MANAGEMENT BOARD'S REPORT
ON THE ACIVITIES OF THE CAPITAL GROUP
OF
BANK GOSPODARKI ŻYWNOŚCIOWEJ S.A.
FOR 2011

Warsaw, 5 March 2012

CONTENT

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

1.1. MACROECONOMIC SITUATION

In the year 2011 Poland maintained high, compared to other EU countries, dynamics of economic growth (4.3% y/y according to preliminary data compared to 3.9% y/y in the year 2010). The main driver behind growth in the GDP was increasing expenditure for tangible fixed assets (growth of 8.7% y/y compared to 0.2% y/y in the year 2010). The main role in the growth played public infrastructural investments, although private investments consecutively improved. However, a significant increase in uncertainty relating to growing fiscal problems in the Euro zone, had adverse effect on the economic conditions in the second half of year. The growth of individual consumption visibly deteriorated (change in this segment decreased from 3.7% y/y in the Q1 to 2.2% y/y in Q4). On the other hand, due to depreciation of Polish currency, a significant increase was recorded in the contribution of foreign trade to the GDP. This was related to reduced demand for imported goods and due to maintained relatively high exports (the result of deteriorating economic condition of main business partners of Poland was neutralized by depreciation of Polish zloty).

Chart 1. Increase in GDP (y/y)

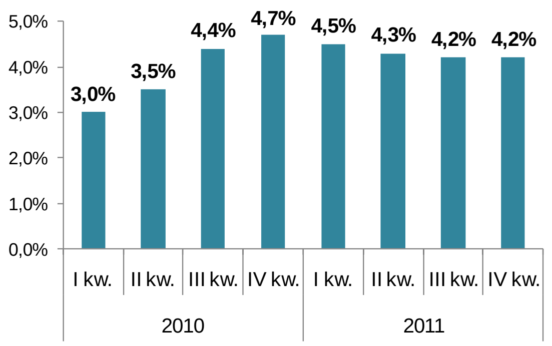
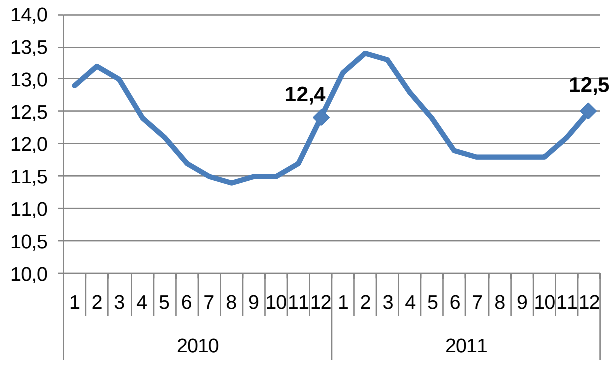


Chart 2. Registered unemployment rate



Source: GUS, own estimates

The relatively high pace of economic growth did not prevent weakening of Polish labour market. Throughout the entire year 2011 the unemployment rate was on average 12.4% (compared to 12.1% in the prior year). At the same time, the dynamics of average wage in real terms in the sector of enterprises decreased (to 0.7% y/y in 2011 from 1.0% y/y in 2010). The improvement in the profitability of exports did not manage to uphold the growth rate of the production at the 2010 levels (yearly average dynamics decreased from 9.0% y/y in 2010 to 6.8% y/y in 2011).

Weakening of Polish zloty and strong increase in fuel prices, as well as fluctuation in regulated prices juxtaposed with the relatively strong internal demand had impact on the material increase in the rate of inflation. The highest increase in prices of goods and consumer services, on a year-to-year basis, was recorded in May and was 5% (i.e. twice the amount of the inflation target of the Monetary Policy Council). On a yearly average basis, the inflation rate was 4.3% compared to 2.6% in the year 2010.

Strong increase in consumer prices combined with higher base inflation rate made the Monetary Policy Council to increase interest rate four times in the year 2011, each time by 25 base points (in January, April, May and June). The reference rate increased from 3.50% to 4.50%, whilst the bills of exchange rediscounting rate which is the reference basis for interest rate of preference loans for agriculture – increased to 4.75%.

Growing problems with excessive debt of some countries of the Euro zone and the resultant threats to the European banking sector led to material outflow of capital from European markets, including in particular from the Eastern Europe countries. This resulted in a rapid depreciation of Polish zloty against currencies of the main economies. At the same time, a strong appreciation was observed of the American currency against euro, which – in turn – caused weakening of Polish zloty against USD. On the other hand, depreciation of Polish zloty against Swiss franc was limited by implementation of the minimum acceptable level of the EUR/CHF exchange rate by the National Bank of Switzerland.

Chart 3. Inflation and interest rates

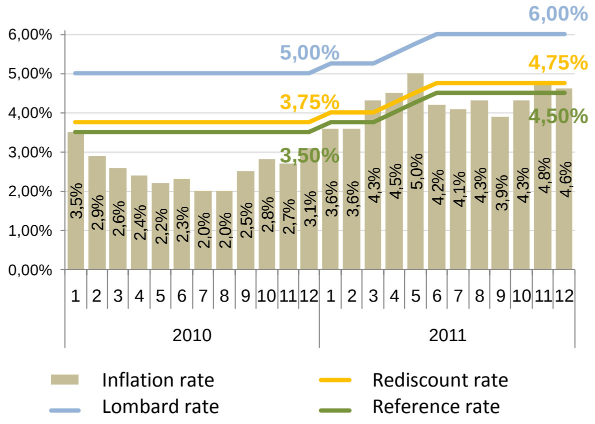
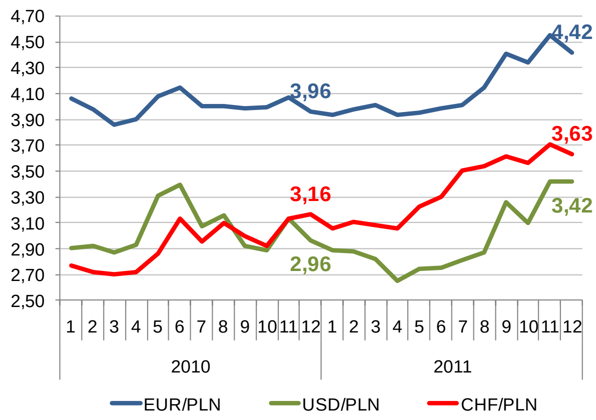


Chart 4. PLN exchange rates



Source: GUS and NBP

1.2. RESULTS OF THE BANKING SECTOR

According to the data published by Polish Financial Supervision Authority (KNF) in the year 2011, the result of the Polish banking sector increased by 37.5% y/y and reached the highest ever level of PLN 15.7 billion (compared to PLN 11.4 billion in the year 2010). The main growth factors of the banking sector net profit was increase in the interest income (by 13.1% y/y), as well as decrease in the negative balance of write-downs against tangible fixed assets (by 29.5% y/y). The decrease in the balance of write-downs was mainly the result of halting the process of deterioration of consumer loan quality. On the other hand, the increase in the balance of interest result should be associated with, among others, development of lending campaigns (in particular in the segment of housing loans and loans to enterprises) as well as improvement of deposit margins. The own funds of domestic banking sector (included in calculation of the solvency ratio) increased in 2011 by 10.2% y/y to PLN 110.9 billion. Whereas general capital requirement – due to the development of credit action and depreciation of PLN – increased by 16.2% y/y up to PLN 67.6 billion. As a result, the solvency ratio of this sector decreased by 0.7 pp to 13.1% on an annual basis.

Table 1. Selected data of income statement for banking sector

billion PLN	**2011**	**2010**	**Change y/y**	
Net interest income	34.9	30.9	4.0	13.1%
Net fee and commission income	14.3	13.8	0.5	4.0%
Dividend income	1.1	1.0	0.1	5.4%
Other elements of the net income from banking activity	7.0	7.4	(0.4)	(5.5%)
Net income on banking activity (general)	**57.3**	**53.1**	**4.2**	**8.0%**
Net income from other operating activities	0.3	0.4	(0.1)	(25.7%)
Operating expenses of banks	(26.8)	(25.5)	(1.3)	5.0%
Amortization/Depreciation	(2.6)	(2.5)	(0.1)	2.2%
Balance of provisions and allowances	(8.7)	(11.2)	2.6	(22.9%)
including: balance of impairment allowance on financial assets	(7.4)	(10.5)	3.1	(29.5%)
Gross profit	**19.6**	**14.2**	**5.4**	**37.7%**
Income tax	(3.9)	(2.8)	(1.1)	38.5%
Net profit	**15.7**	**11.4**	**4.3**	**37.5%**

Source: KNF.

In the year 2011, the activity of the banking sector measured by the pace of growth of loans and deposits volumes increased slightly compared to that of the year 2010. Loans to non-banking clients increased by 14.8% y/y (whilst in the year 2010 - by 9.8% y/y), whilst deposits of this group of clients -

by 11.0% y/y (in the year 2010 - by 9.0% y/y). The ratio of loans to deposits at the end of 2011 was 113.2%, i.e. was 3.8 bps. higher than at the end of 2010.

The growth in loans to private individuals slowed down from 14.8% in 2010 to 11.8% in 2011 mainly as a result of growing statistical base of Polish zloty housing loans. In nominal terms, the increase in those loans amounted in 2011 to PLN 22.9 billion and was almost identical with that recorded in 2010. The reasons behind this situation were particularly due to: continuation of the government-subsidized program *„Rodzina na Swoim"* on customer favourable terms and conditions, fear for its liquidation (encouraging clients to take loan-taking decisions in a shorter period of time), as well as liberalization of price-related lending regulations. Positive impact of above factors on the development of housing loans was clearly seen until the end of Q3 2011. After that, changes were introduced to the *„Rodzina na Swoim"* program, resulting in a decrease of its availability (decrease in the price limit for a flat, where the subsidy is applicable and introduction of age restrictions for people applying for a donation, and the trend of declining credit margins was put to an end. One should note, however, that in 2011 the predominant credit product sold were Polish zloty housing loans. Increase in the balance of outstanding housing loans in foreign currencies (by 16.9% y/y) resulted mainly from depreciation of Polish zloty against Swiss franc (by 14.8% y/y) and against Euro (by 11.5% y/y).

Year 2011 marked the period of stagnation in the segment of consumer loans – the balance of outstanding consumer loans decreased in this period by 2.4% y/y. Such situation was due to the continued trend of low demand for this type of loans and due to coming into effect of the second part of the Recommendation "T", which caused that the banks continued to apply tighter lending policy. In addition, disposal of part of the „bad" loans portfolio by banks had also effect on the decrease in the volume of consumer loans.

Higher than in 2010 pace of the overall growth in the lending market was due to the dynamic increase in loans to enterprises, especially to the SMEs. On one hand, the increase reflected business activity of the SMEs and the drive of some of them to invest, and on the other – was caused by the banks making their lending policies in this segment less strict (in Q1 and Q2 of 2011), which was due, among others, to stabilization of the portfolio of receivables from this group of clients. In the year 2011, the lending campaign in the segment of individual entrepreneurs and in the segment of individual farmers, who modernized their business, developed more quickly.

Table 2. The value of loans of the banking sector

billion PLN, balance at the end of the year	2011	2010	2009	Change	
				2011	2010
Loans to private individuals	**453,2**	**405,4**	**353,2**	**11,8%**	**14,8%**
- Real – estate loans	317,2	266,1	216,4	19,2%	23,0%
- PLN	122,3	99,4	76,3	23,1%	30,2%
- foreign currency	194,9	166,8	140,1	16,9%	19,0%
- consumer loans	135,9	139,3	136,8	(2,4%)	1,8%
Loans to institutional clients	**432,1**	**365,7**	**349,1**	**18,2%**	**4,7%**
- non – banking financial institutions	24,9	24,9	26,6	0,1%	(6,2%)
- non – financial entities	330,4	282,4	278,7	17,0%	1,3%
corporate customers	253,3	214,5	216,6	18,1%	(0,9%)
individual customers	50,7	44,4	40,0	14,2%	11,0%
individual farmers	22,2	20,1	19,4	10,4%	3,5%
non – for – profit organizations	4,2	3,4	2,7	22,4%	25,5%
- loans to public sector	76,8	58,3	43,9	31,7%	32,9%
Loans to non - banking customers	**885,3**	**771,1**	**702,4**	**14,8%**	**9,8%**

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

The main source of increase in the sector of banking deposits in 2011 were still savings of private individuals, which grew faster than in 2010. The increase in the volume of private deposits resulted mainly from the increase in the volume of term deposits, which took place mostly in the second half of 2011. Higher deposit activities of private individuals were affected primarily by relatively low business trading on the Warsaw Stock Exchange lasting since June, which was accompanied by more attractive pricing offered for term deposits. This was partly the result of the increase in NBP interest rates by the Monetary Policy Council which took place in the first half of 2011. To a larger degree, this was caused by certain deterioration of banks overall liquidity condition, which was the result of strong depreciation of Polish zloty and deteriorated effectiveness of the inter-bank market functioning. Worsening of the situation on the inter-bank market occurred in the second half of 2011 and was related to escalation of debt crisis of the Euro-zone countries.

Despite growing trend to invest showed by enterprises, year 2011 also saw a strong, faster than in 2010, trend of growth in deposits volume. The said growth was caused, among others, by dynamic increase in exports revenues in the circumstances of weak Polish zloty, and by the lasting relatively high internal demand. A significant impact on the recorded high dynamics of enterprise deposits in Q4 2011 had nevertheless the transaction of sale by Polish owners of Polkomtel shares. The high increase in enterprise deposits in 2011 was to some extent compensated by considerable decrease in public sector deposits. As a result, deposits of institutional clients in 2011 grew only at a pace approximating that recorded in 2010.

Table 3. The value of deposits in the banking sector

(billion PLN, balance at the end of the year)	**2011**	**2010**	**2009**	**Change**	
				2011	**2010**
Deposits of private individuals	**435,0**	**381,8**	**346,6**	**13,9%**	**10,2%**
- current	204,4	197,2	157,7	3,6%	25,0%
- term	230,7	184,6	188,9	24,9%	(2,2%)
Deposits of institutional clients	**347,2**	**323,1**	**300,1**	**7,5%**	**7,6%**
- non – banking financial institutions	43,3	39,2	35,6	10,5%	10,1%
- non – financial entities	252,9	229,1	211,0	10,4%	8,6%
Corporate customers	205,0	182,8	166,4	12,2%	9,8%
Individual entreprenours	24,8	23,9	23,4	4,0%	2,1%
Individual farmers	7,9	7,4	6,9	7,5%	6,5%
Non – for profit institutions	15,1	15,0	14,3	0,5%	5,4%
- public sector deposits	51,0	54,9	53,6	(7,0%)	2,4%
Deposits of non – banking clients	**782,2**	**704,9**	**646,7**	**11,0%**	**9,0%**

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

1.3. STOCK EXCHANGE AND INVESTMENT CONDITIONS

In Q1 2011, the Warsaw Stock Exchange (WSE) continued to show growing trend that commenced in 2009. The very peak of the boom took place in the first half of April, whilst over the following four months Polish market saw mild declining trend. In the first half of August 2011, a rapid slump was recorded, yet after two weeks of significant decreases, indexes stabilized and since then until year end, the horizontal trend prevailed. At the end of 2011, the values of individual exchange indexes approximated those prevailing at the end of 2009 and thus one may say that the prior year levelled out the 2010 profits. Indexes of large and medium-sized enterprises (WIG20 and mWIG40) fell in the prior year by more or less the same (-21.9% and -22.5%, respectively). The index of smaller enterprises, sWIG80, which decreased by 30.5% was rather weak.

