CAPITAL ADEQUACY OF BANK BGŻ[1] 31 DECEMBER 2014

WARSAW 2015

[1] From 30th April 2015 the Bank operates under the name of Bank BGŻ BNP Paribas SA

LIST OF CONTENTS

A. INTRODUCTION

According to article 111 a. of the Baking Law of the 29th of August 1997 (called "the Banking Law" in this document) and according to Res. No. 385/2008 of the Polish Financial Supervisory Commission of the 17th of December 2008 with subsequent changes concerning detailed rules and the way of disclosing qualitative and quantitative information about capital adequacy by banks as well as the scope of information that should be disclosed, as well as according to Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CRR), Bank Gospodarki Żywnościowej S.A. (referred to in this document as: the Bank or Bank BGŻ), is obliged to publish, in widely accessible form, quantitative and qualitative information about capital adequacy – excluding irrelevant information or information that, when disclosed, could have an disadvantageous impact on the Bank's position on the market (as it is understood by the law concerning protection of the competition and consumers), as well as information that is confidential under the law. The values in the report are presented on the highest consolidation level of the group in Poland. The Bank is also obliged to disclose information on securitized positions. Nevertheless as on the 31st of December 2014, there were no such positions in the Bank's portfolio.

The Bank presents information concerning variable elements of remuneration of persons from the Bank's management.

Bank BGŻ is the parent entity of the capital Group of BGZ S.A. As on the 31st of December 2014 the Bank's capital group includes: Bank BGŻ and Bankowy Fundusz Nieruchomościowy Actus sp. z o.o. which does not have any important impact on the Bank's financial condition nor Bank BGŻ's capital position. As on the 31st of December 2014, the Bank had due receivables from BFN Actus equalling to PLN 36.9 m. All subsidiaries were consolidated as on the 31st of December 2014.

Tab. Fully consolidated subsidiaries – 31.12.2014 in PLN thou.

name of a subsidiary	statutory capital in PLN thou.	share in statutory capital	activity
BFN Actus Sp. z o.o	1 510	100%	real estate purchase & sale
total	**1 510**	**100%**	

B. AIMS AND RULES FOR RISK MANAGEMENT

B1. FLOW OF INFORMATION WITHIN RISK MANAGEMENT SYSTEM

Risk management systems used by the Bank are adequate from the perspective of the strategy and activity profile. Once a year the Management Board of the Bank BGŻ specifies the risk appetite. The Management Board is being regularly (quarterly) informed about the level of economic capital and regulatory capital requirements in relation to their planned values, about the changes in the values and factors which caused them in the Bank BGŻ, as well as about the current credit risk levels and utilization of concentration limits. Operationally, i.e. on a monthly basis, the Balance Sheet and Risk Management Committee (BRMC) deals with monitoring, analyses of changes and preparing recommendations to economic capital management. The main objective of the Committee is to support the Management Board in realisation of Bank's strategic goals, by taking decisions with regard to risk appetite, business policy and balance sheet structure that will facilitate sustainable, safe and profitable growth of Bank's balance sheet within existing and expected market, capital and funding constraints. Support to activities of the Committee is given by five permanent Subcommittees: Liquidity Monitoring Subcommittee, Operational Risk, Compliance & Anti-fraud Subcommittee, Product Subcommittee, Credit Policy, Monitoring and Control Subcommittee, Ethics Subcommittee. The aim of the subcommittees is to analyze and manage risk on operational level as well as make a decision within the limit of competences, prepare, discuss and issue initial acceptance to proposed policies, procedures and models.

B1. CREDIT RISK

Strategies and processes in credit risk management

The basic goal of the credit risk management policy of Bank BGŻ is the proper identification and measurement of credit risk that provides a firm framework for credit approval as well as the monitoring of clients' exposures and credit portfolio management. The important components of the Bank's credit risk management are the principles regarding crediting terms and conditions for individual transaction, principles for collateral management and principles concerning credit risk appetite. The credit risk appetite is an articulation of the level of credit risk the Bank is willing to accept or tolerate in pursuit of its business strategy. The Bank determines the expected level of credit risk appetite by setting Key Risk Indicators by sectors, products, business lines, clients groups. More detailed risk measures and the approach towards managing and limiting the credit risks at BGZ are set by:

1) "Key Credit Risk Limits and Control Structure BGZ"
2) "Concentration Limits".

Credit risk appetite, credit risk management policy and tools used for its implementation are accepted by the Bank's Management Board.

Organization of the credit risk management process

In order to ensure the efficient execution of tasks in the area of credit risk management the Balance and Risk Management Committee was created, with its Credit Policy, Monitoring and Control Subcommittee. Within the Bank risk management areas ere distinguished, i.e. Systemic Risk Area and Analysis and Credit Decisions Area. Within the risk management areas there are organizational units that are responsible, among other things, for:

- calculation of the internal capital and impairment of the financial assets,
- policy, procedures and methodology as well as monitoring of the credit portfolio,
- credit risk assessment and monitoring of credit exposures,
- loan administration and loan documentation,
- support to the employees from sales units in the area of credit risk issues.

Specialized organizational units are responsible for restructuring and recovery of loan receivables.

In the organizational structure of regional units of the Bank there is a Risk Division responsible for applying and realization of credit risk management rules and goals in regions.

Scope and types of risk reporting and measuring systems

In order to efficiently manage risk in the Bank a system has been introduced which delivers information about credit portfolio quality for the management. Based on information from Data Warehouse and transaction systems monthly, quarterly and semi-annual reports on credit portfolio quality are prepared taking into account:

- product structure, in particular institutional exposures related to real estate financing,
- business line structure,
- term structure,
- currency structure,
- collateral structure,
- industry structure,
- quality of products/segments (including the size of delays, migrations between classes of days overdue, vintage analysis, PD and LGD ratios),
- levels of impairment provisions,
- levels of write-offs,
- results of monitoring and vindication processes,
- policy deviations,
- LtV level.

Moreover, the Bank regularly monitors concentration limits, estimates provisions and calculates capital requirements.

Basic tools supporting the credit risk management process are:

- credit limits which set maximal acceptable credit exposure at particular decision levels,
- methods of assessment of economic and financial situation of clients,
- rating and scoring systems,
- system for monitoring of the Bank's exposure to risk,
- software for impairment calculation for financial assets,
- RAROC (credit value at risk estimation),
- Risk Based Pricing model.

Rules for using collaterals and risk mitigation techniques as well as strategies and processes of monitoring efficiency of collaterals and credit risk mitigation techniques

Principles of evaluation, establishing and monitoring of collaterals are defined in the Bank's internal regulations approved by the Management Board. These principles aim to ensure:

- an equivalent Bank's position in relation to other entities providing financing to a client,
- determination of market value of collateral and independent professional appraisal in case of mortgage,
- possibility to use collateral to reduce capital requirements or the basis for creating reserves,
- monitoring and update of collateral value within the whole crediting period, as well as calculation of LtV ratio in case of mortgage-back transactions.

Bank's internal regulations, especially models of collateral agreements, ensure formal correctness of accepted collateral and possibility to recover loan receivables.

B2. MARKET RISK

Market risk comprises foreign currency risk, interest rate risk, price risk, volatility and correlation risk. Existence of market risk is an imminent feature of trading book, where it is a main purpose of having the book in the first place, but it is present also in the banking book, as the effect of offering to the clients of products in different currencies, with different maturities and repricing schemes.

Interest rate risk is primarily associated with mismatch between repricing dates of Bank's assets and liabilities, but it is also connected with the risk of changes is shape of the yield curve, impacting directly net present value of current and future cash flows – fair value and interest streams – and in consequence changing the value of Bank's net equity; and basis risk, being the result of using non-market reference rates as a basis for pricing of selected products.

Price risk is connected with possibility incurring a loss by the Bank as a result of change in market price of instruments that are quoted on organised financial markets (e.g. exchange), in particular this concerns capital and debt securities. Market value of such instruments is not exclusively driven by e.g. interest rates levels, but is as well dependant on the way the market is organised, its liquidity and by specific (e.g. credit, reputation) risks connected with particular issuers.

Foreign exchange risk is a risk of change in value of assets, liabilities and off-balance transactions denominated in or indexed to foreign currencies, taking place as a consequence of change in market quoted rates of exchange.

Volatility and correlation risk is expressed through instability of financial market that fluctuates in a response to internal factors: supply and demand for particular instruments or risk types; and external: economic and political situation, changes in regulatory environment. Volatility risk, understood as an underlying instrument of options, is eliminated in Bank BGŻ through the policy of back-to-back hedging of non-linear positions. Correlation risk can be associated with instability of direction and strength of interdependencies between different risk factors that can lead to inefficiency of hedge strategies and changes in risk profile.

