 000 | 18.5% |
| – reserve capital | 2 950 716 | 2 332 656 | 618 060 | 26.5% |
| – other reserves | 25 000 | 25 000 | - | - |
| –undistributed profit from previous years | 90 000 | 90 000 | - | - |
| – general banking risk reserve | 40 457 | 59 396 | (18 939) | (31.9%) |
| – profit in the course of approving the amount verified by an auditor | **(174 408)** | **(180 499)** | **6 091** | **(3.4%)** |
| **Positions decreasing basic funds** | (152 674) | (146 443) | (6 231) | 4.3% |
| – intangible assets | (26) | (952) | 926 | (97.3%) |
| – unrealized losses on equity instruments classified as available for sale | (121) | (1 281) | 1 160 | (90.6%) |
| – unrealized losses on debt instruments classified as available for sale | (21 587) | (31 823) | 10 236 | (32.2%) |
| – commitment of capital in financial institutions | **2 982 902** | **2 369 690** | **613 212** | **25.9%** |
| **Basic funds after decreases** | | | | |
| | **195 324** | **12 299** | **183 025** | **1 488.1%** |
| **Supplementary Funds** | 194 897 | 12 299 | 182 598 | 1 484.7% |
| – unrealized gains on debt instruments classified as available for sale | 427 | - | 427 | - |
| – unrealized gains on equity instruments classified as available for sale | **(21 587)** | **(12 299)** | **(9 288)** | **75.5%** |
| **Positions decreasing Supplementary Funds** | (21 587) | (12 299) | (9 288) | 75.5% |
| – commitment of capital in financial institutions | **14 674** | **24 751** | **(10 077)** | **(40.7%)** |
| **Short term capital** | **3 171 313** | **2 394 441** | **776 872** | **32.4%** |
| **Total Equity** | | | | |
| **Capital requirements** | | | | |
| credit risk, counterparty risk, dilution and delivery risk for derivative instruments settled in subsequent terms | 1 994 785 | 1 813 512 | 181 273 | 10.0% |
| - operating risk | 161 386 | 152 894 | 8 492 | 5.6% |
| - general interest rate risk | 4 896 | 17 444 | (12 548) | (71.9%) |
| **Total capital requirement** | **2 159 628** | **1 983 850** | **175 778** | **8.9%** |
| | | | | |
| **Capital adequacy ratio (%)** | **11.8%** | **9.7%** | | **2.1%** |

**Financial Ratios:**

The rate of return on equity in 2012 was 4.5% and was lower than in 2011. Despite the increase in net profit, it was due to the significant increase in equity resulted from issuance of shares and profit retention.

Rate of return on assets (0.4%) and a net interest margin (2.9%) remained stable in the period.

Cost to revenues ratio has significantly improved, decreasing from 75.1% in 2011 to 69.8% in 2012, as a result of higher dynamics of revenue growth in relation to cost.

Increase in the cost of credit risk corresponded with an increase in net impairment losses on loans and advances to customers while the lending activities continued.

Liquidity ratios - Loans / Deposits and Loans / Total sources of funding - decreased, what is reflected by the increase in liquidity surplus in the Bank, generated by slower growth in loans.

**Table 17. Financial ratios**

| | 31.12.2012 | 31.12.2011 | Change |
|---|---|---|---|
| Return on Equity (1) | 4.5% | 4.9% | (0,4%) |
| Return on Assets (2) | 0.4% | 0.4% | - |
| Net interest margin (3) | 2.9% | 2.8% | 0,1% |
| Net interest margin together with swap points (4) | 3.0% | 3.0% | - |
| Costs / Revenues(5) | 69.8% | 75.1% | (5,3%) |
| Credit Risk Costs(6) | (1.1%) | (0.8%) | (0,3%) |
| Loans /Deposits(7) | 101.7% | 109.5% | (7,8%) |
| Loans / Total sources of funding(8) | 84.7% | 86.7% | (2,0%) |

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

# 7. BANK OPERATIONS IN THE YEAR 2012

## 7.1. DISTRIBUTION CHANNELS

### 7.1.1. TRADITIONAL CHANNELS

In 2012, the Bank continued to expand its network of branches, a policy started in 2008 in connection with the implementation of a strategy to develop local market growth. New branches were built in the towns, where BGŻ S.A.'s outlets had already existed: Białystok, Bydgoszcz, Toruń and Lublin. The objective of this strategy was to increase the Bank's share in terms of number of branches on a given micro market.

In 2012, 8 subordinated branches were opened. Based on analysis of financial results and location potential, 3 subordinated branches were relocated, 1 operating branch was transformed into a subordinated branch and 1 subordinated branch was transformed into an operating branch. In addition, 1 external cash desk was opened. However, 2 subordinated branches, 1 Bank Shop (located in the Manufaktura Shopping Centre in Łódź) and 4 external cash desks were closed.

As of 31 December 2012, the Bank had 400 branches, of which 120 were operating branches and 280 subordinated branches (compared to 120 operating branches and 274 subordinated branches as of 31 December 2011). The network of branches was supplemented by 14 external cash desks servicing cash transactions and 7 corporate centres servicing large corporations.

**ATM network**

At the end of 2012, the network of ATMs available to the Bank's retail customers for commission-free cash withdrawals, comprised, apart from Bank's own network , ATMs of the Euronet and PlanetCash4You networks (automatic teller machines labelled as „Automatic teller machine available to BGŻ customers for commission-free cash withdrawals").

For institutional customers, the network of ATMs comprised, apart from its own network of the ATMs, also the network of INVEST-BANK S.A.and Krakowski Bank Spółdzielczy, as well as the ATMs of the Euronet and PlanetCash4You networks(automatic teller machines labelled as „Automatic teller machine available to BGŻ customers for commission-free cash withdrawals").

At the end of December 2012, retail customers of the Bank could make commission-free cash withdrawals at 4 173 ATMs, of which 423 were operated by BGŻ S.A. Customers holding a Konto Plus personal account could make commission-free cash withdrawals in all ATMs in Poland. Owners of the Plan Aktywny and Konto bardzo osobiste personal accounts could use all automatic teller machines both in Poland and abroad for commission-free cash withdrawals. Institutional clients could use 4 357 ATMs for commission-free cash withdrawals, of which 423 were operated by BGŻ S.A. Customers holding Plan Agro Lider and Agro Lider Prestiż could use all ATMs in Poland for commission-free cash withdrawals from.

### 7.1.2. ALTERNATIVE CHANNELS

**Internet banking**

In 2012, the Bank recorded a dynamic growth in the number of customers using internet service eBGŻ (retail clients) and eBGŻ Firma (institutional clients). The number of operations executed using the internet channel increased systematically.

**Table 18. Data relating to eBGŻ**

| | | 31.12.2012 | 31.12.2011 | Change y/y | |
|---|---|---|---|---|---|
| Number of customers accessing | eBGŻ | 350 228 | 288 697 | 61 531 | 21,31% |
| | eBGŻ Firma | 70 079 | 52 599 | 17 480 | 33,23% |
| Number of active customers logging | eBGŻ | 228 742 | 181 440 | 47 302 | 26,07% |
| | eBGŻ Firma | 43 149 | 34 340 | 8 809 | 25,65% |
| The average monthly number of transactions | eBGŻ | 963 788 | 733 557 | 230 231 | 31,39% |
| | eBGŻ Firma | 934 541 | 622 945 | 311 596 | 50,02% |

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

The newly implemented Visa cards can be handled via the eBGŻ. . Additionally functionality allowing for additional authorisation orders in eBGZ was made viaTeleBGŻ system.

During Q3 2012, additional functionality was implemented which facilitated viewing details of blockades on the account, including those arising from transactions made with the use of payment cards.

Other new solutions offered to eBGŻ Firma customers, comprised of the option to initiate requests of standing payment transactions, and the useof one token, login and password to manage many multiple related party companies, as well as development of new administrative tools (including the option to delegate to the Bank the function of managing users and user rights within the customer's company).

At the same time, a change was made to the visuals eBGŻ Firma , which ensured consistency of graphic design and colouring to the business line and the Bank's Internet site www.bgz.pl. In addition, many functional and product-type enhancements were introduced into the service (among other things, end session counter which logs of the user in case of lack of user activity, the mechanism for selection of system language or more effective management of complex orders).

During Q3 2012, changes to the process of granting access to eBGŻ and eBGŻ Firma,allowing customers for the access to the services on the same-day access without the necessity of file electronic applications.

**Phone-banking**

In 2012, a further increase in the number of TeleBGŻ users was recorded . in comparison to 2011, an increase was also recorded in the number of monthly incoming and outgoing connections.

**Table 19. Data relating to Tele-banking**

| | | 31.12. 2012 | 31.12. 2011 | Change y/y | |
|---|---|---|---|---|---|
| Number of customers with the Access to TeleBGŻ | Retail customers | 388 910 | 326 843 | 62 067 | 19% |
| | Institutional customers | 109 515 | 82 149 | 27 366 | 33% |
| An average number of calls per month | Incoming from operator | 134183 | 127 761 | 6 422 | 5% |
| | Incoming IVR | 65 760 | 63 175 | 2 585 | 4% |
| | Outbound to the customers | 37 173 | 36 024 | 1 149 | 3% |

In 2012, development work was carried outon the Communication Centre, which was to ensure that the growing number of customers using this service receive higher service standards and information on the banking offer; among other things, the option to directly offer via courier current accounts and credit cards

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 infoline 801 33 66 99 providing a direct connection between customer and consultant. The existing 801 123 456 number, of the TeleBGŻ for the customers and the area of Bank's product infoline, remained unchanged. The changes were also made in the IVR service (so called "the tree structure"), aiding the use of this function by the Bank's customers.

In addition, new functionalities in the phone-banking channel of the Bank were launched to service Personal Banking clients.

### Banking cards

The Bank issues debit, credit and deferred payment cards in MasterCard and Visa -systems. As at 31 December 2012, the number of debit card issued to clients was 631.900 and was 45.800 i.e. 7.81% higher than in the previous year. This increase was mainly due to issuance of debit cards to retail clients (an increase by 33.200 pieces, i.e. by 6.92%). At the same time, a 14.33% increase i.e. by 7.0000 pieces was recorded in sales of credit cards.

**Table 20. Number of banking cards issued by BGŻ SA**

| | 31.12.2012 | 31.12.2011 | Change y/y | |
|---|---|---|---|---|
| Retail customers debit cards | 512 639 | 479 453 | 33 186 | 6.92% |
| Retail customers credit cards | 56 023 | 48 999 | 7 024 | 14.33% |
| Business debit card | 61 692 | 56 130 | 5 562 | 9.91% |
| Business cards with deferred payments | 1 587 | 1 560 | 27 | 1.73% |
| **Total number of banking cards issued** | **631 941** | **586 142** | **45 799** | **7.81%** |

As part of its retail MasterCard credit card offer, the Bank continued a promotion offering to reimbursed part of clients' expenses, as well as with activities dedicated to cyclists, in particular promotional cancellation of fees for insurance coverage services.

These activities resulted in the MasterCard of BGŻ S.A. being ranked as the best in the ranking of credit cards, prepared by the financial portal Bankier.pl. in February 2012.

In May 2012, the Bank resumed issuing Visa credit cards with considerably extended functionalities and launched promotional a promotional campaign concerning the transfer of credit cards from other banks.

The Bank's Visa credit card won a competition organised at the Central European Electronic Card Conference for the Nicest Polish Credit Card in 2012.

### Cooperation with intermediaries and agents

At the end of 2012, the Bank actively collaborated with 34 network intermediaries or agents, such as Open Finance, Notus, Expander and Money Expert. The Bank also collaborated with 132 local agents.