Table 4. Value of main Stock Exchange indices

Index	**31/12/2011**	**31/12/2010**	**31/12/2009**	**Change**	
				2011	**2010**
WIG	37 595.4	47 489.9	39 986.0	(20.8%)	18.8%
WIG20	2 144.5	2 744.2	2 388.7	(21.9%)	14.9%
mWIG40	2 173.9	2 805.3	2 346.1	(22.5%)	19.6%
sWIG80	8 496.5	12 219.9	11 090.9	(30.5%)	10.2%

Source: WSE

The decrease in all WSE indexes caused a 17.78% decrease in capitalization despite 6.5% increase in the number of listed companies.

The WSE share trading result in 2011 was PLN 268.1 billion. Compared to the prior year, turnover in this segment was 14.4% higher and although the increase was lower than in the prior year (33.2%), the trading turnover marked the highest ever annual trading result in the history of Warsaw Stock Exchange. In 2011, the result from trading in derivatives also increased. In the case of options, a 39.5% increase was recorded in terms of value and a 33.0% increase in terms of volume. As regards trading in forward contracts, the trading result increased by 6.2%, whilst the volume - by 4.3%. A very clear decrease (of 41.5%) was recorded on the market of bonds trading.

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

				Change	
	2011	2010	2009	2011	2010
Number of companies	426	400	379	6.5%	5.5%
Capitalization of domestic companies (million PLN)	446 151	542 646	421 178	(17.8%)	28.8%
Shares turnover volume (million PLN)	268 139	234 288	175 943	14.4%	33.2%
Bonds turnover volume (million PLN)	836	1 428	1 476	(41.5%)	(3.3%)
Futures turnover volume (million PLN)	361 665	340 648	258 683	6.2%	31.7%
Futures turnover volume (number)	14 608 953	14 009 202	13 424 593	4.3%	4.4%
Options turnover volume (million PLN)	23 562	16 888	8 391	39.5%	101.3%
Options turnover volume (number)	897 801	675 112	421 648	33.0%	60.1%

Source: WSE

Year 2011 was the fifth year of operations of NewConnect (NC) – the alternative market for trading in shares, conducted by the WSE (it commenced its operations in 2007).

For the purpose of the assessment of boom in the NC market, the most significant seems to be the dynamic increase (by almost 90%) in the number of listed companies. Owing to this increase, the capitalisation increased by 68.6% despite a 34.4% decrease in the NCIndex. However, the value of trading result decreased by as much as 47.0%.

Table 6. Basic NewConnect ratios

				Change	
Specification	2011	2010	2009	2011	2010
Value of NCIndex (In points)	41.62	63.44	49.70	(34.4%)	27.6%
The turnover value of trading in shares (thousand PLN)	1 858 478.93	3 506 652.05	1 079 394.92	(47.0%)	224.9%
Number of transactions	1 082 130	877 947	323 729	23.3%	171.2%
Capitalization (million PLN)	8 383.50	4 970.95	2 457.16	68.6%	102.3%
Number of listed companies (number)	351	185	107	89.7%	72.9%

Source: WSE

The Catalyst bonds market has continued its operations commenced in 2009. The operations have been conducted on the WSE and BondSpot (formerly: MTS CeTO) trading platforms. Catalyst is composed of four trading platforms. Two of them are run by the WSE – regulated market and Alternative Market – and are dedicated to retail clients, and two analogical markets BondSpot dedicated to wholesale clients. All platforms are dedicated to non-treasury debt securities – municipal bonds, corporate bonds, and covered bonds. The value and volume of trading on the Catalyst in the year 2011 showed high levels of dynamics on a y/y basis. The value of new issues in the year 2011 amounted to PLN 531 651 million compared to PLN 21 553 million in 2010.

In the year 2011, 38 new companies had their public offers on the WSE (six of them were transferred from the NewConnect). For comparison purposes, in the year 2010 the number of new companies was 34 and in the record high year 2007, 81 new entities joined the list of listed companies. The number of entities listed on the WSE increased from 400 at the end of 2010 to 428 at the end of 2011.

The value of shares sold (subscribed) during IPOs in 2011 was PLN 8.53 billion, of which new issues accounted for PLN 1.65 billion. For comparison purposes, in the year 2010, the value of IPOs was PLN 15.54 billion.

The prior year was another year which showed a record number of entities entering the NewConnect as 172 issuers entered this market (in the year 2010 - 86 new issuers).

At the end of 2011, on the Catalyst market a total of 268 bonds issues was traded, and the value of issue exceeded PLN 530 million.

At the end of 2011, the net assets of companies managing the Polish investment funds amounted to PLN 114.4 billion compared to PLN 115.6 billion at the end of 2010.

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

As of 31 December 2011, the Bank Gospodarki Żywnościowej S.A. Capital Group consisted of Bank Gospodarki Żywnościowej S.A. as the parent company and:

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

Table 7. Consolidation scope

Entity name	Type of business activities	Share of BGŻ S.A. in the share capital	Consolidation/valuation method
Bankowy Fundusz Nieruchomościowy ACTUS Sp. z o.o.	Acquisition and disposal of properties	100,0%	Full consolidation
BGŻ Leasing Sp. z o.o.	Leasing activities	49,0%	Equity method

3. IMPORTANT EVENTS IN BGŻ S.A. IN 2011

22.04.2011	The Bank and Rabobank Nederland concluded an agreement under which Rabobank Nederland provided the Bank with the funds amounting to CHF 1 008 million for the period of 12 years to finance the existing housing loans portfolio denominated in CHF - the credit facility was made available in 18 tranches starting from 29 April 2011 to 30 September 2011.
28.04.2011	The Polish Financial Supervision Authority (KNF) approved the prospectus prepared by the BGŻ S.A. in connection with the public offering of shares series A and D and with the intention to apply for admission to trading with shares series A, B, C, D, E and F on the regulated market. On 29 April 2011, KNF approved Annex No.1 to the prospectus, which included information about fixing the Maximum Share Price for the purpose of Individual Investors subscription. The price was set at the level of PLN 90.00 per 1 share. The Prospectus was published on 4 May 2011.
17.05.2011	The State Treasury, in agreement with the Global Coordinators and PKO BM Brokerage House (the Co-Offering Agent) set the Sale Shares selling price at PLN 60 per share and the final number of Sale Shares under the offering amounted to 5 200 000 Sale Shares constituting 12.05% of the Bank's share capital.
27.05.2011	The first listing of the Bank's shares on the Warsaw Stock Exchange occurred on 27 May 2011. The shares were initially traded at PLN 62.50 per 1 share. The Bank's shares are traded in continuous trading system under abbreviated name "BGZ" and marked "BGZ".
2.06.2011	The Moody's Investors Service rating agency decreased the rating for the Bank's long-term deposits from A3 to Baa1.

14.11.2011 - 9.12.2011	A comprehensive inspection was carried out in the Bank by the Polish Financial Supervision Authority. Based on the results of the inspection, the Polish Financial Supervision Authority concluded, that as at the date of the control, the economic and financial situation of the Bank was not threatening to the security of funds placed in the Bank's accounts. In the Bank's opinion, the results of the inspection do not have immaterial influence on the financial statements.
16.11.2011	Bank BGŻ started to operate direct internet banking, BGŻOptima, with its product offer available only through internet. Included in the BGŻOptima product offer are deposits, savings accounts and investment funds. The process of opening bank accounts and deposits is only remote and there is no need for the client to vist the Bank's outlet. The BGŻ Optima product offer is complementary to the Bank's main product offer as regards savings and investment products and is dedicated to clients who wish to benefit from Bank's services using the Internet.

4. AUTHORITIES OF THE PARENT COMPANY

4.1.1. CHANGES IN THE COMPOSITION OF THE SUPERVISORY BOARD

The composition of the Bank's Supervisory Board in the period between 1 January and 31 December 2011 as follows:

- Jan Alexander Pruijs – President of the Supervisory Board
- Agata Rowińska – Vice-President of the Supervisory Board (resignation as of 31.05 2011)
- Dariusz Filar – Member of the Supervisory Board (appointed on 21.07.2011), Vice-President of the Supervisory Board (elected on 1.09.2011)
- Roelof Dekker – Member of the Supervisory Board,
- Jarosław Iwanicki - Member of the Supervisory Board,
- Harry de Roo - Member of the Supervisory Board,
- Andrzej Zdebski - Member of the Supervisory Board,
- Waldemar Maj - Member of the Supervisory Board,
- Hendrik Adams - Member of the Supervisory Board,
- Monika Nachyła – Member of the Supervisory Board (appointed as of 21.07.2011).

4.1.2. CHANGES IN THE COMPOSITION OF THE MANAGEMENT BOARD

The composition of the Bank's Management Board in the period between 1 January and 31 December 2011 as follows:

- Jacek Bartkiewicz – President of the Management Board,
- Hieronymus Nijsen – The first Vice-President of the Management Board (resignation on 31.03.2011),
- Gerardus Cornelis Embrechts – The first Vice-President of the Management Board (appointed on 1.04.2011),
- Witold Okarma – Vice-President of the Management Board,
- Andrzej Sieradz – Vice-President of the Management Board,
- Johannes Gerardus Beuming – Vice-President of the Management Board (appointed on 1.05.2011),
- Dariusz Odzioba – Vice-President of the Management Board (appointed on 10.05.2011),

- Wojciech Sass – Vice-President of the Management Board (appointed on 15.06.2011),
- Magdalena Legęć – Vice-President of the Management Board (appointed on 1.10.2011).

5. EXTERNAL RATING OF THE PARENT

5.1. RATINGS

The Bank is rated by the Moody's Investors Service rating agency. On 2 June 2011, the Moody's Investors Service downgraded its long-term deposit rating of the Bank to Baa1 from A3, with negative outlook. The Bank's standalone financial strength rating ("BFSR") of D was not affected and remained on a stable outlook. The short-term bank-deposit rating of Prime-2 remains unchanged. According to Moody's the downgrade reflects the change in ownership structure of the Bank following the IPO, and the rating agency's view that this results in greater uncertainty regarding the potential for exceptional parental or systemic support in case of need. The long-term deposit rating nonetheless continues to factor in a very high expectation of the parental support and a medium expectation of the systemic support. The negative outlook on the supported long-term deposit rating was influenced by the potential for further disposal of the government's remaining stake in the Bank as well as the negative outlook on stand-alone BFSR rating of the Bank's majority shareholder

6. SHAREHOLDING STRUCTURE OF THE BANK

6.1. INITIAL PUBLIC OFFERING

On October 14, 2010, the Extraordinary General Meeting of Shareholders agreed to apply for admission of the Bank's shares for trading on a regulated market and their dematerialization. The subject of the IPO was to be 16,046,596 ordinary shares constituting 37.20% of shares held by the State Treasury.
On April 28, 2011, the KNF approved the prospectus prepared by BGŻ S.A. in connection with the public offering of shares series A and D and with the intention to apply for admission to trading with shares series A, B, C, D, E and F on the regulated market. On April 29, the KNF approved Annex No.1 to the prospectus, which included information about fixing the Maximum Share Price for subscription of Individual Investors. The price was set at PLN 90.00 per share. The Prospectus was published on May 4, 2011.
On May 17, 2011, the State Treasury, in agreement with the Global Coordinators and DM PKO BP Brokerage House (the Co-Offering Agent) set the Sale Shares selling price at PLN 60 per share and the final number of Sale Shares under the offering to 5,200,000 Sale Shares constituting 12.05% of the Bank‟s share capital The first listing of the Bank‟s shares on the Warsaw Stock Exchange occurred on May 27, 2011.
As a result, the Bank established the Investors Relations Team, acting in the area supervised by the first Vice President of the Management Board.
As part of its program of stabilization, the State Treasury re-acquired 149 935 shares of the Bank. As at 31 Dec 2011, the State Treasury held 25.54% shares of the Bank's issued share capital.

6.2. FREE OF CHARGE DISPOSAL OF SHARES BELONGING TO THE STATE TREASURY IN FAVOUR OF EMPLOYEES

In the year 2011, the Bank continued the process of concluding on behalf of the State Treasury of agreements for free of charge disposal of shares of BGŻ S.A. to persons authorized based on the provisions of the act on the functioning of cooperative banks, 32 such agreements were concluded which comprised 1 786 shares.

Table 8. BGŻ S.A. shareholders structure

Shareholder	31.12.2011		31.12.2010	
	Number of shares	Structure (%)	Number of shares	Structure (%)
Rabobank International Holding B.V.	21 298 609	49.37	21 297 584	49.37
Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A.	4 303 695	9.98	4 303 695	9.98
State Treasury	11 015 937	25.54	16 058 045	37.23
Other shareholders	6 518 523	15.11	1 477 440	3.42
TOTAL	43 136 764	100.00	43 136 764	100.00

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

7.1. FINANCIAL POSITION IN 2011 COMPARED WITH 2010

In 2011, the Group generated a net profit of PLN 128 097 thousand compared with PLN 112 341 thousand in 2010. The main driver of growth in net profit was the increase in net interest income.

Table 9. Consolidated income statement

PLN thousand	2011	2010	Change	
			PLN thousand	%
Net interest income	834 011	604 318	229 693	38.0%
Net fee and commission income	269 897	271 527	(1 630)	(0.6%)
Dividend income	3 554	3 147	407	12.9%
Result on trading activities	101 852	143 539	(41 687)	(29.0%)
Result on investing activities	6 899	1 476	5 423	367.4%
Other operating income	59 948	51 948	8 000	15.4%
Net impairment losses on loans and advances	(163 142)	(134 162)	(28 980)	21.6%
Administrative expenses	(855 215)	(713 975)	(141 240)	19.8%
Other operating expenses	(110 708)	(102 627)	(8 081)	7.9%
Operating Result	**147 096**	**125 191**	**21 905**	**17.5%**
Share in profit (loss) of associates	2 470	1 674	796	47.6%
Gross profit	**149 566**	**126 865**	**22 701**	**17.9%**
Corporate income tax	(21 469)	(14 524)	(6 945)	47.8%
Net profit	**128 097**	**112 341**	**15 756**	**14.0%**

Net interest income

In 2011 net interest income increased by PLN 229 693 thousand, i.e. by 38.0% compared to 2010, which was the result of a significant increase in interest income by PLN 315 542 thousand, i.e. 22.9%, exceeding the increase in interest expenses of PLN 85 849 thousand, i.e. by 11.1%.

The increase in interest income was primarily affected by higher interest income on loans and advances to customers by PLN 203 376 thousand, i.e. 20.7% and from overdrafts by PLN 60 406 thousand, i.e. 32.4%, which was achieved through the development of credit activities. In particular, it relates to the interest income on preferential loans, mortgage loans for retail clients and current overdrafts for farmers and SMEs. The important factors in the growth of interest income from preferential loans were four increases in NBP rediscount rate (in January, April, May and June 2011, each by 0.25%), which directly influenced the level of interest rates on these loans. In addition, the increase in interest income was affected by higher income from debt securities – by PLN 40 434 thousand, i.e. 22.4%, which was mainly resulted from changes in portfolio structure of debt securities classified as available for sale – reduction

of share of short term, lower interest NBP bonds to increase share of long-term, higher-interest bonds issued by central government.
The main reason for slower pace of increase in interest expenses was the stabilization of interest expense in respect to amounts due to customers, which was achieved by improvement in interest margins on clients' deposits, in particular including the saving accounts "Eskalacja" as well as term deposits. The process of launching BGŻOptima - Internet direct banking channel on 16 November 2011 did not significantly influence the interest expenses in that year.
Fluctuations in interest expenses on deposits were additionally reduced due to obtaining credit facility denominated in CHF from the majority shareholder. This credit has enabled the Group to reduce funding in local currency, with high-value institutional deposits and public sector institutions.