Risk management strategies and processes

Bank BGŻ, operating as a universal bank, services all types of clients: retail, corporates, public and budget entities, non-banking financial institutions as well as other banks. Apart from typical banking products (loans and deposits), it offers as well intermediation in trading financial market instruments for the clients and, in limited scope, runs its own investment and trading books.

In order to properly reflect specificity of positions, i.e. their purpose, dominant risks and applied book keeping rules; Bank BGŻ assigns all on-balance positions and off-balance transactions to either banking book or trading book. Precise criteria of this division are laid out in documents ("policies") introduced with appropriate Management Board resolutions; that specify purpose of the books, approved size, profile and types of taken risks, methods to estimate and limit those risks as well as competences and placement of various organizational units within the Bank in the process of generating, measuring, limiting and reporting of risk. Those documents are in line with recommendations of Financial Supervisory Commission and standards of Basel Committee on Banking Supervision. Additionally Bank establishes risk appetites, approved by Supervisory Board, that are maximum tolerated risk level associated with Bank's activity on financial markets. They have global and directional nature.

Banking book is composed of two portfolios: ALM and Money Market. ALM positions include the Bank's loan and deposit/account products reflected via Funds Transfer Pricing mechanism, non-interest bearing positions (equity, credit provisions, tangible and intangible assets, taxes, profit, etc.), the investment portfolio run to safely invest Bank's capital, own bond issues, long-term funding facilities and derivatives (used to manage structural interest rate risk), while Money Market portfolio is connected with liquidity management (current account in central bank, interbank deposits, liquid debt securities, IRS/CIRS/OIS and FX Swaps), interest rate risk hedging transactions (derivatives). The Bank's policy with regard to banking book is to exercise additional income above the product margin, without compromising excessively stability of deposits placed by the clients, of Bank's capital and its results; through retaining or adjustment – within approved risk limits – of Bank's natural risk profile in order to benefit from expected mid- and long term financial market trends.

Trading book has a supplementary character, supporting sale of financial market products to corporates (directly) and retail (indirectly, in structured products). By opening own positions to facilitate above needs, Bank is able to generate additional income from short-term change in market parameters (foreign exchange rates, interest rates, quoted prices of debt instruments, etc), staying within approved risk limits. Trading book also includes Bank's total on- and off-balance foreign exchange position. In accordance with approved risk policy, Bank BGŻ is not involved in credit risk trading (e.g. CDS, ABS and corporate debt rated below Poland credit rating) nor does run non-linear positions in options.

Organization of risk management process

Supervisory Board approves financial risk appetite, Management Board, following Bank's long term strategy and financial plan, establishes accepted risk profile, in line with risk appetite, distributing available capital to business lines that further, in a form of risk limits, is assigned to different books by Balance Sheet and Risk Management Committee (BRMC), acting on behalf and under authorization of the Board.

Operational management of trading book is under Financial Markets Department. Banking book (ALM portfolio and Money Market portfolio) is the Assets and Liabilities Management Bureau's responsibility. Risk measurement, reporting and limit breach monitoring, independent valuation and management P&L calculation, booking and processing of the deals is performed by independent units, under supervision of Board members responsible for Finance, Risk, IT and Operations Areas. Acceptance of limit breaches is also organized in hierarchical way: depending on type of limit (its "importance") and size of the excess (technical, minor, major) the acceptance is given on a levels from director or risk reporting unit to the Board member supervising Systemic Risk Area, final acceptance is BRMC competence.

Scope and types of risk reporting and measuring systems

Main risk measures, used to assess risks in banking book, are interest rate gaps: repricing gap and sensitivity gap, indicating respective size and distribution of mismatches of repricing/maturity dates and sensitivities of assets, liabilities and off-balance positions to interest rate changes. Based on this information, the Bank's analysing and limiting: sensitivity of Bank's interest income (Interest at Risk) to yield curve's shifts and sensitivity of present value of Bank's net equity (Equity at Risk) to parallel shifts of the yield curves. Risk monitoring takes also into consideration other parameters, such as types of allowed instruments/transactions, currencies, maximum maturities and minimum rating for debt securities for specified parts of banking book.

Separate monitoring is conducted to verify risk levels expressed in terms of Value at Risk in Money Market portfolio, amended by the stress tests programme, comprising scenarios exceeding statistically expected volatility of the market. Dedicated stress tests to identify and quantify basis risk in banking book are carried out.

Funds transfer system, being a main source of information on risk profile generated by the Bank's core credit & deposit activity in the branches, is based on the replication mechanism, working on a daily basis at the level of a single transaction. In case of market-benchmark-based products (e.g. WIBOR, LIBOR loans) or fixed rate products, risk profile is directly available from repricing schedule or maturity date. For products with unspecified maturity/repricing profile (current accounts, overdrafts), products where the price changes arbitrarily (e.g. by the Board decision), products which price is indirectly correlated with observed market rates (e.g. average market rates, NBP rediscount rate), as well as for overdue loans the Bank uses replicating portfolios, trying to reflect the actual risk profile. In such cases, the exposure is being split into floating part, which usually is being assigned an O/N repricing, and core ("sticky") part, which structure and maturity can differ from product to product, e.g. for current accounts it is 12 yearly deposits, maturing and rolling over consecutively every month. Remaining products are usually being assigned 1M repricing cycle, what reflects their correlation with changes of interest rates by the Monetary Policy Council, or spread in time in line with the actual distribution of repricings.

Value at Risk (VaR) is a main risk measure in trading book and in Money Market portfolio. The Bank is using parametric method with exponential weighting, kurtosis adjustment, 99% confidence interval and 1-day holding period (1 month in Money Market portfolio). The VaR is limited both with respect to end of day position as well as to intraday position. Additional risk limits comprise sensitivity limits (delta/BPV), open position limits, stop-loss limits as well as stress-tests' implied loss limits, basing on theoretical as well as historical scenarios. Further constrains include maximum maturity of transactions, allowed instruments as well as currencies.

Current reporting on market risk in trading and banking books is prepared daily and distributed to employees directly managing the positions, to their supervisors and to Board members. Periodical reports: monthly, quarterly and annually (for BRMC, Management Board and Supervisory Board) present analysis and explanation for the changes that took place, split in different risk types, books / portfolios, currencies etc., as well as specify recommendations and suggestions as to the steps to be taken in order to improve risk profile.

B3. COUNTRY AND COUNTERPARTY RISK

Counterparty credit risk and country risk are understood as risks of the Bank incurring loss as a result of default or increased likelihood of default on whole or part of payments expected from the counterparty, coming from worsening of its financial situation, substantial adverse change in market or economic environment or limitations resulting from deterioration of economic or political situation, or changes in legal system of the country of their residence.

Counterparty risk discussed here concerns financial market transactions: interbank deposits, purchase and sale of debt securities, spot foreign deals as well as derivatives.

Risk management strategies and processes

Bank's policy with regard to country and counterparty risk is to minimize the likelihood of situation, where substantial loss is generated as a result on default on full or partial payment of expected from single or group of connected counterparties.

With regard to financial counterparties, Bank's policy is to concentrate on cooperation with institutions with at least investment grade rating as well as to diversify total exposure with respect to clients and countries. In terms of corporate counterparts, the Bank only supports their needs with regard to transactions hedging their market risk profile generated from core business; and precedes granting of the limit with full and thorough analysis of credit and market risk profile of the client.

Country and counterparty risk is controlled with the system of exposure limits, established for all Bank's counterparts – each transaction uses the counterparty limit and in case he's not a resident, also a country limit.

Organization of risk management process

Counterparty risk assessment process is separated from operational duties, trading deals in particular – design of structure and size of particular exposure limits towards financial counterparties (banks, insurers, investment and pension funds, etc) and countries, as well as periodical monitoring and review of already existing limits are within the scope of responsibilities of unit supervised by Board member responsible for Risk , however final approval of the limits is with BRMC. Size of the limit is established based on methodologies developed internally for individually homogenous groups of clients, that take into account financial situation (dynamic and structure of results, liquidity), size of capital available to cover for risk, external credit ratings, ownership structure and – if available – history of cooperation. With regard to countries, specific additional factors include assessment of economic and political stability. In this process Bank BGŻ is following recommendations from and considers risk profile accepted by majority shareholder.

