REPORT ON THE APPROVAL OF THE APPRAISAL REPORT OF THE SUPERVISORY BOARD ON THE FINANCIAL STATEMENTS OF BGŻ BNP PARIBAS S.A. INCLUDING THE BROKERAGE HOUSE, MANAGEMENT BOARD REPORT ON THE BANK'S ACTIVITY, INCLUDING THE BROKERAGE OFFICE, THE CONSOLIDATED FINANCIAL STATEMENTS OF THE CAPITAL GROUP OF BGŻ BNP PARIBAS S.A., AND OF THE MANAGEMENT BOARD REPORT ON THE ACTIVITY OF THE CAPITAL GROUP OF BGŻ BNP PARIBAS S.A FOR THE FISCAL YEAR FROM 1ST JANUARY 2017 TO 31ST DECEMBER 2017, REPORT ON THE NON-FINANCIAL INFORMATION OF BANK BGŻ BNP PARIBAS S.A. AND THE BANK BGŻ BNP PARIBAS S.A. CAPITAL GROUP IN 2017 AND ON THE MOTION OF THE MANAGEMENT BOARD ON THE DISTRIBUTION OF PROFIT FOR THE FISCAL YEAR 2017 TOGETHER WITH THE ASSESSMENT OF ADEQUACY AND EFFECTIVENESS OF THE INTERNAL CONTROL SYSTEM IN THE BANK BGŻ BNP PARIBAS S.A.

BGŻ BNP PARIBAS

Bank
zmieniającego
się świata

INDEX

1. FINANCIAL STATEMENTS OF THE BANK BGŻ BNP PARIBAS S.A. FOR 2017

Pursuant to Article 382 § 3 of the Code of Commercial Companies and § 20 paragraph 1 item 2) letter a), of the Articles of Association of the Bank, the Supervisory Board of Bank BGŻ BNP Paribas S.A. conducted an assessment of the financial statements of the Bank for the year ended 31 December 2017, the Management Board Report on the activities of Bank BGŻ BNP Paribas S.A., and the recommendation of the Management Board on the allocation of the profit for the year ended 31 December 2017.

The aforementioned assessment has been made based on:

1. The financial statements of the Bank for the year ended 31 December 2017 covering:
   - statement of financial position prepared as at December 31, 2017 showing total assets PLN 71 897 892 thou.,
   - profit and Loss account statement for the period from January 1, 2017 to December 31, 2017 showing net profit of PLN 298 389 thou.
   - statement of total income for the period from January 1, 2017 to December 31, 2017, showing a total income of PLN 440 858 thou.,
   - statement of changes in total equity for the period from January 1, 2017 to December 31, 2017 disclosing an increase in equity by PLN 440 045 thou.,
   - cash-flow statement for the period from January 1, 2017 to December 31, 2017 disclosing a positive net cash in the amount of PLN 989 936 thou.,

   and
   - notes to financial statements.
2. Management Board Report on the activities of Bank BGŻ BNP Paribas S.A. for 2017.
3. Motion of the Management Board on the profit distribution for the year ended 31 December 2017.
4. Report of independent statutory auditor from audit of the financial statements of Bank BGŻ BNP Paribas S.A.

The Supervisory Board states as follows:

Based on the assessment of the financial statements of Bank BGŻ BNP Paribas S.A. for the year ended 31 December 2017, the Supervisory Board has concluded that these financial statements, in all material aspects, have been prepared:

- in accordance with the International Financial Reporting Standards approved by the European Union;
- based on properly maintained accounting records;
- in accordance with the provisions of the law governing preparation of the financial statements and provisions of the Bank's Articles of Association influencing the form and content of the financial statements;

and give a fair and clear view of all information material for the evaluation of the financial result of business activities for the period from 1 January 2017 to 31 December 2017, as well as the economic and financial position of Bank BGŻ BNP Paribas S.A. as at 31 December 2017.

SELECTED FINANCIAL DATA

PLN '000	12 months ended 31.12.2017	12 months ended 31.12.2016	Change y/y PLN '000	
Profit before income tax	471 257	134 349	336 908	250,8%
Net profit for the period	298 389	49 388	249 001	504,2%
Integration costs	*(35 641)*	*(173 453)*	*137 812*	*(79,5%)*
Net profit for the period *excluding integration costs*	327 258	189 885	137 373	72,3%
Total equity	6 561 259	6 121 214	440 045	7,2%
Total liabilities and equity	71 897 892	70 381 933	1 515 959	2.2%

SEPARATE STATEMENT OF PROFIT AND LOSS

In 2017 Bank BGŻ BNP Paribas generated a net profit of PLN 298,389 thousand, that is six times higher than the amount achieved in 2016.

The net income on banking activity amounted to PLN 2,685,147 thousand and was 7.7% higher than in the same period last year. At the same time, the Bank's operating expenses (including depreciation and amortization) totalled to PLN 1,665,605 thousand, being reduced by 6.7% as compared to 2016. The third factor influencing the growth of net profit in 2017 as compared to 2016 was the balance of impairment losses on financial assets and provisions for contingent liabilities, which was lower by 11.3% and amounted to PLN -342,419 thousand.

An important factor determining the comparison of the Bank's results realized in the analysed periods was the merger process of Bank BGŻ BNP Paribas S.A. and Sygma Bank Polska S.A. completed in 2016. The comparability was distorted by the fact of including the results of Sygma Bank Polska S.A. in the Bank's results starting from 31 May 2016.

Additionally, in 2016, the Bank incurred significant costs related to the merger processes of BGŻ S.A., BNP Paribas Polska S.A. and Sygma Bank Polska S.A. The costs of integration processes of the banks in 2017 were lower by 79.5% (i.e. by PLN 137,812 thousand) as compared to 2016 and amounted to PLN 35,641 thousand.
Had the integration cost been eliminated in the analysed periods, the Bank's net profit in 2017 would amount to PLN 327,258 thousand, and would have been 72.3% (i.e. PLN 137,373 thousand) higher than the profit of the previous year.

In 2017 and 2016 the following events independent of the Bank have influenced the level of the results:

- In 2017, due to the amendment of the Bank Guarantee Fund (BFG) act, the methodology of calculating the fee for the guarantee fund and the forced bank restructuring fund has changed. The cycle of paying the restructuring fund has also been changed (from quarterly to annual, with payment deadline for the year 2017 due on 20th of July). The total fees paid to BFG recognized in 2017 were lower than those incurred in the previous year by PLN 31,141 thousand, i.e. by 24.6%.
- In 2016, the acquisition of Visa Europe Limited by Visa Inc. took place (positive impact on the Bank's gross profit amounted to PLN 41,817 thousand).
- In 2016 (by the Act on Tax on the assets of certain financial institutions of 15 January 2016), a taxation of banks' assets was introduced starting from February, at a monthly rate of 0.0366%. Due to the time of introduction of this tax - the results of 2016 were charged with lower costs than the results of 2017 (by PLN 19,990 thousand).
- In 2016, the sale of receivables increased the Bank's result by PLN 53,160 thousand. In 2017, as a result of the sale of receivables, the income was equal to PLN 34,881 thousand.

Net interest income

In 2017, the net interest income, which represents the main source of the Bank's income, increased by PLN 153,840 thousand i.e. by 8.7%, which was the effect of an increase in interest income by PLN 147,720 thousand, i.e. 5.9% y/y with a simultaneous decrease in interest expenses by PLN 6,120 thousand, i.e. by 0.8% y/y. The level of interest income and expenses in 2017 was influenced by the growth rate of commercial volumes and a decrease in financing costs.

Among external factors affecting the level of net interest income, NBP's policy regarding the development of key interest rates and their stabilization at record low level (the reference rate as of March 2015 amounts to 1.5%) and market trends in shaping interest rates on deposits should be mentioned. Among the internal factors, the increase in the scale of operations with a simultaneous decrease in the cost of financing, which allowed the Bank to increase the net interest margin (calculated as the ratio of net interest income and average quarterly assets) from 2.65% in 2016 to 2.73% in 2017, had the largest impact on the level of net interest income.

In the structure of the Bank's interest income, the largest item, i.e. 70.0%, is the income from interest on loans and advances to customers, the value of which increased by PLN 94,456 thousand, i.e. by 5.4% as compared to 2016. This increase was largely caused by the inclusion of the results of Sygma Bank Polska S.A. to the Bank's results only from 31 May 2016.

In addition, interest income on debt securities significantly increased: by PLN 54,304 thousand, i.e. by 20.8%. This growth was the result of the increase in the scale of operations and the increase in the size of the portfolio of assets available for sale (by 11.4% y/y).

The increase in the net interest income was influenced by the improvement of margins on customer deposits (cost reduction), primarily in the case of amounts due to households, which remain the group with the largest share in the total amounts due to customers. The above-mentioned drop in the cost of acquisition was the reason for the nominal increase in interest costs being much slower (+2.4% y/y) despite an increase in the average balance of amounts due to customers (by 6.1% y/y).

The visible decrease in nominal interest expenses from amounts due to banks resulted from the replacement of part of wholesale financing (loans and advances received from banks) with financing obtained from customers. Interest expenses from amounts due to banks in 2017 were lower by PLN 12,921 thousand (i.e. by 17.4%) compared to the previous year.

At the end of 2017, the Bank applied fair value hedge accounting. The change in the fair value measurement of hedging transactions is recognized in the result on hedge accounting. Interest on IRS transactions and hedged items is recognized in net interest income.

Net interest income on hedging relationships (the sum of interest income and interest expense from derivatives under fair value hedge accounting) for 2017 amounted to PLN +7,601 thousand as compared to the negative value at the level of PLN -1,042 thousand for 2016.

Net fee and commission income

Net result on fee and commission in 2017 amounted to PLN 452,955 thousand, and was higher by PLN 11,322 thousand, (i.e. by 2.6% y/y) as a result of an increase in fee and commission income by PLN 28,782 thousand (i.e. 5.2% y/y), with a simultaneous increase in commission expenses by PLN 17,460 thousand (i.e. 16.2%).

The increase in fee and commission income was recorded in almost all commission categories, in particular from the following items:

- increase in loans and advances by PLN 18,911 thousand, i.e. by 11.2%;
- increase in brokerage operations by PLN 14,631 thousand, i.e. by 73.4%;
- increase in payment cards by PLN 13,901 thousand, i.e. by 18.1%;
- increase in asset management by PLN 4,713 thousand, i.e. by 197.1%.