Table 10. Net interest income

PLN thousand	**2011**	**2010**	**Change**	
			PLN thousand	**%**
Amounts due from banks	38 996	27 670	11 326	40.9%
Amounts due from customers under overdraft facilities	247 096	186 690	60 406	32.4%
Loans and advances to customers, after considering reversal of loans interests discount on impairment losses, of which	1 185 362	981 986	203 376	20.7%
Debt securities an all portfolios	220 697	180 263	40 434	22.4%
Interest income	**1 692 151**	**1 376 609**	**315 542**	**22.9%**
Amounts owed to banks	140 076	100 667	39 409	39.1%
Amounts owed to customers	718 064	671 624	46 440	6.9%
Interest expense	**858 140**	**772 291**	**85 849**	**11.1%**
Net interest income	**834 011**	**604 318**	**229 693**	**38.0%**

* Source: BGŻ S.A. managerial information.

Net fee and commission income

Net fee and commission income in 2011 decreased by PLN 1 630 thousand, i.e. 0,6%, mainly due to the decrease of fee and commission income on service of accounts by PLN 15 786 thousand, i.e. 13,5% and an increase in fee and commission expenses by PLN 6 751 thousand, i.e. o 19,7%. There was also an increase in fee and commission income on loans and advances by PLN 11 832 thousand, i.e. 13,4% – and on debit cards – by PLN 7 720 thousand, i.e. 16,0%.

Table 11. Net fee and commission income

PLN thousand	**2011**	**2010**	**Change**	
			PLN thousand	**%**
Fee and commission income from banks	14 723	13 224	1 499	11.3%
Fee and commission income from customers	296 134	292 512	3 625	1.2%
- on loans and advances	100 181	88 349	11 832	13.4%
- on domestic settlements	1 072	1 365	(290)	(21.2%)
- on foreign settlements	5 065	4 985	80	1.6%
- on account service	100 771	116 557	(15 786)	(13.5%)
- on guarantee commitments	12 173	13 365	(1 192)	(8.9%)
- on brokerage operations	13 304	15 232	(1 928)	(12.7%)
- on payment cards	56 062	48 342	7 720	16.0%
- other	7 506	4 317	3 189	73.9%
Fee and commission income	**310 857**	**305 736**	**5 121**	**1.7%**
Fee and commission expense from banks	3 586	4 466	(880)	(19.7%)
Fee and commission expense from customers	37 374	29 743	7 631	25.7%

Fee and commission expense	**40 960**	**34 209**	**6 751**	**19.7%**
Net fee and commission income	**269 897**	**271 527**	**(1 630)**	**(0.6%)**

The decrease in fee and commission income on account servicing resulted mainly from the fact, that since November 2010 the Group has incurred additional costs relating to "Konto z Podwyżką" offer, where the clients receive a 1% premium of inflows on the account, subject to strict conditions. These premiums were accounted for as a decrease of income. In addition, in the fourth quarter of 2010 changes to the table of fees and commissions were introduced, where the level of commission depends on the amounts of funds held on the account, in order to offer more attractive terms for customers and to improve competitive position. These changes resulted in a decrease of commission income, but they were one of the conditions that stimulated the increase of fund held on current accounts.

The increase in commission income was achieved mainly due to the greater activity in granting overdraft facilities, especially for corporate customers and farmers. The increase in fee and commission income on debit cards was due to good results of sales of "Konto z Podwyżką".

Fee and commission expenses increased mainly due to the higher settlement costs with MasterCard and Visa operators.

Dividend income

Dividend income in 2011 increased by PLN 407 thousand, i.e. 12.9%. The increase consisted of dividends on shares of Krajowa Izba Rozliczeniowa S.A. - the National Clearing House SA (KIR), Biuro Informacji Kredytowej - the Credit Information Bureau SA (BIK) and the Warsaw Stock Exchange (WSE), from distribution of 2010 profits of these companies, approved by their General Assemblies. The revenue growth was mainly due to higher dividends from BIK.

Result on trading activities and result on investing activities

Result on trading activities decreased by PLN 41 687 thousand, i.e. 29.0% due to the change of external financing structure as a result of obtaining the loan in CHF.

With direct funding in CHF, the Group reduced the scale of swap transactions, which hedge the currency risk and interest rate risk of the old mortgage loans portfolio for retail customers granted till April 2009. This resulted in a decrease in result on so-called swap point, recognized in result on trading activities, and enabled growth in the net interest income due to replacement of higher interest-bearing PLN funding with lower interest-bearing CHF funding.

Result on investing activities in 2011 increased by PLN 5 423 thousand, i.e. 367.4%. The main component of the result in 2010 were the proceeds from sale of shares in VISA Inc. amounting to PLN 1 627 thousand, while in 2011 it was influenced by the portfolio of securities available for sale.

Other operating income

Other operating income increased in 2011 by PLN 8 000 thousand, i.e. 15.4%, primarily due to increase of income from recovered receivables that were previously written off, expired, canceled or determined uncollectible, as well as – barred or bad debts and repayments excluded from the balance sheet in the amount of PLN 6 183 thousand, i.e. 75.7%, which was achieved due to debt collection activities.

The increase in other operating income by PLN 4 525 thousand, i.e. 94.4%, resulted mainly from release of provision for 2010 liabilities, related to bonuses for employees and external services. The increase of PARP expenses compensation by PLN 3 256 thousand, i.e. 164.4% resulted mainly from conduction of a training program "Rośnijmy razem", which was subsidized by the Polish Agency for Enterprise Development.

Table 12. Other operating income

PLN thousand	2011	2010	Change	
			PLN thousand	%
From management of third-party properties	1 430	1 520	(90)	(5.9%)
From sale or liquidation of property, plant and equipment, intangible assets and assets held-for-sale	1 956	5 606	(3 650)	(65.1%)
From recovered statute –barred receivables, written off or bad debts, repayments of derecognized receivables	14 349	8 166	6 183	75.7%
Sales of goods and services	10 374	9 845	529	5.4%
Reversal of provisions for other receivables (excluding loan receivables)	847	532	315	59.2%
Reversal of impairment allowances for fixed assets	14	14	-	-
Reversal of provisions for liabilities	8 415	9 171	(756)	(8.2%)
From recovery of costs incurred	1 903	2 414	(511)	(21.2%)
Valuation of investment property	-	700	(700)	(100.0%)
Revenue from PARP expenditures compensation	5 237	1 981	3 256	164.4%
Reversal of not utilized provision for non – personnel costs	6 104	7 205	(1 101)	(15.3%)
Other operating income	9 319	4 794	4 525	94.4%
Total other operating income	**59 948**	**51 948**	**8 000**	**15.4%**

Net impairment losses on loans and advances

Net impairment losses on loans and advances increased by PLN 28 980 thousand, i.e. 21.6%. It was mainly the result of higher write – offs for mortgage loans for retail customers. The net write – offs for cash loans – decreased.

The increase of write–offs in 2011 compared to 2010 resulted also from an update of parameters in the model used for calculation of impairment losses, that resulted in reversal of provisions for financial assets by PLN 77.1 million recognized in profit or loss.

General administrative expenses

General administrative expenses increased by PLN 141 240 thousand, i.e. 19.8%, mainly due to higher staff costs, external services, other material expenses and contributions to the BFG and the KNF. Growth in each of the above-mentioned categories of expenses was partly caused by the fact, that approximately ¾ of 61 new branches opened in 2010 was launched in the second half of the year and 2011 was the first full year of their operations.

The increase in staff expenses by PLN 74 445 thousand, i.e. 19.5%, resulted from an increase in accruals for individual premiums and employees bonuses (in 2010 the Bank applied the restrictions on employee bonuses introduced in 2009), employment growth related with the continuing expansion of the Bank's branch network, and the adjustment of the remuneration policy (from 1 April 2011) in response to the increase in competition in the labour market in the banking sector.

The increase in the external services expenses by PLN 19 002 thousand, i.e. 11.7% was caused by the increase in Bank's demand on advisory services related to the preparation for IPO. The total IPO costs included in 2011 amounted to PLN 12 390 thousand.

The increase in other overhead expenses by PLN 33 097 thousand, i.e. 28.1%, was mainly due to the expansion of the Bank's branch network, which resulted in increased costs of renting premises. The increase in contributions to the BFG and the KNF was due to more than double increase in rate of contribution to BFG effective in 2011 compared with the previous year.

In 2011 the Bank has incurred costs connected with launch of direct banking BGŻOptima, which amounted to PLN 18 822 thousand and relating mainly to marketing, consulting services and amortization of intangible assets – licenses for systems.

Table 13. General administrative expenses

PLN thousand	2011	2010	Change	
			PLN thousand	%
Employee benefit costs, of which:	456 433	381 988	74 445	19.5%
- Payroll	372 711	315 955	56 756	18.0%
- Social security	49 140	40 420	8 720	21.6%
- Other	34 582	25 613	8 969	35.0%
Materials and energy	35 656	34 269	1 387	4.0%
External services	181 510	162 508	19 002	11.7%
Other non-personnel costs	150 814	117 717	33 097	28.1%
Taxes and charges	6 135	5 029	1 106	22.0%
Contributions and amounts transferred to the Bank Guarantee Fund (BFG) and PFSA	24 667	12 464	12 203	97.9%
General administrative expenses, total	**855 215**	**713 975**	**141 240**	**19.8%**
Amortization and depreciation(1)	83 000	73 235	9 765	13.3%
Total costs (2)	**938 215**	**787 210**	**151 005**	**19.2%**

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

Other operating costs

Other operating costs in 2011 increased by PLN 8 081 thousand, i.e. 7.9%, primarily due to increase in depreciation by PLN 9 765 thousand, i.e. 13.3%, which was connected with the described above expansion of Bank's branch network and continuation of investment in the IT area and the commencement of amortization of BGŻOptima license.

Table 14. Other operating costs

PLN thousand	2011	2010	Change	
			PLN thousand	%
Due to the management of third-party assets	1 089	1 312	(223)	(17,0%)
Due to the sale or liquidation of property, plant and equipment, intangible assets and assets or sale	1 873	3 311	(1 438)	(43,4%)
Due to recognized provisions for other receivables (other than loans and advances)	1 082	1 049	33	3,1%
Due to recognized provisions for liabilities	11 126	10 233	893	8,7%
Due to debt recovery	7 060	5 415	1 645	30,4%
Donations	2 997	2 656	341	12,8%
Amortization and depreciation	83 000	73 235	9 765	13,3%
Valuation of investment property	499	-	499	-
Other operating costs	1 982	5 416	(3 434)	(63,4%)
Other operating costs, total	**110 708**	**102 627**	**8 081**	**7,9%**

Total comprehensive income

The Group's comprehensive income in 2011 increased by PLN 34 194 thousand, i.e. o 31.5%, due to positive revaluation of available-for-sale financial assets included in other comprehensive income in the amount of PLN 18 207 thousand, compared to negative revaluation in the amount of PLN 4 555 thousand in 2010. Positive revaluation in 2011 related to the portfolio of long-term State Treasury bonds and resulted from decrease in market margins at the so-called long end of the yield curve after a series of increases of interest rates by NBP, which caused weakening of long-term inflation expectations.

Assets

At the end of 2011, total Group's assets amounted to PLN 33 407 213 thousand and were by PLN 4 777 614 thousand, i.e. 16.7% higher than in the prior year. The main growth factor were loans and advances to clients which increased by PLN 4 353 214 thousand, i.e. 21.9%, mainly due to increase in overdraft facilities of enterprises and farmers, investment loans for enterprises and preference loans for farmers.

In 2011, there were no restructuring bonds element in the Group's assets, previously reported in other debt securities line. On 24 September 2011, in accordance with timetable, the Ministry of Finance redeemed the last tranche of restructuring bonds granted to Bank in 1996 with the aim to increase own funds.

The increase in intangible assets by PLN 49 656 thousand, i.e. 51,3%, resulted mainly from a capitalization of a system for BGŻOptima and investment in current infrastructure development.

The increase in investment in associates by PLN 14 703 thousand, i.e. 46,6%, resulted mainly from succeeding recapitalization of BGŻ Leasing sp. z o.o. associate.

Table 15. Assets

PLN thousand	2011	2010	Change	
			PLN thousand	%
Cash and balances with the Central Bank	1 383 321	1 379 737	3 584	0,3%
Amounts due from other banks	221 071	280 920	(59 849)	(21,3%)
Receivables arising from reverse repo transactions	366 343	651 706	(285 363)	(43,8%)
Held-for-trading securities	1 632 434	1 814 899	(182 465)	(10,1%)
Derivative financial instruments	883 109	220 987	662 122	299,6%
Loans and advances to customers	24 222 391	19 869 177	4 353 214	21,9%
Securities available for sale	3 624 750	3 290 675	334 075	10,2%
Other debt securities	-	109 232	(109 232)	(100,0%)
Investment property	63 401	63 900	(499)	(0,8%)
Investments in subsidiaries and associates	46 245	31 542	14 703	46,6%
Intangible assets	146 443	96 787	49 656	51,3%
Property, plant and equipment	485 943	464 818	21 125	4,5%
Deferred tax asset	207 794	232 141	(24 347)	(10,5%)
Current tax asset	-	44 800	(44 800)	(100,0%)
Other assets	123 968	78 278	45 690	58,4%
TOTAL ASSETS	**33 407 213**	**28 629 599**	**4 777 614**	**16,7%**

Liabilities and equity

At the end of 2011, total Group's liabilities amounted to PLN 30 769 351 thousand and were by PLN 4 634 769 thousand, i.e. 17.7% higher compared to the prior year. The main growth factor related to increase in liabilities to other banks by PLN 3 426 297 thousand, i.e. 335.8%, mainly due to obtaining CHF denominated loan from the majority shareholder and loan amounting to EUR 50 million from

European Bank for Reconstruction and Development. Liabilities to customers increased significantly – by PLN 1 889 937 thousand, i.e. 9.0% – mainly due to deposits obtained through BGŻOptima.

Table 16. Liabilities and equity

PLN thousand	31.12. 2011	31.12. 2010	Change	
			PLN thousand	%
Amounts owed to other banks	4 446 716	1 020 419	3 426 297	335.8%
Liabilities arising from repo transactions	-	1 268 921	(1 268 921)	(100.0%)
Derivative financial instruments and other liabilities held for trading	795 707	732 098	63 609	8.7%
Amounts owed to customers	22 941 652	21 051 715	1 889 937	9.0%
Liabilities from issued debt securities	2 033 267	1 745 198	288 069	16.5%
Other liabilities	474 952	241 895	233 057	96.3%
Deferred tax liability	9 719	9 814	(95)	(1.0%)
Current tax liabilities	-	3	(3)	(100.0%)
Provisions	41 926	41 697	229	0.5%
Liabilities arising from employee benefits	25 412	22 822	2 590	11.3%
TOTAL LIABILITIES	**30 769 351**	**26 134 582**	**4 634 769**	**17.7%**
Issued share capital	43 137	43 137	-	-
Reserve capital	2 332 656	2 220 155	112 501	5.1%
Accumulated profit/ (loss) from previous years	8 327	8 487	(160)	(1.9%)
Other reserves	125 645	110 897	14 748	13.3%
Undistributed profit	128 097	112 341	15 756	14.0%
EQUITY	**2 637 862**	**2 495 017**	**142 845**	**5.7%**
LIABILITIES AND EQUITY	**33 407 213**	**28 629 599**	**4 777 614**	**16.7%**

Another important event, relating to liabilities to customers, was decrease in deposits from public sector, resulting from effective from July 1, 2011, regulations concerning consolidation of financial resources of selected state budget institutions at the state-owned bank, Bank Gospodarstwa Krajowego S.A. (BGK). The above change in regulations affected one of the most important deposit client of the Bank, i.e. government agency operating in the agricultural sector. As a result, liabilities to public sector decreased in 2011 by PLN 931 390 thousand, i.e. 54.1%. At the same time, the effect of outflow of such deposits was balanced by increase in other client deposits, mainly deposits from other financial entities, and subsequently from corporate customers and BGŻOptima customers. In 2011 the Group increased the issue of certificates of deposits – by PLN 288 069 thousand, i.e. 16.5% – which are flexible and relatively inexpensive source of financing.