In case of non-financial counterparties, process of establishment of transactional limit is a part of credit process, i.e. it is based on assessment of financial standing of the client, recognition of specifics of its operations (e.g. amounts, currencies and schedule of payments, likelihood of payments actually happening, hedging transactions made with other banks, etc) and in consequence fitting of financial market instruments to client's risk profile, in order to mitigate identified risks and stabilize the results. Bank BGŻ excludes possibility of intentional speculative transactions, even if the cooperation is based under cash collateral. Final sizing of the limit, specification of non-monetary constrains (types of allowed transactions, allowed currencies, max maturities, etc), establishment of conditions needed to be met before the limit can be made available as well as decision on the list of applicable collaterals is within scope of responsibility of Credit Committee of 1st of 2nd degree in Bank's headquarter.

Scope and types of risk reporting and measuring systems

As a main tool to mitigate counterparty risk Bank's using exposure limits: presettlement and settlement limits. Presettlement limit controls the size of credit exposure during the life of transactions: in Bank BGŻ it is composed of current NPV of the transaction and risk add-on, reflecting the expected, statistically justified adverse change of that NPV until the maturity date of the deal. Settlement limit is used to reduce concentration of cash flows due from the counterparties on a single date (at reporting date and in all future dates) and is utilized by all expected cash flows, taking into account specific settlement mechanisms of various instruments (i.e. cash settlement vs. delivery).

In case of financial institutions Bank BGŻ specifies a catalogue of available instruments, including additional limit on transactions that engage Bank's actual funding (e.g. interbank deposits, purchase of debt securities issued by the counterparty); and in case of non-financial clients limits allowed currencies/pairs, max maturities, possibility to roll over on historical prices, max open FX position. Limits are being established for maximum 12 months, but even during that time financial situation of the counterparty is under monitoring.

Utilization of available limits as well as overview of remaining constraints is available on-line in the front office system for Bank's employees authorized to deal transactions with financial and non-financial clients. Independent verification of limits' utilization and adherence to non-monetary restrictions (allowed instruments, currencies, maturities, etc.) is carried out by independent unit under supervision of Board member responsible for Risk Area, that reports daily on the size and structure of exposures in various analytical dimensions to the dealers, to their supervisors and to Board members; as well as requests explanation and acceptance – according to approved authority hierarchy – of limit breaches. In case of non-financial counterparties the unit also prepares information of client's advisors in branches, regions and business centers, in order to allow them to agree hedging or collateralization strategy with the client once the exposure gets close to the limit, limit expired or was closed.

Monthly reports summarizing Bank's activity, size and structure of exposure are being prepared for BRMC; quarterly information for Management Board and Supervisory Board.

B4. OPERATIONAL RISK

Strategies and processes in operational risk management

The Bank manages the operational risk based on the approved strategy and policy.

Operational risk is defined by the Bank as the possibility to incur losses or an unjustified cost resulting from inadequate or failed internal processes, people and systems or from external events. Legal risk and compliance risk (partly including legal risk) are included into the operational risk. Compliance risk is the risk of occurrence of legal sanctions, financial losses or damage in the Bank's reputation as a result of the non-compliance of the Bank's business with the commonly binding laws and the Bank's internal regulations, including the best practice standards. The compliance risk shall be also generated by the inconsistency of the Bank's internal regulations and the regulations inside the capital group, faulty agreements and change in the laws or the interpretation thereof. Strategic risk is excluded from the operational risk.

The objective of the operational risk management is to ensure the top quality standards of services rendered by the Bank, to ensure their security and compliance with the binding regulations and the best standards and lowering the losses and costs caused by the operational risk at the same time. Organizational culture in operational risk management plays an important role for the Bank. Key element is employees' awareness about the risk and their share in the responsibility for its reduction. Operational risk is commonly present in the banking activity, what means that each of the employees and each of the organizational units are responsible for operational risk identification within their scope of responsibilities and taking actions aimed at risk reduction.

Operational risk management system is integrated. It means that all actions and functions concerning operational risk management are combined in one, consistent, transparent, complete and efficient system.

In order to avoid a potential conflict of interests and in order to ensure objectivity, operational risk assessment function in the Bank is separated from the function responsible for making business decisions. Operational risk control function is autonomous and placed in Risk Area.

Operational risk management process included the following stages:

a. risk identification,
b. defining risk causes (sources),
c. assessment of the risk amount and setting its acceptable level,
d. analysis of possible solutions to reduce the identified risk (risk countermeasures),
e. taking a decision to reduce risk,
f. taking necessary actions,
g. control and assessment of applied risk reduction tools (feedback).

Organization of the operational risk management process

Operational risk management is carried out in an integrated form, within the dedicated operational risk management structure, that is separated both in organizational and functional form. It includes:

a. Operational Risk, Compliance and Antifraud Subcommittee acting as part of the Balance Sheet and Risk Management Committee – responsible for supervision, coordination of the processes and allocation of tasks and resources within the operational risk management system,

b. dedicated unit in the Head Office of the Bank – responsible for development, coordination and control of the basic operational risk management processes, as well as development and implementation of tools, procedures and operational risk management rules,

c. operational risk management positions in Regions – responsible for operational risk management in Regions.

Operational risk management is closely connected to the management of other kinds of risk due to the fact that a substantial part of the operational risk losses occur between operational risk and credit risk or operational risk and financial risk, as well as other banking risks.

Actions directly aimed at operational risk mitigation are taken by units responsible for individual areas exposed to operational risk (first line of responsibility).

Scope and types of risk reporting and measuring systems

One of the operational risk management stages is taking actions aimed at risk reduction. Those actions mean preventing the threat or reducing the consequences of the event as well as carrying out system actions aimed at elimination of causes of the events. Systems actions are e.g. eliminating the gaps in internal regulations and procedures, preparing new or changing the existing tools, introducing changes to work organization, improving control mechanisms and introducing changes to IT systems. Before taking such actions, their costs are analyzed as well as potential losses that can be borne without implementing the suggested solution.

For the operational risk monitoring and assessment the Bank applies among others: the self-assessment method, Key Operational Risk Indicators (KRI) as well as the data about identified operational risk events and threats, incl. operational risk losses – using the internal and external data. The Bank decides on its risk tolerance (operational risk appetite) and takes appropriate actions when the accepted risk level is exceeded.

The Bank's Management is regularly informed about the level of operational risk as well as about actions taken due to identified operational risk events and threats.

The Bank applies insurances within the framework of risk transfer.

C. OWN FUNDS

Own funds in 2014 increased by PLN 371 325 thousand, which was the result of the merger with Rabobank Polska and in particular of following factors:

- increase of equity by PLN 5 002 thousand – due to issuance of H series shares;
- increase of supplementary capital, of which: (i) retained Bank's net profit from 2013 in amount higher by PLN 28 060 thousand than in 2012, (ii) capital created as a result of merger – PLN 183 323 thousand;
- increase of supplementary capital and general risk fund by total PLN 156 859 thousand due to merger.

There are no significant obstacles against fast transfer of own funds or repayment of liabilities by a parent company or its subsidiary.

Tab. Own funds - 31.12.2014 in PLN thou.

own fund category	PLN thousand
Tier I	**3 597 420**
- share capital	56 139
- net profit for previous period	4 127
- other supplementary capital	3 430 785
- other reserve capital	151 219
- general risk fund	120 640
- intangible assets	-165 307
- equity investments in financial institutions	0
- unrealised losses on financial instruments, classified as available for sale, evaluation	-183
Tier II	**319 023**
- subordinated loan	319 023
total own funds	**3 916 443**

Bank's share capital as on the 31st of December 2014 amounted to PLN 56,139 thousand. The nominal value of each share is PLN 1.00, out of which:

- 49,952,737 belong to BNP Paribas SA,
- 5,613,875 belong to Rabobank International Holding B.V.,
- 572,152 belong to other shareholders.

As at 31 December 2014 and 31 December 2013 none of the members of Management Board or Supervisory Board held the Bank's shares directly.

Statutory reserve capital consists of distributions made from the net profit for the year or from other sources. Statutory reserve capital is allocated to absorb the Bank's accounting losses or for other purposes, including distribution in the form of dividends to shareholders. The Annual General Meeting decides on the appropriation of the statutory reserve capital.

Other reserves is a special fund for unidentified risks from all or part of the general banking risk reserve. This reserve can only be used to absorb the Bank's accounting losses. Other reserves include a reserve, which is created as the result of the revaluation of financial assets available for sale.

The general banking risk reserve was established in accordance with the Banking Act dated on the 29th of August 1997 from the net profit for the year. The general banking risk reserve can be appropriated only with the approval of the shareholders at the General Shareholders Meeting of the Bank.