The increase in fees and commissions was mainly caused by:

- higher by PLN 13,419 thousand, i.e. by 173.1%, expenses of fees and commissions on bancassurance,
- higher by PLN 12,696 thousand, i.e. by 23.3%, commission expenses related to payment cards, incurred in favour of payment card operators due to the greater number of transactions carried out by the Bank's clients.

Dividend income

Dividend income in 2017 came from the profits of companies for 2016, in which the Bank held minority interests, i.e .: Krajowa Izba Rozliczeniowa S.A. (KIR, PLN 827/5 thousand), Biuro Informacji Kredytowej S.A. (BIK, PLN 3,881.0 thousand) and VISA (PLN 65.9 thousand), as well as from the profits of subsidiaries of BNP Paribas Group Services Center S.A. (PLN 14,899.6 thousand) and BGŻ BNP Paribas Faktoring Sp. z o.o. (PLN 5,645.6 thousand). In addition, the Bank received an advance dividend from the profit of BNP Paribas Group Services Center S.A. for 2017 in the amount of PLN 12,197.2 thousand.

Net trading income and net investment income

The net trading income in 2017 amounted to PLN 251,455 thousand and was lower by PLN 2,390 thousand, i.e. by 0.9% y/y. The level and volatility of this result are mainly determined by the valuation of derivative instruments and the result on foreign exchange transaction.

Result on investment activities in 2017 amounted to PLN 28,398 thousand and was lower by 363 thousand, i.e. by 1.3% as compared to the result achieved in 2016.

The result generated in 2016 was mainly influenced by the remuneration resulting from the settlement of the Visa Europe Limited acquisition by Visa Inc. As a result of this settlement, the Bank received EUR 6.9 million in cash (i.e. PLN 30,518 thousand, translated at the exchange rate at 4.3945 of 20 June 2016) and 2,521 preferential shares of Visa Inc. Series C. The total profit due to the execution of this transaction amounted to PLN 41,817 thousand.

The result for 2017 consists of profits from the sale of a portfolio of securities available for sale in the amount of PLN 25,543 thousand and profit from the sale of shares - PLN 2,855 thousand (including the sale of BGŻ BNP Paribas Faktoring Sp. z o.o. carried out in the fourth quarter of 2017 in the amount of PLN 2,757 thousand).

Other operating income

In 2017, other operating income amounted to PLN 133,374 thousand and was higher by PLN 26,353 thousand, i.e. by 24.6% as compared to the previous year. This was mainly due to:

- increase of the other operating income item by PLN 25,063 thousand, i.e. by 88.4% (among others: higher revenues due to the reimbursement of brokerage expenses by BNP Paribas Leasing Services, revenues related to re-invoicing costs and release of provisions for legal risks);
- an increase in profits on the sale or liquidation of fixed assets and intangible assets by PLN 15,038 thousand, i.e. by 149.7% (profit on the sale or liquidation of Banks' fixed assets in 2017 was equal to PLN 15,098 thousand);
- an increase in income due to the recovery of debt collection costs by PLN 8,823 thousand, i.e. by 112.8%.

At the same time, revenues from the sale of goods and services, release of provisions for litigation and claims as well as revenues from the recovery of overdue debts, redeemed receivables, non-collectible debts and payment of receivables that were excluded from the consolidated statement of financial position were lower in comparison with 2016.

"Other operating income" includes, among others, an annual adjustment of VAT tax charged for 2016 in the amount of PLN 7,873 thousand (as compared to PLN 8,820 thousand in the previous year).

Other operating expenses

In 2017, other operating expenses totalled to PLN 138,888 thousand and were higher by PLN 22,860 thousand PLN (i.e. by 19.7%) as compared to 2016, which resulted mainly from the following:

- an increase in costs due to created impairment losses on other receivables by PLN 9,554 thousand. The creation of provision for unsettled balances of card transactions resulting from the migration process in the first quarter of 2017 had the largest impact on this item,
- an increase of PLN 7,126 thousand, i.e. by 27.0%, of the costs of debt collection,
- an increase of PLN 20,662 thousand, i.e. by 153.7% of the balance of other operating expenses (among others higher brokerage expenses related to sale of BNP Paribas Leasing Services products).

In 2016 and 2017, other operating expenses included the costs related to the integration of banks - they relate primarily to the write-off of intangible assets, costs of liquidation of fixed assets and additional costs incurred due to termination of cooperation with one of the companies performing non-cash financial settlements. In 2016 the total amount of integration costs included in other operating costs was PLN 18,947 thousand, while in 2017 the impact of this category was positive and amounted to PLN 126 thousand.

Net impairment losses on financial assets and provisions for contingent liabilities

The result of impairment losses on financial assets and provisions for contingent liabilities in 2017 totalled to PLN -342,419 thousand and its negative impact on the Bank's results was lower by PLN 43,511 thousand, i.e. by 11.3% as compared to 2016. The balance of impairment allowances in 2017 was lower despite the fact that the positive impact of the sale of receivables in 2016 was higher by PLN 18,279 thousand.

In 2017 the Bank entered into 9 agreements regarding the sale of the loan portfolio. The amount of receivables (covered by a significant part of impairment allowances, or written down in full from the Bank's balance sheet) sold under the agreements, amounted to PLN 651,152 thousand (principal amount, interest and other side receivables). The contractual price for the sale of these portfolios has been set at PLN 138,119 thousand. The net effect on the Bank's income from the sale of portfolios amounted to PLN 34,881 thousand and is presented in the result of impairment losses on financial assets and provisions for contingent liabilities.

In 2016 the Bank entered into 3 agreements regarding the sale of the loan portfolio. The amount of receivables sold under the agreements (covered by a significant part of impairment allowances, or written down in full from the Bank's balance sheet) amounted to PLN 545,133 thousand (principal amount, interest and other side receivables). The contractual price for the sale of these portfolios has been set at PLN 75,604 thousand. The net effect on the Bank's income from the sale of portfolios amounted to PLN 53,160 thousand and is presented in the result of impairment losses on financial assets and provisions for contingent liabilities.

The cost of credit risk exposure expressed as the ratio of net impairment losses to net loans and advances to customers (calculated on the basis of balances at the end of quarters) was 0.64% in 2017 and improved by 11 bps as compared to 2016 (0.75%).

Considering the key operating segments[1]:

- the Retail and Business Banking segment recorded an improvement in the balance of allowances by PLN 44,610 thousand y/y,
- SME Banking segment - improvement by PLN 14,475 thousand y/y,
- Corporate Banking segment (including CIB) - improvement by PLN 2,995 thousand y/y.

General administrative expenses, personnel expenses, amortization and depreciation

[1] *Information based on the note with operating segments included in the Separate Financial Statements of the Bank BGŻ BNP Paribas for the year ended on 31 December 2017.*

The general administrative expenses of the Bank incurred from 1 January to 31 December 2017 amounted to PLN 1,492,071 thousand and were lower by PLN 97,306 thousand i.e. 6.1% as compared to the previous year. It should be emphasized that in 2016, exSygma costs were included in the administrative costs of the Bank from the moment of legal merger, i.e. from 31 May 2016 (7 months).

The reduction in costs in 2017 was, among others, influenced by lower integration costs incurred by the Bank. In 2017 these costs amounted to PLN 35.6 million (in 2016 - PLN 173.4 million), of which:

- PLN 36.3 million was included in the general administrative expenses, depreciation and amortization (in 2016 - PLN 154.5 million);
- PLN 0.71 million as a reduction of other operating expenses (in 2016, PLN 18.9 million as operating expenses).

The integration costs in 2017 include mainly:

- expenses related to accelerated depreciation and amortization of systems and liquidation of assets in connection with the merger of banks - PLN 9.3 million,
- projects implemented due to the integration - PLN 21.9 million (including: operational integration with Sygma - PLN 15.3 million).

The largest decrease in administrative expenses concerns employee costs, which were lower by PLN 35,457 thousand as compared to the previous year. The impact on the decrease of expenses was reduction of employment by 592 FTEs (FTE as of 31.12.2017 - 7,386, as of 31.12.2016 - 7,978) and by PLN 23.5 million lower than the costs of the restructuring provision, which in 2016 amounted to PLN 26 million.

The decrease in expenses in 2017 was also recorded in the BFG fee item. In total, the BFG premiums booked by the Bank in 2017 expenses were PLN 95.5 million and are PLN 31.1 million lower than in the previous year. This is due to the implementation of the Act of 10 June 2016 on the Bank Guarantee Fund, deposit guarantee system and forced restructuring (Journal of Laws, item 996 from 2016). The implementation of the Act introduced changes in the method of calculating the base and indicators for the purpose of calculating fees for BFG, which resulted in reduction of costs incurred by the Bank in this respect.

Depreciation and amortization expenses incurred in 2017 decreased by PLN 23,182 thousand, i.e. by 11.8% as compared to 2016. This was primarily caused by cease of the use of assets which after completion of the operational merger with BNPP Bank Polska were liquidated, as well as lower by PLN 15.2 million costs of accelerated depreciation and amortization.

STATEMENT OF OTHER COMPREHENSIVE INCOME

In 2017 the comprehensive income of the Bank was higher by PLN 589,629 thousand than in the corresponding period of the previous year. The immediate reason for the observed improvement was a significant change in the valuation of available-for-sale financial assets (a positive effect of PLN 424,333 thousand) and a significant increase in net profit generated in the periods compared.

STATEMENT OF FINANCIAL POSITION

Assets

At the end of December 2017, the Bank's balance sheet total amounted to PLN 71,897,892 thousand and was PLN 1,515,959 thousand (2.2%) higher than at the end of December 2016.

The key changes in the structure of Bank's assets during 2017 included: a growth in the share of receivables from banks and in financial assets available for sale, accompanied with a decrease in the share of loans and advances to customers.

Loans and advances to customers, which accounted for 72.6% of total assets as at the end of December 2017 vs. 75.6% at the end of 2016, were the key items in the structure of assets. In terms of value, net loans and advances decreased by PLN 984,514 thousand, i.e. 1.9%, which was mainly caused by the decrease in the value of foreign exchange mortgage loans, which resulted from the Polish zloty strengthening

Financial assets available for sale were the second largest asset item and constituted 19.4% of the balance sheet total at the end of 2017 (vs. 17.8% at the end of 2016). In 2017, their value increased by PLN 1,429,656 thousand, i.e. by 11.4%, mostly as a result of extension of the money bills portfolio (an increase by PLN 1,099,470 thousand) and a purchase of NBP treasury bonds of PLN 329,620 thousand.