At the end of 2011 total Group's shareholders' equity amounted to PLN 2 637 862 thousand and was by PLN 142 845 thousand, i.e. 5.7% higher than in previous year. The increase resulted from retaining of net profit for the year 2010, as well as of the increase in the revaluation reserve for available-for-sale financial assets, which is described in the section *Other comprehensive income*.

Loan portfolio quality

The ratio of impaired receivables in gross loans and borrowings to clients improved from 6.4% at the end of 2010 to 5.7% at the end of 2011. This resulted from the increase in gross loan portfolio by 22.1%, which exceeded the increase in gross receivables that were impaired, by 9.0%. The factor stabilizing portfolio quality was very good and still improving situation of the farmer loans portfolio, which at the end of 2011 accounted for 21.0% of the gross Group portfolio. Also, the quality of the portfolio of institutional loans not operating in the Agro sector improved and this was the result of collecting significant amounts from large enterprise clients.

The main factors behind the increase in impaired receivables were retail client receivables arising from mortgage and – to a lesser extent – cash loans.

Table 17. Loan portfolio quality inidices

PLN thousand	31.12. 2011	31.12. 2010	Change	
			PLN thousand	%
Total gross loans and advances to customers	25 105 296	20 567 994	4 537 302	22.1%
Impairment allowances (negative value)	(882 905)	(698 817)	(184 088)	26.3%
Total net loans and advances to customers	**24 222 391**	**19 869 177**	**4 353 214**	**21.9%**
Incurred but not reported losses				
Gross statement of financial position exposure	23 665 232	19 246 702	4 418 530	23.0%
Impairment allowance on exposures analyzed on the portfolio basis	(95 001)	(69 820)	(25 181)	36.1%
Net exposure	**23 570 231**	**19 176 882**	**4 393 349**	**22.9%**
Impaired exposures				
Gross statement of financial position exposure	1 440 064	1 321 292	118 772	9.0%
Impairment allowance on exposures analyzed on the portfolio and individual basis	(787 904)	(628 997)	(158 907)	25.3%
Net exposure	**652 160**	**692 295**	**(40 135)**	**(5.8%)**
Indices				
Share of impaired loans in gross loan portfolio	5.7%	6.4%	x	(0.7%)
Coverage of impaired loans with impairment allowances	54.7%	47.6%	x	7.1%

Capital and capital adequacy ratio

Capital adequacy ratio decreased from 11.1% at the end of 2010 to 9.7% at the end of 2011, breached the minimal level established by the Group (10%). The capital increased in 2011 by PLN 130 596 thousand mainly due to incorporating of the audited net profit for 2010 and net profit for the first half of 2011 (reviewed by independent auditor) as well as increase in supplementary capital from revaluation of available-for-sale financial assets.

Increase in total capital requirements by PLN 342 310 thousand resulted from dynamic development of credit campaign by the Group.

On 15 December 2011 the Management Board submitted to the Supervisory Board a request for recapitalization together with an analysis of possible options to raise capital. Following this request, the major shareholders of the Bank – Rabobank and the Ministry of Treasury – entered into discussion of the matter relating to the recapitalization of the Bank. By the date of approval of the Consolidated Financial Statement for 2011, no binding agreements were made.

Table 18. Capital and capital adequacy ratio

PLN thousand	31.12. 2011	31.12. 2010	Change	
			PLN thousand	%
Total capital	2 399 781	2 263 845	135 936	6.0%
Total capital requirement	1 980 349	1 638 039	342 310	20.9%
Capital adequacy ratio (%)	**9.7%**	**11.1%**	**x**	**(1.4%)**

Financial ratios

In 2011 the Group improved all profitability ratios compared to 2010. Return on equity and return on assets improved due to increase in the net profit. Increase in interest margin ratios resulted from improvement in deposit and preference loans margins.

Cost/Income ratio remained stable due to proportional increase in income and expenses, and in case IPO costs would be excluded, this ratio would amount to 74.2% in 2011. Main factors limiting

improvement of the ratio in 2011 were costs relating to mid – term strategy of the Bank's organic growth, assuming continuous development of branch network and launching internet direct banking BGŻOptima. Increase in credit risk ratio resulted from increase of impairment losses on loans and advances with simultaneous development of credit activities.
Increase in Loans / Deposits ratio – for the first time in the Group's history the ratio exceeded 100% - resulted from change in the structure of the Group's liabilities, following obtaining CHF denominated loan from the majority shareholder. Due to higher importance of other than deposits sources of financing (loans from banks, certificates of deposits), the gross loans to sources of financing ratio became more important. In 2011 it improved from 89.4% to 86.7%.

Table 19. Financial ratios

	2011	2010	Change
Return on equity (1)	5.0%	4.6%	0.4%
Return on assets (2)	0.4%	0.4%	0.0%
Net interest margin (3)	2.8%	2.3%	0.5%
Net interest margin including swap points (4)	3.0%	2.7%	0.3%
Cost/Income (5)	75.2%	75.2%	(0.0%)
Credit risk cost (6)	(0.8%)	(0.7%)	(0.1%)
Loans/Deposit (7)	109.4%	97.7%	11.7%
Gross loans / Total sources of finance(8)	86.7%	89.4%	(2.8%)

(1) Relation of the net profit to average shareholders' capital based on the balances at the end of the quarters.
(2) Relation of the net profit to average assets based on the balances at the end of the quarters.
(3) Relation of the net interest income to average assets based on the balances at the end of the quarters,
(4) Relation of the net interest income including swap points to average assets based on the balances at the end of the quarters.
(5) Relation of the total of administrative costs and depreciation/ amortization to the total of result on banking on banking activities and other operating income and costs, excluding depreciation/ amortization.
(6) Relation of net impairment losses on loans and advances to the average balance of loans and advances to customers based on the balances at the end of the quarters.
(7) Relation of the carrying amount of loans and advances to customers to deposits from customers based on the balances at the end of the period.
(8) Relation of Gross loans and advances to clients to the total of liabilities to customers, issued debt securities and loans from other banks. Balance at the end of the period

8. ACTIVITIES OF THE BANK IN 2011

8.1. DISTRIBUTION CHANNELS

8.1.1. TRADITIONAL CHANNELS

Bank's branches

In 2011 the Bank continued to expand its network of branches, a policy started in 2008 in connection with the implementation of a growth strategy on local markets. The main direction of network expansion is in the county (powiaty) towns in which BGŻ has not yet held a branch. New branches are being located in central points of towns, with convenient access for clients and a modern interior standard.
In 2011, 50 branches became operational (of which 49 subordinated branches and 1 operating branch). Based on the conducted analysis of financial results and location potential, 5 branches were re-located (of which 4 subordinated and 1 operating) and 4 subordinated branches were closed.
As at 31 December 2011, the Bank had 394 outlets, of which 120 were operating branches, and 274 subordinated branches (compared to 117 operating branches and 231 subordinated branches as at

31 December 2010). The network of branches was supplemented by 1 Bank Shop (outlet located in the Manufaktura Shopping Centre in Łódź), 17 external cash desks servicing cash transactions and 7 corporate centres servicing large corporations.

ATM network

At the end of 2011, the network of ATMs available to the Bank's customers for commission-free cash withdrawals comprised of ATMs owned by BGŻ S.A. and those of Kredyt Bank, INVESTBANK S.A., Spółdzielcza Grupa Bankowa as well as the Euronet networks. At the end of December 2011, Bank customers could use without commission 4 076 ATMs, of which 512 were the machines operated by BGŻ S.A. Customers holding personal account as part of the "Plan Aktywny" product and the "Konto z Podwyżką" could use without commission all ATMs in Poland.

8.1.2. ALTERNATIVE CHANNELS

Internet banking

In 2011, the Bank recorded a dynamic growth in the number of customers using the eBGŻ internet service (retail clients) and eBGŻ Firma (institutional clients). The number of operations executed using the internet channel grew systematically.

Table 20. Data relating to eBGŻ

		31.12.2011	31.12.2010	Change y/y	
Number of customers accessing	eBGŻ	288 697	232 393	56 304	24.2%
	eBGŻ Firma	52 599	37 926	14 673	38.7%
Number of active customers logging	eBGŻ	181 440	139 448	41 992	30.1%
	eBGŻ Firma	34 340	27 658	6 682	24.2%
The average monthly number of transactions	eBGŻ	733 557	530 937	202 620	38.2%
	eBGŻ Firma	622 945	484 654	138 291	28.5%

On 16 November 2011, BGŻ Bank opened its BGŻOptima branch, which product offer is available in the Internet. More information on this offer is described in point **8.2.2. Establishing the BGŻOptima Branch.**

Phone banking

In 2011, further increase was recorded in the number of TeleBGŻ clients and the number of operations made using this service product. Particularly high dynamics was recorded in the number of outgoing calls initiated by TeleBGŻ operators, which reflected the development of the selling functionality, the Communication Centre, achieved, among others, by execution of a number of pre-approved sales campaigns. In 2011, the consultants of the Communication Centre forwarded to branches some 68 297 sales contracts compared to 56 314 contracts in the year 2010 (growth of 21.3%).

Table 21. Data relating to TeleBGŻ

		31.12. 2011	31.12. 2010	Change y/y	
Number of customers with the Access to TeleBGŻ	Retail customers	326 843	272 926	53 917	19.8%
	Institutional customers	82 149	57 103	25 046	43.9%
Average monthly number of TeleBGŻ calls	Incoming form operator	63 175	50 832	12 343	24.3%
	Incoming IVR	90 039	99 307	(9 268)	(9.3%)
	Outbound to the customers	36 024	19 410	16 614	85.6%

In order to ensure smooth client servicing by phone, as of February 2011 the scope of services of the Communication Centre in Radom was extended – info-line and telemarketing campaigns – to include basic transaction service i.e. servicing bank transfers and standing orders. In addition, changes were made to the telephone service of IVR which simplified and enhanced the process of automatic authorization.

As part of the TeleBGŻ service, sales mechanism was launched that facilitated presenting to the already verified (authorised) client contacting the Communication Centre personalized product offer.

In 2011, the Bank was awarded the prestigious *Contact Center Customer Innovation* award granted each year to the companies using in an innovative manner Contact Center services or otherwise demonstrating creative approach to systems and processes supporting comprehensive customer service. The award was granted for comprehensive and innovative Contact Center facility using several domains services by single interface optimizing costs and increasing service quality and efficiency.

Banking cards

The Bank issues debit, credit and deferred payment MasterCard-system cards. As at 31 December 2011, 586,1 thousand debit cards were issued to clients and this number was 45.5 thousand i.e. 8.4% higher than in the prior year. This increase was possible mainly due to debit cards issued to retail clients and corresponded with growth of the "Konto Plus" account sales. The number of debit cards issued to corporate clients also increased (23.6% y/y). At the same time, a 7% increase was recorded in sales of credit cards whereas the market was decreasing (compared to 2010 lower by 20%).

Table 22. Number of bank cards issued by BGŻ SA

	31.12. 2011	**31.12. 2010**	**Change y/y**	
Retail customers debit cards	479 453	447 762	31 691	7.1%
Institutional customers debit cards	48 999	45 830	3 169	6.9%
Business debit cards	56 130	45 425	10 705	23.6%
Business cards with deferred payments	1 560	1 577	(17)	(1.1%)
Total number of banking cards issued	**586 142**	**540 594**	**45 548**	**8.4%**

Product modifications in 2011 related to further "Standard" credit cards enhancements, mainly by promoting the reimbursement of part of client expenditures. Activities concerning product dedicated to cyclists were continued *(„Karta rowerowa Banku BGŻ"),* and in particular the Bank offered a free-of charge insurance coverage for cardholders and product discounts at selected bicycle shops.

Cooperation with intermediaries and agents

At the end of 2011, the Bank actively collaborated with 20 network intermediaries or agents, such as Open Finance, Notus or Money Expert – local agents and 6 internet-based intermediaries. The cooperation consisted of soliciting clients by providing information and promoting bank products offered to retail and institutional clients (within the SME and micro-enterprise sectors). In the second half of the year, the information and promotion agreements were transformed into acquisition agreements. In the case of the Agro industry clients and beneficiaries of the EU funds, the collaboration was conducted mainly on agreements on information and promotion concluded with advisory firms and agricultural machines dealers; in the second half of 2011 these agreements were also transformed into acquisition agreements.

At the same time, in the second half of 2011, the Bank conducted an analysis of efficiency of certain agreements and terminated some of them.

8.2. RETAIL BANKING

8.2.1. Product offer development

In 2011, product oriented activities in the area of retail banking at BGŻ branches were targeted at optimization of margins realised on deposit and credit products, development of stable deposit base and increase in sales of credit products. The additional aspect of the undertaken activities was the necessity to secure compliance of product regulations to changing legal regulations (including, to the Recommendation T issued by the Polish Financial Supervision Authority, act on consumer loan or the so-called „anti-spread act"), improvements in the process of servicing selected bank products (including personal account, mortgage-type products), standardization and simplification of product documentation and improvement of systems supporting sales of credit products.

8.2.2. Establishment of the BGŻOptima Branch

On 17 November 2011, the Bank established an Internet-based BGŻOptima branch. The product offer of BGŻOptima is supplementary to the Bank's product offer in regard to savings and investment products directed to clients who wish to use Internet-based financial services. Currently, the product offer of BGŻOptima includes deposits, savings accounts and investment funds.
As at 31 December 2011, the number of clients using the BGŻOptima services amounted 37.2 thousand and the value of funds gathered by those clients amounted to PLN 1 599 920 thousand, of which almost 90% of the funds was obtained from the markets.

8.2.3. Deposit activities

At the end of 2011, the balance of retail deposit increased by PLN 2 064 322 thousand, i.e. by 18.2%, to reach the amount of PLN 13 433 828 thousand. A significant change was recorded in the structure of deposit base - the share of term deposits increased whilst the share of current and savings accounts – decreased, which was due to the flow of funds from the "Eskalacja" savings accounts to term deposit accounts. The main factor justifying the increase in retail deposits were the funds secured by the BGŻOptima in the total amount of PLN 1 599 920 thousand, of which 96.2% accounted for short-term deposits.