D. ADHERENCE TO THE CAPITAL REQUIREMENTS

D1. CAPITAL ADEQUACY ASSESSMENT METHOD

In 2014 Bank BGŻ calculated risk weighted assets in line with the Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms including at the same time national options indicated by Polish Financial Supervisor (Komisja Nadzoru Finansowego). As far as the credit risk is concerned, the Bank made use of the standardized approach. In case of operational risk the basic indicator approach was used, and for market risk the standardized methods in line with Basel II were implemented. Within the process of risk weighted asstes calculation the Bank made use of the credit ratings assigned by Moody's Investors Services. All the ratings used by the bank were implemented in the process of the regulatory capital requirement calculation for credit risk of exposures to governments and central banks, to institutions and to companies.

In order to reduce the regulatory capital requirements, the Bank made use of credit risk mitigation techniques, including: a) collaterals - the reduction in credit risk results from the rights to liquidate, transfer, take over or keep specified assets or amounts in case of a client's default; b) guarantees – the reduction in credit risk results from a third party's commitment to repay a specified amount in case of a client's default or other specified credit events. With respect to credit risk mitigation techniques 56% of overall protection is provided by one credit institution.

D2. CAPITAL ADEQUACY RATIO

Capital adequacy ratio

The capital adequacy ratio increased from 13.27% at the end of 2013 to 13.81% at the end of 2014.

The following tables present regulatory capital requirements per risk types as well as the division of regulatory capital requirements for credit risk per category of an exposure.

Tab. Consolidated risk weighted assets – 31.12.2014 in PLN thou.

	PLN thousand
credit risk, settlement risk & counterparty credit risk	25 271 559
market risk including:	255 383
FX risk	-
commodity risk	-
price risk of equities	-
specific risk of debt instruments	-
general interest rate risk	255 383
exceeding of the limit of exposure concentration and the limit of big exposures	-
exceeding of capital concentration's threshold	-
operational risk (BIA)	2 702 037
CVA	120 547
total	**28 349 526**

Tab. Risk weighted assets for credit risk – 31.12.2014 in PLN thou.

category	PLN thousand
claims on sovereigns	337 792,75
claims on local authorities	45 384
claims on non-central government public sector entities (PSEs)	61 473
claims on multilateral development banks (MDBs)	-
claims on international organizations	-
claims on institutions	519 576
claims on corporates	4 728 330
claims included in the regulatory retail portfolios	3 806 758
claims secured by realestate mortgage	13 766 883
past due loans	1 508 469
higher-risk categories	0
secured bonds	-
short term exposures to banks and corporates	-
investments units	-
equity exposures	4 124
other	492 768,78
total	**25 271 559**

D3. RISK MITIGATION TECHNIQUES

Policy and procedures for netting on-balance and off-balance sheet

Bank BGŻ does not use compensation of on- and off- balance exposures in normal operational activities and therefore does not take such effects into account while calculating its regulatory capital requirements.

However, the Bank takes into account that framework agreements signed with particular clients (see the part “H. Counterparty credit risk”) allow for compensation of mutual liabilities in case of early termination and settlement of transactions, if the client breaks the agreement or his financial situation deteriorates significantly. Therefore the Bank includes this netting effect while calculating the size of exposure to manage its counterparty credit risk, as well as while estimating its economic capital and adjusting fair value.

Policy and procedures for collateral valuation and collateral management

Credit risk management policy and other Bank's internal regulations determine requirements concerning principles of assessment of entities that establish personal collaterals and general rules for material collaterals' valuation.

The acceptance of personal collateral has to be preceded by the assessment of credibility and financial standing of collateral issuer. In case of material collateral, e.g. register pledge and transfer of ownership, the assessment of current market value of collateral is required.

In case of mortgage-backed transactions for institutional clients (based on external valuation prepared by professional appraiser) Bank BGŻ determines bank's internal value of real estate that is used to calculate LTV ratio. Bank's internal value of real estate is determined according to separate Bank's internal regulations, particularly in a process of individual verification by Team of Real Estate Valuation Experts. In case of selected types of real properties (agricultural land), the Bank accepts internal valuations basing on statistics and transactional prices.

In case of mortgage-backed transactions for retail clients Bank BGŻ estimates the bank's value of real estates on the base of valuation submitted by external professional entity with whom the Bank concluded co-operation agreement.

The update of collateral value is an element of monitoring.

Types of credit collaterals, guarantors and counterparties within credit derivatives

According to the art. 93 of the Banking Law, to secure bank's receivables a bank may request a client to establish collateral which is governed by the rules of Civil Code, law on bills of exchange or customs being in force in domestic or international market. Following the general statement of the Banking Law, Bank BGŻ accepts personal collaterals where the whole property of a debtor titled from collateral may be used to meet Bank's claims and material collaterals - where Bank's claims may be realized from property being the subject of collateral agreement. In the Bank civil guarantee is the most often used collateral out of the catalogue of personal collaterals. As far as the catalogue of material collaterals is concerned, the most often used collaterals by the Bank are: register pledge, mortgage and transfer of ownership.

Tab. Exposures protected with recognized collaterals and guarantees – 31.12.2013 in PLN thou.

exposure class	PLN thou.
claims on sovereigns	-
claims on local authorities	-
claims on non-central government public sector entities (PSEs)	515
claims on multilateral development banks (MDBs)	-
claims on international organizations	-
claims on institutions	-
claims on corporates	396 412
claims included in the regulatory retail portfolios	215 037
claims secured by realestate mortgage	134 128
past due loans	8 479
higher-risk categories	-
secured bonds	-
short term exposures to banks and corporates	-
investments units	-
equity exposures	-
other	-
total	**754 571**

Tab. Exposures protected with guarantees defined under New Basel Capital Accord – 31.12.2013 in PLN thou.

exposure class	PLN thou.
claims on sovereigns	-
claims on local authorities	-
claims on non-central government public sector entities (PSEs)	415
claims on multilateral development banks (MDBs)	-
claims on international organizations	-
claims on institutions	-
claims on corporates	362 367
claims included in the regulatory retail portfolios	175 995
claims secured by realestate mortgage	124 046
past due loans	7 627
higher-risk categories	-
secured bonds	-
short term exposures to banks and corporates	-
investments units	-
other	-
total	**670 450**

The Bank does not use credit derivatives. As far as guarantees are concerned, the main guarantors are: Rabobank Nederland as well as Bank Gospodarstwa Krajowego.

D4. LEVERAGE RATIO

The leverage ratio was calculated as the arithmetic mean of monthly leverage ratios over the quarter, using tier 1 capital as per Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CRR), art. 499 par. 1 point (a).

Tab. Leverage Ratio – 31.12.2014

End of quarter leverage ratio	8,04
Leverage ratio (avg. of monthly leverage ratios over quarter)	7,96

Tab. Breakdown of the leverage ratio total exposure measure - 31.12.2014 in thou PLN

	PLN thousand
Off-balance sheet items, derivatives, SFTs and trading book	3 132 236
Off-balance sheet items	2 529 234
Derivatives and SFTs subject to a cross-product netting agreement	0
Derivatives not subject to a cross-product netting agreement	602 446
SFTs not subject to a cross-product netting agreement	556
Other assets belonging to the trading book	0
Other non-trading book exposures	41 767 686
Covered bonds	0
Exposures treated as sovereigns	8 441 666
Exposures to regional governments, MDB, international organisations and PSE NOT treated as sovereigns	239 058
Institutions	398 297
Secured by mortgages of immovable properties; of w hich	18 795 989
Secured by mortgages of residential properties	6 916 770
Retail exposures	5 302 440
Corporate	4 312 234
Exposures in default	2 451 152
Other exposures	1 826 850
total	**44 899 922**

E. INTERNAL CAPITAL REQUIREMENTS – ECONOMIC CAPITAL

Bank BGŻ defines internal capital as the value of capital that should be kept by the Bank to cover losses with such a value, that the probability of incurring them within 12 months is lower than 0.1%. The total value of internal capital consists of capital for the following risk types:

- credit risk,
- country and transfer risk,
- concentration risk,
- market risk (incl. market risk in the trading portfolio and the interest rate risk in the banking book);
- operational risk,
- business risk,
- significant immeasurable risks.

Internal capital for the business risk is calculated on a yearly basis. Internal capital for all other risk types is calculated monthly. Bank BGŻ treats internal capital as one of the Bank's management tools allowing for defining risk limits and estimation of Bank's effectiveness. The Bank has implemented internal tools allowing for estimation of risk adjusted return on (internal) capital (i.e. RAROC). The table below presents the structure of internal (economic) capital at the end of 2014.