At the beginning of 2012, the Bank introduced some changes to its policies of cooperation with external partners in the area of sales of banking products for retail and institutional clients (from SMEs and micro-enterprises' sectors). In the second half of 2012, the Bank continued cooperation with financial intermediaries in the area of sales of bank products to retail and institutional clients (from the segment of SMEs and microenterprises). The Bank focused solely on signing contracts involving the the acquisition of banking products. In addition, a tool was implemented to facilitate settlement of sales and assessment of the quality of loans acquired via intermediaries. Direct supervision over all cooperation agreements (both with network-based and local) was performed by the Bank's Head Office.

## 7.2. RETAIL BANKING

### 7.2.1. PRODUCT OFFER DEVELOPMENT

In 2012, BGŻ S.A. made continous changes to its product offer, its retail customer segmentation and its service standards thus executing a strategy, implemented on the new communication platform launched in 2011 called *BGŻ Bank Serves People Well* („Bank BGŻ dobrze służy ludziom").

The New CRM application made available to banking consultants in Q4 2012 allowed the Bank to develop a modern portfolio and then offer products and services of *Personal Banking* to its most affluent clients.

The Bank successfully continued offering the best, product in the market of personal accounts called *Konto z Premią* (the leader in the market rankings of Gazeta Wyborcza, Bankier.pl, Money.pl and Comperia.pl). The Bank regularly delivered to its customers, attractive deposit-, credit- and investment-type product offers, whilst executing a strategy of product margin optimisation and product profitability improvement.

In the area of credit product offers, the main objective of the bank's strategy was execution of profitable and safe lending activities targeted both existing and prospective clients. The focus on processes improvements and standardisation of processes was a support for sales activities, carried out with a view to optimizing the credit risk management function at BGŻ S.A.

### 7.2.2. BGŻOPTIMA

The BGŻOptima product offer supplements the Bank's product offer with regards to savings and investment products, and is directed to clients who wish to use Internet-based services. The BGŻOptima offer comprises of deposits, savings accounts and investment funds. In 2012, the Bank's offer was rapidly developed in the area of deposit and investment products. In May 2012, the offer of BGŻOptima was extended to include, for the first time, a structured product, namely a structured policy. The offer of available investment funds was also continuously developed. As at 31 December 2012, the number of clients serviced by BGŻOptima was 75.700. From the beginning of 2012, 39.100 new clients were acquired.

### 7.2.3. DEPOSIT ACTIVITIES

At the end of 2012, the value of retail deposits held by the Bank was PLN 15,802,420,000 and was PLN 2,368,592,000 (17.6%) higher than in the previous year. The main growth factor of retail deposits continued to be BGŻOptima, which attracted new clients from the market, thus realising growth with a value of PLN 1,778,166,000. A change was recorded in the structure of retail deposits obtained by BGŻOptima; the share of deposits placed in savings accounts increased to 63% from 4% at the end of 2011, among other things, due to withdrawal from the product offer of one-day deposits, and due to promotional interest rates in savings accounts.

**Table 21. Volume and structure of retail deposits**

| *PLN thousand* | 31.12. 2012 | 31.12. 2011 | Change y/y | |
|---|---|---|---|---|
| Current and savings accounts | 8 439 404 | 6 174 921 | 2 264 483 | 36.7% |
| Term deposits | 7 351 820 | 7 249 879 | 101 941 | 1.4% |
| Other liabilities | 11 196 | 9 028 | 2 168 | 24.0% |
| - cash collateral | 6 671 | 5 242 | 1 429 | 27.3% |

| | | | | |
|---|---|---|---|---|
| - other | 4 525 | 3 786 | 739 | 19.5% |
| **Amounts owed to retail customers, total** | **15 802 420** | **13 433 828** | **2 368 592** | **17.6%** |
| **including: BGŻOptima** | **3 375 643** | **1 597 477** | **1 778 166** | **111.3%** |

In 2012, the acquisition business of BGŻ S.A. branches as regards retail deposits focused on personal accounts and term deposits, and – as a result – an increase in the balance of deposits of PLN 590,426,000 i.e. 5.0% was realised. This observable increase in the volume of term deposit accounts was possible owing to, among other things, attractive acquisition offers for „new funds" realised in 2-month time intervals and to progressive deposits rewarding long-term savings. In addition, the Bank successively developed its deposit product offer, which contributed to extending client deposit periods, as apart from the 12-month progressive deposit, customers showed an interest in investment deposits, and insurance-linked products, which, apart from the guarantee of a capital and interest payment, ensured services in case of accidental events.

Compared to the previous year, the Bank also recorded a 12.6% increase in the funds gathered in personal accounts. At the same time, a 6.8% increase was recorded in the number of personal accounts to the level of 593,300 pieces, and together with a product for youth *Maax* the level of 601,000 pieces of personal accounts was exceeded. *Konto z Premią* remained unquestionably the most popular among all types of personal accounts available as the owners were awarded a financial bonus for activities in the account. The number of personal accounts sold in year 2012 was 117,700 pieces and which almost 18,000 more than in the previous year. *Konto z Premią* accounted for almost 70% of the newly-opened personal accounts. Positive sales results were also achieved thanks to mass a media advertising campaign and enhancement of the process of opening personal accounts at Bank's branches. *Konto z Premią* also served as a vehicle for new branches to attract clients. Highly attractive and highly rated as regards quality, *Konto z Premią* confirmed its 1st place in the ranking of best personal accounts prepared by the Money.pl. portal in January 2011 and 2012 and came out on top in the Bankier.pl ranking in March 2012.

In December 2012, the Bank's product offer was extended to include an attractive product dedicated to VIP clients. As part of its new solutions, the Bank offered to its clients in the Personal Banking segment a new account with a dedicated tariff plan *Konto Bardzo Osobiste* and special policies for servicing of this account by individual personal bankers as a "comfortable banking" offer.

**Table 22. Number of retail deposits accounts**

| *Number of items (In thousands)* | **31.12. 2012** | **31.12. 2011** | **Change y/y** | |
|---|---|---|---|---|
| **Number of deposits accounts in branches** | **1 533.4** | **1 440.1** | **93.3** | **6.5%** |
| A 'vista accounts, including: | 1 250.5 | 1 152.1 | 98.4 | 8.5% |
| Personal accounts | 593.3 | 555.6 | 37.7 | 6.8% |
| Max Accounts | 8.0 | 8.9 | (0.9) | (10.1%) |
| Eskalacja savings accounts | 251.6 | 211.7 | 39.9 | 18.8% |
| Term deposits accounts | 282.9 | 288.0 | (5.1) | (1.8%) |
| **Number of deposits accounts in BGŻOptima** | **147.7** | **188.9** | **(41.2)** | **(21.8%)** |
| Savings accounts | 83.9 | 38.5 | 45.4 | 117.9% |
| Term deposits accounts | 63.8 | 150.4 | (86.6) | (57.6%) |

### 7.2.4. LENDING ACTIVITIES

In 2012, lending activities were directed towards increasing profitability of key credit products as well as towards strengthening initiatives in the area of package offers dedicated to retail clients.

Sales of key credit products increased the credit portfolio of retail clients. At the end of 2012, the value of the retail client loan portfolio was PLN 8,974,778,000 and was PLN 511,493,000 i.e. 6.0% higher than in the previous year. The main growth factors were sales of mortgage and cash loans and credit cards.

The value of zloty mortgage and construction loans (together with consolidation loans) sold in 2012 was PLN 1,393,500,000 and was 108.5% higher compared to 2011, while the value of these loans sold was PLN 668,400,000. In March 2012, product advertising campaign was conducted which emphasised a „guaranteed lowest margin" that is granted at the moment of loan granting and special open days with mortgage loans' promotional offers. In addition, in order to improve acquisition results, consistent sales policy, based on the concept of „the bank of the local community", was conducted, and product packages (comprising mortgage loans, underlying accounts, credit card and life/ property insurance) were offered to target clients.

This sales increase translated into the value of the portfolio of zloty housing loans increasing by PLN 914,040,000 (i.e. 26.1%). Following the strengthening of the zloty exchange rate and client repayments, the value of the foreign currency housing loans (product withdrawn from the credit offer in 2009) portfolio decreased.

**Table 23. Volume and structure of retail loans**

| *PLN thousand* | 31.12. 2012 | 31.12. 2011 | Change y/y | |
|---|---|---|---|---|
| Current account loans | 107 615 | 132 123 | (24 508) | (18.5%) |
| Housing loans | 7 600 490 | 7 118 474 | 482 016 | 6.8% |
| – in PLN | 4 412 921 | 3 498 881 | 914 040 | 26.1% |
| – in foreign currencies | 3 187 570 | 3 619 593 | (432 023) | (11.9%) |
| Cash loans | 803 967 | 719 466 | 84 501 | 11.7% |
| Other loans to retail clients | 462 706 | 493 222 | (30 516) | (6.2%) |
| **Total loans to retail clients** | **8 974 778** | **8 463 285** | **511 493** | **6.0%** |

In the case of cash loans, sales in 2012 amounted to PLN 517,500,000 compared to PLN 338,400,000 in 2011 (a 53% increase), and as a result the volume of the credit portfolio for this product increased by PLN 84,501,000 i.e. 11.7% compared to the end of the previous year. This dynamic sales increase was brought about by making the product offer more attractive by launching seasonal promotions such as "new school-year offer" granted at the day of the loan grant supported by a TV campaign, supplementing the offer with new Aviva insurance ensuring credit repayment in the event of job loss, temporary incapacity to work, ensuring protection of the borrower's family in the event of the borrower death, as well as the implemented in November 2012 the Risk Based Pricing policy, which conditioned the credit price on the borrower's credit capacity. Credit with new insurance became very popular among clients. In Q4 2012, the share of credit with insurance in total loans granted accounted for 63%. Apart from activities aimed at attracting clients from the market, the Bank actively offered products to its existing clients, for example as part of a „pre-approval" campaign. It consisted in offering to selected clients a multifunctional credit limit which could be used for opening one, two or three credit products: credit card, revolving loan and cash loan.

**Table 24. Number of credit accounts**

| *Number of items (in thousands)* | 31.12. 2012 | 31.12.2011 | Change y/y | |
|---|---|---|---|---|
| Mortgage, housing and consolidation loans | 53.3 | 48.3 | 5.0 | 10.4% |
| Cash loans | 92.4 | 82.7 | 9.7 | 11.7% |
| Credit cards | 64.9 | 59.5 | 5.4 | 9.1% |

2012 the value of the credit cards portfolio was PLN 70.7 million and was 34.0% higher compared to the previous year, with a simultaneous increase in the number of credit accounts for this product by 15.2% to the level of 64,900. The new Visa Standard card, launched in Q2 2012 contributed to this sharp increase.

## 7.3. BROKERAGE SERVICES AND DISTRIBUTION OF PARTICIPATION UNITS IN INVESTMENT FUND MANAGING COMPANIES (TFI)

The Brokerage Office of BGŻ („BM BGŻ" or the "Brokerage Office") focuses its operations on servicing retail clients, and the scope of the 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 entrusted assets.

Brokerage fees in 2012 amounted to PLN 5,392,400, compared to PLN 5,577,000 in 2011. The decrease in the brokerage fees was caused by the general slump in the economy, and hence reduced trading volumes in the whole market, and from a change in the structure of clients. The Brokerage Office of BGŻ S.A. renders services mainly to domestic investors, including, in particular, individual investors, whose share in the trading result has continued to decrease in recent years.

At the end of 2012, BM BGŻ maintained 32,033 securities accounts (of which 5,257 internet accounts are maintained in the bmBGŻ.net transaction system), which compared to the 30,858 accounts at the end of 2011 is a 3.8% increase.