Tabela 23. Volume and structure of retail deposits

PLN thousand	31.12. 2011	31.12. 2010	Change y/y	
Current accounts	6 174 921	6 326 540	(151 619)	(2.4%)
Term deposits	7 249 879	5 034 689	2 215 190	44.0%
Other liabilities	9 028	8 277	751	9.1%
Amounts owed to customers, total	**13 433 828**	**11 369 506**	**2 064 322**	**18.2%**

In 2011, the Bank recorded a 3.3% increase in the number of personal accounts to 555.6 thousand pcs; the increase was caused by launching in November 2010 the "Konto z Podwyżką" product, as well as by development of a network of branches. The owners of the "Konto z Podwyżką" fulfilling the specific requirements of the Bank receive financial premium from the Bank every month. The total number of open personal accounts in the year 2011 was 99.8 thousand accounts and was 33.6 thousand accounts i.e. 50.7% higher than in the prior year. The majority of them i.e. 67.6 thousand accounts were "Konto z Podwyżką". Good sales results were achieved thanks to attractiveness of this product, promotional campaign in mass media and enhancement of the very process of opening personal accounts at Bank's branches. "Konto z Podwyżką" also served as product facilitating obtaining clients in new branches. High attractiveness of this product was confirmed by awarding "Konto z Podwyżką" the 1st place in the ranking of best personal accounts in the year 2011 prepared by the Money.pl. portal.

Table 24. Number of retail deposits accounts

	31.12. 2011	31.12. 2010	Change y/y	
Number of deposits accounts	**1 440,1**	**1 395,2**	**44.9**	**3.2%**
A'vista accounts, including	1 152,1	1 113,4	38.7	3.5%
– Personal accounts	555,6	537,9	17.7	3.3%
– Max Accounts	8,9	8,7	0.2	2.3%
– Eskalacja savings accounts	211,7	203,7	8.0	3.9%
Term deposits	288,0	281,8	6.2	2.2%
Number of deposits accounts in BGŻOptima	188,9	-	188.9	-
Savings accounts	38,5	-	38.5	-
Term deposits accounts	150,4	-	150.4	-

8.2.4. Lending activities

The value of mortgage loans sold in the year 2011 amounted to PLN 644.8 million compared to PLN 743.2 million in the year 2010 (decrease by 13.2%). Sales decrease was caused by tightening lending criteria for these loans implemented in the year 2010 and by conservative policy of the Bank in the area of interest margins. At the same time, a number of solutions were implemented with a view to boosting sales. Among others, new pricing policies for interest margins were implemented – the then binding complex margin networks were liquidated and new policies for reducing loan prices where loan was combined with another product (e.g. active credit card or active personal account etc.) were offered. In addition, since the beginning of February a price promotion was offered to clients, and at the turn of May and June an advertising campaign was conducted in mass media. As a result, in the second half of the year sales increased by more than 51.4% compared to the first half.

In the case of cash loans, in 2011 sales revenues amounted to PLN 338.5 million compared to PLN 452.7 million in the prior year (a 25.2% decrease). The main reason behind decrease in sales of cash loans was more conservative approach of the Bank to extending loans to retail clients due to deterioration of the portfolio of these loans granted in prior years. In addition, the Bank limited and afterwards terminated cooperation with agents in the area of distribution of this product and concentrated on sales directed to own clients obtained following the pre-approval campaign. Selected clients received an offer of credit limit, which could be used for the opening of one, two or three credit products from the consumer finance group i.e. credit card, revolving credit or cash loan.

Table 25. Volume and structure of retail credit accounts

PLN thousand	31.12. 2011	31.12. 2010	Change y/y	
Current account loans	132 123	124 928	7 195	5.8%
Housing loans	7 118 474	6 558 895	559 579	8.5%
– in PLN	3 498 881	3 233 535	265 346	8.2%
– in foreign currencies	3 619 593	3 325 360	294 233	8.8%
Cash loans	719 466	705 572	13 894	2.0%
Other loans to retail clients	493 222	501 283	(8 061)	(1.6%)
Total loans to retail clients	**8 463 285**	**7 890 678**	**572 607**	**7.3%**

Lower than in the prior year sales of credit products resulted in a limited growth of retail client portfolio – at the end of 2011, the value of this portfolio was PLN 8 463 285 thousand and was PLN 572 567 thousand i.e. 7.3% higher than in the prior year. The main reasons behind the retail client port folio increase were sales of Polish zloty housing loans described in the preceding paragraphs and increase in the PLN value of foreign currency housing loans, which was due to fluctuations in exchange rates (foreign currency retail loans were withdrawn from product offer in 2009).

Table 26. Number of retail credit accounts (in thousand)

	31.12. 2011	**31.12. 2010**	**Change y/y**	
Number of retail credit accounts, including:	**297.7**	**289.7**	**8.0**	**2.8%**
– mortgage, housing and consolidation loans	48.3	46.8	1.5	3.2%
– cash loans	82.7	80.8	1.9	2.4%

8.2.5. Insurance

In 2011, some action were conducted on the implementation of Aviva insurance products, based on the contracts signed 17 December 2010 with Aviva General Insurance Company and Aviva Life Insurance Company. The commercial launch of these products is planned for 2012.

In 2011, there was a continuous sale of insurance offered in cooperation with other insurance companies. It was mainly insurance enclosed to bank products: cash loans, mortgage loand, credit cards and personal accounts.

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

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

Brokerage fee in the year 2011 amounted to PLN 5 577 thousand compared to PLN 6 907 thousand in the year 2010. In 2011 the share of BM BGŻ in shares trading result was 0.23% compared to 0.24% in the prior year. The decrease in the brokerage fees and reduction of share in the trading result was caused by the structure of clients. The Brokerage Office of BGŻ renders services mainly to domestic investors, including in particular individual investors whose share in the trading result has continued to decrease in recent years.

At the end of 2011, the Brokerage Office of BGŻ maintained 30 858 securities accounts which compared to 28 978 securities accounts at the end of 2010 represented a 6.49% increase. Increase in the number of Internet accounts maintained by the Brokerage Office in the bmBGŻ.net transaction system at the end of 2011 was 21.44%. As at 31 December 2011, the number of internet serviced accounts was 5 341, compared to 4 398 at the end of 2010.

Table 27. Share of the BGŻ Brokerage Office in trading on the WSE

		2011		**2010**	
		market share	**volume**	**market share**	**volume**
Stock	*PLN million*	0.23%	1 146.41	0.24%	1 125.56
Bonds	*PLN million*	1.15%	18.18	0.37%	10.50
Futures	*Number of contracts*	0.38%	109 790	0.63%	175 942
Options	*Number of contracts*	1.11%	19 012	3.52%	47 467

At the end of 2011, BM BGŻ distributed participation units in 54 funds managed by 4 investment fund managing companies (Union Investment TFI, Aviva Investors Poland TFI, Skarbiec TFI, Opera TFI). The product offer of the Brokerage Office offers wide possibilities with respect to TFIs and covering the so called safe funds (bond- and cash-based funds), balanced and stable growth funds as well as funds of aggressive investing policy (share-based funds).
In 1Q 2011, due to improvement on financial markets, an increasing client interest was recorded in acquisition of investment funds participation units. However, the subsequent months experienced deterioration of sales results. This translated directly into lower revenues. In 2011, revenues from the sale of investment funds participation units amounted to PLN 6 874 thousand compared to PLN 7 643 thousand in 2010.
Due to worsening of financial market conditions and increase in the value of redeemed participation units in investment funds, a decrease was recorded in the value of customers assets. As at 31 December 2011, the value of customers assets amounted to PLN 554.8 million compared to PLN 696.3 million in 2010.
In addition, BM BGŻ operates as agent on the over-the-counter market organised by BondSpot S.A. As of 3 December 2007, the Brokerage Office has been the participant of the alternative trading system, NewConnect. To date, due to relatively insignificant trading result of this alternative market, it did not play any significant role of the Brokerage Office revenues. However, owing to increasing number of listed companies, the range of revenues of BM BGŻ from this type of business has continued to grow.
In 2011, BM BGŻ participated in 10 public offerings on the primary market. In the case of 7 offerings, the Brokerage Office acted as offering agent and hence participated both in the preparation and execution of the offer as offer organizer at each stage.

8.4. INSTITUTIONAL BANKING

8.4.1. CLIENT SEGMENTATION

In 2011, institutional clients of the Bank were allocated to the following segments:

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

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

8.4.2. PRODUCT OFFER DEVELOPMENT

Product packages and transaction products

As of 21 March 2011, the Bank introduced to its product offer new product packages: “Biznes Lider” package for micro enterprises and “Agro Lider” for farmers (described in the chapter devoted to agro business products). The new product offer replaced the current package offer “Firma Plan 1” and package Plan Agro. Included in the “Biznes Lider” package are: current account, telephone-banking and internet banking services, MasterCard Business payment card, deposit account, progressive accounts. As part of the package, the Bank decided not to collect fee for keeping the account or for payments in or payments out.

Since the date of new product offer launch, i.e. as of 21 March 2011 to 31 December 2011, the Bank recorded a significant increase in the number of packages sold, secured new clients and migrated some of the current clients (“Biznes Lider” – 7 912 clients and “Agro Lider” – 5 618 clients). The Bank also modified the current Package Offer “Firma Plan 2” and “Firma Plan 3” by attaching to them the eBGŻ treasury transaction platform. In the period from January 2011 to December 2011, 20 920 new clients were attracted. The total number of active product packages as at the end of 2011 was 72 232 pcs., whilst the number of Bank clients not using product packages was 19 352.

In 2011, a number of changes were implemented enhancing the process of client servicing, among others, the process of signing agreements was improved, documentation was simplified and comprehensive framework agreement for the LE segment with 10 dedicated products was introduced. In addition, in order to improve the process of concluding agreements, a new application was made available to advisors that helps generate package agreements. This application automatically adjusts the contents of the agreement to client legal form, number of authorized representatives and ensures topicality of forms and intuitive character of service.

In 2011, 48 agreements were signed on rendering by the Bank the service called "Identyfikacja Płatnika" (based on the IDEN system) aimed at serving mass incoming payments. In 2011, the IDEN processed 1.2 million transactions for the total amount of PLN 873.2 million.

As of the end of 2011, the Bank withdrew from its product offer foreign checks.

Treasury products

In 2011, the Bank introduced to its product offer Asian currency options which allow clients hedge against foreign exchange risk. In addition, the Bank introduced new, simplified client documentation which accounts for, among others, continuation of compliance with Polish executive regulations for the MiFID, provisions of the Recommendation A issued by Polish Financial Supervision Authority, and regulates the issue of rendering by the Bank of general investment advisory services.

Agro-business products

Product packages

The current "Plan Agro" package was replaced by the "Agro Lider" Package comprising: current account, Tele-banking and Internet banking services, the "Agro Eskalacja" deposit account and free of charge cash payments and withdrawals. To simplify the process of sale of the *Agro Leader* Package, a new template of agreement and forms were prepared that are adjusted to the specificity of the Agro client and account for the need to common account. Until the end of 2011, 5 618 such packages was sold.

Deposit accounts

The main savings product dedicated to farmers is the "Agro Eskalacja" deposit account. This account is particularly popular at the time of direct subsidies payment by the Agency for Restructuring and Modernisation of Agriculture (ARMiR). In 2011, the Bank extended its current target group of the "Agro Eskalacja" deposit account users to include clients from the SMEs segment.

Loans and borrowings

Since 4 April 2011 the Bank has offered a new overdraft-type product, "Agro Formuła", which is a modification of the *Agro Line* with two possible amounts of overdraft sum depending on the overdraft facility calculation basis i.e. up to PLN 50 thousand based on the declared payments to the account and up to PLN 250 thousand based on documented average monthly payments to the account. In both variants, the Bank decided that account owner shall not provide statements from KRUS ("Agricultural Social Insurance Fund"), municipal office ("Urząd Gminy") or Tax Office – the overdraft facility is awarded based on client statement provided in loan/ borrowing application. Scoring was introduced to client assessment procedure. Sale of this product was supported by the marketing campaign which lasted until the end of May.

In August 2011, "BGŻ Unia" loan product offer was modified and possibility was opened to finance investment projects in the field of renewable energy sources which obtain support from the aid programs implemented by the National Fund for Environmental Protection and Water Management *(NFOŚiGW)* i.e. „Green Investments Systems – agricultural bio-gas production plants", „System zielonych inwestycji GIS – Biogazownie Rolnicze", „System zielonych inwestycji GIS – Elektrociepłownie i ciepłownie na biomasę" and „OZE i Kongregacja".

In September 2011, an investment loan product was implemented for the realization of projects co-financed from the funds of the European Bank for Reconstruction and Development under the Program of Financing the Sustainable Energy Development in Poland (PolSEFF). The loan product "Czysta Energia" in the maximum amount of EUR 1 million is dedicated to financing investment projects serving to improve the efficiency of electric energy and construction of small renewable energy sources. The product is addressed to companies which fulfil the requirements of the EU definition of SME and farmers. The clients who decide to participate in the Program receive investment bonus in the amount of 10 or 15% of the loan taken out.

In the second half of 2011, several modifications were made to the flag consumer loan dedicated to farmers, "Agro Ekspres". The maximum loan balance was increased from PLN 1 to PLN 2 million and principles of mortgage collateralization were changed.

Insurance

In November 2010, the Bank signed a collaboration agreement with Concordia Polska Towarzystwo Ubezpieczeń Wzajemnych S.A. – a company specializing in the field of agricultural loans. As part of the collaboration with the Concordia Polska TUW, the Bank's product offer for the Agro segment clients was extended to include insurance products. Insurance packages were introduced to product offer and these include basic insurance products under which farmers can insure their crops, agricultural equipment, farm buildings and houses, moveable property and can take private third party liability insurance and insurance policy for operating agricultural farm. The additional insurance coverage relates to accident and illness insurance, legal service at the insurer cost and assistance-type services (medical assistance, assistance at home, during car journey, during trip abroad and concierge). These insurance products may also be sold individually, irrespective of package products.

In the second half of 2011, the most popular insurance product was the "Ubezpieczenie Upraw Ozimych" due to the requirement to hold insurance policy by those who claim direct subsidy to agricultural land.

At the end of 2011, 5 319 insurance policies were sold with a total insurance premium of PLN 12.4 million.

8.4.3. LENDING ACTIVITIES

At the end of 2011, the gross value of the portfolio of loans to institutional clients was PLN 16 642 011 thousand and was PLN 3 964 695 thousand i.e. 31.3% higher than in the prior year. This high dynamics of loan sales was achieved in all segments: LE, SMEs and Micro.

From the point of view of product offer, the main driver behind the portfolio growth were investment loans to clients (increase of PLN 1 538 626 thousand i.e. 56.4%), granted mainly to enterprises from the LE and SMEs sectors. High dynamics of growth (by PLN 775 796 thousand i.e. by 31.0%) was also recorded for overdraft facilities which was achieved owing to good results on the "Ekspres Linia" product for SMEs and "Agro Ekspres" for farmers. At the beginning of 2011, the Bank implemented a more efficient process of sale of these products.

Traditionally for the BGŻ Bank, an important factor for the development of lending campaign were also loans for farmers the balance of which increased in 2011 by PLN 673 920 thousand i.e. 19.4%, with preference loans as the main growth.

Table 28. Loans and advances to institutional customers, gross

PLN thousand	31.12. 2011	31.12. 2010	Change y/y	
Overdraft facilities, including	3 276 428	2 500 632	775 796	31.0%
– businesses	1 814 091	1 407 450	406 641	28.9%
– individual entreprenuers	313 568	245 821	67 747	27.6%
– farmers	1 129 431	836 184	293 247	35.1%
Loans and advances to customers:	13 365 583	10 174 963	3 190 620	31.4%
– businesses, including:	7 641 938	5 524 428	2 117 510	38.3%
- investment loans	4 265 207	2 726 581	1 538 626	56.4%
- operating loans	2 366 793	2 026 163	340 630	16.8%
– individual entrepreneurs	1 173 698	852 108	321 590	37.7%
– farmers	4 146 549	3 472 629	673 920	19.4%
– public sector institutions	288 652	214 429	74 223	34.6%
– other entities	114 746	111 369	3 377	3.0%
Other	-	1 721	-	-
Total	**16 642 011**	**12 677 316**	**3 964 695**	**31.3%**
Including:				
Preferential loans*	4 057 019	3 492 138	564 881	16.2%

Leasing

Sale of leasing services, product servicing and managing risk in the lease portfolio is coordinated by BGŻ Leasing Sp. z o.o. Year 2011 brought several records for BGŻ Leasing. As part of its business activities, BGŻ Leasing leased in 2011 fixed assets with a value of PLN 584.6 million which represents growth of 31% compared to 2010. 1 662 lease agreements were signed in 2011.