Tab. Economic capital structure – 31.12.2014 in PLN thou.

risk type	PLN thou.	share
credit risk	1 714 773	70,16%
concentration risk	82 463	3,37%
country and counterparty risk	25 735	1,05%
operational risk	213 858	8,75%
market risk	67 937	2,78%
other asset related risks	36 119	1,48%
buisness risk	303 200	12,41%
total	**2 444 085**	**100,00%**

Brief information on internal capital model for credit risk, country and transfer risk as well as concentration risk

For the purpose of internal capital calculation for credit risk the Bank distinguishes models for non-financial as well as for financial obligors.

Internal capital calculation for non-financial obligors is performed in Bank BGŻ with the use of methods originating from the AIRB approach. Each credit exposure is assigned a score, a rating or a risk class which is dependent on different characteristics of the exposure. Furthermore, for each score, rating , as well as a risk class a probability of default is applied. A level of the probability of default combined with information of a client's segment and specificity of client's activity influence the correlation coefficients. The correlation coefficients represent the level of dependence of a client's economic and financial situation on macroeconomic factors (systematic factor). Loss given default coefficients (LGD) are assigned to all credit exposures depending on the characteristics of: a facility, a client's segment and collaterals.

The Bank has comparatively large exposures to some of its clients. Therefore additional economic capital has to be calculated to cover the concentration risk. A model designed to cope with the task is based on the Monte Carlo simulation. It assumes that the additional capital requirement is obtained through comparison of loss distributions for: a) an ideally granulated portfolio, b) an existing credit portfolio. The capital requirements for the credit risk as well as for the concentration risk are calculated monthly. The assumed confidence level is 99.9%.

Internal capital calculation for banks, countries and all exposures resulting from derivatives is performed with the use of a separate model originating from the AIRB method, too. In this case, the starting point for the calculation is a set of internal or external ratings. As far as the loss given default (LGD) parameter is concerned, IRB Foundation assumptions from New Basel Capital Accord are used. Similarly as in the case of credit risk of non-financial obligors, a yearly risk-taking horizon and a confidence level of 99.9% are assumed. The capital is calculated on a monthly basis.

Brief description of the internal capital models for the market risk

Economic capital for the market risk is calculated as a sum of:

- Interest Income at Risk worse scenario(out of 5 scenarios assuming yield curves 1-year changes) - for the ALM portfolio (banking book);
- Value at Risk (VaR), based on parametric delta-normal model (Bank does not allow for open positions in options – all corporate transactions are immediately closed on a back-to-back principle) with and adjustment for kurtosis observed in empirical distribution of changes in risk factors, with no exponentially weighting, for combined Trading Book and Money Market portfolio in banking book.

  Important assumptions:
- Diversification of risk factors is taken into account when calculating economic capital only for summarized expositions from Trading and Money Market portfolio (VaR), whereas it is not taken into account in case of VaR and IaR total;
- VaR (holding period: 1Y) is based on Foreign Exchange (FX) and Interest Rate (IR) risk factors, and it does not take into account: commodity risk and equities price risk, as those kinds of exposures are closed back-to-back or non-existent in the Bank respectively.

Calculation of internal capital for market risk, including also interest rate risk in banking book, is performed on a monthly basis.

Brief description of the internal capital model for the operational risk

For calculation of the internal capital for operational risk, the Bank applies the method commonly used in insurance and by other banks as a standard for operational risk assessment as well as for calculation of the regulatory capital requirements under the Advanced Measurement Approach (AMA). This method is based on a separate analysis of the probability distribution of the number of operational risk events, which occurred in the assumed time period, as well as on analysis of loss severity distribution for the individual event that happened. Both distributions are combined then, and it leads to obtaining a distribution of the probability of annual loss and to estimating the internal capital. When estimating the amount of this capital, the Bank's internal data is used as well as the results of scenario analysis performed by the Bank's operational risk management experts. Similar to other risks mentioned above, a one year horizon of losses and the confidence level of 99.9% are assumed.

F. IMPAIRMENT OF FINANCIAL ASSETS

The following chapter presents only the values of assets that are tested for impairment under International Accounting Standards (IAS39), which differs from values in Financial Statement where all assets are presented. Impairment assessment of financial assets in line with the International Accounting Standards (IAS 39) is performed for such assets that are valued in line with amortized cost. Those assets include:

a. credits and loans,

b. debt securities classified as held till maturity

c. off-balance sheet commitments resulting from guarantees, letters of credit, unused credit limits, with the exception for those off-balance sheet commitments that result from derivatives.

The impairment assessment concerns also unlisted capital instruments and capital commitments classified as "available for sale" for which the loss is directly reflected in own funds and there is objective evidence for impairment of such an asset. Furthermore, the impairment assessment is not performed for derivatives that are priced in line with the fair value method.

Bank BGŻ performs monthly calculation of impairment of financial assets. The calculations are performed according to IAS 39 with the use of an IT application. An initial point for the calculation is an assignment of impairment evidences to exposures. Generally following situations are considered as an impairment evidence:

a. a delay or lack of principal, interests or other payments resulting from credit agreement; the delay must be longer than 90 days;

a. preferential treatment of a client as a consequence of economic or legal reason due to financial difficulties of a client, while the preferential treatment would not be accepted in other circumstances[2],

b. disadvantageous changes in financial and economic standing of the client[3],

c. termination of a loan agreement by the Bank,

d. bankruptcy, liquidation or beginning of the liquidation process of the client,

e. statement made by a client on initiated remedial proceedings;

f. initiated execution against a client,

[2] Including loan restructuring which generates economic loss for the Bank.

[3] E.g. it can be recognized through analysis of a financial statement (or other documents provided by a client) or it can results from getting information on loss of job, income decrease, debt increase or missed payments in other institutions.

g. disadvantageous changes in scoring or rating analysis,

h. lack of active market for a credit exposure due to financial difficulties,

i. contest of a credit exposure by a client through legal proceedings.

When the impairment's evidence is recognized for an individually significant asset, a Bank's employee responsible for the exposure estimates the value of the future cash flows that, after discounting, represent current value of the exposure and allows for calculation of impairment of the asset. Individually significant financial assets for which impairment was not recognized, as well as all individually insignificant financial assets are assessed on a collective basis. Within collective approach the value of impairment provision for exposures with recognized impairment evidence is calculated. The collective approach covers also the calculation of IBNR provision (incurred but not reported losses) for those exposures that were not recognized as impaired.

Tab. Exposures per impairment assessment method – 31.12.2014 in PLN thou.

assessment method	number of exposures	average exposure value	gross exposure value		impairment provision	nett exposure value	
individual - impaired exposures	1 088	1 511	1 644 105	4,5%	667 486	976 619	2,8%
collective - impaired exposures	24 169	39	950 008	2,6%	627 649	322 360	0,9%
collective - not impaired exposures	391 995	87	34 169 419	92,9%	158 942	34 010 477	96,3%
total	**417 252**	**88**	**36 763 532**	**100,0%**	**1 454 076**	**35 309 456**	**100,0%**

The exposure is understood as a sum of on-balance and off-balance sheet exposure.

Tab. Exposures and impairment provisions per economy sector – 31.12.2014 in PLN thou.

industry	exposure					impaiment provisions		
	non impaired		impaired		total	non impaired	impaired	total
agriculture	11 159 412	97,1%	331 000	2,9%	11 490 412	46 101	140 681	186 782
wholesale trade	2 472 577	89,3%	295 021	10,7%	2 767 599	18 474	174 695	193 169
manufacture of food products	2 436 311	87,0%	362 997	13,0%	2 799 308	10 075	127 011	137 086
construction	420 551	61,3%	264 990	38,7%	685 541	3 578	118 603	122 181
manufacture of chemical prod.	547 514	96,5%	19 714	3,5%	567 228	2 716	12 902	15 618
retail trade	576 143	86,0%	94 058	14,0%	670 201	6 257	58 433	64 690
real estate activities	346 851	89,1%	42 357	10,9%	389 209	4 777	12 547	17 325
manufacture of metals and minerals	437 915	81,0%	102 807	19,0%	540 722	2 291	56 395	58 686
professional, scientific and technical activities	451 288	80,2%	111 150	19,8%	562 437	2 647	96 251	98 898
manufacture of wood and paper products	387 357	83,2%	78 342	16,8%	465 699	2 482	44 466	46 948
electricity, gas, steam and air conditioning supply	450 408	94,3%	27 297	5,7%	477 705	3 667	6 345	10 011
transportation and storage	387 129	92,1%	33 351	7,9%	420 480	3 504	20 765	24 269
other business	508 815	96,4%	19 114	3,6%	527 928	1 261	7 143	8 404
manufacture of machinery, equipment and vehicle	486 266	94,1%	30 331	5,9%	516 597	2 762	14 382	17 145
hotels and restaurants	157 032	74,8%	52 769	25,2%	209 801	1 992	14 040	16 032
information and communication	60 499	89,1%	7 384	10,9%	67 882	498	5 108	5 606
manufacture of textile, leather	83 044	73,4%	30 044	26,6%	113 088	847	19 674	20 521
health care & social help	129 361	97,4%	3 419	2,6%	132 780	1 004	1 602	2 606
other industries	2 478 667	94,5%	145 191	5,5%	2 623 858	10 291	77 130	87 420
private persons	10 192 278	94,9%	542 778	5,1%	10 735 056	33 719	286 963	320 681
total	**34 169 419**	**92,9%**	**2 594 113**	**7,1%**	**36 763 532**	**158 942**	**1 295 135**	**1 454 076**

The exposure is understood as a sum of on-balance and off-balance sheet exposure.