Changes in earning assets were accompanied by an increase in the share of receivables from banks to 3.5%. These receivables increased by PLN 1,289,545 thousand, i.e. by 105.2%, mainly due to the increase of current accounts by PLN 1,410,982 thousand.

Loan portfolio

Structure and quality of the loan portfolio

At the end of 2017, gross loans and advances to customers amounted to PLN 54,967,103 thousand and decreased by PLN 1,209,529 thousand (2.2%) as compared to 2016. The decrease was mainly caused by strengthening of Polish zloty and revaluation of the portfolio of foreign currency mortgage loans. Without including this category, gross value of loan portfolio would increase by PLN 187,253 thousand, i.e. 0.4% y/y.

Loans and advances to enterprises decreased by 0.9% and represented 31.6% of the gross loan portfolio (31.2% at the end of 2016). Loans and advances to households (including individual entrepreneurs and farmers) decreased by PLN 1,096,711 thousand, i.e. 3.1%. Mortgage loans, totalling PLN 13,628,114 thousand at the end of December 2017, represented 39.7% of loans and advances to households (42.4% at the end of 2016).

The share of impaired exposures in gross loans and advances to customers increased to 7.5% at the end of 2017 as compared to 8.0% at the end of 2016.

In December 2017, the Bank performed a securitization transaction on the portfolio of cash and car loans. The transaction is a traditional securitization involving the transfer of ownership of the securitized receivables to SPV (BGŻ Poland ABS1 DAC based in Ireland). The revolving period is 24 months.

SPV issued bonds with a total value of PLN 2,180,850 thousand on the basis of securitized assets and received a loan of PLN 119,621 thousand, which was secured by a registered pledge on the rights to cash flows from securitized assets.

As a result of securitization, the Bank obtained financing in return for the transfer of rights to future cash flows resulting from the securitized loan portfolio in the amount of PLN 2,300,471 thousand as at 22 November 2017 (cut-off). The maximum deadline for full redemption of bonds and repayment of the loan is 27 April 2032.

The main benefit of the performed transaction is a positive impact on capital adequacy ratios and improvement of liquidity and diversification of financing sources.

In the light of the provisions of IAS 39, the contractual terms of the securitization do not fulfil the conditions for derecognition of securitized assets. In connection with the above, the Bank recognizes securitized assets in “Loans and advances to customers” as at 31 December 2017 at net value of PLN 2,106,698 thousand. At the same time, the Bank recognizes a liability due to cash flows from securitizations in "Liabilities due to customers" in the amount equal to PLN 2,300,471 thousand as at 31 December 2017. As at 31 December 2017, the Bank held receivables due to settlements with a securitization company in the amount of PLN 87,699 thousand. These receivables are presented in “Other assets”.

The Bank acts as a servicing entity in the transaction.

Liabilities and equity

As at the end of December 2017, the Bank's total liabilities amounted to PLN 65,336,633 thousand and were higher by PLN 1,075,914 thousand, i.e. 1.7% than at the end of 2016.

At the end of 2017, the share of liabilities in the total of liabilities and equity was 90.9%, i.e. 0.4 pp lower than at the end of December 2016. The main change in the structure of liabilities in 2017 was the increase in the share of amounts due to customers, accompanied by a decrease in amounts due to banks.

At the end of December 2017, amounts due to customers increased by PLN 3,360,743 thousand (6.1%) as compared to the end of December 2016 and amounted to PLN 58,658,067 thousand. Due to a material increase of the volume, their share in the total of liabilities increased to 89.8% as compared to 86.1% at the end of 2016.

In 2017 the reduction of debt arising from loans and advances received from Banks continued, which resulted in a drop in the share of liabilities to banks in the total liabilities. At the end of 2017 the share amounted to 4.5%, compared to 8.2% at the end of 2016. At the end of December 2017, amounts due to banks amounted to PLN 2,926,396 thousand and were lower by PLN 2,356,063 thousand (i.e. 44.7%) than in the previous financial year.

Amounts due to customers

At the end of December 2017, amounts due to customers reached PLN 58,658,067 thousand and increased by 6.1% as compared to the end of December 2016. This increase concerned all sectors, primarily corporate clients and other financial entities, which resulted from the execution of securitization transactions in the consumer loan portfolio and obtaining new financing sources. The share of current liabilities increased in maturity structure.

The share of current accounts in the total structure of amounts due to customers increased from 50.0% at the end of December 2016 to 51.7% at the end of December 2017. The value of funds deposited in current accounts increased by PLN 2,684,522 thousand, i.e. 9.7%.

On the other hand, the share of term deposits in the total structure of amounts due to customers decreased from 45.6% at the end of December 2016 to 41.0% at the end of 2017. Term deposits value decreased by PLN 1,153,736 thousand, i.e. 4.6% as compared to December 2016.

Amounts due to customers at the end of 2017 also include the amount of PLN 2,303,210 thousand, which concerned liabilities due to securitization settlements, which constituted 3.9% of the amounts due to customers.

Loans and advances received from other financial institutions decreased by PLN 547,978 thousand.

Amounts due to retail customers increased by PLN 114,739 thousand, i.e. 0.4%, and accounted for 47.1% of all amounts due to customers at the end of December 2017 (decrease by 2.7 pp as compared to the end of December 2016).

Amounts due to corporate customers increased by PLN 1,843,816 thousand, i.e. 8.1%. Their share in total amounts due to customers grew from 41.3% at the end of December 2016 to 42.0% at the end of 2017.

As a result of securitization transaction of the portfolio of consumer loans, amounts due to other financial institutions increased (by PLN 1,314,110 thousand). Their share in the total structure of amounts due to customers increased from 7.5% at the end of December 2016 to 9.3% at the end of 2017.

In the case of the public sector, the increase in liabilities amounted to PLN 88,078 thousand, while their share at the end of 2017 remained at the level of 1.5% of total amounts due to customers.

Equity

As at the end of December 2017, the Bank's equity amounted to PLN 6,561,259 thousand and was higher by PLN 440,045 thousand than at the end of 2016.

The change resulted mostly from the increase in the net profit by PLN 249,001 recorded by the Bank in 2017 versus 2016. The positive impact on equity resulted also from the increase in the value of revaluation reserve (from PLN -552.0 thousand at the end of 2016 to PLN 141,917 thousand at the end of 2017) as a result of a positive revaluation of financial assets available for sale.

EQUITY AND CAPITAL RATIOS

As at 31 December 2017, the total capital ratio of the Bank amounted to 13.92% and was 1.02 pp lower than at the end of December 2016.

The Common Equity Tier 1 capital ratio (CET I) and the Tier 1 ratio of the Bank as at the end of 2017 were identical and amounted to 10.95%.

As at 31 December 2017, total own funds increased by PLN 64,836 thousand as compared to 31 December 2016, primarily due to:

- retaining profit of Bank BGŻ BNP Paribas for 2016 in the amount of PLN 49,388 thousand for the general banking risk fund following a resolution of the Ordinary General Shareholders' Meeting of Bank BGŻ BNP Paribas of 22 June 2017;
- recognizing a part of current year profit for the period from 1 January 2017 to 30 June 2017 in the amount of PLN 130,029 thousand in equity, in accordance with the PFSA decision issued on 23 November 2017.

In the analysed period, the total risk exposure amounted to PLN 55,307,981 thousand and increased by PLN 4,209,455 thousand y/y.

On 28 November 2017, the Bank received a recommendation from the Polish Financial Supervision Authority concerning the Bank's maintenance of own funds necessary to cover an additional capital requirement at the level of 0.62 pp in order to hedge the risk resulting from foreign currency mortgage loans granted to households, which should consist at least in 75% of Tier 1 capital (corresponding to 0.47 pp) and at least in 56% of Common Equity Tier 1 capital (corresponding to 0.35 pp).

On 29 December 2017, the Bank received a decision from the Polish Financial Supervision Authority dated 19 December 2017 concerning imposing on the Bank (on a consolidated and individual basis) a buffer of other systemically important institution equivalent to 0.25% of the total risk exposure amount.

In connection with the above, the minimal capital ratios obligatory for the Bank until the end of 2017, considering both the above-mentioned decisions and additional recommendations of the PFSA were:

- 10.85% for the Common Equity Tier 1 ratio (CET 1);
- 10.97% for Tier 1 capital ratio;
- 14.12% for the total capital ratio TCR.

At the same time, as at 31 December 2017, the required levels of the separate capital ratio CET 1, Tier 1 and TCR resulting from the Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, the Act of 5 August 2015 on macro-prudential supervision of the financial system and crisis management in the financial sector as well as taking into account the PFSA decisions, were:

- 6.35% for the Common Equity Tier 1 ratio (CET 1);
- 7.97% for Tier 1 capital ratio;
- 10.12% for the total capital ratio TCR.

As at 31 December 2017, the Bank's capital ratios exceeded the above levels, meeting the requirement of the combined buffer indicated in Article 60 of the Act of 5 August 2015 on macro-prudential supervision over the financial system and crisis management in the financial sector.

In accordance with the Act of 5 August 2015 on macro-prudential supervision over the financial system and crisis management in the financial sector, and the Regulation of the Minister of Finance, from 1 January 2018, the capital requirements applicable to banks in Poland increased through:

- introducing a systemic risk buffer of 3%;
- increase in the capital conservation buffer level from 1.25% to 1.875%.

As a result of the above changes, in accordance with the "Position of the PFSA on minimum levels of capital ratios" obligatory for banks in 2018, published on 24 November 2017, the minimal capital ratios of Bank BGŻ BNP Paribas S.A. from 1 January 2018 should be:

- 9.98% for the Common Equity Tier 1 ratio (CET 1);
- 11.60% for Tier 1 capital ratio;
- 13.75% for the total capital ratio TCR.

On 6 February 2018, after the preparation of the opening balance as at 1 January 2018, which takes into account the implementation of IFRS 9, the Management Board of Bank BGŻ BNP Paribas S.A. learned information on the level of solvency ratios as of 1 January 2018. Tier 1 capital ratio (Tier 1) in separate terms was below the new requirements. Solvency ratios as at 1 January 2018, on a standalone basis, amounted to:

- CET 1 - 10.84%,
- Tier 1 - 10.84%,
- TCR - 13.79%.