**Table 25. Share of the BGŻ Brokerage Office in trading on the WSE**

| | | 2012 | | 2011 | |
|---|---|---|---|---|---|
| | | **Market share** | **Volume** | **Market share** | **Volume** |
| Stock | PLN million | 0.23% | 853.55 | 0.23% | 1141.46 |
| Bonds | PLN million | 0.49% | 9.98 | 1.15% | 18.18 |
| Futures | Number of contracts | 0.48% | 98770 | 0.38% | 109790 |
| Options | Number of contracts | 0.23% | 3082 | 1.11% | 19012 |

At the end of 2012, BM BGŻ distributed participation units in 62 funds managed by 6 investment fund managing companies (Union Investment TFI, Aviva Investors Poland TFI, Skarbiec TFI, Opera TFI, BPH TFI, Quercus TFI). The product offer of the Brokerage Office comprises of a variety participation units in TFIs and covers 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 2012, revenues from the sale of TFI participation units amounted to PLN 5,683,700 compared to PLN 6,874,000 in 2011.

Following improved economic conditions in financial markets and an increase in the value of acquired TFI participation units, an increase was recorded in the value of assets acquired by BGŻ S.A. As at 31 December 2012, the value of those assets was PLN 611.2 million compared to PLN 554.8 million at the end of 2011.

BM BGŻ offers agency services in the OTC market organised by BondSpot S.A. As of 2007, BM BGŻ has been an active participant in the alternative NewConnect trading system.

In 2012, BM BGŻ participated in 10 public offerings in the primary market. In the case of 7 offerings, the Brokerage Office acted as a offering agent and hence participated at each stage of both the preparation and execution of the offer and as the offering organiser.

## 7.4. INSTITUTIONAL BANKING

### 7.4.1. CLIENT SEGMENTATION

Institutional clients of the Bank are 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 ranging from the PLN equivalent of EUR 1,200,000 to PLN 60 million,
- Microenterprises (Micro) – with annual sales revenues being the PLN equivalent of up to EUR 1,200,000.

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

### 7.4.2. PRODUCT OFFER DEVELOPMENT

**Product packages and transaction products**

In March 2012, the Bank introduced to its product offer the following new and modified product packages: the *Biznes Lider* and *Biznes Lider Plus* packages for microenterprises, *Biznes Lider Aktywny* and *Biznes Lider Prestiż* for SMEs, the *Społeczny Lider* package for clients from the micro non-profit segment and *Agro Lider* and the *Agro Lider Prestiż* packages for farmers. These new products replaced the *Firma Plan2* and *Firma Plan3* packages, and withdrew from the product offer the *e-Plan Firma* package and supplemented or modified the package offer.

The product package offer was constructed in such a way as to ensure that within one agreement a client could acquiring many products at one price and, at the same time, had the possibility of acquire other products and services offered by the Bank at preferential prices and with no additional formalities. The main products included in the packages are: PLN current account, phone banking, eBGŻ, deposit account and term deposits. As part of the *Biznes Lider Plus* package, a client who has conducted business activities for at least 12 months may also receive an overdraft facility up to the amount of PLN 10,000 for a period of up to 36 months.

Included in the SMEs packages i.e. in the *Biznes Lider Aktywny* and *Biznes Lider Prestiż*, apart from the the basic products from packages for Micro segment clients, are – depending on the type of the package: foreign currency accounts, debit cards, individually negotiated deposit and foreign currency transactions (eBGŻ Treasury). Additionally, the possibility of using a lump sum fee for making internet transfers to other banks was opened.

In addition, the Bank launched a new package *Agro Lider Prestiż* for farmers and producer groups with more higher banking requirements. The package contains, in addition to basic banking products, the possibility of negotiating exchange rates and deposit interest rates and the option of receiving agro-market reports prepared by Bank specialists. At the same time, the Bank free of charge cash withdrawals from all ATMs in Poland was introduced to the offer for Agro-enterprises.

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

Since the period from the introduction of new offer (15 March 2012) to 31 December 2012 the Bank acquired 22,461 new clients. Compared to the corresponding period of 2011, in 2012 the Bank attracted 4,555 more new clients.

In the first half of 2012 the offer of currency accounts was extended by the launch of 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 – cash settlements are unavailable.

In February 2012, the Bank has made modifications in the cash processing offer. The changes included standardisation of contracts for all segments and introducing daily limits for closed payments and introduction ofdaily limits for closed payments recorded based on the amount declared by the client.

In 2012, 71 agreements were signed on the rendering by the Bank of a service called *Identyfikacja Płatnika* (based on the IDEN system) aimed at serving mass incoming payments. In the corresponding period of 2011, 48 agreements for this type of service were signed. In 2012, the IDEN system processed approximately 1,650,000 transactions with a value of PLN 1,180,000,000. In 2011, the system processed 1,200,000 transactions in the amount of PLN 873,000,000.

**Loans**

In March 2012, as part of the new package offer, a new credit product was launched that is to finance the current needs of the sub-segment of micro clients, i.e. *Kredyt – debet w rachunku bieżącym*. This new overdraft facility is available to clients holding current accounts under the *Biznes Lider Plus* package and conducting business activities for the period of at least 12 months. It is granted up to the amount of PLN 10,000 for a period not exceeding 36 months, with no collateral required.

In August 2012, the Bank launched a new loan dedicated to finance business activities and settling client business transactions - *Limit Wieloproduktowy* (Multiproduct Limit) which replaced the *Wielofunkcyjna Linia kredytowa* (Multifunction Credit Facility). The new product is dedicated to LEs, SMEs or the Micro Farmer sub-segment of institutional clients, who given the range and type of conducted business use various credit-type products. Under the *Limit* granted, sub-limits are offered for the following: overdraft facility, revolving loan, guarantees, letters of credit and factoring

The functioning principles of these individual products granted as part of *Limit Wieloproduktowy* are the same as those binding for the products operating outside the *Limit. Limit Wieloproduktowy* and the sub-limits are revolving facilities. Under *Limit Wieloproduktowy*, a sub-limit is granted each time for the overdraft facility, whilst other sub-limits are made available depending on individual client needs.

*Limit Wieloproduktowy* and individual sub-limits are granted in PLN. The overdraft facility and revolving loans are also granted in PLN.

**Agro-business financing**

In March 2012, a new product was launched that linked crop loans with recourse factoring in such *()* in such a way that the prepayments received under a factoring agreement constitute a source of crop loan repayment.

In addition, since March 2012, clients have had the possibility of purchasing agricultural machines and equipment under the Program for Financing Development of Balanced Energy in Poland *(Program Finansowania Rozwoju Energii Zrównoważonej w Polsce - PolSEFF).* Acceptance of this type of transaction by PolSEFF engineers is realised based on a simplified procedure. Clients buying tractors or harvesters who decide to participate in this Program receive an investment bonus of 10% of the amount of the loan taken out. Since September 2012, clients taking out loans for the purpose of carrying out a PolSEFF investment project have had the possibility of replacing their own contribution with a deposit of 15% of the investment value to increase the amount of the investment bonus awarded.

Also as of September 2012, following an amendment in a Decree of the Council of Ministers, commission for granting preference loan was reduced from 2% to 1%. This amendment enabled the Bank to freely change commissions over the period of the loan term. In addition, the bill of exchange rediscounting ratio, as the basis for calculating the loan interest rate, was reduced from 1.6 to 1.5

**Farmers insurance**

In the first half of 2012, in collaboration with Concordia Polska TUW, the Bank introduced to its product offer, as part of a pilot program conducted by branches, *Concordia Auto* farmer motor insurance covering civil liability (OC), *Auto Casco* (AC), Auto Assistance, Accidental Death and Dismemberment Insurance (AD&D Insurance (NWW), Legal Assistance, civil liability of owners of mechanical vehicles that cause damage to the natural environment. Since October 2012, this product has been sold at all Branches of the Bank. Sales of the motor insurance werr increased by the possibility of automatic client verification in the database of the Insurance Guarantee Fund (database on motor insurance policies in Poland).

### 7.4.3. LENDING ACTIVITIES

At the end of December 2012, the gross value of the loan portfolio of institutional clients was PLN 18,418,858,000 and was 10.7% higher than in the previous year; on a year to year basis, the increase in institutional clients loan portfolio in 2011 amounted to 31.3%.

The main driver behind the growth in the loan portfolio of institutional clients in 2012 was overdraft facilities offered to companies and farmers and realised mainly on the *Ekspres Linia* product for SMEs and *Agro Ekspres* product for farmers (with dynamics approximating those from 2011). A slower increase was, however, recorded in the portfolio of company investment loans and preference loans, whilst working capital loans to companies decreased.

The value of farmer loans increased by PLN 432,875,000, i.e. by 10.4% and the growth was shaped by the dynamics of investment and preference loans. The main factor restricting the dynamics of preference loans was the reduced, compared to 2011, limit for lending activities for banks imposed by the Agency for Restructuring and Modernisation of Agriculture *(ARiMR).* As a result, preference loans were one of the loan types that showed the slowest growth in the portfolio of institutional client loans (+3.7% y/y). An additional limit that allowed the further granting of preference loans by the Bank in 2012 was provided by the ARiMR in September 2012.

**Table 26. Loans and advances to institutional customers, gross**

| *PLN thousand* | 31.12. 2012 | 31.12. 2011 | Change y/y | |
|---|---|---|---|---|
| Overdraft facilities, including | 4 184 718 | 3 276 428 | 908 290 | 27.7% |
| – businesses | 2 251 740 | 1 814 091 | 437 649 | 24.1% |
| – individual entrepreneurs | 345 581 | 313 568 | 32 013 | 10.2% |
| – farmers | 1 556 847 | 1 129 431 | 427 416 | 37.8% |
| Loans and advances to customers: | 14 252 086 | 13 381 459 | 870 627 | 6.5% |
| – businesses, including: | 8 052 945 | 7 657 814 | 395 131 | 5.2% |
| - investment loans | 4 850 132 | 4 265 207 | 584 925 | 13.7% |
| - operating loans | 2 088 980 | 2 366 793 | (277 813) | (11.7%) |
| – individual entrepreneurs | 1 242 443 | 1 173 698 | 68 745 | 5.9% |
| – farmers | 4 579 424 | 4 146 549 | 432 875 | 10.4% |
| – public sector institutions | 313 976 | 288 652 | 25 324 | 8.8% |
| – other entities | 63 298 | 114 746 | (51 448) | (44.8%) |
| Other | - | - | - | - |
| **Total** | **18 436 804** | **16 657 887** | **1 778 917** | **10.7%** |
| *of which: Preferential loans* | *4 208 569* | *4 057 019* | *151 550* | *3.7%* |

**Leasing**

Sale of leasing services, product servicing and managing risk in the lease portfolio is coordinated by BGŻ Leasing Sp. z o.o. In the framework of the provision of leasing services 1 725 lease contracts were signed with a value of PLN 439.9 million.

### 7.4.4. DEPOSIT ACTIVITIES

In 2012, the Bank pursued a conservative price policy towards the deposits of institutional clients which aimed at obtaining better results on interest margins and securing the required liquidity levels. Another priority of the Bank was to increase current account balances in all segments.

In 2012, liabilities towards clients grew by a total of PLN 1,631,727,000, i.e. 17.2% and the growth related mainly to the increase in liabilities to other financial institutions (by PLN 1,720,166,000), caused by long-term placements made by TFIs and insurance industry clients. Farmer deposits also showed positive dynamics – an increase of PLN 132,394,000, i.e. 15.1%, with *Agro Eskalacja* savings accounts as the main driver of the increase.

On the other hand, the balance of corporate customers (except for farmers) and budget sector deposits decreased, especially as regards term deposits, which was the result of the policy to gradually limit the volumes of short-term and expensive high-value deposits.