Tab. Exposures and impairment provisions per residual maturity class – 31.12.2014 in PLN thou.

residual maturity	exposures					impairment provisions for exposures		
	not impaired		impaired		total	not impaired	impaired	total
up to 1 year	5 846 544	83,1%	1 188 263	16,9%	7 034 807	32 137	732 176	764 312
from 1 to 3 years	4 683 391	92,7%	367 509	7,3%	5 050 900	22 280	144 470	166 750
from 3 to 5 years	4 477 742	96,3%	172 120	3,7%	4 649 862	25 759	83 874	109 633
from 5 to 10 years	5 505 187	93,9%	356 711	6,1%	5 861 898	34 918	140 322	175 240
over 10 years	13 225 736	96,8%	437 120	3,2%	13 662 856	42 927	166 199	209 126
unspecified	430 819	85,6%	72 390	14,4%	503 210	920	28 095	29 015
total	**34 169 419**	**92,9%**	**2 594 113**	**7,1%**	**36 763 532**	**158 942**	**1 295 135**	**1 454 076**

The exposure is understood as a sum of on-balance and off-balance sheet exposure.

Tab. Exposures and impairment provisions per region – 31.12.2014 in PLN thou.

region	exposures					impairment provision for exposures		
	not impaired		impaired		total	not impaired	impaired	total
Head Office	2 359 204	77,0%	704 745	23,0%	3 063 949	6 629	492 329	498 958
Central	3 978 056	90,7%	409 746	9,3%	4 387 802	20 718	122 380	143 099
Central-Western	4 597 682	94,6%	262 809	5,4%	4 860 491	20 180	158 734	178 914
South-Eastern	3 161 149	94,3%	190 352	5,7%	3 351 501	18 115	91 414	109 530
South-Western	3 081 651	96,4%	115 371	3,6%	3 197 023	12 409	50 119	62 528
Southern	2 235 850	93,9%	144 384	6,1%	2 380 234	10 453	77 291	87 744
North-Eastern	3 505 662	98,0%	72 426	2,0%	3 578 087	16 919	29 841	46 760
North-Western	2 286 124	95,2%	114 383	4,8%	2 400 508	10 212	41 870	52 081
Northern	5 400 743	92,5%	439 790	7,5%	5 840 534	25 063	179 434	204 497
Eastern	3 563 297	96,2%	140 106	3,8%	3 703 403	18 242	51 724	69 966
total	**34 169 419**	**92,9%**	**2 594 113**	**7,1%**	**36 763 532**	**158 942**	**1 295 135**	**1 454 076**

Remark: The exposure is understood as a sum of on-balance and off-balance sheet exposure; the regional structure is in line with the Bank's structure.

Tab. Changes in impairment provisions in 2014 in PLN thou.

PLN thou.	current account loans	loans and advances	banks	corporate customers	households	public sector institutions	other entities	off-balance sheet exposures	total
impairment allowances at the beginning of the period	**176 542**	**1 040 011**	**584**	**449 676**	**582 435**	**260**	**7 056**	**18 338**	**1 234 891**
allowance recognised	208 139	1 248 834	117	476 762	770 241	303	1 411	33 189	1 490 162
allowance reversed	(152 828)	(997 193)	(216)	(349 998)	(645 714)	(348)	(917)	(29 175)	(1 179 196)
write-off	(5 013)	(143 082)	-	(8 353)	(128 421)	-	(6 308)	-	(148 095)
impairment acquired as a result of the merge	29 688	16 540	-	16 540	-	-	-	1 977	48 205
other changes (exchange differences)	(404)	9 642	2	674	8 966	-	-	(1 129)	8 109
impairment allowances at the end of the period	**256 124**	**1 174 752**	**487**	**585 301**	**587 507**	**215**	**1 242**	**23 200**	**1 454 076**

G. MARKET RISK

The Bank's product policy, i.e. using of floating rates for credits, financed by short term fixed rate deposits results in a well matched interest rate exposure, concentrated in short tenors: as at end of 2014 89% of balance positions reprices or matures within 6 months, 79% within 3 months, and 52% within one month. Derivatives were used to hedge interest rate risk of state treasury debt securities portfolio as well as a source of liquidity to finance foreign currency denominated portfolio of retail mortgage loans (to a limited extent). The table on next page presents key risk measures for banking book as of end of 2013 and 2014.

Tab. Banking book risk profile in PLN thousand

risk measure	31.12.2013	31.12.2014	change	change [%]
Repricing gap (marginal)				
up to 1M	4 591 236	10 152 162	5 560 926	121%
1-3M	-168 620	-2 095 788	-1 927 169	-1143%
3-6M	2 115 495	-757 686	-2 873 181	-136%
6-24M	-3 994 792	-4 675 275	-680 483	-17%
over 2Y	681 391	841 737	160 347	24%
Interest at Risk 1)	14 128	23 518	9 390	66%
PLN impact	11 269	19 172	7 903	70%
EUR impact	2 646	4 393	1 748	66%
USD impact	-459	-426	33	7%
other currencies	672	378	-294	-44%
Equity ar Risk (up) 2)	-47 177	-67 614	-20 438	-43%
Equity ar Risk (down) 2)	67 867	95 160	27 293	40%

1) Sensitivity of 12-month interest income to 50bps interest rate movement.
2) Sensitivity of net equity's fair value to 200 bps interest rate movement.

In 2014 Bank BGŻ continued its conservative policy with regard to market risk in trading book, concentrating its efforts on support of sale of treasury products as well as on investing of surplus liquidity. Foreign exchange position was closed by the end of the day, Bank did not run option book (all client options were closed back-to-back) and did not engaged into credit derivatives and corporate debt.

Money Market portfolio consisted mainly of short-term debt instruments held as liquid assets, interbank deposits, FX Swap transactions (short-term foreign currencies funding), and OIS/IRS transactions (debt instruments risk hedging, funding cost stabilization, portfolio's risk profile modification).

The table below presents key risk measures for trading book and Money Market portfolio as end of 2013 and 2014.

Tab. Trading book and Money Market risk profile in PLN thousand

risk measure	31.12.2013	31.12.2014	change	change (%)
Trading book:				
Value at Risk (99%, 1D holding period)	325	793	468	144%
FX risk	23	4	-19	-82%
IR risk	325	792	467	144%
overall FX position	-4 275	683	4 958	-116%
the most harmful stress test	1 805	2 259	454	25%
Money Market portfolio:				
Value at Risk (99%, 1M holding period)	1 897	1 384	-513	-27%
the most harmful stress test	15 604	1 947	-13 657	-88%

H. COUNTERPARTY CREDIT RISK

In addition to conservative credit risk policy, pertaining to establishment of safe size of transactional exposure limits towards the counterparties, Bank BGŻ puts emphasis also on the quality of legal framework, under which the transactions are being made.

Bank BGŻ aims to cooperate with all financial clients under ISDA agreements annexed with CSA (Credit Support Annex) that enables netting of undue exposures as well as is setting a maximum accepted exposure level (threshold), above which the side of the agreement for which the valuation of transactions is negative is obliged to provide additional collateral (margin call). As at end of 2014, Bank BGŻ had signed ISDA agreements with nearly 80% of its active counterparts, in that majority has been annexed with CSA. Benefits resulting from application of netting clauses amount to 99,7%, i.e. total positive NPV exposure in the amount of PLN 381,6 million gets reduced by PLN 380,2 million after netting.