Taking into account the above mentioned situation, the Management Board of the Bank decided to immediately take additional actions to meet the new regulatory requirements. Among various other activities, the Bank is planning to increase the share capital by issuing new shares. The BNP Paribas Capital Group provided the support to the Bank's Management Board in the implementation of the planned activities aimed at achieving the required capital ratios. The capital increase should be realized at the turn of 2nd and 3rd quarter of 2018, provided that the consents required by law are obtained.

On 12 December 2017, the European Parliament and the EU Council adopted the Regulation No. 2017/2395 amending the Regulation No. 575/2013 regarding transitional arrangements to mitigate the impact of implementing IFRS 9 on equity and the solutions regarding the fact of treating some exposures to public sector entities, which are denominated in the national currency of any Member State, as large exposures. This Regulation entered into force on the day following its publication in the Official Journal of the European Union and has been applicable since 1 January 2018. The European Parliament and the Council (EU) considered that the implementation of IFRS 9 could possibly lead to a sudden increase in impairment allowances for expected credit losses, and hence, the decrease in Tier 1 capital.

The Bank, after analysing the requirements of Regulation No. 2017/2395, decided to apply the transitional provisions provided for in this Regulation, which means that the full impact of the implementation of IFRS 9 will not be taken into account for the purpose of assessing capital adequacy of the Bank and the Group. As a result of adjusting the calculation of regulatory capital requirements it was estimated that the full impact of IFRS 9 implementation would decrease the total capital ratio of the Bank by 53 basis points.

FINANCIAL RATIOS

The ROE of the Bank, calculated after excluding the impact of integration costs in 2017, was 5.2%. The increase in comparison to 2016 is caused by an improvement in the net income on banking activity, primarily the net interest income. The return rate on assets, calculated after excluding the impact of integration costs, was 0.5% and increased by 0.2 pp as compared to 2016.

The change in the cost to income ratio is indicative of the improvement of the main activity profitability. This ratio improved as a result of an increase in revenues with a simultaneous decrease in operating costs (excluding integration costs). The Cost / Income ratio (excluding integration costs) is at the level of 60.7%, lower by 4.3 pp compared to 65.0% at the end of 2016. For the purpose of calculating the above mentioned ratio, the denominator is the category of net income on banking activity, which is the sum of net interest income, net fee and commission income, dividend income, trading income, investment income, result on hedge accounting and other operating income and expenses.

Presentation of the ratios calculated based on the profit and loss account, excluding integration costs (understood as additional costs related to the merger processes of BGŻ SA, BNP Paribas Polska SA and Sygma Bank Polska SA), aims to provide an additional information to assess the current potential of merged banks.

Net interest margin, calculated in relation to assets, improved (by 8 bps) to the level of 2.7%, as a result of the increase in the share of interest-bearing assets in the structure of assets.

The risk cost ratio decreased compared to the level recorded in 2016 by 9 bps and amounted to 0.6%.

The value of the ratio constituting the relation of net loans and advances to deposits improved compared to the end of 2016 due to the increase in the share of customer deposits in financing the Bank's activity, with a simultaneous decrease in the value of net loans and advances.

Financial ratios

	31.12.2017	31.12.2016	31.12.2015	Change y/y in pp
Return on equity(1)	5.2%*	3.0%*	3.3%*	2.2 pp
Return on assets(2)	0.5%*	0.3%*	0.3%*	0.2 pp
Net interest margin(3)	2.7%	2.6%	2.6%	0.1 pp
Cost/Income(4)	60.7%*	65.0%*	73.9%*	(4.3) pp
Cost of credit risk(5)	(0.6%)	(0.7%)	(0.7%)	0.1 pp
Net loans and advances/Deposits(6)	91.3%	99.8%	112.3%	(8.5) pp
Gross loans and advances/Total source of funding(7)	87.1%	90.0%	97.4%	(2.9) pp

** Normalised values, excluding integration costs. The impact of integration costs on the net profit was estimated using the standard 19% income tax rate. In the case of the "costs" category, the amount included in the financial statements was reduced by the amount of integration costs recorded as general administrative expenses and depreciation. In the case of the "income" category, the amounts of the profit or loss statement comprising the net income on banking activities was adjusted for integration costs recorded under other operating costs.*

(1) Net profit in relation to average equity, calculated based on quarter-end balances.

(2) Net profit in relation to average assets, calculated based on quarter-end balances.

(3) Net interest income in relation to average assets, calculated based on quarter-end balances.

(4) Total general administrative expenses, amortization and depreciation in relation to total net banking income, calculated as the total of net interest income, net fee and commission income, dividend income, net trading income, net investment income, result on hedge accounting and other operating income and expenses.

(5) Net impairment losses on loans and advances in relation to the average balance of net loans and advances to customers, calculated based on quarter-end balances.

(6) (Net) loans and advances to customers in relation to customer deposits, balance at the end of the period.

(7) Gross loans and advances to customers in relation to total liabilities to customers, debt securities issued, loans from other banks and subordinated liabilities, balance at the end of the period.

ASSESSMENT MADE BY THE SUPERVISORY BOARD

After becoming acquainted with the Financial statements of Bank BGŻ BNP Paribas S.A. for the year ended on 31 December 2017 prepared by the Management Board, and the Report of the independent statutory auditor for audit of the financial statement of Bank BGŻ BNP Paribas S.A. for the year ended on 31 December 2017, the Supervisory Board decides to give a positive opinion to the Financial statement of the Bank for the year ended on 31 December 2017, and recommend the approval of the financial statements to the Ordinary General Meeting.

2. REPORT OF THE MANAGEMENT BOARD ON ACTIVITY OF BANK BGŻ BNP PARIBAS S.A. FOR 2017

The Supervisory Board declares that the report of the Management Board on activity of Bank BGŻ BNP Paribas S.A. in 2017 is factually correct and consistent with the books and documents, including information contained in the Financial statement of Bank BGŻ BNP Paribas S.A. for the year ended on 31 December 2017. The Supervisory Board recommends the approval of the report of the Management Board on activity of the Bank BGŻ BNP Paribas S.A. in 2017 to the Ordinary General Meeting of Bank BGŻ BNP Paribas S.A.

3. RECOMMENDATION OF THE MANAGEMENT BOARD ON 2017 PROFIT ALLOCATION

Supervisory Board hereby recommends to the Ordinary Shareholders Meeting of the Bank that the whole profit after taxation (net profit) for the fiscal year 2017 in the amount of PLN 298 389 438,93 (say: two hundred ninety eight million three hundred eighty nine thousand four hundred and thirty eight zlotys and ninety three grosz) shall be transferred to the reserve capital.

4. FINANCIAL STATEMENTS OF THE BANK'S CAPITAL GROUP

Pursuant to § 20 paragraph 1 item 2) letter b) of the Articles of Association, the Supervisory Board of Bank BGŻ BNP Paribas S.A. conducted an assessment of the consolidated financial statements of Bank BGŻ BNP Paribas S.A. Capital Group for the year ended 31 December 2017 and the report on the activity of the Capital Group in 2017.

The aforementioned assessment was conducted on the basis of:

1. Bank BGŻ BNP Paribas S.A. Capital Group consolidated financial statements for the year ended on 31 December 2017 covering:
   - consolidated statement of financial situation drawn up as at December 31, 2017 with balance sheet total of PLN 72 749 259 thou.,
   - consolidated profit and loss account for the period from January 1, 2017 to December 31, 2017 showing net profit of PLN 279 707,
   - consolidated statement of comprehensive income for the period from January 1, 2017 to December 31, 2017 showing a total income of PLN 422 192 thou.,
   - consolidated statement of changes in equity for the period from January 1, 2017 to December 31, 2017 showing a increase in equity of PLN 412 642 thou.,
   - consolidated cash-flow statement for the period from January 1, 2017 to December 31, 2017 disclosing a positive net cash in the amount of PLN 959 582 thou.,

   and
   - notes to the consolidated financial statements.

2. Report of the Management Board on the activities of Bank BGŻ BNP Paribas S.A. Capital Group for the year ended on 31 December 2017.
3. Report of independent statutory auditor on audit of the consolidated financial statements of Bank BGŻ BNP Paribas S.A. Capital Group for the year ended on 31 December 2017

The Supervisory Board states as follows:

As a result of the assessment of consolidated financial statements of Bank BGŻ BNP Paribas S.A. Capital Group for the year ended on 31 December 2017, the Supervisory Board states that the statements in all relevant aspects:

- have been drawn up in accordance with the International Financial Reporting Standards approved by the European Union,

- are compliant with legal provisions regulating the preparation of financial statements, which affect the form and contents of the financial statements,

and reliably and clearly present all information relevant for the assessment of the financial result on the business activity for the period from 1 January 2017 to 31 December 2017, as well as the economic and financial position of Bank BGŻ BNP Paribas S.A. Capital Group as at 31 December 2017.

SELECTED FINANCIAL DATA

PLN '000	12 months ended 31.12.2017	12 months ended 31.12.2016	Change YoY PLN 000	Change YoY %
Profit before income tax	453 885	174 507	279 378	160,1%
Net profit for the period	279 707	76 860	202 847	263,9%
Integration costs	*(35 641)*	*(181 404)*	*145 763*	*(80,4%)*
Net profit for the period *excluding integration cost*	308 576	223 797	84 779	37,9%
Total equity	6 559 463	6 146 821	412 642	6,7%
Total liabilities and equity	72 749 259	72 304 999	444 260	0,6%

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

In 2017 the Capital Group of Bank BGŻ BNP Paribas generated a net profit of PLN 279,707 thousand, that is over three times higher than the amount achieved in 2016.

The net income on banking activity amounted to PLN 2,695,980 thousand and was 2.1% higher than in the previous year. The Group's operating expenses (including depreciation and amortization) totalled to PLN 1,680,930 thousand, being reduced by 10.6%. The third factor influencing the growth of net profit in 2017 as compared to 2016 was the balance of impairment losses on financial assets and provisions for contingent liabilities, which was lower by 10.9% and amounted to PLN -355,299 thousand.

In 2016, the Group incurred significant costs related to the merger processes of BGŻ S.A., BNP Paribas Polska S.A. and Sygma Bank Polska S.A. The costs of integration processes of the banks in 2017 were lower by 80.4% (i.e. by PLN 181,404 thousand) as compared to 2016 and amounted to PLN 35,641 thousand. If the impact integration costs in the analysed periods would be eliminated, the net income generated by the Group would amount to PLN 308,576 thousand and would be higher by 37.9% (i.e. PLN 84,779) in comparison to the previous year.