**Table 27. Amounts owed to institutional customers**

| *PLN thousand* | 31.12. 2012 | 31.12. 2011 | Change y/y | |
|---|---|---|---|---|
| **Other financial institutions:** | **2 537 917** | **817 751** | **1 720 166** | **210.4%** |
| Current accounts | 9 268 | 16 842 | (7 574) | (45.0%) |
| Term deposits | 2 528 638 | 800 898 | 1 727 740 | 215.7% |
| Other liabilities | 11 | 11 | - | - |
| **Corporate customers:** | **7 924 618** | **7 901 494** | **23 142** | **0.3%** |
| Current accounts | 3 974 989 | 3 442 442 | 532 565 | 15.5% |
| Term deposits | 3 871 567 | 4 382 143 | (510 576) | (11.7%) |
| Other liabilities | 78 062 | 76 909 | 1 153 | 1.5% |
| **Corporate customers, of which farmers:** | **1 009 139** | **876 745** | **132 394** | **15.1%** |
| Current accounts | 856 815 | 722 838 | 133 977 | 18.5% |
| Term deposits | 143 693 | 149 479 | (5 786) | (3.9%) |
| Other liabilities | 8 631 | 4 428 | 4 203 | 94.9% |
| **Public sector customers:** | **677 074** | **788 655** | **(111 581)** | **(14.1%)** |
| Current accounts | 484 830 | 413 291 | 71 539 | 17.3% |
| Term deposits | 192 118 | 375 241 | (183 123) | (48.8%) |
| Other liabilities | 126 | 123 | 3 | 2.4% |
| **Total** | **11 139 551** | **9 507 824** | **1 631 727** | **17.2%** |

### 7.4.5. TRADING BUSINESS FINANCING

**Factoring**

As part of providing factoring services, in 2012 the Bank acquired 121,800 invoices with a total value of PLN 3,065,000,000, compared to 108,400 invoices acquired in 2011 with a value of PLN 2,575,000,000 (a 19% increase). The Bank attracted 119 new factoring clients and the value of new limits exceeded PLN 240 million.

The factoring offer of the Bank was extended to include new solutions for the Agro segment (LEs and SMEs clients) which consisted of selling factoring and crop loans as one package. The main assumption behind this new solution was to link financing of the agro-purchase loan with recourse factoring in such a way as to ensure that the prepayments made under the factoring agreement were allocated to agro-purchase loan repayment and served as collateral for the timely repayment of that loan.

In May 2012 the Bank has renewed terms of insurance policy for insured non recourse factoring. The renewed insurance policy negotiated by the Bank will be valid until 30 September 2013.

**Bank guarantees and letters of credit**

In the second half of 2012, the Bank implemented a new system for servicing the transactions of bank guarantees and letters of credit, and of other products used for financing trading business. Processes that related to servicing these products in the area of Operations were adjusted.

In addition, amendments to the policies of servicing third party guarantees issued by other banks to the Bank's clients were made to make them more precise in the area of issuance of advisory notes *(awizo),* requests filing and servicing. The guarantee confirmations which, alternatively, may be replaced by re-guarantees were excluded from the Bank's offer. Tourist guarantees were also removed from the product offer.

As at the end of 2012, the total value of guarantee liabilities granted to clients amounted to PLN 615,619,000 compared to PLN 789,391,000 at the end of 2011. The Bank's portfolio included 1 768 granted guarantees which represented a 17% increase compared to the corresponding period of the previous year (1 505 guarantees).

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.

In 2012, the Bank issued 277 import letters of credit with a total value of PLN 81.9 million (compared to 392 import letters of credit with a total value of PLN 166.3 million in 2011) and processed 142 export letters of credit with a total value of PLN 71.8 million (compared to 104 export letters of credit with a total value of PLN 32.8 million in 2011).

### 7.4.6. ACTIVITIES IN DEBT SECURITIES MARKET

In 2012, the Bank serviced 5 programs of issues of debt securities (one issue expired in February 2012), of which 3 related to issuance of securities of local government units. In 2012, the Bank did not act as an organiser of new issues of debts securities.

## 7.5. ACTIVITIES IN MONEY AND FOREIGN EXCHANGE MARKETS

In 2012, the activities of the Bank in money and foreign exchange markets were significantly affected by the following factors:

- a considerable slowdown in economic growth in Poland, observable especially in the second half of the year, which was accompanied by a decrease in the inflation rate to the level approximating the RPP target,
- appreciation of the zloty against foreign currencies in the first half of the year, discontinued in April and May, due to the situation in international markets, followed by zloty exchange rate stabilisation,
- a 25 bps increase in interest rates by the RPP in May 2012 in response to high inflation outlook, followed by a cycle of interest rate decreases in November 2012 in response to de-inflation processes in the Polish economy,
- a reduction in interest rates by the RPP and the relatively good situation of public finance led to a higher demand for Polish debt securities, especially by foreign investors, which resulted in a decrease in the profitability of bonds to the lowest historical levels,
- stabilisation of Polish banking sector liquidity in 2012 was conducive to reducing the costs of obtaining finance from the Bank's clients.

In November 2012, the Bank decided that it would no longer participate in the fixing of WIBOR and WIBID reference rates.

**Activities on own account**

*FX market*

In 2012, activities of BGŻ S.A. in the inter-bank market focused on zloty and currencies of the G7 countries. The higher trading result was due to a higher volume of FX transactions realised both by the Bank's clients and by the Bank itself. Improved efficiency in the process of managing the Bank's FX position contributed to recording the highest ever financial results in this area of banking business. The highest trading result in the FX transactions was recorded for the EUR/PLN currency pair and then for the USD/PLN and GBP/PLN currency pairs. The Bank's activities in the market of foreign currency options showed a moderate increase, which is mainly the effect of a low base in previous years.

*Interest rate market*

The Bank recorded an outstanding result in the inter-bank interest rate market. Interest rate profit was generated by fixed and variable interest treasury bonds, and this trend was supported by the situation in the market of treasury debt securities. Bank activities concentrated in the PLN profitability curve. The Bank as a Dealer of Treasury Securities was an active participant of local inter-bank market. A lower activity level was recorded on the EUR and USD profitability curve. The offer in the segment of interest rate derivatives was extended to include cap and floor option transactions. In 2012, the Bank did not conduct trading activities in the market of non-treasury debt securities.

**Short-term liquidity management**

The lasting restricted liquidity of the inter-bank market and restrictive liquidity requirements imposed by the PFSA associated with the Basel 3 Recommendation and to internal risk weights led to to the situation that the deposit transactions with other banks being concluded only to manage spot or short-term liquidity of the Bank. The main instrument for placing short-term liquidity surpluses were NBP money bills and short- and mid-term (with a maturity period of up to 2 years) liquid State Treasury bonds. The Bank did not treat neither the interbank market nor resources of non-bank financial institutions as sources of financing for its credit activities. Market risk relating to short-term liquidity management and to instruments offered to clients was actively managed by such transaction as: OISs, FRAs, IRSs and FX Swaps. As regards derivative transactions concerning short-term interest rate, the Bank was an active participant in the inter-bank market as Money Market Dealer.

**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 other things, 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 Bank entered into IRS, OIS, CIRS and basis swap transactions to achieve the optimum profile, from the point of view of risk (limits utilisation) and profitability. Given the outlook prepared in the first months of the year, which provided for the commencement of the cycle of interest rate reductions in Poland at the end of 2012 or the beginning of 2013, and given the specific construction of preference loans with subsidies from ARiMR, where the Bank's margin is related by multiplier to the level of the bill of exchange rediscounting rate, the Bank managed to stabilise this margin by entering in April 2012 into a series of 2-year IRS transactions for the total amount of PLN 1.5 billion, to which the Bank applied for the first time the mechanism of hedge accounting which resulted in limiting financial result variability. At the end of 2012, positive valuation of the above hedging in the amount of PLN 21,857,000 was recognised in equity.

*Long-term financing*

The Bank has been proactive in increasing the share of long-term, stable financing in the balance sheet structure, and as a result, it was granted on 15 November 2012 from the European Investment Bank (EIB) ten year credit facility in the amount of PLN 205,400,000 to finance SMEs loans. The cost of this facility is Wibor 3M + 0.367%, increased by a cost of guarantee issued by Rabobank in the amount of 0.95% from a 120% outstanding exposure. It is yet another credit facility made available after those opened in 2011, obtained from Rabobank (12 years, CHF 1,000,000,000, which cost amounts to CHF Libor 3M and 6M + on average 1.38%) and EBRD (both facilities for a 5 year period, EUR 50,000,000 each, cost: Euribor 6M + 1.25%).

*Certificates of deposit*

Certificates of Deposit are used by the Bank since 2008 to diversify sources of finance, to which in 2012 the Bank implemented certain changes, i.e. a strategy was implemented to significantly extend maturity dates: as at 31 December 2012, the Bank's position from own issue comprised certificates of deposit with a value of PLN 1,310,000,000 and residual maturity of not less than 1 year and certificates of deposit with a value of PLN 570,000,000 and residual maturity of 1 - 5 years. Since interest expense on long-term securities is variable and based on 6M WIBOR, at the end of 2012 the Bank started the process of hedging i.e. the process of stabilising interest rates for long-term certificates through the transactions of IRS purchases, whilst taking advantage of historically low market quotations.

*Investment portfolio*

The investment portfolio of the Bank is composed of liquid treasury bonds and NBP treasury bills. Among treasury bonds held, the shortest maturity date is January 2013 and the longest – September 2022. As at 31 December 2012, the Bank's investment portfolio nominal value was PLN 3,000,000,000, of which PLN 300,000,000 were NBP treasury bills. In 2012, revenue in the investment portfolio, such as interest, settlement of premium/discount and sale result, was PLN 202,700,000, of which the result on sell of some items before the maturity date was PLN 43,100,000. Disposal of bonds before the maturity date was replaced to a large extend by purchases of other securities: in the first three quarters of the year, the Bank acquired securities with maturity dates exceeding those of the securities sold in order to adjust the net equity duration to increasing total assets balance, whilst in Q4 2012, the Bank acquired NBP treasury bills to replace the securities sold in order to maximise interest income and limit any potential fluctuations in the fair value of the bonds portfolio, which as at 31 December 2012 at PLN 244,000,000 was recognised in revaluation reserve.

**Sale of treasury products to clients**

In 2012, and especially during the first half of the year, the Bank recorded a considerable increase, compared to the previous year, in the sale of treasury products in all segments of institutional client portfolio. The main reason behind the increase was the significant variability of the financial markets, the new model of sale of treasury products which to a larger extent concentrated on particular client segments, as well as greater interest in sale of hedging solutions. In the second half of the year, despite considerably lower fluctuations in financial markets, especially as regards the EUR/PLN currency pair, spot and forward currency transactions continued to generate the largest portfolio income.

The most significant revenue growth factor remained currency spot and forward transactions which were supported by the electronic, treasury eBGŻ channel. Hedging solutions in the first half of 2012 were more diversified than in 2011. More clients hedged against interest rate risk and some clients used currency options to hedge against currency risk. A decrease in market interest rates at the end of 2012 led to new IRS transactions were being concluded with SME and LE clients.

In 2012, the Bank extended its product offer of treasury instruments hedging against interest rate risk by offering interest rate options. The Bank also offered instruments hedging against the risk of changes in prices of goods, such as commodity options and swaps. In addition, in the second half of the year, some clients from the agro-food industry opened their positions in the ground soya and rapeseed market.

## 7.6. COLLATERALS RECEIVED

A 10-year loan in the amount of PLN 205,440,000 granted to BGŻ in November 2012 by the European Investment Bank (EIB) is secured by a guarantee issued by Rabobank. This is a three-way warranty - an agreement between the EIB and Rabobank establishes an unconditional obligation of the latter relative to the EIB amounting to 120% of the outstanding loan, in the event that the Bank BGŻ did little with the provisions of the loan agreement, and the agreement between Rabobank and Bank BGŻ requires BGZ to implement all the provisions of the credit agreement and specifies the guarantee commission of 0.95% from 120% of the loan outstanding. Amortization schedule and the amount of the guarantee commission payments under the guarantee covers the payment schedule of principal and interest from EIB loan.

## 7.7. COLLABORATION WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

**Correspondent banking and money orders**

In 2012, the Bank maintained correspondence contacts with approximately 870 financial business entities, and at year's end, the Bank maintained 24 Nostro accounts in 15 main currencies in foreign banks.