8.4.4. DEPOSIT ACTIVITIES

In 2011, the Bank conducted conservative policy towards institutional deposits aimed at obtaining better results in interest margins and diversifying and securing deposits stability. The flexible margin policy was offered to the best and the most loyal customers. The Bank's priority was, among others, to increase balances on current accounts as well as to secure deposits from the SMEs and microenterprises, and from farmers.

The most significant change in the structure of institutional deposits was made in June 2011 when one of the then significant deposit customers of the Bank – a government agency operating in the agricultural sector – withdrew its funds and transferred them to the state owned bank, Bank Gospodarstwa Krajowego, which was the consequence of the new regulations on public finance consolidation that became effective. The Bank monitored all legislation changes in the area of public finance and prepared itself for those changes well in advance, so that the regulatory liquidity ratios remained at safe levels.

In 2011, institutional deposits decreased by PLN 174 385 thousand i.e. by 1.8%, and the reason for the decrease was described above outflow of deposits of public sector customers as well as reduced scale of the wholesale financing from other financial entities. At the same time, deposits of institutional clients, mainly from the SMEs, micro enterprises and from farmers increased. These were positive changes from the point of view of quality and costs of the financing structure due to the fact of securing additional finance in CHF from the majority shareholder and additional funds from the retail sector through BGŻOptima.

Table 29. Amounts owed to institutional customers

PLN thousand	31.12. 2011	31.12. 2010	Change y/y	
Other financial institutions:	**817 751**	**1 090 373**	**(272 622)**	**(25.0%)**
– Current accounts	16 842	15 200	1 642	10.8%
– Term deposits	800 898	1 072 109	(271 211)	(25.3%)
– Other liabilities	11	3 064	(3 053)	(99.6%)
Corporate customers:	**7 901 418**	**6 871 791**	**1 029 627**	**15.0%**
– Current accounts	3 442 366	3 476 534	(34 168)	(1.0%)
– Term deposits	4 382 143	3 321 879	1 060 264	31.9%
– Other liabilities	76 909	73 378	3 531	4.8%
Corporate customers, from which farmers:	**876 745**	**686 217**	**190 528**	**27.8%**
– Current accounts	722 838	647 779	75 059	11.6%
– Term deposits	149 479	28 949	120 530	416.4%
– Other liabilities	4 428	9 489	(5 061)	(53.3%)
Public sector customers:	**788 655**	**1 720 045**	**(931 390)**	**(54.1%)**
– Current accounts	413 291	870 988	(457 697)	(52.5%)
– Term deposits	375 241	848 932	(473 691)	(55.8%)
– Other liabilities	123	125	(2)	(1.6%)
Total	**9 507 824**	**9 682 209**	**(174 385)**	**(1.8%)**

8.4.5. FINANCING TRADING BUSINESS

In 2011, the Bank's factoring offer was extended to include the following types of factoring:

- reverse factoring, which consists in paying by BGŻ of liabilities of recipient towards declared suppliers;
- administrative factoring, which consist in purchasing receivables, collecting payments from business partners and conducting payment reminders activities without obligation on the part of BGŻ Bank to finance the underlying debt;
- maturity factoring, which consists in the BGŻ Bank paying the prepayment towards invoiced amount at the invoiced maturity date,
- full insured factoring, with the global Bank's policy, which consists in acquiring by the Bank debts insured by Towarzystwo Ubezpieczeń Euler Hermes, without recourse to Client. The insurance policy negotiated by the BGZ Bank is valid until 30 June 2012.

In 2011, the Bank recorded an increase in the number of signed agreements (by 63%) and in the value of limits from those agreements (by 130%). The Bank purchased debts with a total value of PLN 2 575 million compared to PLN 1 792 million in the prior year i.e. 45% more. The increase in trading resulted in Bank's higher exposure i.e. from PLN 273 122 thousand in 2010 to PLN 389 527 thousand in 2011 i.e. by 42.6%.

Bank guarantees

The portfolio of Bank's guarantees issued in 2011 comprises mainly performance bonds, guarantee of payment for purchased goods/ rendered services, tender guarantee as well as guarantees for prepayment return. Bank BGŻ prepared SA special offer for transport companies in the form of guarantee securing toll payment for the use of toll national roads and motorways – *the viaTOLL* guarantee. They are used in order to secure payments, to make which a owner of a lorries which are using domestic roads or their sections of deferred payment.

At the end of 2011, the total value of guarantees issued to clients amounted to PLN 789 391 thousand and total revenues of the Bank from guarantee fee amounted to PLN 12 173 thousand. At the end of

2011, the guarantee portfolio comprised 1 505 guarantees compared to 1 295 guarantees issued in 2010.

Letters of credit

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

In 2011, the Bank recorded an increase in fee revenues for letter of credit issuance which amounted to PLN 1.793 million (PLN 1.4 million in 2010) with and total value of open letters of credit of PLN 166.3 million (PLN 182.2 million in 2010) and services import letters of credit at the level of PLN 32.8 million.

8.4.6. ACTIVITIES ON DEBT SECURITIES MARKET

In 2011, the Bank serviced 5 programs of issue of debt securities, of which 3 related to the issuance of securities of local government units (municipal bonds). In 2011, the Bank did not act as organizer of new issues of debts securities.

8.5. ACTIVITIES ON MONEY AND FOREIGN EXCHANGE MARKETS

In 2011, the activities of the Bank on money and foreign exchange markets were significantly affected by the following factors:

- uncertainty related to debt crisis of some Euro-zone countries,
- deteriorated credit capacity of many developed countries or banks operating on global financial markets,
- lower liquidity of the inter-bank market in the area of deposit transactions,
- higher demand for liquidity in the banking sector in the second half of 2011, which translates into higher costs of obtaining finance from Bank's clients,
- slower appreciation trends followed by material depreciation of Polish zloty against major currency pairs,
- four increases of NBP interest rates in the first half of 2011 by a total of 1.00 pp,
- high interest on the side of foreign investors in Polish debt instruments despite turbulence in global financial markets.

Activities on own account

FX market

In 2011 trading result achieved by Bank BGŻ on the inter-bank market in the field of foreign currency transactions increased by more than 60% compared to the prior year. The increase in the trading resulted from both higher volume of foreign currency transactions by the Bank's clients and active management of the Bank's currency position. The largest trading in foreign exchange was recorded on the EUR/PLN currency pair (accounts for 70% of the entire result), and then on the USD/PLN and GBP/PLN currency pairs. Greater Bank's presence on the FX market did not relate to currency options which traditionally were not of much interest to the Bank's Clients.

Interest rate market

Trading result on the market of debt instruments increased almost two-fold; trading under buy-sell-back and sell-buy-back – 4 times, whilst trading in IRSs – by 55% compared to the prior year. Increase in activities on the inter-bank market resulted mainly from higher interest of the Bank's Clients (mainly non-banking financial institutions) in the interest rate products and from the higher activities of the Bank on own account. A significant increase in the Bank's position on the interest rate market contributed to obtaining by the Bank of the status of Dealer in Treasury Securities for the year 2012.

Liquidity management

The lasting restricted liquidity of the inter-bank market caused that transactions were concluded only to manage spot or short-term liquidity of the Bank. The main instrument for placing deposits of short –term liquid assets were NBP money bills. The Bank did not treat the inter-bank market as the source of obtaining finance for current operations. The risk of short-term interest rate arising from deposit transactions of the Bank's clients and from other instruments offered to Clients was actively managed by way of using the OISs *(IRS based on the Polonia index),* FRAs *(Forward Rate Agreements),* IRS and FX Swaps.

Assets and liabilities management

As regards assets and liabilities management, the Bank conducted financial operations with a view to managing structural exposure of the Bank to interest rate, foreign currency or interest rate risks by way of, among others, managing excess source of finance, securing long-term financing or issuance of debt securities, and hedging against the related risks.

CHF Loan

On 22 April 2011, the Bank and Cooperatieve Centrale Raiffeisen–Boerenleenbank B.A. concluded an agreement whereby the Bank received funds in the amount of CHF 1 008 million for the period of 12 years in order to finance the existing portfolio of housing loans denominated in CHF at fixed and predictable cost. The facility line was made available in 18 tranches over the period from 29 April 2011 to 30 September 2011. As at 31 December 2011, loan principal was PLN 3 547 917 thousand. For half of the loan the cost was determined at CHF 3M LIBOR + margin, whilst for the other half – at CHF 6M LIBOR + margin. The loan is repaid in instalments every 3 and 6 months. Owing to this loan the Bank became insensitive to fluctuations of PLN against CHF exchange rates, both from the point of view of cost and liquidity risk.

EBRD credit facility

On 31 August 2011, the second long-term (5-year) credit facility was made available by EBRD in the amount of EUR 50 million; the facility is to support investments in the segment of SMEs and microenterprises relating to utilization of renewable energy sources. In order to distribute these funds, the Bank launched a dedicated credit product and concluded a hedging transaction.

The Bank has also another open credit facility at EBRD for the amount of EUR 50 million which was secured in the first half of 2010. As at 31 December 2011, loan principal of these two facilities amounted to PLN 441 680 thousand.

Investment portfolio

At the end of 2011, the nominal value of the Bank's investment portfolio amounted to PLN 2.65 billion. The entire portfolio was made up of liquid State Treasury bonds with maturity date falling in 2-10 years, which were classified as available-for-sale i.e. with changes in valuation taken to equity. In the second half of 2011, the portfolio generated gains of PLN 80.9 million, of which PLN 7.9 million from the sale of bonds before maturity date. In order to adjust the duration of the portfolio to growing balance, the Bank sold short-term securities and purchased long-term securities thus keeping the nominal value of the portfolio in the target range of PLN 2.5 – 2.7 billion.

Certificates of deposit

In 2011, the Bank issued short-term commercial papers of the BGŻ Bank (Certificates of Deposit) as supplementary source of finance. As at 31 December 2011, based on the Agreement dated 14 March 2008 concerning the program of issuance of short – term and medium – term bearer securities denominated in PLN, the Bank has issued the Certificates of Deposit with the nominal value of PLN 2 044 500 thousand and their maturity dates falling in the period of 3-6 months.

Sale of treasury products to clients

In 2011, the Bank recorded higher, compared to 2010, customer activity both in the field of spot currency transactions and in currency forwards. This was, among others, due to increased sales campaign for treasury products and further fast development of the eBGŻ Treasury channel, the electronic channel for distribution of financial markets products. Also, further increase was recorded in the interest in transactions hedging foreign exchange risk (mainly in currency forwards) and interest rate risk (IRSs).

8.6. COLLABORATION WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

Correspondent banking and money orders

In 2011, the Bank maintained correspondence contacts with approx. 680 financial business entities, and at year end, the Bank maintained 23 Nostro accounts in 14 main currencies at foreign banks. As at 31 December 2011, the Bank maintained 39 Loro accounts in 6 currencies for 21 foreign banks, 2 domestic banks and 4 foreign non-banking financial institutions. The Loro accounts are maintained in the BGŻ S.A. books of account and represent external source of securing working capital funds at no cost, which serve to satisfy operating needs of the Bank. Using these accounts, the Bank executes primarily client transfers and bank-to-bank transfers.

In 2011, BGŻ collaborated with four foreign non- banking financial institutions offering cheap and swift electronic money orders: MoneyGram (USA), Doma International Transfers (USA), Vigo Remittance Corporation (USA) and OneMoneyMail (Great Britain). The subject of collaboration is both money orders as well as transfers to bank accounts. In the case of MoneyGram, transactions were executed in both directions i.e. to and from Poland.

In 2011 the Bank continued collaboration with other domestic and foreign financial institutions, mainly with investment funds, insurers, pension fund management companies and with brokerage offices/ houses and with banks. Owing to this collaboration, the Bank was able to offer a truly wide range of treasury and deposit transactions.

Financing foreign trade operations

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

In 2011, 513 959 transactions were settled via active nostro accounts maintained at foreign and domestic commercial banks and at NBP; compared to the corresponding period of the prior year of 388 194 transactions, this represents a 32.4% increase. The value of the transactions settled via nostro accounts increased in 2011 by 9.5 % compared to 2010 and reached the total amount of PLN 3 083 billion.

In the year 2011, a total of 113 792 transactions (inter-bank and client orders) were settled using the loro accounts. Compared to 2010 (with 100 832 transactions), this represents a 13% increase. From the point of view of the value of trading, in 2011 transactions were settled for the total of PLN 892 billion, which compared to 2010 represents a 45% increase (in 2010 trading result was PLN 614.5 billion)

The number of payment orders abroad increased in 2011 by 18% to 137 728 transfers, whilst the number of import transfers increased by 63% and amounted to PLN 11 972 billion.

The share of electronic transfer channels in the total number of import transfers continued to increase and changed from 72% in 2010 to 80% in the corresponding period of 2011.

As regards export transfers, compared to 2010 its number grew by 20.3% (in 2011, a total of 346 329 payments from abroad were realised), and the value of export transfers in 2011 amounted to PLN 17 177 million i.e. 42% more than in 2010.

The number and the value of transfers executed with the use of *SEPA Credit Transfer* product doubled for outgoing transfers compared to the corresponding period of the prior year and currently is 60 772 transfers with a value of PLN 3 254 million (in 2010 - 31 725 transfers with a value of PLN 1 613 million were executed).
As regards incoming SEPA transfers, the quantitative and qualitative increase was approx. 70% and in 2011 was as follows: 152 354 transfers with a value of PLN 3 372 million (in 2010 - 90 418 transfers with a value of PLN 1 972 million).
The share of *SEPA Credit Transfer* in total import (incoming) and export (outgoing) transfers in 2011 materially increased and for both types was 44%.

As part of servicing own document operations (letters of credit and bills for collection) and own guarantees, as well as loan facilities committed by the Bank, the number of new transactions in 2011 executed to the order of Bank's clients increased compared to 2010 by 27% to 1 731 new transactions reaching the value of PLN 1 104.5 million, which represented an increase of 48.10%. The value of new letters of credit issued by the Bank and own collections remained at the level comparable to that of 2010 and was 172.6 million, whilst the volume of letters of credit issued and own collections increased compared to 2010 by 22.5% and was 474 transactions. In 2011, a 28.8 % increase, compared to 2010, was recorded in the number of issued guarantees (1 257 transactions were executed) whilst the value of those transactions was PLN 931.9 million, which represents a 65.5% increase in the value of issued guarantees compared to the corresponding prior year period.
As regards third party letters of credit and third party guarantees, the value of transactions executed in 2011 in favor of the Bank's clients amounted to PLN 139.4 million, which compared to 2010 represents a 12.5% increase in the value of executed transactions with comparable to prior year volume, which in 2011 was 513 transactions.