In addition, in 2017, the Bank sold a subsidiary BGŻ BNP Paribas Faktoring Sp. z o.o. The sale and the resulting deconsolidation (i.e., the fact that the company is not included in the consolidated financial statements, income statement and balance sheet, as of 31 December 2017) affect the comparability of results with 2016.

In 2017 and 2016 the following events independent of the Bank have influenced the level of the results:

- In 2017, due to the amendment of the Bank Guarantee Fund (BFG) act, the methodology of calculating the fee for the guarantee fund and the forced bank restructuring fund has changed. The cycle of paying the restructuring fund has also been changed (from quarterly to annual, with payment deadline for the year 2017 due on 20th of July). The total fees paid to BFG recognized in 2017 were lower than those incurred in the previous year by PLN 33,430 thousand, i.e. by 25.9%.
- In 2016, the acquisition of Visa Europe Limited by Visa Inc. took place (positive impact on the Group's gross profit amounted to PLN 41,817 thousand).
- In 2016 (by the Act on Tax on the assets of certain financial institutions of 15 January 2016), a taxation of banks' assets was introduced starting from February, at a monthly rate of 0.0366%. Due to the time of introduction of this tax - the results of 2016 were charged with lower costs than the results of 2017 (by PLN 19,990 thousand).

- In 2016, the sale of receivables increased the Bank's result by PLN 53,160 thousand. In 2017, as a result of the sale of receivables, the income was equal to PLN 34,881 thousand.

Net interest income

In 2017, the net interest income, which represents the main source of the Group's income, increased by PLN 100,592 thousand i.e. by 7.5%, which was the effect of an increase in interest income by PLN 80,655 thousand, i.e. 3.1% y/y with a simultaneous decrease in interest expenses by PLN 19,937 thousand, i.e. by 2.6% y/y. The level of interest income and expenses in 2017 was influenced by the growth rate of commercial volumes and a decrease in financing costs. Negative impact on the comparison of interest income is due to the lack of interest income on receivables of BGŻ BNP Paribas Faktoring Sp. z o.o. in 2017, while the company was consolidated in 2016.

Among external factors affecting the level of net interest income, NBP's policy regarding the development of key interest rates and their stabilization at record low level (the reference rate as of March 2015 amounts to 1.5%) and market trends in shaping interest rates on deposits should be mentioned. Among the internal factors, the increase in the scale of operations with a simultaneous decrease in the cost of financing.

The most valuable nominal increase occurred in the category of interest income on debt securities, which increased by PLN 53,589 thousand, i.e. by 20.5%. This increase was the result of the increase in the scale of operations and an increase in the available for sale assets portfolio (by 11.4% y/y).

In the structure of the Group's interest income, the largest item, i.e. 70.4%, is the income from interest on loans and advances to customers, the value of which increased by PLN 26,823, i.e. by 1.5% as compared to 2016. This increase was largely caused by the increase in the scale of operations and realized margins in the "other entities" category, in which, among others, lease receivables are presented.

The significant decrease in nominal interest costs on liabilities to banks resulted from the replacement of part of the wholesale financing (loans and advances received from banks) with the financing obtained from customers. Interest expenses due to liabilities to banks in 2017 were lower by PLN 26,414 thousand (i.e. 25.1%) as compared to the previous year.

The positive impact on the level of net interest income was influenced by the improvement of margins on customer deposits (cost reduction), primarily in the case of amounts due to households, which remain the group with the largest share in the total amounts due to customers. The above-mentioned drop in the cost of acquisition was the reason for the nominal increase in interest costs being much slower (+ 1.9% y/y) despite an increase in the average balance of amounts due to customers (by 2.1% y/y).

At the end of 2017, the Group applied fair value hedge accounting. The change in the fair value measurement of hedging transactions is recognized in the result on hedge accounting. Interest on IRS transactions and hedged items is recognized in net interest income.

Net interest income on hedging relationships (the sum of interest income and interest expense from derivatives under fair value hedge accounting) for 2017 amounted to PLN +7,601 thousand as compared to the negative value at the level of PLN -1,042 thousand for 2016.

Net fee and commission income

Net result on fee and commission in 2017 amounted to PLN 485,979 thousand and was lower by PLN 7,241 thousand, i.e. by 1.5% y/y as a result of a faster increase in commission costs (by PLN 11,469 thousand, i.e. 10.0%) than an increase in fee and commission income (by PLN 4,228 thousand, i.e. 0.7% y/y). The fact that revenue from credit commissions of BGŻ BNP Paribas Faktoring Sp. z o.o., consolidated in 2016, impacts negatively on the net result on fee and commission.

The increase in fee and commission income was recorded mainly in income categories, and resulted from:

- increase in brokerage operations by PLN 17,163 thousand, i.e. by 98.6%;
- increase in payment cards by PLN 11,831 thousand, i.e. by 15.0%;
- increase in asset management by PLN 7,025 thousand, i.e. by 77.3%.

The increase in fees and commissions was mainly caused by:

- higher by PLN 13,419 thousand, i.e. by 173.1%, expenses of fees and commissions on bancassurance,
- higher by PLN 12,301 thousand, i.e. by 22.4%, commission expenses related to payment cards, incurred in favour of payment card operators.

Dividend income

Dividend income in 2017 came from the profits of companies for 2016, in which the Bank held minority interests, i.e .: Krajowa Izba Rozliczeniowa S.A. (KIR, PLN 827/5 thousand), Biuro Informacji Kredytowej S.A. (BIK, PLN 3,881.0 thousand) and VISA (PLN 44.8 thousand) and BGŻ BNP Paribas Faktoring Sp. z o.o. (PLN 5,645.6 thousand).

Net trading income and net investment income

The net trading income in 2017 amounted to PLN 251,408 thousand and was lower by PLN 3,783 thousand, i.e. by 1.5% y/y. The level and volatility of this result are mainly determined by the valuation of derivative instruments and the result on foreign exchange transaction.

Result on investment activities in 2017 amounted to PLN 28,398 thousand and was lower by 17,801 thousand, i.e. by 38.5% as compared to the result achieved in 2016.

The result generated in 2016 was mainly influenced by the remuneration resulting from the settlement of the Visa Europe Limited acquisition by Visa Inc. As a result of this settlement, the Group received EUR 6.9 million in cash (i.e. PLN 30,518 thousand, translated at the exchange rate of 20 June 2016 at 4.3945) and 2,521 preferential shares of Visa Inc. Series C. The total profit due to the execution of this transaction amounted to PLN 41,817 thousand.

The result for 2017 consists of profits from the sale of a portfolio of securities available for sale in the amount of PLN 25,543 thousand and profit from the sale of shares – in the amount of PLN 2,855 thousand (including the amount of PLN 2,757 from the sale of shares of BGŻ BNP Paribas Faktoring Sp. z o.o. carried out in the fourth quarter of 2017).

Other operating income

In 2017, other operating income amounted to PLN 131,282 thousand and was higher by PLN 958 thousand, i.e. by 0.7% as compared to the previous year. This was mainly due to:

- increase of the other operating income item by PLN 17,867 thousand, i.e. by 64.8% (among others: higher revenues related to re-invoicing costs and release of provisions for legal risks);
- an increase in profits on the sale or liquidation of fixed assets and intangible assets by PLN 15,873 thousand, i.e. by 172.3% (profit on the sale or liquidation of Banks' fixed assets in 2017 was equal to PLN 15,098 thousand);
- an increase in income due to the recovery of debt collection costs by PLN 8,890 thousand, i.e. by 113.7%.

At the same time, revenues from the recovery of overdue debts, redeemed receivables, non-collectible debts and payment of receivables that were excluded from the consolidated statement of financial position as well as revenues from the sale of goods and services were lower than in 2016.

"Other operating income" in 2017 includes, among others, the annual adjustment of VAT tax charged for 2016 in the amount of PLN 7,873 thousand (as compared to PLN 8,820 thousand in the previous year).

Other operating expenses

In 2017, other operating expenses totalled to PLN 141,495 thousand and were higher by PLN 24,904 thousand PLN (i.e. by 21.4%) as compared to 2016, which resulted mainly from the following:

- an increase in costs due to created impairment losses on other receivables by PLN 94,517 thousand. The creation of provision for unsettled balances of card transactions resulting from the migration process in the first quarter of 2017 had the largest impact on this item,
- an increase of PLN 6,088 thousand, i.e. by 27.2%, of the costs of debt collection,
- an increase of PLN 23,273 thousand, i.e. by 177.0% of the balance of other operating expenses (among others higher brokerage expenses related to sale of BNP Paribas Leasing Services products).

In 2016 and 2017, other operating expenses included the costs related to the integration of banks - they relate primarily to the write-off of intangible assets, costs of liquidation of fixed assets and additional costs incurred due to termination of cooperation with one of the companies performing non-cash financial settlements. In 2016 the total amount of integration costs included in other operating costs was PLN 18,947 thousand, while in 2017 the impact of this category was positive and amounted to PLN 126 thousand.

Net impairment losses on financial assets and provisions for contingent liabilities

The result of impairment losses on financial assets and provisions for contingent liabilities in 2017 totalled to PLN -355,299 thousand and its negative impact on the Group's results was lower by PLN 43,584 thousand, i.e. by 10.9% as compared to

2016. The balance of impairment allowances in 2017 was lower despite the fact that the positive impact of the sale of receivables in 2016 was higher by PLN 18,279 thousand.

In 2017 the Bank entered into 9 agreements regarding the sale of the loan portfolio. The amount of receivables (covered by a significant part of impairment allowances, or written down in full from the Bank's balance sheet) sold under the agreements, amounted to PLN 651,152 thousand (principal amount, interest and other side receivables). The contractual price for the sale of these portfolios has been set at PLN 138,119 thousand. The net effect on the Bank's income from the sale of portfolios amounted to PLN 34,881 thousand and is presented in the result of impairment losses on financial assets and provisions for contingent liabilities.

In 2016 the Bank entered into 3 agreements regarding the sale of the loan portfolio. The amount of receivables sold under the agreements (covered by a significant part of impairment allowances, or written down in full from the Bank's balance sheet) amounted to PLN 545,133 thousand (principal amount, interest and other side receivables). The contractual price for the sale of these portfolios has been set at PLN 75,604 thousand. The net effect on the Bank's income from the sale of portfolios amounted to PLN 53,160 thousand and is presented in the result of impairment losses on financial assets and provisions for contingent liabilities.