As at 31 December 2012, the Bank maintained 33 Loro accounts in 6 currencies for 21 foreign banks, 1 domestic bank and 1 foreign non-banking financial institution. The Loro accounts are maintained in the BGŻ S.A. books of account and represent an external source of securing working capital funds at no cost, which serve to satisfy the operating needs of the Bank. Using these accounts, the Bank executes primarily client transfers and bank-to-bank transfers. Loro accounts are subject to periodic analyses in terms of their cost-effectiveness and usefulness for BGŻ S.A. and therefore number of is adjusted.

In 2012, BGŻ S.A. collaborated with four foreign non- banking financial institutions offering cheap and swift electronic money transfer services: 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. As of the end of the year, the Bank discontinued collaboration with Doma International Transfers, Vigo Remittance Corporation and OneMoneyMail.

In 2012, the Bank continued collaboration with other domestic and foreign financial institutions, mainly with investment funds, insurers, pension funds, 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.

**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. In the second half of the year, a new functionality was implemented in the Head Office system, Flexcube, dedicated to service Trade Finance products; as a result, the process of registration and servicing foreign trade operations was transferred from the Eurobank system to the Flexcube system. Following Trade Finance module implementation to Flexcube, the function of servicing client-awarded limits concerning issuance of guarantees and letters of credit as part of facility contracts was also transferred from the Eurobank system, which gave the possibility of servicing, under one limit, guarantees and letters of credit in currencies other than the currency of the limit granted.

In 2012, the Bank maintained high dynamics in foreign trade transfers. The share of SEPA Credit Transfer in the total number of import and export transfers increased in 2012 and was 52% and 59%, respectively.

**Table 28. Statistics of operations handled by BGŻ S.A.**

| Type of transaction | Quantity/value | 2012 | 2011 | Change y/y |
|---|---|---|---|---|
| Transactions using the nostro accounts (commercial banks and NBP) | Number of transactions | 700 253 | 513 959 | 36.2% |
| | Value in PLN billion | 2 947 | 3 076 | (4.2%) |
| Transactions using the loro accounts | Number of transactions | 119 303 | 113 792 | 4.8% |
| | Value in PLN billion | 783 | 892 | (12.2%) |
| Export transfers | Number of transfers | 433 383 | 346 329 | 25.1% |
| | Value in PLN million | 22 887 | 17 177 | 33.2% |
| including: transfers of SEPA Credit Transfer | Number of transfers | 257 397 | 152 354 | 68.9% |
| | Value in PLN million | 6 800 | 3 372 | 101.7% |
| Import transfers | Number of transfers | 175 227 | 137 728 | 27.2% |
| | Value in PLN million | 13 426 | 11 973 | 12.1% |
| including: transfers of SEPA Credit Transfer | Number of transfers | 90 789 | 60 772 | 49.4% |
| | Value in PLN million | 4 616 | 3 254 | 41.9% |
| Own letters of credit and own documentary collection (newly opened) | Number | 328 | 474 | (30.8%) |
| | Value in PLN million | 81 | 173 | (53.2%) |
| Guarantees and own promissory notes granted | Number | 1 533 | 1 262 | 21.5% |
| | Value in PLN million | 390 | 932 | (58.2%) |
| Third party letters of credit and third party guarantees | Number | 514 | 518 | (0.8%) |
| | Value in PLN million | 154 | 141 | 9.2% |

## 7.8. AVERAGE BASIC INTEREST RATES USED DURING THE FINANCIAL YEAR

**Table 29. Average Basic interest rates of BGŻ S.A. in 2012**

| | Households | Corporate customers |
|---|---|---|
| **Current accounts and term deposits** | | |
| PLN | 2.41% | 2.87% |
| of which only deposits | 4.85% | 4.27% |
| EUR | 0.09% | 0.12% |

| | | |
|---|---|---|
| **Loans** | | |
| PLN | 9.95% | 8.78% |
| EUR | 2.77% | 1.71% |
| CHF | 3.40% | - |

## 7.9. BANK ORGANIZATION AND HUMAN RESOURCES

### 7.9.1. ORGANIZATIONAL STRUCTURE

The most significant changes in the organisational structure made in the Head Office in 2012 related to the regulatory requirement to fully separate sale tasks and the risk management business in the broad sense. These changes were implemented in two stages, from 10 August 2012 and from 1 January 2013.

Risk Management Division, which grouped departments responsible for financial and operating risk management, design and implementation of the Bank's policy and procedures concerning system-based credit risk management, for determining provision balance and performing measurements and comprehensive analyses of economic capital for various types of risk, has been separated from the Risk Area.

### 7.9.2. HUMAN RESOURCES

**Employment levels**

At the end of 2012, BGŻ S.A. had 5,637 employees, i.e. 0.8% more than in the previous year. At the Head Office, the number of employees decreased by 1.0% y/y, which was mainly due to the group redundancy program started in October 2012. The employment level in the entire Bank network grew by 1.4% y/y despite group redundancy in the risk division. This overall increase resulted from filing in vacancies in the sales area and creating the new posts of sales coordinator and trainer. The increase in the employment was also attributed the launch of the Internet branch BGŻOptima.

At the end of 2012, the largest group of employees were persons with higher education (80%).

In October 2012, the Bank started the group redundancy program as part of a project of employment restructuring, especially at the Head Office, with a view to enhancing operating and cost efficiency. The group redundancy program will operate until 30 June 2013 and will cover a total of not more than 370 persons.

**Table 30. Bank's employment in employees and FTEs**

| | 31.12.2012 | 31.12.2011 | Change y/y | |
|---|---|---|---|---|
| Network | 4 085 | 4 027 | 58 | 1.4% |
| Headquarters | 1 438 | 1 453 | (15) | (1.0%) |
| Brokerage Office | 32 | 36 | (4) | (11.1%) |
| BGŻOptima | 49 | 43 | 6 | 14.0% |
| Holiday resorts | 30 | 30 | - | - |
| Trade unions | 3 | 3 | - | - |
| **Total (employees)** | **5 637** | **5 592** | **45** | **0.8%** |
| Network | 4 056.45 | 3 992.82 | 64 | 1.6% |
| Headquarters | 1 426.87 | 1 447.98 | (21) | (1.5%) |
| Brokerage Office | 32.00 | 36.00 | (4) | (11.1%) |
| BGŻOptima | 39.88 | 21.45 | 18 | 85.9% |
| Holiday resorts | 29.50 | 29.50 | - | - |
| Trade unions | 3.00 | 3.00 | - | - |
| **Total (FTEs)** | **5 587.70** | **5 530.75** | **57** | **1.0%** |

**Salaries**

The key objective of the Bank's Remuneration policy, which serves execution of the Bank's business

The key objective of the Bank's Remuneration policy, which serves execution of the Bank's business strategy and creation of its competitive advantage, is to attract, keep and motivate top-notch employees. The Bank's Remuneration policy is based on the concept of a comprehensive approach to employee rewarding and accounts for, apart from such major main elements as fixed and variable remuneration, the issues of recognition, career development, work environment and business culture.

The Bank has pursued a reasonable and balanced remuneration policy which has reflected its client-oriented approach, accounted for the long-term Bank's interests and supported reasonable and effective risk management.

The Bank has participated in salary-oriented market research and thus has regularly monitored competitiveness of its remuneration package (of fixed and variable part) against the market.

The Bank's Remuneration policy also includes detailed principles of rewarding of these employees at managerial posts who have a considerable impact on the Bank's risk profile (as per the PFSA Resolution No. 258/2011).

**Table 31. Payroll**

| PLN thousand | 31.12.2012 | 31.12.2011 | Change | |
|---|---|---|---|---|
| | | | PLN thousand | PLN thousand |
| Payroll costs. including: | 406 703 | 372 543 | 34 161 | 9.2% |
| - base remuneration | 336 242 | 307 449 | 28 793 | 9.4% |
| - other components of salaries and wages * | 6 111 | 3 570 | 2 541 | 71.2% |
| - awards and bonuses | 60 695 | 58 520 | 2 175 | 3.7% |
| - non-employment contracts | 3 655 | 3 003 | 652 | 21.7% |
| Salary overheads | 57 997 | 49 124 | 8 873 | 18.1% |
| Fringe benefits | 8 659 | 16 803 | (8 144) | (48.5%) |
| Provisions for restructuring costs | 16 901 | - | 16 901 | - |
| Costs related to Company Social Benefits Fund | 6 232 | 5 923 | 309 | 5.2% |
| Other | 11 845 | 11 856 | (11) | (0.1%) |
| **Total payroll** | **508 337** | **456 249** | **52 088** | **11.4%** |
| **Awards and bonuses as % of base remuneration** | ***18.1%*** | ***19.0%*** | | ***(1.0%)*** |

Compared to 2011, the costs of basis salary increased by 9.4% in 2012, and the increase was due to strengthening of business areas of the Bank, i.e. development of the BGŻOptima internet channel and the Bankk's network of branches. Higher basic salaries resulted also from an increase of remuneration implemented in June 2012 to reward the best employees.

Information about the remuneration of the members of the Management Board and Supervisory Board can be found in the Group financial statements in note 47 BGŻ Transactions with related parties.

Information about a direct ownership of shares by members of the Management Board and Supervisory Board can be found in the Group financial statements in note 40 BGZ capital.

**Incentive schemes**

The Bank operates incentive schemes which combine three elements: goals and objectives relating to the priorities under the Bank's strategy and financial plans, the results which are the work output of the Bank's employees and the amount of bonus.

The incentive schemes, which are adjusted to the specific character of tasks realised in the area of sales, sales support and risk and risk support, are based primarily on the Management by Objectives (MbO) formula, which means that an individual bonus is related to the level and quality of the task performed. The system concentrates of defining tasks or objectives which set the development direction of the entire organisation and then are divided into the objectives of individual organisational units and individual employees.

The Bank also operates a separate bonus system for variable remuneration, including bonuses for employees fulfilling managerial functions who have a significant impact on the Bank's risk profile. The adopted solution is also a result of implementation of the PFSA Resolution No. 258/2011 dated 4 October 2011.

**Training and career development**

In 2012, a training program supported implementation of the Banks' strategic goals through the development of employee skills and competences. The program covered training organised both in traditional and e-learning form. In 2012, the number of employees who participated in the Bank's training program was 24 245.

The most significant training initiatives taken in 2012 were as follows:

- Training for employees in the Regions – in 2012, a team of internal trainers was appointed who are responsible for conduction of trainings for retail network employees.
- E-learning – in 2012, the catalogue of e-learning sessions included product-related sessions dedicated to sales employees. In 2012, training sessions on operating risk, combating of fraud, compliance issues and information security were conducted. These sessions were addressed to all employees of the Bank.
- New hires training – each newly employed person of the sales network participates in a training program addressed to this group of employees; the new hire training program covers sales techniques and product-type training.
- Training co-financed by the European Social Fund – in March 2012, the project *Let's Grow Together („Rośnijmy Razem")* was completed, under which training on development of employee interpersonal skills was conducted. Also, the project *Client first, on the way to deliver highquality service („Po pierwsze klient – w drodze do realizacji wysokiej jakości obsługi w Banku BGŻ")* was continued which concentrated on enhancement of client service quality at the Bank. This project was dedicated to client servicing personnel.
- Training for network sales management – in 2012, a number of training sessions were delivered on management skills development.
- Credit process related training under the Risk Culture Program – in 2012, a 2-year training program started relating to credit risk management. This training program is dedicated to network sales and risk employees.

In 2012, the Bank continued to operate the *„Prestige"* program dedicated to supporting development of the most talented employees.