8.7. AVERAGE BASIC INTEREST RATES USED IN THE FINANCIAL YEAR

Table 30. Average basic interest rates BGŻ S.A. in 2011

	Retail	Corporate customers
Term deposits*		
PLN	4,32%	4,51%
EUR	0,20%	0,20%
Loans		
PLN	10,31%	8,80%
EUR	3,20%	3,20%
CHF	4,77%	-

** excluding 1 day placements.*

8.8. BANK ORGANIZATION AND PERSONNEL DEPARTMENT

8.8.1. ORGANIZATIONAL STRUCTURE

In January 2011, reorganization was performed in the Area of Financial Markets which consisted in establishing a new unit responsible for attracting non-banking clients and direct sale of financial market products, as well as for rendering to these non-financial clients advisory services concerning mitigating currency and interest rate risks and launching new products on the financial market. At the same time, the role of the then current Treasury Department (currently the Department of Financial Markets) was changed to include management of the Bank's cash funds and cash flows and conduct operations on the domestic and international financial markets on Bank's account in order to maximize profits under the limits awarded. Assets and liabilities management function was delegated to the newly established unit in the area of Finance.

In April 2011, total reorganization was carried out of the IT Department.

In May 2011, changes were implemented to the structure of management functions at the Head Office in connection with appointment of new Management Board Members. In particular, the Department of Retail Banking, Distribution Channel Management and the Department of Institutional Banking were established. Included in the second Department are the Agro-Business and the SMEs. The previous structure of business management covered the Department of Distribution Channel Management and the Department of Product Development and Marketing.

In July 2011, changes were implemented to the structure of Bank management by way of creating a new department of retail banking and distribution channel management in connection with appointment of a new Management Board Member.

In October 2011, the new Department of Human Capital (Human Resources) was established in connection with the appointment of a new Management Board Member responsible for that Department. In addition, the Department of Bank Safety and Fraud Counteraction responsible for all aspects of possible types of fraud at the Bank and the Office for Business Modeling were established which are responsible for managing long-term business initiatives and providing support in execution of short-term business initiatives undertaken by the Department of Retail Banking and Distribution Channel Management.

In November 2011, the first stage of the reorganization of the Risk Department was carried out.

8.8.2. HUMAN RESOURCES DEPARTMENT

Employment levels
At the end of 2011, BGŻ S.A. had 5 592 employees i.e. 5.5% more than in the prior year. At the Head Office, the number of employees increased by 1.3% y/y, which was mainly due to changes in the organizational structure of the Bank's network and strengthening the function of risk management. The employment level in the entire Bank's network increased by 6.1% y/y as a result of dynamic development of the Bank's operating units.

Table 31. Bank's employment in employees and FTEs

	31.12.2011	31.12.2010	change	change (%)
Network	4 027	3 795	232	6.1%
Headquarters	1 453	1 435	18	1.3%
Brokerage Office	36	34	2	5.9%
BGŻOptima	43	-	43	-
Holiday resorts	30	32	(2)	(6.3%)
Trade unions	3	3	0	0.0%
Total (employees)	**5 592**	**5 299**	**293**	**5.5%**
Network	3 992.8	3 761.4	231.4	6.2%
Headquarters	1 447.0	1 427.4	19.6	1.4%
Brokerage Office	36.0	34.0	2.0	5.9%
BGŻOptima	21.4	-	21.4	-
Holiday resorts	29.5	31.5	(2.0)	(6.3%)
Trade unions	3.0	3.0	-	0.0%
Total (FTEs)	**5 529.8**	**5 257.3**	**272.5**	**5.2%**

The largest group of employees at the end of 2011 are persons with higher education (78%), and compared to the end of 2010 the greatest increase in the number of newly employed persons (1.78 %) was recorded for this group.

Salaries

In connection with the KNF Resolution No. 258/2011 becoming effective, the Bank commenced the works aimed at implementing recommendations provided in this Resolution, including works on the change of policy regarding variable salary components, relating in particular to the posts with the most significant effect on risk profile.

As part of these works, assumptions underlying the Remuneration Policy for Bank's Management Board Members were developed, and by way of a thorough analysis a group of management posts was identified with material effect on the Bank's risk profile, within the meaning of the KNF Resolution.

Table 32. Payroll

PLN thousand	2011	2010	Change	
			PLN thousand	%
Base remuneration	307 449	279 105	28 344	10.2%
Other components of salaries and wages	3 570	3 031	539	17.8%
Awards and bonuses *	58 520	31 060	27 460	88.4%
Non-employment contracts	3 003	2 589	414	16.0%
Salary-related costs	49 124	40 403	8 721	21.6%
Other employment benefits	16 803	10 441	6 362	60.9%
Costs related to Company Social Benefits Fund	5 923	5 272	651	12.3%
Other	11 856	9 900	1 956	19.8%
Total payroll	**456 249**	**381 801**	**74 448**	**19.5%**
Awards and bonuses as % of base remuneration	**19.0%**	**11.1%**	**x**	**7.9%**

Compared to 2010, the increase in basic salaries at the Bank in the year 2011 was 10.2%. This was caused mainly by the development of the network of the Bank's operating units and strengthening of business areas. In addition, as of 1 April 2011, the Bank regulated the issue of basic salaries due to implementation of new remuneration regulations, as well as due to the increase in salaries of its best employees. The significant increase in costs of bonuses resulted from the fact that in 2011 the Bank reinstated individual result-based bonus program. (In the year 2010, Bonus regulations and bonus payments were suspended).

As at 31.12.2011 and 31.12.2010 none of the members of Management Board, Supervisory Board or a key management personnel held the Bank's shares.

8.9. IT DEPARTMENT

In the year 2011, the Bank spent 103 million 45 thousand for investments in the area of IT. The number of investment projects in progress at the end of 2011 was 31.

The most significant investment projects were as follows:

- Starting operations of the BGŻOptima internet bank. The project was carried out together with Rabobank International Direct Banking.
- Migration of the main transaction system to the 3-layer architecture.
- Implementation of tools for reporting function automation and execution of processes relating to MIFID-based customer profiling.
- Further development of phone sales channel via Contact Center development. New solution ensures appropriate standard of client service and facilitates servicing sales clients and credit applications obtained from the WWW channel.
- Implementation of several functionalities in the system of electronic banking for institutional clients.
- Implementation of a solution facilitating calculation of funds guaranteed by the Banking Guarantee Fund – adjustment to the provisions of the act.
- Migration of ATMs to the new system and upgrade of ATMs network to the requirements of MasterCard and Visa – PIN management service and inquiries about balance of third party cards.
- Realization of main works aimed to develop a concept of the system for managing relations with CRM clients and the architecture of this solution.
- Implementation of the system for servicing and distribution of electronic bank statements.
- Running a live global going concern test for all critical IT services and business processes.
- Extending for another three years of the Bank's participation in the *Enterprise Agreement* with Microsoft for the supply of license for institutions of the Rabobank Group.

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

BGŻ S.A. Capital Group strategy assumes a consecutive portfolio divestment in capital exposures that are not the part of its core business activities, namely banking and financial services, and concentration on best financial result on specific transactions.

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

In 2011 the supervisory action undertaken against BFN ACTUS Sp. z o.o. were concentrated on creating conditions to sell a property located in Wroclaw – Marszowice.
The company was created in 1999, with main business activities focusing on:

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

As at 31.12.2011, the investment portfolio was composed of one property in the form of undeveloped land with an area of 48.44 hectares. According with the applicable Local Zoning Plan, the property is intended for housing construction.

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

PLN thousand	31.12.2011	30.06.2011	31.12.2010	30.06.2010
Total assets	63 598.3	64 058.0	64 061.7	63 303.6
Long-term investment	63 401.0	63 900.0	63 900.0	63 200.0
Equity	21 930.8	23 356.7	24 358.4	24 757.1
including: net profit	(2 712.6)	(1 122.0)	(1 821.6)	(1 191.8)

9.2. BGŻ LEASING SP. Z O.O.

The company was created in April 2007 as a subsidiary of De Lage Landen International B.V. (the Rabobank Group). The company provides leasing services focusing on equipment, cars, and other fixed assets it also provides loans.

On July 1st, 2008 BGŻ S.A. purchased a 49% equity stake in the company for PLN 19.6 million. The co-operation of the Bank with the BGŻ Leasing covers providing leasing services to the Bank's customers. BGŻ Leasing provides essential and technical background to support the Bank's advisors in the sale of lease products.

2011 was a record in the activities of BGŻ Leasing. Under the provision of leasing services, in 2011 the company leased assets with the value of PLN 584.6 million PLN, which indicates the growth of 31% w compared to 2010. In general, 1662 lease agreements were signed.

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

PLN thousand	31.12.2011	31.12.2010
Total assets	1 013 331.00	676 505.40
Net leasing receivables and advances	881 638.90	584 797.70
Shareholders' equity	94 178.90	64 294.30
of which: net financial result	4 841.60	3 366.50

10. RISK MANAGEMENT

10.1. CREDIT RISK

Credit risk management

Credit risk is defined as the risk of default of financial liabilities by debtor, being – in particular – the risk of non - payment of loan liabilities as well as the risk of worsening of the debtor's financial situation, which both have effect on valuation and quality of the Bank's assets.
For the purpose of managing credit risk, the Bank' Management Board implemented policies determining the maximum credit risk exposure *(credit risk appetite statement),* the Bank is ready to accept in connection with its business strategy.
In the process of credit risk management, the Bank executes activities based on current analyses of the macroeconomic environment and conducts internal analyses of credit portfolios.
The applied approach facilitates taking up swift remedial measures where unfavourable trends appear in the external environment or in the quality or structure of the credit portfolio.

Active credit risk management is executed by the Bank among others, by way of:

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

The most significant tasks realised by the Bank in 2011 were as follows:

- verification of lending process for compliance with the requirements of Recommendation S and preparation for implementation of changes aimed at ensuring the Bank's compliance with those Recommendation;
- review and modification of processes of mortgage debt restructuring;
- review of current and implementation of new models for assessment of credit capacity of retail and institutional clients.

Quality and structure of credit portfolio

In 2011, the share of impaired loans and borrowings in the credit portfolio decreased from 6.4% to 5.7%. This was mainly due to the improvement of institutional client credit portfolio, in which the share of impaired loans and borrowings in total loans and borrowings decreased from 7.7% to 5.9%. This decrease was possible owing to a dynamic (by 31.3%) growth of the portfolio with the concurrent slight (by 1.1%) increase in impaired loans and borrowings. Retail client portfolio deteriorated with the impaired loans and borrowings share increasing from 4.4% to 5.4% mainly due to defaults of housing and cash loans.

The Bank maintains relatively safe structure of its credit portfolio with high share of loans and borrowings with more favourable risk profile i.e. housing loans (accounting for 28.4% of the gross value of credit portfolio at the end of 2011) and loans to farmers (21.0% of the gross value of credit portfolio). Foreign currency loans account for about half of the housing loans portfolio, however their share has systematically decreased when in April 2009 the Bank ceased to issue such loans. The share of cash loans with higher credit risk losses in total loans and borrowings is 3.2%, whilst in the banking sector this item is approx. 13%.

Table 35. Structure of credit portfolio

PLN thousand	**31.12.2011**		**31.12.2010**		**Change y/y**	
	PLN thousand	**share %**	**PLN thousand**	**share %**		
Loans ang advances, gross	**25 105 296**	**100.0%**	**20 567 994**	**100.0%**	**4 537 302**	**22.1%**
Real-estate loans	7 118 474	28.4%	6 558 895	31.9%	559 579	8.5%
– in PLN	3 498 881	13.9%	3 233 535	15.7%	265 346	8.2%
– in foreing currency	3 619 593	14.4%	3 325 360	16.2%	294 233	8.8%
Cash loans	719 466	2.9%	705 572	3.4%	13 894	2.0%
Other retail loans	493 222	2.0%	501 323	2.4%	(8 101)	(1.6%)
Individual entrepreneurs	1 487 266	5.9%	1 097 929	5.3%	389 337	35.5%
Farmers	5 275 980	21.0%	4 308 813	20.9%	967 167	22.4%
Businesses	9 456 029	37.7%	6 931 878	33.7%	2 524 151	36.4%
Public sector institutions	288 652	1.1%	214 429	1.0%	74 223	34.6%
Other receivables	266 207	1.1%	249 155	1.2%	17 052	6.8%

Restructuring and recovery of high risk debt

The policy of restructuring and recovery of high risk debt conducted in 2011 was that of continuation of activities in the area of:

- identification, negotiation and implementation of activities aimed at maximizing repayments by debtors or – where possible – implementation and monitoring of debtor corporate recovery proceedings leading to improvement of debtor financial and economic position, with the overall view to returning debtors for servicing by their original sales units,
- reducing the share of high risk debt in the Banks' portfolio,
- active monitoring of execution and bankruptcy proceedings,
- strengthening the structure of transactions through requesting additional transactions insurance, change in the repayment schedule, change in the drawing schedule, adjusting/ adding new contract clauses, changing the type of transactions,
- tax optimization of executed strategies,
- identification of early warning signals and taking appropriate steps (where possible, in collaboration with sales units) to limit the risk of potential losses,
- further integration and coordination of activities with the function of debt restructuring and recovery at the Rabobank Group (GSAM) for the largest transactions, and with sales units of the Bank for defined specific transactions,
- personnel recruitment and appropriate training so as to ensure that the Bank has appropriate human resources to manage the given portfolio,
- improvement of the Bank's organizational structure, procedures and tools to enhance the efficiency of the tasks carried out.

Debts recovered in the year 2011 serviced by the Institutional Debt Recovery Department, Retail Debt Recovery Bureau and Debt Restructuring Department in the amount of PLN 498.4 million (principal) was the result of the conducted court execution proceedings, bankruptcy proceedings in progress, civil-legal agreements with debtors and compositions proceedings in process.

In addition, the number of debt collection orders issued by the Bank in 2011 and the number of collaterals established on accounts of active borrowers was 551 for corporate loans and 2 538 for corporate loans.

The value of collaterals in the portfolio covered with restructuring or debt recovery procedures in terms of LTV ratio is as follows:

Loan to value (LTV) ratio for Polish zloty mortgage loans is 51.5%, whilst for mortgage loans in foreign currencies – 72.2%. This means a relatively high level of collateralization with the concurrent limitation of risk of debt non-recovery.

Table 4. The number and value of debt collection orders issued in 2011

Currency	***Corporate loans***		***Retail loans***	
	Number of the enforcement orders	Value in currency (thousand)	Number of the enforcement orders	Value in currency (thousand)
PLN	532	164 760	2 509	64 551
USD	4	7 220	0	0
CHF	7	985	28	2 450
EUR	8	1 716	1	16
Total	**551**		**2 538**	

10.2. FINANCIAL RISK

10.2.1. Market risk

Activities of the BGŻ Bank are recorded in the trading and banking books. Fluctuations in market interest rates, currency exchange rates, prices of securities or in the implied volatility of option instruments cause that the current value of these books changes. The risk of unfavourable fluctuations in value due to the above risk factors is recognised by the Bank as market risk, and due to the very different nature of said books, this risk is monitored and managed separately for each book.

In addition, one should note that in 2011 Bank did not operate on the commodities market whilst the activities on the share market conducted by the Brokerage Office were practically reduced to zero.

Market risk in the banking book

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

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

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

- interest rate gap, life of assets/liabilities, the so-called „duration";
- sensitivity measures – defining sensitivity of financial amount valuation, interest revenues or net value of economic capital – to changes in risk parameters;
- IaR (Interest-at-Risk – sensitivity of interest result);
- EaR (Equity-at-Risk – sensitivity of the present value of net capital).

The Bank manages the risk of banking book by limiting risk measures and ongoing risk monitoring.