The cost of credit risk exposure expressed as the ratio of net impairment losses to net loans and advances to customers (calculated on the basis of balances at the end of quarters) was 0.64% in 2017 and improved by 10 bps as compared to 2016 (0.74%).

Considering the key operating segments[2]:

- Retail and Business Banking segment recorded an improvement in the balance of allowances by PLN 38,043 thousand y/y,
- SME Banking segment - improvement by PLN 15,107 thousand y/y,
- Corporate Banking segment (including CIB) - improvement by PLN 5,111 thousand y/y.

General administrative expenses, personnel expenses, amortization and depreciation

The general administrative expenses of the Group incurred from 1 January to 31 December 2017 amounted to PLN 1,506,866 thousand and were lower by PLN 167,490 thousand i.e. 0.0% as compared to the previous year.

Comparability of general administrative expenses, depreciation and amortization in the analysed periods is affected by the derecognition of the subsidiary BGŻ BNP Paribas Faktoring Sp. z o.o. in in 2017, as the subsidiary was sold in December.

The highest decrease in terms of volume in case of administrative expenses is related to personnel costs, which were lower by PLN 69,427 thousand than in the previous year. The decrease was a result of the reduction of employment by 439 FTEs (7,634 FTEs as at 31 December 2017, as compared to 8,073 FTEs as at 31 December 2016, including 75 FTEs in BGŻ BNP Paribas Faktoring Sp. z o.o.), as well as lower costs of the restructuring fund, which amounted to PLN 26 million as at the end of 2016.

The reduction in costs in 2017 was influenced by lower integration costs. In 2017 these costs amounted to PLN 35.6 million (in 2016 - PLN 181.4 million), of which:

- PLN 36.3 million was included in the general administrative expenses, depreciation and amortization (in 2016 - PLN 162.5 million);
- PLN 0.7 million as a reduction of other operating expenses (in 2016, PLN 18.9 million as operating expenses).

The integration costs in 2017 include mainly:

- expenses related to accelerated depreciation and amortization of systems and liquidation of assets in connection with the merger of banks - PLN 9.3 million,
- projects implemented due to the integration - PLN 21.9 million (including: integration with Sygma - PLN 15.3 million).

The impact on the decrease of expenses was reduction of employment by 592 FTEs (FTE as of 31.12.2017 - 7,386, as of 31.12.2016 - 7,978) and by PLN 23.5 million lower than the costs of the restructuring provision, which in 2016 amounted to PLN 26 million.

The decrease in expenses in 2017 was also recorded in the BFG fee item. In total, the BFG premiums booked in 2017 expenses were PLN 95.5 million and are PLN 33.4 million lower than in the previous year. This is due to the implementation of the Act of 10 June 2016 on the Bank Guarantee Fund, deposit guarantee system and forced restructuring (Journal of Laws,

[2] *Information based on the note with operating segments included in the Consolidated Financial Statements of the Bank BGŻ BNP Paribas Group for the year ended on 31 December 2017.*

item 996 from 2016). The implementation of the Act introduced changes in the method of calculating the base and indicators for the purpose of calculating fees for BFG, which resulted in reduction of costs incurred by the Bank in this respect.

Depreciation and amortization expenses in the analysed period, as compared to 2016, decreased by PLN 32.5 million, i.e. by 15.7%. This was primarily caused by cease of the use of assets which after completion of the operational merger with BNPP Bank Polska were liquidated, as well as lower by PLN 15.2 million costs of accelerated depreciation and amortization.

STATEMENT OF COMPREHENSIVE INCOME

In 2017 the comprehensive income of the Bank was higher by PLN 543,919 thousand than in the corresponding period of the previous year. The immediate reason for the observed improvement was a significant change in the valuation of available-for-sale financial assets (a positive effect of PLN 424,936 thousand) and a significant increase in net profit generated in the periods compared.

STATEMENT OF FINANCIAL POSITION OF THE CAPITAL GROUP

Assets

At the end of December 2017, the Group's balance sheet total amounted to PLN 72,749,259 thousand and was higher by PLN 444,260 thousand (0.6%) than at the end of December 2016.

The key changes in the structure of Group's assets during 2017 included: a growth in the share of receivables from banks and in financial assets available for sale, accompanied with a decrease in the share of loans and advances to customers.

Loans and advances to customers, which accounted for 72.8% of total assets as at the end of December 2017 vs. 76.2% at the end of 2016, were the key items in the structure of assets. In terms of value, net loans and advances decreased by PLN 42,108,303 thousand, i.e. 3.8%, which was caused by deconsolidation of BGŻ BNP Paribas Faktoring Sp. z o.o. and the decrease in the value of foreign currency mortgage loans due to zloty strengthening.

Assets available for sale were the second largest asset item and constituted 19.41% of the balance sheet total at the end of 2017 (vs. 17.3% at the end of 2016). In 2017, their value increased by PLN 1,424,685 thousand, i.e. by 11.4%, mostly as a result of extension of the money bills portfolio (an increase by PLN 1,099,470) and a purchase of NBP treasury bonds of PLN 329,620.

Changes in earning assets were accompanied by an increase in the share of receivables from banks to 3.6%. These receivables increased by PLN 1,370,097 thousand, i.e. by 111.1%, mainly due to the increase of current accounts by PLN 1,496,313 thousand.

Loan portfolio

Quality and structure of loan portfolio

At the end of 2017, gross loans and advances to customers amounted to PLN 55,752,348 thousand and decreased by PLN 2,324,879 thousand (4.0% y/y). The decrease was mainly caused by the sale and deconsolidation of a subsidiary BGŻ BNP Paribas Faktoring Sp. z o.o. and strengthening of Polish zloty and revaluation of the portfolio of foreign currency mortgage loans. Without including the above mentioned deconsolidation and the category of foreign currency mortgage loans, gross value of loan portfolio would increase by ca. 1.7% y/y.

Loans and advances to enterprises decreased by 10.1% and represented 31.2% of the gross loan portfolio (33.3% at the end of 2016). Loans and advances to households (including individual entrepreneurs and farmers) decreased by PLN 1,096,711 thousand, i.e. 3.1%. Mortgage loans, totalling PLN 13,628,114 thousand at the end of December 2017, represented 39.7% of loans and advances to households (42.4% at the end of 2016).

The share of impaired exposures in gross loans and advances to customers increased to 7.4% at the end of 2017 vs. 7.7% at the end of 2016.

In December 2017, the Bank performed a securitization transaction on the portfolio of cash and car loans. The transaction is a traditional securitization involving the transfer of ownership of the securitized receivables to SPV (BGŻ Poland ABS1 DAC based in Ireland). The revolving period is 24 months.

SPV issued bonds with a total value of PLN 2,180,850 thousand on the basis of securitized assets and received a loan of PLN 119,621 thousand, which was secured by a registered pledge on the rights to cash flows from securitized assets.

As a result of securitization, the Bank obtained financing in return for the transfer of rights to future cash flows resulting from the securitized loan portfolio in the amount of PLN 2,300,471 thousand as at 22 November 2017 (cut-off). The maximum deadline for full redemption of bonds and repayment of the loan is 27 April 2032.

The main benefit of the performed transaction is a positive impact on capital adequacy ratios and improvement of liquidity and diversification of financing sources.

In the light of the provisions of IAS 39, the contractual terms of the securitization do not fulfil the conditions for derecognition of securitized assets. In connection with the above, the Bank recognizes securitized assets in “Loans and advances to customers” as at 31 December 2017 at net value of PLN 2,106,698 thousand. At the same time, the Bank recognizes a liability due to cash flows from securitizations in "Liabilities due to customers" in the amount equal to PLN 2,300,471 thousand as at 31 December 2017. As at 31 December 2017, the Bank held receivables due to settlements with a securitization company in the amount of PLN 87,699 thousand. These receivables are presented in “Other assets”.

The Bank acts as a servicing entity in the transaction.

Liabilities and equity

As at the end of December 2017, the Group's total liabilities amounted to PLN 66,189,796 thousand and were higher by PLN 31,618 thousand as compared to the end of 2016.

At the end of 2017, the share of liabilities in the total of liabilities and equity was 91.0%, i.e. 0.45 pp lower than a year before. The main change in the structure of liabilities in 2017 was the increase in the share of amounts due to customers and due to the issue of securities, accompanied by a decrease in amounts due to banks.

At the end of December 2017, amounts due to customers increased by PLN 1,173,883 thousand (2.1%) vs. the end of December 2016 and amounted to PLN 56,328,897 thousand. Due to a material increase of the volume, their share in the total of liabilities increased to 85.1% as compared to 83.4% at the end of 2016.

In 2017 the tendency to continue a reduction of debt arising from loans and advances received from Banks occurred, which resulted in a drop in the share of amounts due to banks in the total liabilities. At the end of 2017 the share amounted to 5.9%, compared to 11.0% at the end of 2016. At the end of December 2017, liabilities to banks amounted to PLN 3,891,235 thousand and were lower by PLN 3,417,579 thousand (i.e. 46.8%) lower than in the previous financial year.

As a result of the consumer loan portfolio securitization transaction performed by the Bank in the fourth quarter of 2017, the share of debt securities issued in the structure of the Group's liabilities increased by 3.7% at the end of 2017 (increase from the level of 0.6% at the end 2016). The value of liabilities due to issue at the end of December 2017 amounted to PLN 2,471,966 thousand (including PLN 2,180,850 thousand from the issuance of securitization company’s securities).

Amounts due to customers

At the end of December 2017, amounts due to customers reached PLN 56,328,897 thousand and rose by 2.1% y/y. This increase concerned primarily corporate clients, and retail clients and clients from the public sector to a lesser degree. As part of the maturity structure, the share of current liabilities increased.

The share of current accounts in the total structure of amounts due to customers increased from 50.1% at the end of December 2016 to 53.9% at the end of December 2017. The value of funds deposited in current accounts increased by PLN 2,721,322 thousand, i.e. 9.9%.

On the other hand, the share of term deposits in the total structure of amounts due to customers decreased from 45.5% at the end of December 2016 to 42.7% at the end of 2017. In terms of value, term deposits decreased by PLN 1,082,257 thousand, i.e. 4.3% vs. December 2016.