**Internship programs**

The Bank offers internship programs to students and graduates. In 2012, the Bank had 600 interns. A special program of summer internship was developed, under which the Bank organised internship workshops where the participants could familiarise themselves with the Bank's structure and history, its corporate values and prospects for career development. In addition, during the summer internship program, the interns participated in business training sessions *Personal Account Fulfilling Your Expectations („Konto osobiste spełniające Twoje oczekiwania").*

**Employer branding**

In 2012, the Bank continued its employer branding activities. In 2012, the Bank was placed on the list of Best Employees in the Universum ranking of TOP 100 Ideal Employers.

## 7.10. IT DEPARTMENT

In 2012, the IT Department spent PLN 61,160,000 on its investment projects. During this period, 26 projects were completed. At the end of 2012, 20 projects remained uncompleted.

The most significant IT initiatives undertaken are as follows:

- Launch of the CRM system for client relations management, which facilitated implementation of a consistent sales-services model at the Bank
- Completion of migration of the main transaction system to a 3-layer architecture
- Implementation of new products by BGŻOptima (project realised in collaboration with Rabobank International Direct Banking)
- Contact Centre development as regards service channels for BGŻOptima

- Providing clients with the first contactless Visa/BGŻ card
- Implementation of the Client transaction authorization in the electronic banking system by means of unique SMS codes
- Implementation of new visualisation for the Internet channel
- Launch of a service function for document and some derivatives operations, and extension of the scope of securities servicing
- Implementation of solutions to reduce the risk of unauthorised breach of integrity of payment-related data
- Enhancement of lending process support systems for the segments of SMEs and Farmers
- Launch of solutions to support soft debt collection procedures
- Implementation of workflow solutions to support lending process service
- Implementation of workflow solutions to support Clients inquiries service
- Implementation of provisions of the Act and the Payment Services Directive
- Optimisation of management board's reports preparation in the MIS system
- Launch of an advanced data protection system on mobile computers
- Migration of server platforms to new technical solutions
- Migration to a new system version of catalogue services.

# 8. RISK MANAGEMENT

## 8.1. 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 2012 were as follows:

- strengthening of supervision rules, which apply to the loans granted for the corporate customers,
- modification of guidelines concerning creditworthiness assessment rules for corporate and retail customers
- 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,
- implementation of risk base pricing for cash loans granted to retail customers,
- expansion of internal limits schedule in order to manage portfolio risk more effective.

**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 27.7% of the gross value of credit portfolio at the end of 2012) and loans to farmers (22.4% of the gross value of credit portfolio).

In 2012, there was a significant decrease in share of mortgage loans in foreign currencies (effect of appreciation of PLN against CHF and natural expiration of portfolio as a result of customers' repayments). The share of cash loans, characterized by an increased risk of credit losses, is relatively low i.e. 2.9%. As at the end of 2012, the Bank's involvement towards clients from the building sector was PLN 576 303 thousand in comparison to PLN 736 432 thousand as at the end of 2011.

**Table 32. Structure of the loan portfolio**

| *PLN thousand* | 31.12.2012 | | 31.12.2011 | | Change | |
|---|---|---|---|---|---|---|
| | *PLN thousand* | Share in % | *PLN thousand* | Share in % | *PLN thousand* | Share in % |
| **Loans and advances, gross** | **27 411 582** | **100,0%** | **25 121 172** | **100,0%** | **2 290 410** | **9,1%** |
| Mortgage loans | 7 600 490 | 27.7% | 7 118 474 | 28.3% | 482 016 | 6.8% |
| – in PLN | 4 412 921 | 16.1% | 3 498 881 | 13.9% | 914 040 | 26.1% |
| – in foreign currencies | 3 187 570 | 11.6% | 3 619 593 | 14.4% | (432 023) | (11.9%) |
| Cash loans | 803 967 | 2.9% | 719 466 | 2.9% | 84 501 | 11.7% |
| Other loans to retail clients | 570 321 | 2.1% | 625 345 | 2.0% | (55 024) | (8.8%) |
| Individual entrepreneurs | 1 588 024 | 5.8% | 1 487 266 | 5.9% | 100 758 | 6.8% |
| Farmers | 6 136 271 | 22.4% | 5 275 980 | 21.0% | 860 291 | 16.3% |
| Corporates | 10 304 685 | 37.6% | 9 471 905 | 37.7% | 832 780 | 8.8% |
| Public sector | 314 877 | 1.1% | 289 919 | 1.2% | 24 958 | 8.6% |
| Other receivables | 92 947 | 0.4% | 132 817 | 1.1% | (39 870) | (30.0%) |

The share of impaired loans in gross amount of loans and advances granted to customers decreased from 5.8% as at the end of 2011 to 7.1% as at the end of 2012. The deterioration was partly an effect of changes to impairment model implemented in December 2012 (including mainly the concept of loans quarantine for receivables exiting the status of being ”impairment”). The above changes in the greatest extend influenced the index of mortgage loans quality, increasing it by 1.5 bp. Analyzing the changes of indexes in 2012, excluding the changes to model, it is worth emphasizing that they are quite stable in mortgage loans portfolio and they improved in cash loans portfolio. There was a deterioration in quality of corporate loans, both in the Large Enterprises sector (mainly due to bankruptcy of one customer from the building sector), but also in quality of loans to Small and Medium Enterprises and Micro – enterprises as a result of deterioration of macroeconomic situation.

The factor that was stabilizing the quality of the whole portfolio was a portfolio of loans to individual farmers (as at the end of 2012 they accounted for 22.4% of the Group portfolio), where the share of impaired loans as at the end of 2012 was 3.6% (before the change in the model: 3.2%) compared to 3.5% as at the end of 2011.

**Table 33. Quality of the loan portfolio**

| *PLN thousand* | 31.12. 2012 | 31.12. 2011 | Change y/y | |
|---|---|---|---|---|
| | | | *PLN thousand* | *PLN thousand* |
| **Retail loans** | **8 974 778** | **8 463 285** | **511 493** | **6.0%** |
| impaired | 593 540 | 459 408 | 134 132 | 29.2% |
| % share | 6.6% | 5.4% | | 1.2% |
| **Institutional loans** | **18 436 804** | **16 657 887** | **1 778 917** | **10.7%** |
| impaired | 1 360 256 | 996 532 | 363 724 | 36.5% |
| % share | 7.4% | 5.9% | | 1.5% |
| **of which: farmers** | **6 136 271** | **5 275 980** | **860 291** | **16.3%** |
| impaired | 219 038 | 184 508 | 34 530 | 18.7% |
| % share | 3.6% | 3.5% | | 0.1% |

**Restructuring and recovery of high risk debt**

The policy of restructuring and recovery of high risk debt conducted in 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,
- intensification of active portfolio management (as a result the quality of portfolio increased) and adapting it to changes in market conditions through the establishment of temporary rapid response teams (SWAT) in the regional structure of the Bank. The teams consist of representatives of the Credit Risk Division and Debt Restructuring and business units of the Bank, which will ensure a fully coordinated approach to managing portfolio risk and the selection of appropriate preventive measures.
- active monitoring of execution and bankruptcy proceedings,
- disposal of a part of non – performing loans,
- 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,
- providing a support for business units in handling loans at risk
- 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,
- appropriate training for business units personnel and credit area personnel in order to increase efficiency in identifying warning signals, helping with proper granting of loans (particularly in the security establishment, which apart from the repayments are the main source of recovery) and the consequences of the impact of NPLs
- improvement of the Bank's organizational structure, procedures and tools to enhance the efficiency of the tasks carried out.

Debts recovered in 2012 in the amount of PLN 350.2 million (principal) were 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 2012 amounted to 887 for corporate loans and, 3 906 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 – 38.9%,
- institutional in foreign currencies – 51.2%,
- retail in PLN – 68.3%,
- retail in foreign currencies – 107.6%.

The above information reflects 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) in previous years.

**Table 34. Number and volume of enforceable titles issued In 2012**

| ***Currency*** | ***Institutional loans*** | | ***Retail loans*** | |
|---|---|---|---|---|
| | Number of enforceable titles | Volume in currency (In thousands) | Number of enforceable titles | Volume in currency (In thousands) |
| PLN | 871 | 333 011 | 3 851 | 71 508 |
| CHF | 12 | 1 052 | 52 | 5 291 |
| EUR | 4 | 314 | 3 | 12 |
| ***TOTAL*** | **887** | | **3 906** | |

## 8.2. FINANCIAL RISK

### 8.2.1. MARKET RISK

Activities of the 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 in present values of these books'. 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**

Banking Book of BGŻ Bank consists of two elements – ALM, which aims to manage the interest rate risk and long-term liquidity of the Bank. Second element is the Money Market portfolio, which functions as a short term liquidity management centre.

ALM consists of deposits and loans, strategic positions (long-term investments, debt issue), hedging financial market operations to secure the banking book (by derivatives) and non-interest positions (i.e. equity, tangible assets, intangible assets, taxes and provisions, current profit). Management over all these elements is transferred to Bank's Headquarters through Funds' Transfer Pricing (TCF) system.

Money Market encompasses liquid assets and the closed-up differences on client's derivatives transactions (mostly regarding currency forward/futures contracts). This portfolio consists of derivatives operations, whose goal is to stabilize the cost of financing, to meet the liquidity needs of ALM portfolio through market operations, to secure cash flows from client's transactions and to adjust the level of risk to an acceptable level.

The Bank's policy with respect to the banking book is to earn additional income in excess of product margins, while avoiding the risk of instability of client deposits, capital or net profit. The Bank achieves this goal by keeping or matching the natural risk exposure resulting from deposit and lending activities within current risk limits or middle- and long-term financial market trends.

The main measures of the market risk applied by the Bank in the ALM portfolio are:

- interest rate revaluation gap,
- the weighted average duration of assets / liabilities and capital so called „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 portfolio of Money Market, according to its nature and purpose, apply measures equivalent to those used in the trading book:

- VaR – Value-at-Risk – indicating the maximum acceptable level of loss on the position under normal market conditions, at a specified time horizon, possible to exceed with a certain probability, the Bank uses a parametric model with a modified variance-covariance matrix and the exponential weighting of historical observation, shall be adopted: a 99% confidence level, holding period of 1 month;
- Scenario analysis and stress tests – to complement VaR for events outside the statistically predictable market behaviour: historical economic and political crises, the theoretical scenarios
- BpV (basis point value) – price sensitivity to a parallel shift of the yield curve.

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

**Situation in 2012**

At the end of 2012 the value of the „duration" measure – i.e. the weighted period to revaluation of interest rate of balance sheet assets was approx. 2.9 months (at the end of 2011 3.5 months), for the balance sheet liabilities – 2.6 months (previously – 2.8 month). Almost 93% of assets' and liabilities' items had revaluation deadline lower than 6 months (at the end of 2011 it was also 93%), however almost 59% 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 billion 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 recognised 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, influenced for the portfolio. In the second half of the year there were no significant changes.

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

- immediate growth of interest rates by 50 bps: decrease of the Bank's interest income during one year by PLN 1.3 million (at the end of 2011 increase by PLN 8.3 million),
- immediate decrease of interest rates by 50 bps: increase of the Bank's interest income during one year by PLN 3.5 million (at the end of 2011 decrease by PLN 24.1 million),
- a gradual increase of interest rates by 200 bps during one year: interest income decreased by PLN 4.0 million (at the end of 2011 increase by PLN 9.5 million),
- a gradual decrease of interest rates by 200 bps during one year: interest income increased by PLN 8.8 million (at the end of 2011 decrease by PLN 48.0 million).