Cooperation with non-financial clients is based on standard, internally developed framework agreement, that specifies: rights and obligations of both sides, in particular the list of triggers indicating deterioration of client's financial situation, situations and instruments to be used by the client to provide additional collateral should the limit be breached or expired, or if other important clauses of the agreements are broken; mechanism of settlement compensation in case of early termination. The benefits from compensation in case of corporate clients are very low due to positive pricing of all client's IRS deals (from the Bank's standpoint) and amount to PLN 0,9 million, i.e. 3,9% of exposure.

The level of collateral as of the end of 2014 that should be provided by Bank in case of significant decrease of its credibility is estimated in the level of PLN 90 m.

The table below presents structure of residual maturity of derivatives' portfolio, its positive, negative (and net) valuation (that can be perceived as a concentration of market risk split into instruments) and netting benefits as at end of 2014.

Tab. Exposure in derivatives (part 1) – 31.12.2014 in PLN thou.

type of instrument	notional							
	up to 1M	1-3M	3-6M	6-12M	1-2Y	2-5Y	5Y+	total
with banks	**6 871 328**	**5 323 577**	**3 402 531**	**7 841 740**	**6 751 677**	**1 916 276**	**757 090**	**32 864 220**
FRA	1 250 000	1 750 000	1 750 000	2 700 000	500 000	0	0	7 950 000
IRS / CIRS / OIS	1 737 680	2 588 743	1 550 000	4 672 482	6 228 720	1 914 410	757 090	19 449 124
FX Swap	3 872 311	981 013	101 163	468 853	2 683	0	0	5 426 023
FX Options[1], incl.:	4 209	0	0	0	0	0	0	4 209
- vanilla	0	0	0	0	0	0	0	0
- exotic	4 209	0	0	0	0	0	0	4 209
Commodity Swap[2]	7 129	3 822	1 368	405	0	0	0	12 723
FX Forward	0	0	0	0	20 274	1 867	0	22 141
with non-banks	**161 420**	**268 077**	**368 076**	**105 730**	**110 371**	**407 380**	**8 766**	**1 429 820**
IRS / CIRS	5 344	20 900	2 000	0	65 286	403 532	8 766	505 828
FX Forward	69 849	70 821	35 900	21 383	44 116	3 848	0	245 916
FX Forward (NDF)	74 925	130 556	115 415	83 947	969	0	0	405 811
FX Options[1], incl.:	4 050	0	0	0	0	0	0	4 050
- vanilla	0	0	0	0	0	0	0	0
- exotic	4 050	0	0	0	0	0	0	4 050
FX Swap	0	41 978	213 392	0	0	0	0	255 370
Swap Towarowy2)	7 252	3 822	1 370	400	0	0	0	12 844
total	**7 032 748**	**5 591 654**	**3 770 607**	**7 947 470**	**6 862 048**	**2 323 656**	**765 856**	**34 294 040**

1) Interbank options include structured deposits embedded options' hedge
2) Commodity interbank swaps matched with clients respective transactions by underlying commodity amount, not by their notional value

Tab. Exposure in derivatives (part 2) – 31.12.2014 in PLN thou.

type of instrument	NPV			netting benefits	
	NPV +	NPV -	NPV net	NPV	%
with banks	**381 615**	**-433 317**	**-51 703**	**380 283**	**99,65%**
FRA	9 405	-12 028	-2 623	9 405	100,00%
IRS / CIRS / OIS	275 650	-277 070	-1 420	275 650	100,00%
FX Swap	94 890	-143 881	-48 991	94 890	100,00%
FX Options, incl.:	163	0	163	0	0,00%
- vanilla	0	0	0	0	0,00%
- exotic	163	0	163	0	0,00%
Commodity Swap	354	-337	16	337	95,39%
FX Forward	1 153	0	1 153	0	0,00%
with non-banks	**24 028**	**-6 584**	**22 922**	**943**	**3,93%**
IRS / CIRS	16 726	0	16 726	0	0,00%
FX Forward	1 397	-3 804	1 112	285	20,41%
FX Forward (NDF)	5 544	-415	5 129	415	7,48%
FX Options, incl.:	0	-163	-163	0	0,00%
- vanilla	0	0	0	0	0,00%
- exotic	0	-163	-163	0	0,00%
Commodity Swap	0	-1 960	0	0	0,00%
FX Swap	360	-243	117	243	67,55%
total	**405 642**	**-439 902**	**-28 781**	**381 226**	**93,98%**

No credit provisions are being made on off-balance receivables, in particular resulting from derivative instruments, unless the transaction is terminated before its contractual maturity and is not settled – then it is converted into overdue receivable and standard provisioning procedures are then applied. In order to reflect in Bank's P&L account the risk of such event taking place, since December 2008 Bank BGŻ applies monthly adjustment of fair value of non-financial counterparts' transactions. The model that is being used scales the regular fair value, treated in this process as an exposure at default (EAD), by the factor resulting from expected probability of default given by internal rating of the counterparty multiplied by expected level of loss assuming partial successful recovery (LGD). Such approach is applied to majority of counterparts; however using expert knowledge with regard to individual PD and LGD estimates is also possible. Above described adjustment takes into account cash collaterals provided by the clients as well as netting clauses in accordance with framework agreements.

As of 31.12.2014, the adjustment of fair value with credit risk component amounted to PLN 1 525 thus.

I. OPERATIONAL RISK

The gross losses resulting from the operational risk events reported in 2014 have been presented in the table below by event types and categories within types. The amount of gross loss means a sum of losses resulting from the operational risk incidents registered in the Bank's internal database, both realized and not realized (in the Bank's opinion possible to be realized) without taking into account reductions resulting from amounts recovered from the insurance. Data includes the operational risk losses connected to the credit risk and financial risk.

Tab. Gross losses resulting from operational risk events reported in 2014 (in PLN '000)

event type / event category within event type	PLN '000
1.Internal frauds	**185**
Theft and internal fraud	185
2.External frauds	**24 439**
Theft and external fraud	22 891
Systems security	1 548
3.Employment practices and workplace safety	**257**
Employee relations	257
4.Clients, products and business practices	**3 476**
Suitability, disclosure & fiduciary	29
Product defects	3 441
Customers classification and exposures	6
5.Damages to physical assets	**160**
Disasters and other events	160
6.Business disruption and system failures	**1 957**
Systems	1 957
7.Execution, Delivery and Process Management	**3 647**
Transaction capture, execution & maintenance	3 160

Customer intake and documentation	337
Trade counterparties	150
total	**34 121**

In order to mitigate risk the Bank strengthens processes and mechanisms aimed at limiting level of risk. This includes amongst others prevention of frauds to the Bank's detriment (especially in the loan area where the largest operational risk losses were reported) and control of correctness of execution of processes in which the irregularities are identified (especially by developing IT system functionalities). Moreover, the Bank regularly verifies and assesses the internal control environment as well as determines actions improving the control mechanisms efficiency.

J. CAPITAL EXPOSURES NOT INCLUDED IN THE TRADING BOOK

Equity instruments outside the trading book comprise shares and investments of a strategic or infrastructural character. Valuation of these exposures is done by estimation of their fair value based on reliable information as of possible sale price to be obtained, or based on net assets. In case of lack of observable quotations on active markets and no possibility to reliably estimate fair value using alternative methods, such assets are carried at cost less any impairment.

As of the 31st of December 2014 carrying amount of the exposures amounted to PLN 5.1 million, including PLN 3.4 million instruments quoted on regulated markets.

As of 31st December 2014 the unrealized gains from revaluation equalled PLN 0.2 million. Gains from sales equalled PLN 0.6 million.

K. REMUNERATION POLICY FOR THE BANK'S MANAGEMENT

Process of setting a policy according to variable components of remuneration

In the Bank are functioning the Management Board Remuneration Policy and the Remuneration Policy for all employees, including employees in management positions, having a significant impact on the risk profile of the Bank. Policies have been developed in accordance with the recommendations of Resolution No. 258/2011 with a support from an external consultant PwC Polska Sp. z o.o and approved by the Supervisory Board on 21 June 2012.