Loans and advances received from other financial institutions decreased by PLN 547,978 thousand.

Amounts due to individual customers increased by PLN 122,810 thousand, i.e. 0.4%, and accounted for 49.1% of all amounts due to customers at the end of December 2017 (decrease by 2.7 pp as compared to the end of December 2016).

Amounts due to corporate customers increased by PLN 1,843,816 thousand, i.e. 8.1%. Their share in total amounts due to customers grew from 43.8% at the end of December 2016 to 41.4% at the end of 2016.

In the case of the public sector, the increase in liabilities amounted to PLN 88,078 thousand, while their share at the end of 2017 increased to the level 1.6% of total amounts due to customers.

Equity

As at the end of December 2017, the Group’s equity amounted to PLN 6,559,463 thousand and was higher by PLN 412,642 thousand than at the end of 2016. The change resulted mostly from the increase in the net profit recorded in 2017 vs 2016 (by

PLN 202,101 thousand). The positive impact on equity resulted also from the increase in the value of revaluation reserve (from PLN -497 thousand at the end of 2016 to PLN 141,988 thousand at the end of 2017) as a result of a positive revaluation of financial assets available for sale.

EQUITY AND CAPITAL RATIOS

As at 31 December 2017, the total capital ratio of the Group amounted to 13.75% and was 0.65 pp lower than at the end of December 2016.

The consolidated Common Equity Tier 1 capital ratio (CET I) and the consolidated Tier 1 ratio of the Group as at the end of 2017 were identical and amounted to 10.81%.

As at 31 December 2017, total own funds increased by PLN 84,332 thousand as compared to 31 December 2016, primarily due to:

- retaining profit of Bank BGŻ BNP Paribas for 2016 in the amount of PLN 49,388 thousand for the general banking risk fund following a resolution of the Ordinary General Shareholders' Meeting of Bank BGŻ BNP Paribas of 22 June 2017;
- recognizing a part of current year profit for the period from 1 January 2017 to 30 June 2017 in the amount of PLN 130,029 thousand in equity, in accordance with the PFSA decision issued on 23 November 2017.

In the analysed period, the total risk exposure amount was equal to PLN 55,988,130 thousand and increased y/y by PLN 3,043,119 thousand.

On 15 December 2017, the Bank received a recommendation from the Polish Financial Supervision Authority concerning the Group's maintenance of own funds necessary to cover an additional capital requirement at the level of 0.60 pp in order to hedge the risk resulting from foreign currency mortgage loans granted to households, which should consist at least in 75% of Tier 1 capital (corresponding to 0.45 pp) and at least in 56% of Common Equity Tier 1 capital (corresponding to 0.34 pp).

On 29 December 2017, the Bank received a decision from the Polish Financial Supervision Authority dated 19 December 2017 concerning imposing on the Bank (on a consolidated and individual basis) a buffer of other systemically important institution equivalent to 0.25% of the total risk exposure amount.

In connection with the above, the minimal consolidated capital ratios obligatory for the Group until the end of 2017, considering both the above-mentioned decisions and additional recommendations of the PFSA were:

- 10.84% for the Common Equity Tier 1 ratio (CET 1);
- 10.95% for Tier 1 capital ratio;
- 14.10% for the total capital ratio TCR.

At the same time, as at 31 December 2017, the required levels of the consolidated capital ratio CET 1, Tier 1 and TCR resulting from the Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on macro-prudential requirements for credit institutions and investment firms, the Act of 5 August 2015 on macro-prudential supervision of the financial system and crisis management in the financial sector as well as taking into account the PFSA decisions, were:

- 6.34% for the Common Equity Tier 1 ratio (CET 1);
- 7.95% for Tier 1 capital ratio;
- 10.10% for the total capital ratio TCR.

As at 31 December 2017, the Group's capital ratios exceeded the above levels, meeting the requirement of the combined buffer indicated in Article 60 of the Act of 5 August 2015 on macro-prudential supervision over the financial system and crisis management in the financial sector.

In accordance with the Act of 5 August 2015 on macro-prudential supervision over the financial system and crisis management in the financial sector, and the Regulation of the Minister of Finance, from 1 January 2018, the capital requirements applicable to banks in Poland increased through:

- introducing a systemic risk buffer of 3%;
- increase in the capital conservation buffer level from 1.25% to 1.875%.

As a result of the above changes, in accordance with the "Position of the PFSA on minimal levels of capital ratios" obligatory for banks in 2018, published on 24 November 2017, the minimum capital ratios of Bank BGŻ BNP Paribas S.A. Capital Group from 1 January 2018 should be:

- 9.97% for the Common Equity Tier 1 ratio (CET 1);

- 11.58% for Tier 1 capital ratio;
- 13.73% for the total capital ratio TCR.

On 6 February 2018, after the preparation of the opening balance as at 1 January 2018, which takes into account the implementation of IFRS 9, the Management Board of Bank BGŻ BNP Paribas S.A. learned information on the level of solvency ratios as of 1 January 2018. Tier 1 capital ratio (Tier 1) and the total capital ratio (TCR) in consolidated terms was below the new requirements. Solvency ratios as at 1 January 2018, on a standalone basis, amounted to:

- CET 1 - 10.71%,
- Tier 1 - 10.71%,
- TCR - 13.62%.

Taking into account the above mentioned situation, the Management Board of the Bank decided to immediately take additional actions to meet the new regulatory requirements. Among various other activities, the Bank is planning to increase the share capital by issuing new shares. The BNP Paribas Capital Group provided the support to the Bank's Management Board in the implementation of the planned activities aimed at achieving the required capital ratios. The capital increase should be realized at the beginning of the 3rd quarter of 2018, provided that the consents required by law are obtained.

On 12 December 2017, the European Parliament and the EU Council adopted the Regulation No. 2017/2395 amending the Regulation No. 575/2013 regarding transitional arrangements to mitigate the impact of implementing IFRS 9 on equity and the solutions regarding the fact of treating some exposures to public sector entities, which are denominated in the national currency of any Member State, as large exposures. This Regulation entered into force on the day following its publication in the Official Journal of the European Union and has been applicable since 1 January 2018. The European Parliament and the Council (EU) considered that the implementation of IFRS 9 could possibly lead to a sudden increase in impairment allowances for expected credit losses, and hence, the decrease in Tier 1 capital.

The Group, after analysing the requirements of Regulation No. 2017/2395, decided to apply the transitional provisions provided for in this Regulation, which means that the full impact of the implementation of IFRS 9 will not be taken into account for the purpose of assessing capital adequacy of the Bank and the Group. As a result of adjusting the calculation of regulatory capital requirements it was estimated that the full impact of IFRS 9 implementation would decrease the total capital ratio of the Group by 52 basis points.

EQUITY AND CAPITAL RATIOS

The ROE of the Group, calculated after excluding the impact of integration costs in 2017, was 4.8%. The increase in comparison to 2016 is caused by an improvement in the net income on banking activity (primarily the net interest income), limiting the operations cost and decrease in risk costs. The return rate on assets, calculated after excluding the impact of integration costs, was 0.5% and increased by 0.1 pp as compared to 2016.

The change in the cost to income ratio is indicative of the improvement of the main activity profitability. This ratio improved as a result of an increase in revenues with a simultaneous decrease in operating costs (also in the approach that assumes excluding integration costs). The Cost / Income ratio (excluding integration costs) is at the level of 61.0%, lower by 3.6 pp compared to 64.6% at the end of 2016. For the purpose of calculating the above mentioned ratio, the denominator is the category of net income on banking activity, which is the sum of net interest income, net fee and commission income, dividend income, trading income, investment income, result on hedge accounting and other operating income and expenses.

Presentation of the ratios calculated based on the profit and loss account, excluding integration costs (understood as additional costs related to the merger processes of BGŻ SA, BNP Paribas Polska SA and Sygma Bank Polska SA), aims to provide an additional information to assess the current potential of merged banks.

Net interest margin, calculated in relation to the average value of assets was at the level of 2.7% and did not change in comparison to the level calculated in 2016.

The risk cost ratio decreased compared to the level recorded in 2016 by 10 bps and amounted to 0.6%.

The value of the ratio constituting the relation of net loans and advances to deposits improved compared to the end of 2016 due to the increase in the share of customer deposits in financing the Group's activity, with a simultaneous decrease in the value of net loans and advances.

Financial ratios

	31.12.2017	31.12.2016	31.12.2015	Change y/y in pp
Return on equity(1)	4.8%*	3.6%*	3.4%*	1.2
Return on assets(2)	0.4%*	0.3%*	0.3%*	0.1
Net interest margin(3)	2.7%	2.7%	2.6%	0.0
Cost/Income(4)	61.0%*	64.6%*	74.2%*	(3.6)
Cost of credit risk(5)	(0.6%)	(0.7%)	(0.7%)	0.1
Net loans and advances/Deposits(6)	96.6%	103.7%	118.0%	(7.1)
Gross loans and advances/Total source of funding(7)	87.2%	90.4%	98.2%	(3.2)

** Normalised values, excluding integration costs. The impact of integration costs on the net profit was estimated using the standard 19% income tax rate. In the case of the "costs" category, the amount included in the financial statements was reduced by the amount of integration costs recorded as general administrative expenses and depreciation. In the case of the "income" category, the amounts of the profit or loss statement comprising the net income on banking activities was adjusted for integration costs recorded under other operating costs.*

(1) Net profit in relation to average equity, calculated based on quarter-end balances.

(2) Net profit in relation to average assets, calculated based on quarter-end balances.

(3) Net interest income in relation to average assets, calculated based on quarter-end balances.

(4) Total general administrative expenses, amortization and depreciation in relation to total net banking income, calculated as the total of net interest income, net fee and commission income, dividend income, net trading income, net investment income, result on hedge accounting and other operating income and expenses.

(5) Net impairment losses on loans and advances in relation to the average balance of net loans and advances to customers, calculated based on quarter-end balances.

(6) (Net) loans and advances to customers in relation to customer deposits, balance at the end of the period.

(7) Gross loans and advances to customers in relation to total liabilities to customers, debt securities issued, loans from other banks and subordinated liabilities, balance at the end of the period.