Money Market portfolio exposure was dominated by positions in short-term treasury bonds and treasury bills issued by NBP (held for a short-term liquidity management purposes) and Interest Rates Swaps (OIS and IRS – formation of exposure, hedging the price risk) and FX Swap (bank financing). The usage of VaR limits, was in 2012 at 53% on average (58% in 2011). In term of foreign exchange, exposures in PLN had the highest share (over 90% of volatility measured in BPV), exposures in EUR, USD and CHF had minor influence

**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 the Bank generates revenues from short-term fluctuations in price parameters (foreign currency exchange rates, interest rates, debt securities prices etc.) whilst keeping the exposure within defined risk limit, the Bank does not have open position in 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 period; can be exceeded with defined probability; BGŻ S.A. 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 2012**

A review of limits in the trading book was conducted during the first half of 2012, however the basic border values (VaR, stress test) remained unchanged. The maximum possible sensitivity level (BPV) for the individual node points (tenors) of profitability curves were specified, lowering the accepted risk level for the longer tenors. The risk appetite key measures were not exceeded.

Thanks to the favourable market conditions and the positive results in intraday trading, the Bank achieved the annual budget plans for both the interest rate, as well as currency portfolio. Interest rate risk profile of the portfolio evaluated throughout the year: especially in the second half of the year it was subject to significant changes. In the early half of the year, the Bank has built a significant position in government debt securities (dominated by low-risk securities price), while at the end of year the reduction contributed to historically low levels of the exposure. Open positions in interest rate swaps had a significant impact on the risk profile, its positive sensitivity was a counterweight to the position in bonds, and at the end of the year it dominated the exposure of the portfolio.

In 2012. the average measure of trading portfolio exposure to the price risk, the value at risk (VaR), was kept at the average level of 64% of the limit, which almost entirely resulted from interest rate exposure. VaR for interest rate risk amounted to the average level of 67% of limit, and for currency risk – 7% of the limit. In 2012, the risk appetite key measures in the trading books were not exceeded.

In November and December the Bank for the first time in the history of derivative transactions entered into commodity markets (commodity swaps). It were a client transactions, at the same time the Bank entered into opposite transactions in the interbank market.

**Liquidity risk and assessment of finance sources stability**

The Bank maintained safe level of financial liquidity. The growth of depository base, which occurred in 2011 was retained in the second half of 2012. The financial resources 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 at the end of December to PLN 1.16 billion.

At the end of 2012, the excess of financing resources originated from non interbanking market above credit limit amounted to PLN 4.8 billion, whilst the excess of stable deposits over credit portfolio – PLN 1.31 billion

Stability of the Bank's financing was kept at high average level achieving at the end of the year a level of 88.5%, which was possible mainly due to low fluctuations of balances of retail deposits and BGŻOptima (increase in stability level of 93.1%), 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 due to the CHF loan from Rabobank.

## 8.3. 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. The Bank includes also the risk of the lack of compliance and legal risk to the operating risk scope.

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.

## 8.4. LEGAL RISK

The litigation situation in 2012 within insurance and employment claims was stable and did not generate material legal risk for the Bank. There were no court proceedings or before public administration relating to liabilities or receivables of BGŻ SA, of which value was at least 10% of the BGŻ S.A. equity as at 31.12.2012

## 9. INFORMATION ABOUT THE AUDITOR

The entity authorized to audit the Bank's BGŻ S.A. and the Capital Group's financial statements is the Ernst & Young Audit spółka z o.o. with its registered office in Warsaw, Rondo ONZ 1 (registered in Krajowa Izba Biegłych Rewidentów under 130 number), based on the agreement dated 14 June 2010, effective for years 2010, 2011, 2012.

Information about remuneration of the auditor:

**Table 35. Remuneration of Ernst & Young Audit Sp. z o.o. authorized for auditing financial statements for the year ended 31 December 2012 and 31 December 2011, by types of services (in PLN thousand).**

| Type of service | Year ended 31 December 2012 | Year ended 31 December 2011 |
|---|---|---|
| Obligatory audit of financial statements * | 601 | 582 |
| Other attestation services * | 221 | 221 |
| Tax consultancy services * | - | - |
| Other services * | 101 | 1 635 |
| **Total** | **923** | **2438** |

* including VAT

## 10. REPORT ON APLICATION OF CORPORATE GOVERNANE POLICIES IN THE YEAR 2012 BY BANK GOSPODARKI ŻYWNOŚCIOWEJ S.A.

### Statement of compliance with corporate governance policies

Pursuant to the provisions of §91 section 5 point 4) of the Ordinance of the Minister of Finance dated 19 February 2009 on the current and periodic reports disclosed by the securities issuers and on equivalence of information disclosures required by law of non-EU member states (Official Journal No. 33/ 2009, item 259 with subsequent amendments), the Management Board of the Bank is pleased to present the following information on application by the Bank of corporate governance policies in 2012.

**Corporate governance policies at BGŻ S.A. and public availability of the underlying document**

Corporate governance principles, which the Bank was subject to in 2012, are included in the "Best Practices of WSE Listed Companies" which is an Appendix to Resolution No. 20/1287/2011 of the WSE dated 19 May 2010/

This document is publicly available on the Internet at http://corp-gov.gpw.pl/publications.asp. , which is the official website of the Warsaw Stock Exchange devoted to issues of corporate governance of listed companies.

**Information on departure by issuer from application corporate governance policies and the reasons for such departure**

The Bank adopted corporate governance policies defined in „The Best Practices of WSE Listed Companies („Best Practices)" in the wording arising from the update of these practices made by the Supervisory Board of the WSE made based on the Resolution No. 17/1249/2010 of the Supervisory Board of the WSE dated 19 May 2010 concerning authorizing changes to „The Best Practices of WSE Listed Companies". The Best Practices in the above wording were adopted for use by the Bank's Management Board based in the Resolution No. 78/SG/14/2011 dated 12 April 2011, with the provison that the Bank decided that the policy defined in point I. 5 of the Best Practices [The Company should have policy of remunerating and policies for remuneration calculation]. The policy of remunerating should, in particular, define the form, structure and the level of emoluments for the members of supervisory and management boards. In determining the policy of awarding remuneration for members of management and supervisory boards, the provisions of the Recommendation of the European Commission ("EC") dated 14 December 2004 concerning supporting appropriate system of remuneration for directors of listed companies (2004/913/EC), supplemented by the Recommendation of the EC dated 30 April 2009 (2009/385/EC)] will be applied by the Bank after the policy of remunerating and after policies of remuneration calculation have been adopted and implemented.

The Supervisory Board of Bank Gospodarki Żywnościowe S.A acting pursuant to § 27 paragraph. 1 of Resolution No. 285/2011 of the Polish Financial Supervisory Authority dated 4 October 2011, concerning detailed principles of functioning of the risk management and internal control systems and detailed principles of estimating by the banks of internal capital and performing reviews of the process of estimating and maintaining internal capital, and the principles of determining the policy for determining variable components of emoluments for persons fulfilling management functions at the Bank approved at the meeting of 21 June 2012, the Remuneration policy of the members of the Management Board and the remuneration policy of the Bank employees (Supervisory Board Resolution No. 37/2012 and No 38/2012 of 21 June 2012). At the meeting on 19 December 2012, the Supervisory Board approved amendments to the above Policies.

The Management Board of the Bank represents that the Bank and its authorities complied in the year 2012 the adopted principles of corporate governance as defined in the Best Practices. In the period covered by this report, no instances of breach of the adopted principles of corporate governance were identified

**Key features of the issuer's internal control and risk management systems with respect to the process of the preparation of financial statements of Bank Gospodarki Żywnościowej SA**

The Bank operates the system o internal control and internal audit which has been adjusted to the organizational structure and covers organizational units and main organizational units of the Bank and the subsidiary of the Bank.

The objective of the internal control system of the Bank is to provide support to decision-making processes that contribute to ensuring:

- effectiveness and efficiency of the Bank's operations
- financial reporting reliability
- compliance of the Bank's operations with legal and internal regulations.

The Bank's internal control system comprises:

- risk control mechanisms,
- verification of the compliance of Bank's operations with legal and internal regulations,
- internal audit,
- functional control.

The Bank operates an organisational unit that conducts internal audits, and the objective of this unit is to provide an independent and objective audit (verification) and assessment of the adequacy and efficiency of the internal control system as well as providing opinions on the system of managing the Bank, including the efficiency of managing operating risk. Detailed principles concerning internal control system are defined in the internal regulations. The Director of the Internal Audit Department reports directly to the President of the Management Board of the Bank.

The Bank adopted the accounting principles that are provided in the International Financial Reporting Standards. It is the Finance Department and the Control Department that is supervised by the First Vice-President of the Management Board that is responsible for the preparation of the financial statements, current reports or periodic reporting and providing management information.

**Shareholders with direct or indirect ownership of significant packages of shares, number of shares held by those shareholders, their percentage share in the Bank's share capital, number of votes and percentage share of the votes held in the total number of votes at the General Shareholders' Meeting**

The main shareholders of the Bank are the following entities:

- Rabobank International Holding B.V. with its registered office in Utrecht (Croeselaan 18, 3521 CB Utrecht, Holland) („RIH"), holding directly 45 941 751 shares of the Bank, which account for 89,84% of the entire issued share capital of the Bank. RIH is the parent company for the Rabobank Group, which primarily focuses on performing banking operations and rendering banking services.
- Coöperatieve Centrale Raiffeisen - Boerenleenbank B.A., with its registered office in Amsterdam and the main place of conducting operations in Utrecht, (Croeselaan 18, 3521 CB, Utrecht, Holland) holding directly 4 303 695 shares of the Bank, which account for 8.42% of the issued share capital of the Bank.
- Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. is the immediate parent of RIH and the sole owner of RIH.

Detailed information on the Bank's shareholding structure has been provided in Table 6. BGŻ S.A. shareholding structure in section 5. Shareholder's structure of the Bank.

**Holders of securities which give special control rights, together with description of such rights**

The Bank's shares are ordinary bearer shares and registered (or inscribed) shares (as at 31 December 2012 – 8 022 915 registered shares). No special control rights are attached to the ordinary shares.

Registered shares, series B (as at 31 December 2012 – four (4) shares) are preference shares and the privilege associated to those shares is the right to recover full nominal amount of those shares in case of Bank's liquidation and after satisfying Bank's debtors, before any payments are made in respect of ordinary shares, for which payments – after making payments towards preference shares – may not cover their underlying nominal amount

**Restrictions on exercising voting right such as restriction to exercise voting right by holders of defined part or number of votes, time limits to exercise voting right or provisions under which, upon company collaboration, equity rights attached to securities are separated from the securities held**

The Bank's Articles of Association do not include any restrictions on exercising voting right and do not include any provisions which would separate equity rights attached to securities from securities holding. In accordance with § 10 section 4 of the Bank's Articles of Association , each share gives right to one vote at the General Shareholders' Meeting.

**Restrictions on transfer of ownership rights to securities issuer**

The Bank's Articles of Association do not include any restrictions on transfer of ownership rights to securities issued by the Bank.

**Regulations concerning appointment or dismissal of Management or Supervisory Board Members, rights of those persons, in particular, the right to take decision on share issue or redemption**

In accordance with § 21 section 1 of the Bank's Articles of Association , The Management Board of the Bank is composed of four to eight persons appointed for the common term of three years.
The Management Board of the Bank is composed of the President of the Management Board, First Vice-president, Vice-presidents and/ or Members of the Management Board, who are appointed, dismissed or suspended by the Supervisory Board. At least two members of the Management Board, including President of the Management Board, should have knowledge and experience that ensure that the Bank is managed in a stable and prudent manner. At least half of the Bank' Management Board Members should be represented by persons with good knowledge of the banking market in Poland i.e. these

persons should be permanent residents of Poland, should command Polish language and should have appropriate experience in the Polish market (§ 21 of the Bank's Articles of Association ).
The Management Board of the Bank conducts its affairs and represents the Bank. The provisions of the Bank's Articles of Association do not provide the Management Board with any special authorizations in the field of share issue or redemption. Detailed description, including the description of the Management Board authorizations is included in § 22 section 2 of the Bank's Articles of Association .