In the above mentioned Policies in 2014 were introduced changes, approved by the Supervisory Board on 1 April 2014, 28 November 2014 connected with implementation of Directive of the European Parliament and of the Council 2013/36/UE dated 26 June 2013 (CRD IV) and compliance with BNP Pariba Group remuneration policy

The participants and the decision process for determining and updating the Remuneration Policies:

participants in the process of determining and updating the remuneration policy	role in the process
Performance Management and Compensation Department with a support from an external consultant	development of policies, recommending for approval of the Management Board
Performance Management and Compensation Department	preparation of amendments to the policy, recommendation for the approval of the Management Board
The Legal Department	legal support, compatibility with the provisions of labor law
The Management Board	supervision of the development and approval of policies and changes to policies
Human Resources and Remuneration Committee	Giving opinion to the Supervisory Board - supporting Supervisory Board in the policy approval process and changes to policies
The Supervisory Board	approval of the policy and changes to policies

The Bank has established Human Resources and Remuneration Committee, which supports the Supervisory Board in carrying out supervisory responsibilities in the area of human resource management by monitoring and supervision of key processes, in particular: succession plans, professional development of employees, remuneration policies. The Committee shall draw for the Supervisory Board opinions and recommendations on, among others, conditions of employment of the members of the Management Board, including the amount of established and awarded variable remuneration.

The Human Resources and Remuneration Committee consists of at least two members appointed out of the members of the Supervisory Board. In addition Chairman of the Audit Committee participates in the works of giving opinion on the remuneration policy, its implementation and evaluation in the Bank. The Committee is managed by the chairman of the Supervisory Board.

In 2014 there were 6 meetings of Management Board and 4 meetings of the Human Resources and Remuneration Committee and Supervisory Board dedicated to the remuneration policy and variable remuneration for Bank’s management.

Setting remuneration level

BGŻ carries a rational, sustainable and controlled remuneration policy, ensuring its compliance with the strategy, acceptable level of risk and standards and core values of the Bank. The remuneration policy reflects the Bank's customer orientation while taking into account the long-term welfare of the Bank and socially accepted practice in the area of remuneration. It is compatible with the relevant laws and regulations.

The remuneration policy applies to all employees. In particular determines conditions and rules for setting, granting and paying the performance-based, variable remuneration to employees in managerial positions which have significant impact on the risk profile of the Bank (within the meaning of KNF Resolution No. 258/2011).

The main principles for remuneration setting (including performance-based remuneration) are:

1) The ratio between fixed and variable remuneration is balanced enough to allow for setting a fully flexible variable remuneration policy, including the possibility of reducing or (where justified) of not granting variable remuneration components at all.

2) Variable remuneration (performance-based) is not granted and paid in cases if the level of earnings is lower than the 85% of earnings assumed in the financial plan.

3) Variable remuneration is set in such a way that it adequately reflects the results in terms of balanced development of the Bank (taking into account the Bank's risk) and is not a reward for lack of performance.

   While determining the variable remuneration the following issues are taken into account:

   a. avoiding situations in which variable remuneration limits the possibilities to strengthen regulatory capital, adequacy ratio and equity,

   b. including risk assessment and necessary mitigation measures to achieve the desired risk profile,

   c. referring short-term financial results to the long term ones.

   Risk assessment applies to both quantitative risk-adjustments (e.g. based on economic capital and RAROC) and qualitative ones (e.g. based on available information on risk management and compliance).

4) In order to ensure that the variable remuneration is in line with the risk profile of BGŻ, the minimum requirement is: after the calculation and payment of variable remuneration (including deferred remuneration) basic funds are equal to or higher than the threshold specified in regulations (Basel, guidelines and resolutions by Financial Supervisory Commission). If this minimum requirement is not met, the variable remuneration (including deferred remuneration) is not due to the extent that violates the requirement.

Performance criteria entitling to the variable components of remuneration

1) The amount of the variable remuneration granted to persons holding managerial positions having significant impact on bank's risk profile is determined based on the individual employee's performance, performance of the relevant business unit and the performance of the Bank as a whole, taking into account the influence of risks. Weights for these performance components are determined in advance and are adequately balanced with Risk Takers' responsibilities. The variable remuneration is based on both financial and non-financial performance criteria. Objectives related to Bank's performance take into account long-term risks, liquidity and capital levels.

2) The amount of variable remuneration awarded to persons in managerial positions having significant impact on bank's risk profile responsible for control functions is based on the individual

employee's job-related performance targets. Financial criteria are not connected with financial results of the areas that are monitored by a given employee in the control function.

3) Variable remuneration is not granted and paid if the employee does not reach a minimum level of achievement of individual objectives.

4) The performance assessment is performed on a three-year basis in order to ensure that the actual payment of performance-related remuneration is spread over a period which takes into account the underlying business cycle of the Bank and its business risks.

Main parameters and rules for determining the remuneration of persons holding managerial positions which have significant impact on the risk profile in the Bank, including a relationship between the remuneration and the results

1) Maximum amount of variable remuneration, the base value for the variable remuneration and the amount of the variable remuneration granted to Risk Takers are determined by the Management Board. In case of Management Board Members decision is taken by the Supervisory Board

2) The ratio between fixed pay and variable pay is adequately balanced and the fixed pay represents a sufficiently high proportion of the total remuneration to allow for creation of a fully flexible policy on variable remuneration components, including the possibility to decrease or pay no variable remuneration (malus).

3) While determining fixed and variable pay for persons holding managerial positions having significant impact on bank's risk profile responsible for control functions fixed pay is preferred. Variable remuneration for above positions is granted mainly on the basis of realization of goals related to the occupied position. Financial criteria of evaluation are not bases on the results of area controlled by the employee in control function.

4) The amount of the variable pay awarded to Risk Takers is determined basing on the individual employee's performance, performance of the relevant business unit and the performance of the Bank as a whole, including the impact of risk on these results.

5) Part of the variable pay is paid out after the performance period while the rest of the payment is deferred. At least 50% of the deferred and the non-deferred part is granted in financial instrument in the form of phantom shares.

6) While granting total remuneration to employees, Management Board takes into account the long-term business strategy of the BGŻ, the continuity of its activities and the interests of all stakeholders. Variable pay is awarded in a restraint way and the construction of the remuneration motivates behaviours that are compliant with BGŻ's objectives and risk profile of the Bank.

7) Maximum variable pay including bonuses for Risk Takers amounts to 100% of fixed pay.

Aggregate quantitative information on remuneration divided into business lines used in the Bank

The following table presents quantitative information on remuneration of persons holding managerial positions having significant impact on bank's risk profile divided into business lines used in the Bank.

business lines	total cash
Retail and Micro	2 503 029
Corporate and SME	6 447 739
Risk and Support	27 128 955

Aggregate quantitative information on remuneration of Risk Takers (persons holding managerial positions within the meaning of KNF Resolution)

The following table presents aggregate quantitative information on remuneration of Risk Takers (persons holding managerial positions having a significant impact on the risk profile of the Bank within the meaning of KNF Resolution).

Information on remuneration	Managerial positions in the Bank:		
	specified in § 1 point. 6) letter a) of the KNF Resolution	specified in § 1 point 6) letter b of the KNF	Management Board Members
Number of people	**22**	**9**	**9**
Fixed remuneration	**12 424 274**	**2 169 098**	**13 351 052**
Variable remuneration for 2014 (deferred and non-deferred)	**2 318 665**	**607 527**	**4 430 926**
Non-deferred variable remuneration	**1 399 800**	**381 016**	**2 067 541**
cash - paid out	710 654	211 134	1 033 771
phantom shares - granted	689 146	169 882	1 033 771
Deferred variable remuneration (for 2012 and 2013)- granted:	**502 535**	**8 425**	**128 656**
cash	255 092	4 001	52 650
phantom shares	247 443	4 424	76 006
Deferred variable remuneration (for 2012, 2013 and 2014) - non granted:	**1 700 429**	**243 633**	**6 453 703**
cash	830 093	121 256	2 987 256
phantom shares	870 336	122 377	3 466 447
Payments related to taking up and termination of employment *:	**1 923 557**	**0**	**0**
Amount	1 923 557	0	0
Number of people	4	0	0

**the highest payment for one person was 1 074 057 PLN*

Bank once a year, till January 31, communicate to the Financial Supervision Commission data on the number of persons employed therein whose total remuneration during the previous year exceeded the equivalent of 1 million Euro, together with information on the positions taken by these people and the main elements of salary, of bonuses and long-term rewards and discharged pension contributions. In 2014, none of the employees of the Bank has reached such remuneration.

L. RULES OF RISK MANAGEMENT

Bank implemented in 2014 the „Policy of assessment of Management Board Members and persons performing most important functions".

The Policy has been developed basing on the guidelines of EBA. It regulates the process and the scope of the assessment of adequacy as well as criteria related to reputation, experience, competences and lack of conflict of interest.

Assessment is performer for Management Board Members and persons performing most important functions. The assessment is also one of the significant element within the process of recruitment and nomination of candidates for Board Members and persons performing most important functions. The assessment covers as well the overall verification of Management Board competences.