ASSESSMENT MADE BY THE SUPERVISORY BOARD

After becoming acquainted with the Consolidated financial statements of Bank BGŻ BNP Paribas S.A. Capital Group for the year ended on 31 December 2017 prepared by the Management Board, and the opinion and Report of the independent statutory auditor on the audit of consolidated financial statements of Bank BGŻ BNP Paribas S.A. Capital Group, the Supervisory Board decides to give a positive opinion to the financial statements of the Group for the year ended on 31 December 2017, and recommend the approval of the financial statements to the Ordinary General Meeting.

5. REPORT OF THE MANAGEMENT BOARD ON ACTIVITY OF BANK BGŻ BNP PARIBAS S.A. CAPITAL GROUP IN 2017

The Supervisory Board declares that the Report of the Management Board on activity of Bank BGŻ BNP Paribas S.A. Capital Group for the year ended 31 December 2017 is factually correct, consistent with the books and documents, including information contained in the Consolidated financial statements of Bank BGŻ BNP Paribas S.A. Capital Group for the year ended on 31 December 2017. The Supervisory Board recommends the approval of the Report on activity of the Bank BGŻ BNP Paribas S.A. Capital Group for the year ended 31 December 2017 to the Ordinary General Meeting of Bank BGŻ BNP Paribas S.A.

6. ASSESSMENT OF REPORT ON THE NON-FINANCIAL INFORMATION OF BANK BGŻ BNP PARIBAS S.A. AND THE BANK BGŻ BNP PARIBAS S.A. CAPITAL GROUP IN 2017

As a result of the assessment of Report on the non-financial information of Bank BGŻ BNP Paribas S.A. and the Bank BGŻ BNP Paribas S.A. Capital Group in 2017 the Supervisory Board states that the report was prepared in compliance to Art. 49b of the Accounting Act dated 29 September 1994 and presents in a reliable and clear manner the non-financial effectiveness indicators connected to the Bank and Bank's Capital Group activities, as well as information on employment and natural environment matters that are relevant to the assessment of economic activity for the period from 1 January 2017 to 31 December 2017. The Supervisory Board recommends the approval of the Report on the non-financial information of Bank BGŻ BNP Paribas S.A. and the Bank BGŻ BNP Paribas S.A. Capital Group in 2017 to the Ordinary General Meeting of Bank BGŻ BNP Paribas S.A.

7. ASSESSMENT OF ADEQUACY AND EFFECTIVENESS OF THE INTERNAL CONTROL SYSTEM AT THE BANK

The organization of the internal control system is in line with the Banking Law of 29 August 1997 requirements and Regulation of Minister of Development and Finance of 6 March 2017 on risk management and internal control system, remuneration policy and detailed conditions of estimation of internal capital in banks and it encompasses the risk control mechanisms (including: functional control), checking the compliance of the Bank's activities with the provisions of law and internal regulations, as well as the internal audit. The internal control system is adjusted to the specifics of the conducted activity and takes into consideration the Bank's resources. The Bank performs periodic verification of the risk control mechanisms functioning in the Bank.

The Management Board of the Bank is responsible for the effectiveness of the risk management system, internal control system, internal capital assessment and reviews, the internal capital assessment and maintenance process, and for the supervision over the efficiency of these processes, making necessary adjustments and improvements in case of a change of the risk level in the Bank's activity, economic environment factors, and irregularities in systems and processes functioning. Moreover, the Management Board determines the principles of functioning of the organizational units which participate in the Bank management, and is responsible for the preparation, introduction, and update of the written policies, strategies, and procedures in this respect.

The Supervisory Board performs supervision over the internal control system and evaluates its adequacy and effectiveness via the Bank's Audit Committee. The Audit Committee performs assessment, among others, on the basis of the results of audits conducted by the Internal Audit Line, about which it is informed in periodic reports on the activities of the Internal Audit Line. Besides, the Committee becomes familiar with the progress in the realization of the recommendations and findings without recommendations, issued by the Internal Audit Line, external auditor and the supervisory bodies.

The Audit Committee was informed about the changes in the Audit Plan and the level of its realization. The Internal Audit Line monitors the situation in the Bank on the current basis, and changes in its environment and – if needed – makes necessary adjustments in the Audit Plan.

The Internal Audit Line supports the Bank in achieving its targets by the checking and assessing, in an independent and objective manner, adequacy and effectiveness of the internal control system, including the quality of management of the risk related to the Bank's activity.

is an important element of the internal control system next to Internal Audit Line.

Compliance is responsible for compliance and anti-fraud monitoring and encompasses support of the Management Board and the Supervisory Board in the identification and assessment of the following risks:

- the non-compliance risk,
- the reputational risk
- the fraud risk
- anti-money laundering and sanctions risk.

Compliance and anti-fraud monitoring includes also employee behaviour, systems and processes within the Bank with scope in requirements of applicable laws as well as regulations by the Bank and the standards of conduct, including market behaviour.

Monitoring and evaluation of compliance is made on the basis of, among others, assessment of key compliance risks, monitoring of Bank's organizational units, the opinion issued by the organizational units included in the Compliance Line to the internal regulations and risk assessment carried out in the framework of the implementation of new banking products and services.

The evaluation results are submitted to the Management Board and Supervisory Board members through the presentation of reports on the activities of the Compliance Line in the work of the Audit Committee of the Bank.

Compliance Line supports the decision-making processes within the Bank, provides support to the Management and Supervisory Boards in the identification and assessment of compliance risks, acts as an advisor, indicates potential hazards, and submits solutions proposed for effective management compliance risks.

The Operational Risk & Control (ORC) department supervises and coordinates the process of implementation of functional control in the Bank, carried out semi-annually, as well as the process of verification of the mechanisms and procedures of internal control in the Bank, realised annually. Functional control is realised semi-annually by managers of all units of the Bank (network and Head Office units), or by persons appointed by them. Periodical functional control covers verification of correctness of operation of individual areas, and risk self-assessment. With respect to the functional control process, the monitoring of post-control recommendations implementation rated as high and medium risk, is undertaken.

The ORC Department prepares semi-annual reports including the results of functional control, indicating the areas with biggest irregularities identified, and in consultation with the competent units actions are determined, aiming at elimination of irregularities in the future. The reports are presented to the Management Board for approval.

The ORC Department also performs supervision over the operational control process in the Bank, as a 2. level control, under which it coordinates and supports the process of implementing the Fundamental Monitoring Points (FMP) concept, and also cooperates with the units responsible for operational control in the Bank.

The process of verification of mechanisms and procedures of internal control is realized every year through self-assessment of risk and control environment by managers supervising individual areas of the Bank's activity (owners of control processes and mechanisms). The purpose of the review is identification of possible gaps in the control environment, including potential ineffectiveness of some controls. The review results in a report indicating cross-sectional data and statistics with respect to currently applied in the Bank control mechanisms, as well as deficiencies in the control process. In case the analysis shows gaps and irregularities, such report indicates actions to be taken to eliminate such gaps/ irregularities. The report is presented to the Management and Supervisory Boards for approval.

8. ASSESSMENT OF ADEQUACY AND EFFECTIVENESS OF RISK MANAGEMENT WITH REGARD TO RISKS ESSENTIAL FOR THE BANK

The system of risk management in the Bank is a formal system governed, i.a., by the policy of managing and reporting capital adequacy of the Bank (ICAAP), credit policy, policy of managing retail exposure risk, strategy of risk management, specifying the Bank's appetite for key risks associated with the Bank's activity, approved by the Supervisory Board. The Bank has a list of essential risks, approved by the Management Board, and the system of their measuring, limiting and reporting. The limits and thresholds for the major risks are specified once a year and reflected in the risk appetite statement of Bank BGŻ BNP Paribas. The Bank regularly monitors and reports compliance with the limits, and if a limit is exceeded, the Bank takes actions to restore the situation where the risks are held within the limits specified by the Management and Supervisory Boards of the Bank. Regular monitoring and reporting cover also the size and type of deviations from the principles and policies applicable in the Bank.

The Management Board of the Bank and the relevant Committees approve detailed policies and principles of risk management and perform daily supervision over the risk management system. The Bank operates the **Assets and Liabilities Committee (ALCO)** responsible for supervision and supporting management risks associated with financial liquidity risks and market risks within the Bank's portfolio. The Bank also has the **Risk Management Committee** responsible for various risks associated with Bank's activities including the risks associated falling under ALCO controls. The Bank has the **Internal Control Coordination Committee**, which supports the Bank's Management Board in implementing the Bank's operational risk strategy and in particular, performs control of consistency, completeness and effectiveness of the internal control system, and the processes of operational risk management. The Committee also manages major risks connected to the system of internal control in the Bank and its subsidiary entities.

With the above in mind as 31 December 2017 amongst others the following committees operated in the Bank:

- Risk Management Committee

- RB Risk Committee,
- PF Risk Committee,
- Credit Committee,
- Bad Loan Committee,
- Capital Investments Committee,
- Information Security and Business Continuity Committee,
- Internal Control Coordination Committee,
- Products, Services, Transactions and Activities Approval Committee (NPAO),
- Customer Approval Committee (CAC),
- Disciplinary Committee,
- Investment Project Committee,
- Assets and Liabilities Committee (ALCO),
- Reference Rate Quote Committee,
- Real Estate Committee,
- Brokerage House Investment Committee,
- Financial and Compliance Risk Committee,
- Procurement Committee,
- Bonds Committee,
- Compliance and Risk Evaluation Committee,
- Complaints Committee,
- Data Governance Strategy Committee.

The Bank's Management Board through dedicated committees obtains regular and comprehensive information on the Bank's exposures to credit risks, operational risks, financial liquidity risks as well as market and interest rate risks. Appropriate committees within their competences define task which must be undertaken in case the Bank engages in excessive risks.

Supervisory Board regularly obtains reports prepared by organizational units of the Head Office covering significant risks in Bank's operations. Additionally the Supervisory Board has established two committees operating Internal Audit Committee and Risk Committee.

The scope of reported information covers the Bank's exposures to various risks including credit (including stress test risk), operational, interest rate and liquidity risks.

SUPERVISORY BOARD ASSESSMENT

In the opinion of the Supervisory Board the system of internal controls is adequate for the level of activities and complexity of the activities of the Bank.

In the opinion of the Supervisory Board the key risks management system is managed adequately and is carried out in accordance with policies adopted by the Bank.

Nonetheless, the Supervisory Board identifies some areas in which a strengthening of corrective measures is expected. Those areas are especially the organizational culture, systems/automatisation and process ownership. In respect of those areas specific action plans have been developed and their execution shall be monitored by the Supervisory Board