**Implementing changes to issuer Articles of Association**

Each change or modification of the Bank' Articles of Association is to be made by way of resolution of the General Shareholders' Meeting and entry in the National Court Register. To the extent defined in art. 34 section 2 of the act dated 29 August 1997 – Banking Law (uniform text: Journal of Laws 2002/72, item 665 with subsequent amendments) any change to the Articles of Association require consent of the Polish Financial Supervision Authority.

Applications of Members of the Management Board of the Bank concerning implementing changes to the Bank's Articles of Association , as well as any other matters requested by the Bank's Management Board to be considered by the General Shareholders' Meeting, should be first presented to the Supervisory Board for consideration

As regards changes to the Bank's Articles of Association , including in particular changes to the Bank's name, registered office, profile of its business activities referred to in § 5 section 2 of the Bank's Articles of Association , increase or decrease in the Bank's share capital, should be made by way of resolution of the General Shareholders' Meeting accepted by 3/4 of total votes. (§13 section 2 of the Bank's Articles of Association ).

Pursuant to the provisions of §20 section 1 letter ł) of the Bank's Articles of Association , immediately after General Shareholders' Meeting accepting changes to the Bank's Articles of Association , the competence of the Supervisory Board becomes determining the uniform text of the Articles of Association and implementing other editorial changes to the Articles of Association defined by the Resolution of the General Shareholders' Meeting.

**Functioning of the Shareholders' Meeting, its fundamental powers, rights of the shareholders and the manner of exercising those rights, in particular rights arising from the Regulations of the General Meeting of Shareholders to the extent they do not arise directly from legal regulations**

Pursuant to the provisions of §8 section 6 of the Bank's Articles of Association , the Shareholders' Meeting is convened by placing an announcement on the Bank's Internet website and in the manner defined for forwarding current information in accordance with the regulations concerning public tender and the terms and conditions of introducing financial instruments to organized trading and public companies, at least 26 days before the scheduled date of the Shareholders' Meeting.

The Shareholders Meetings are convened in the Bank's registered office which is located in Warsaw. The General Shareholders Meetings are convened as ordinary or extraordinary meetings. The General Shareholders Meeting is convened by the Management Board of the Bank. Ordinary Shareholders Meeting is convened once a year, not later than within 6 months after the end of each financial year (§8 section 2 of the Bank's Articles of Association ).

The Extraordinary Shareholders' Meetings are convened as needed by the Bank's Management Board on the initiative of the Management Board or at the request of the Supervisory Board, or at the request of the shareholder or shareholders representing at least 1/20 of the issued share capital (§8 section 3 of the Bank's Articles of Association – the first sentence).

The shareholder or shareholders representing in total at least 1/20 of the share capital of the Bank may request that Extraordinary General Shareholders' meeting is convened and may request that specific matters are included in the agenda of this General Shareholders' Meeting. The shareholders representing at least half of the share capital of the Bank or at least half of the total votes may request that the Extraordinary Shareholders' Meeting is convened. The shareholders appoint President of the convened Extraordinary Shareholders' Meeting (§ 8 section 5 of the Bank's Articles of Association ).

Pursuant to the provisions of §9 of the Bank's Articles of Association , all matters proposed to agenda of the Shareholders' Meeting by the Management Board should be first forwarded to the Supervisory Board for consideration.

The shareholder or shareholders representing a total of at least 1/20 of the Bank's issued share capital and demanding that certain matters are included in the agenda of the nearest Shareholders' Meeting should forward these matters in writing or by e-mail to the Management Board of the Bank, and the Management Board will – in turn- forward them to the Supervisory Board. The application of a shareholder including justification or a draft of resolution on the proposed agenda point should be forwarded to the Bank's Management Board not later than 21 days before the designated date of the General Shareholders' Meeting (§ 9 section 1 second sentence of the Bank's Articles of Association ).

Removing from the agenda or desisting from considering a matter proposed for the agenda by the shareholders of the Bank should be made by resolution of a Shareholders' Meeting and upon consent of all Bank's shareholders who applied for including the given matter in the agenda.

The Shareholders' Meeting of the Bank is valid irrespective of the number of shares represented at such meeting. Issues relating to convening and functioning of the Shareholders' Meeting are described in the Code of Commercial Companies, and defined in the Bank's Articles of Association , in the Regulations of the Shareholders' Meeting and in the announcement of convening the Shareholders' Meeting.

On 21 July 2011, the Extraordinary Shareholders' Meeting adopted new Regulations of the Shareholders' Meeting, whereby the Shareholder's Meeting should be convened in accordance with the provisions of the Code of Commercial Companies, Banking Law, the Bank's Articles of Association , Regulations, after considering the Best Practices. Pursuant to the provisions of §10 of the Regulations of the Shareholders' Meeting, participants of the Shareholders' Meeting are Members of the Bank's Supervisory Board and Management and the number of the participating members should facilitate providing professional answers to questions asked during the Shareholders' Meeting. If the subject of the meeting is to include the financial matters, certified auditor should be present at such meeting. Regulations of the Shareholders' Meeting include, in particular, provisions concerning appointment, including the appointment of the Supervisory Board, in separate groups voting.

In accordance with the provisions of the Code of Commercial Companies, Banking Law and provisions of the Bank's Articles of Association , the main competences of the Shareholders' Meeting are the following:

- considering and authorization of directors' report on the Bank's activities and of the financial statements for the prior financial year,
- considering and authorization of directors' report on the activities of Banking Capital Group and of the consolidated financial statements for the prior financial year,
- adopting a resolution on appropriation of profit or absorption of loss for the year,
- acknowledgment of the fulfilment of duties by Members of the Bank's Management and Supervisory Boards.

Apart from the above, the Shareholders' Meeting may take resolution in the following matters:

- changes in the Bank's Articles of Association ,
- appointment or dismissal of Supervisory Board Members,
- increase or decrease in the issued share capital of the Bank,

- issuance of convertible bonds and bonds with pre-emptive right to take up Bank's shares, as well as subscription warrants,
- redemption of shares and defining detailed terms and conditions for such redemption,
- Bank merger or liquidation, selection of liquidators and the manner of conducting liquidation,
- determining remunerating policy and determining emoluments of Supervisory Board members,
- proposed by the Supervisory or Management Board,
- proposed by the shareholders in accordance with binding regulations and the Bank's Articles of Association ,
- other [matters] reserved by law or the Bank's Articles of Association .

**Composition and changes in the last financial year and functioning of management, supervisory or administrative authorities of the issuer or their committees**

The Composition of the Management and Supervisory Board of the Bank is described in section **Błąd! Nie można odnaleźć źródła odwołania.**. Authorties of the Bank

In the year 2012, the Supervisory Board fulfilled the oversight function over the activities of the Bank and approved the Bank's strategy, its financial plans, Organizational Regulations, policies, and audit plan. The Supervisory Board considered information on the significant issues of the Bank's operations, including the execution of the financial plan, outstanding projects, types of risk and capital adequacy.

In its activities, the Supervisory Board was supported by two committees whose members were appointed from Supervisory Board Members i.e. the Internal Audit Committee and the Human Capital and Payroll Committee.

The Internal Audit Committee considered the results of both internal and external controls, information on implementing post-audit recommendations and recommendations of the PFSA, risk compliance reports, information on the review of the types of the risk incurred by the Bank, documents relating to the Risk appetite, complaint reports, restructuring and recovery activity reports, operational risk reports, summary of the most significant correspondence with the Polish Financial Supervisory Authority and the reports on the implementation of the Plan to improve risk management in the Bank.

Composition:

- Harry de Roo – Chairman
- Jarosław Iwanicki – Member (dismissed as Member of the Internal Audit Committee based on the Resolution of the Supervisory Board as of 6.09.2012 due to his appointment as member of the Human Capital and Payroll Committee)
- Roelof Dekker – Member (resignation on 22.06.2012),
- Dariusz Filar – Member
- Monika Nachyła – Member
- Evert Derks Drok – Member (appointed as member of Internal Audit Committee of the Bank based on the Resolution of the Supervisory Board dated 6.09.2012)

On the other hand, the Human Capital and Payroll Committee discussed inter alia list of leadership positions in the BGŻ S.A., under Resolution No. 258/2011 of the Financial Supervision Commission of 4 October 2011, proposals for the aims for the Board Members for 2012, the Remuneration Policy of Management Board Members, the Remuneration policy of the Bank's employees, changes in the mission, strategy and personnel policy of the Bank and the amendments to the Rules of the Human Capital and Payroll Committee. In addition, the committee took note of the information on employment and wages in 2011, and has examined the proposal to amend the structure and amount of remuneration of the members of the Management Board - to adapt to the requirements of the regulator and market practice.

Composition of committee in 2012:

- Jan Alexander Pruijs – Chairman
- Roelof Dekker – Member (resigned as of 22.06.2012)
- Andrzej Zdebski – Member (resigned as of 28.08.2012)

- Jarosław Iwanicki – Member (appointed as member the Human Capital and Payroll Committee based on the Resolution of the Supervisory Board dated 6.09.2012)

## 11. CORPORATE SOCIAL RESPONSIBILITY

Priorities of the Corporate Social Responsibility policy (CSR) in 2012, are a continuation of the activities launched in 2011 by the Bank's in sustainable development in the followingareas : environment, employees, community, customers / products.

In 2011, the Bank focused on the activities in two areas: within the organization - employees, the impact of the Bank on the environment, and outside - social engagement. In 2012, the next step was to create a platform for dialogue with key stakeholders. Through these activities, the mission of the Bank for local communities is carried out.

- The Bank published its first corporate responsibility report "Bank communities" for 2011 (available on www.bgz.pl), through which the Bank reliably inform about the Bank's social commitment and efforts against key stakeholders
- The Customer Council have been developed which is designed to create a coalition with the customers of the Bank to engage in solving local problems and to adapt the Bank's services to local needs

**Activities in other areas**
*Employees:* implementation of teleworking in the Bank..
*Environment*: under the "Green Office" program, activities and actions was carried out to reduce the negative impact of the Bank on the environment such as grouping of waste in the Bank Head Office, an action "a day without a car", competitions for employees, i.e. ideas for reducing consumption of paper.

*Society:* more than 350 different activities were organized for the local communities, the Bank has supported about 200 different organizations, launched the first edition of the voluntary work. The BGŻ Foundation, that implements social projects of the Bank, conducted a nationwide educational program "Driving with the head", in which more than 4 500 junior high school students gained practical knowledge of basic road safety rules.

The program "Class BGŻ" that was run by the BGŻ Foundation was chosen as the best scholarship software in the contest Good Scholarships 2012.

## 12. DEVELOPMENT PROSPECTS OF THE 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 continuing 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 funds for 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 recapitalization of 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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## 13. SIGINFICANT DEVEPOMENTS AFTER THE REPORT DATE

**Resignation of the President of the Management Board BGŻ S.A.**

On February 24, 2013 the Management Board was notified on the resignation of Mr Jacek Bartkiewicz from the post of the President of the Management Board the Management Board of BGŻ S.A. of March 31, 2013.

**Appointment of Vice President of the Management Board and assignment of the responsibilities of President of the Management BGŻ S.A., and conditional appointment as President of the Management Board of BGŻ S.A.**

On March 1, 2013 The Management Board was notified on the resignation of Ms Monika Nachyła from the position of member of the Supervisory Board of BGŻ S.A. as from March 1, 2013. Supervisory Board of the Bank during its seating on March 1, 2013 appointed Ms. Monika Nachyła as Vice President of the Management Board of the Bank and assigned to her the responsibilities of President of the Management Board of BGŻ S.A. Also that on 1st March 2013 the Supervisory Board passed resolution on appointment of Ms Monika Nachyła as President of the Management Board of BGŻ S.A.. The resolution shall come into force once the appointment is approved by the Polish Financial Supervision Authority under art. 22 b of the Banking law act.

................................
*Jacek Bartkiewicz*
*President of the Management Board*

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*Gerardus Cornelis Embrechts*
*First Vice-President*
*of the Management Board*

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*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, 4 March 2013