Situation in 2011

At the end of 2011, the value of the duration – i.e. the weighted period to revaluation of interest rate of balance sheet assets was approx. 3.8 month (in the prior year – 1.7 month), whilst for the balance sheet liabilities - 2,8 month (in the prior year – 1.8 month). More than 93% of assets and liabilities' items has revaluation deadline lower than 6 months (at the end of 2010 - 98%), however, 54% of assets and liabilities are to be re-valued within one month (in the prior year - 70%).

Extending periods in the structure of balance sheet revaluation result from changes in the balance sheet structure that occurred in the last year. On the assets side, said changes related to the acquisition to the ALM portfolio of long-term treasury bonds with fixed interest rate. The main reason behind such operation was to extend the average period of assets revaluation. On the liabilities side, the main structural change was the CHF loan taken out from the Rabobank which is re-valued every 3 and 6 months.

Changes in the structure of revaluations at the Bank caused also changes in sensitivity of the interest result. The immediate increase in interest rate by 50bps would lead to increase in the interest result of the Bank in one year by approx. PLN 8.3 million, whilst gradual increase in interest rate by 200 bps during one year would result in an increase of interest result of PLN 9.5 million. Changes in the structure of banking book significantly changed sensitivity of interest result to interest rate fluctuations. At the end of 2010, an immediate increase in interest rates of 50bps, would have caused an increase of interest result of PLN 18 million, whilst gradual increase of 200bps – would have increased the interest result by approx. PLN 33.3 million. Sensitivity of interest result to interest rate decreases is greater due to existence of interest rate liabilities not sensitive to interest rate fluctuations (some costs do not decrease with interest rate decrease) or low-level of base interest rates (e.g. CHF or USD). An immediate decrease in interest rate of 50bps would result in a decrease of interest result of the Bank in one year by PLN 24.1 million (PLN 32.4 million in the prior year), whilst gradual decrease in interest rate of 200 bps in one year - by PLN 48 million (PLN 67 million in the prior year).

Market risk in the trading book

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

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

- Value-at-Risk (VaR) – showing maximum acceptable level of loss on the given item in normal market conditions in a defined time span; can be exceeded with defined probability; BGŻ applies the parametric model with modified variance – covariance matrix and exponential weighting of historical observations; the accepted confidence level is 99%, and the period of position holding for trading book – 1 day;
- Scenario analyses and Stress Test – supplement VaR to include statistically predictable market events; historical economic and political crises, expected shortfall analyses (expected loss of value above confidence level) and max-loss (the highest possible loss based on a known history of fluctuations in market-based factors);
- BpV (basis point value) – sensitivity of price to parallel shift of profitability curve;
- Nominal measures – among others, value of currency position during a day and at day end, securities nominal value;
- Non-monetary limitations – among others, allowed types of instruments, currencies and pairs of currencies, maximum maturity dates, minimal credit rating for acquired debt securities;
- Stop – loss limits (level of the maximum loss acceptable) – for various time periods (day, month, year) at the portfolio and sub-portfolio level.

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

Situation in 2011

In the year 2011, a slight increase or recalibration of limits in the trading books was recorded which allowed the Bank to use the limits more effectively. This, however, had effect on the activities of the Treasury Department which managed to significantly reduce the number of exceeded limits, in particular those relating to key measures – the risk appetite.

The yearly average measure of trading items' risk exposure – the so-called value at risk (VaR) in the trading book was kept at the level of 50% of the limit. The second key measure – stress test, was on average 60% of the limit. Only 5 instances were recorded of exceeding the limit for risk appetite which marks 50% improvement compared to 2010; the total number of instances of exceeded limits also decreased. In the last quarter of 2011, no instance of exceeded in the trading book was recorded.

In the second half of 2011, on the initiative of the Treasury Department, the Financial Risk Bureau conducted an analysis and proposed a new range of limits for the trading book. The implemented changes were directed to increase the effectiveness of VaR utilization, which remained at the stable level of (1.3 million), by adjusting other limits (VaR calculated on portfolios, Stress Test, delta) to market situation and characteristics of the positions held. Stress Test increased materially from PLN 9 million to PLN 13 million. All those changes brought the expected effect - without exceeding risk appetite limits, average utilisation of VaR remained at 75% since August, whilst the maximum utilization was- 92%, compared to 43% and 74% respectively prior to changes implementation.

Liquidity risk and assessment of finance sources stability

In 2010 and 2011, the Bank maintained safe level of financial liquidity. The financial resources held allowed the Bank to discharge all its liabilities on time. The portfolio of the most liquid securities was kept at the level fully securing any potential outflow of funds by the Bank's largest depositors. The excess of liquid assets over the minimum limit amounted at the end of 2011 to PLN 1.85 billion.

At the end of 2011, the excess of financing resources originated on other than inter-banking market above the credit limit amounted to PLN 4 billion PLN, whilst the excess of stable deposits over credit portfolio balance – PLN 1.34 billion.

During the period from January 2011 to June 2011 the Bank's ratio of stability of financing remained at high average level of 86.7%, and reached the year end the level of 90%. For comparison purposes, in the year 2010, stability of financing recorded the average of 85% – such high stability of financing was possible mainly due: to low fluctuations of balances of retail deposits placed by SMEs and microenterprises (excluding migration between individual products), sediment funds of large enterprises and state budget entities, growing balance of certificates of deposit and the secured EBRD credit facility, and in the second half of 2011 – also due to the CHF loan from Rabobank.

10.3. OPERATING RISK

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

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

Organization

A superior role in the organizational structure responsible for managing organizational risk is fulfilled by the BRMC as well as the Operational Risk and Conformity Subcomittee, which act as intermediaries of the Management Board, supervising the operational risk management system and the risk level. The responsibilities of the Operational Risk Management Department in the Risk Management Function include but are not limited to the processes and tools related to operating risk management. There is an operational risk coordinator in each organizational unit at the Head Office of the Bank, while in the Regional Headquarters there are Posts for Operational Risk Management.

Procedures

The operating risk management rules implemented by the Bank are consistent with supervisory regulations and market experience in this scope. The principles for operating risk management constitute Operating Risk Policy resolved by the Management Board, which is supplemented by Operating Risk Policy for information systems, Bank Security Policy, Compliance Policy and other detailed regulations.

Risk management

An important element of operating risk management system is early identification of risk, precise evaluation of its size and rules that enable undertaking effective actions against risk. Operating risk identification and reporting system embraces all Bank's organizational units which ensures completeness and accuracy of data that constitute basis for risk evaluation and decision making that influence the size of the risk borne by the Bank. The Bank's employees are trained among others in identification and reporting of operating risk events and threats.

Economic capital and risk evaluation

Bank has a 9-year data history of losses caused by operating risk. The data concerning operating risk losses and threats collected by the Bank are used to evaluate economic capital required to cover operating risk that strictly corresponds with Bank's operating profile. The evaluation of economical capital is based on implemented rules and statistical model. Irrespective of the above, according to the regulations in force, the Bank determines regulating capital to cover operating risk. The basic index method (BIA) is applied to calculate it.

The process of operating risk assessment is supplemented with the operating risk self- assessment method and the Key Operating Risk Indicators Method. The Key Operating Risk Indicators are the tool to monitor operating risk for selected, significant processes of the Bank using the three-grade risk evaluation scale.

10.4. LEGAL RISK

The legal situation in 2011 in compensation claims within insurance and employment claims was stable and did not generate material legal risk for the Bank.

Tabela 35. Created / reversed provisions in 2011 (with a unit value exceeding PLN 100 thousand)

Purpose	Amount of provision [as at 31.12.2011 or balance at the reversal date]	**Creation date**	**Reversal date**
Court proceedings initiated by the ARiMR	579	2010-05-05	2011-06-30
Court proceedings initiated by the customer	217	2010-03-18	2011-03-17
Court proceedings initiated by the customer	254	2010-03-18	2011-06-08
Court proceedings initiated by the ARiMR	1 043	2011-03-18	_______
Court proceedings initiated by the customer	127	2011-02-21	_______
Penalties for the ARiMR	1 508	2005-09-30	2011- 04-06
Court proceedings initiated by the customer	126	2011-12-31	_______

Legal proceedings or proceedings before government administration bodies relating liabilities or debts of BGŻ S.A. with a value of at least 10% of the BGŻ S.A. equity: according to information as at 31 December 2011 (approx. PLN 237 million) – no such proceedings took place.

11. INFORMATION ABOUT THE AUDITOR

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

Information about remuneration of the auditor:

Table 36. Remuneration of Ernst & Young Audit Sp. z o.o. authorized for auditing financial statements for the year ended 31 December 2011 and 31 December 2010, by types of services (in PLN thousand).

Type of service	Year ended 31 December 2011	Year ended 31 December 2010
Obligatory audit of financial statements*	582	383
Other attestation services *	221	323
Tax consultancy services *	-	-
Other services*	1 635	68
Audit relating to subsidiaries*	27	27
Total	**2 464**	**801**

* including VAT

12. REPORT ON APPLICATION OF CORPORATE GOVERNANCE RULES IN THE YEAR 2011 BY BANK GOSPODARKI ŻYWNOŚCIOWEJ S.A.

Statement of compliance with corporate governance rules

Pursuant to the provisions of §91 section 5 point 4) of the Ordinance of the Minister of Finance dated February 19, 2009 on the current and periodic reports disclosed by the securities issuers and on equivalence of information disclosures required by law of non-EU member states (Official Journal No. 33/ 2009, item 259 with subsequent amendments), the Management Board of the Bank is pleased to present the following information on application by the Bank of corporate governance rules in the year 2011:

Corporate governance rules at BGŻ SA and public availability of the underlying rules

The corporate governance rules the Bank complied to during 2011 are included in the „The Best Practices of WSE Listed Companies" being the Appendix to Resolution No. 17/1249/2010 of the WSE Supervisory Board dated 19 May 2010. Starting from 2012, rules concerning corporate governance are included in the „The Best Practices of WSE Listed Companies" being the Appendix to Resolution No. 20/1287/2011 of the WSE Supervisory Board dated 19 May 2010.

The said documents are publically available on the Internet website http://corp-gov.gpw.pl/publications.asp., which is an official website of the Warsaw Stock Exchange dedicated to the issue of corporate governance of listed entities.

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

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

The Bank has not developed yet the policy referred to in point I. 5 of the Best Practices, however, the Management Board of the Bank whilst conducting its works on implementation of the above policy, firstly made assumptions for the policy of remunerating Management Board Members; this is also related to the subsequent adoption by the Polish Financial Supervisory Authority the Resolution No. 258/2011 dated 4 October 2011 concerning detailed principles of functioning of the risk management and internal control systems and detailed principles of estimating by the banks of internal capital and performing reviews of the process of estimating and maintaining internal capital, and the principles of determining the policy for determining variable components of wages for persons fulfilling management functions at the Bank. Currently, works are underway on the final version of the remunerating policy referred to in point I. 5 of the Best Practices.

As regards changes made to the Best Practices, the Bank, in particular, adjusted the contents of its Internet website to the recommendations included in the Best Practices, by implementing visualisation approximating the guidelines to the pattern recommended by the WSE.

<u>The Management Board of the Bank represents that the Bank and its bodies complied in the year 2011 the adopted principles of corporate governance defined by the Best Practices.</u>

In the period covered by this report, no instances of breach of the adopted rules of corporate governance were identified.

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

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

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

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

The Bank's internal control system comprises:

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

The Bank operates an organisational unit that conducts internal audits, and the objective of this unit is to provide an independent and objective audit (verification) and assessment of the adequacy and efficiency of the internal control system as well as to provide opinions on the system managing the Bank, including the efficiency of managing operating risk. Detailed principles concerning internal control system are defined in the internal regulations. The Director of the Internal Audit Department reports directly to the President of the Management Board of the Bank.
The Bank adopted the accounting principles that are provided in the International Financial Reporting Standards. It is the Finance Division and the Controlling Division supervised by the First Vice-President of the Management Board that are responsible for the preparation of the financial statements, current reports or periodic reporting and providing management information.

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

The main shareholders of the Bank are the following entities:

- Rabobank International Holding B.V. with its registered office in Utrecht (Croeselaan 18, 3521 CB Utrecht, Holland) („RIH"), holding directly 21 298 609 shares of the Bank, which account for 49.37% of the entire issued share capital of the Bank. RIH is the parent company for the Rabobank Group, which primarily deals with performing banking operations and rendering banking services.
- Coöperatieve Centrale Raiffeisen - Boerenleenbank B.A., with its registered office in Amsterdam and the main place of conducting operations in Utrecht, (Croeselaan 18, 3521 CB, Utrecht, Holland) holding directly 4 303 695 shares of the Bank, which account for 9.98% of the issued share capital of the Bank.
- Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. is the immediate parent of RIH and the sole owner of RIH.

Detailed information on the Bank's shareholding structure has been provided in Table 8. *BGŻ S.A. Shareholding structure* in chapter 6. *Shareholding structure of the Bank.*

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

The Bank's shares are ordinary bearer shares and registered) shares (as at 31 December 2011 – 22 915 registered shares). No special control rights are attached to the ordinary shares.

Registered shares, B series (as at 31 December 2011 – four (4) shares) are preference shares and the privilege attached to those shares is the right to recover full nominal amount of those shares in case of Bank's liquidation and after satisfying Bank's debtors, before any payments are made in respect of ordinary shares, for which payments – after making payments towards preference shares – may not cover their underlying nominal amount.
In accordance with § 32 section 1 of the Bank's Statutes, disposal of the Bank's registered shares or burdening the shares with limited property rights requires prior approval of the Management Board of the Bank, unless the acquirer of the shares or lienor is the current shareholder. The permission issued by the Management Board of the Bank has to be in writing to be valid.

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

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

Restrictions on transfer of ownership rights to securities of issuer

The Bank's Statutes do not include any restrictions on transfer of ownership rights to securities issued by the Bank. Except for § 32 section 1, the Bank's Statutes, under which disposal of the registered shares or burdening the shares with limited property rights requires prior approval of the Management Board, unless the acquirer of the shares or lienor is the current shareholder, the permission issued by the Management Board of the Bank has to be in writing to be valid.

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

In accordance with § 21 section 1 of the Bank's Statutes, The Management Board of the Bank is composed of four to eight persons appointed for the common term of office of three years.
The Management Board of the Bank is composed of the President of the Management Board, First Vice-president, Vice-presidents and/ or Members of the Management Board, who are appointed, dismissed or suspended by the Supervisory Board. At least two members of the Management Board, including President of the Management Board, should have knowledge and experience that ensure that the Bank is managed in a stable and prudent manner. At least half of the Bank' Management Board Members should be represented by persons with good knowledge of the banking sector in Poland i.e. these persons should be permanent residents of Poland, should command Polish language and should have appropriate experience in the Polish market (§ 21 of the Bank's Statutes).
The Management Board of the Bank conducts its affairs and represents the Bank. The provisions of the Bank's Statutes do not provide the Management Board with any special authorizations in the field of share issue or redemption. Detailed description, including the description of the Management Board authorizations is included in § 22 section 2 of the Bank's Statutes.

Implementing changes to issuer Statutes

Each change or modification of the Bank' Statutes is to be made by way of resolution of the general shareholders' meeting and entry to the National Court Register. To the extent defined in art. 34 section 2 of the act dated 29 August 1997 – Banking Law (uniform text: Journal of Laws 2002/72, item 665 with subsequent amendments) any change to the Statutes requires consent of the KNF.

Motions of Members of the Management Board of the Bank concerning implementing changes to the Bank's Statutes, as well as any other requests made by the Bank's Management Board to be considered by the General Shareholders' Meeting, should be first presented to the Supervisory Board for consideration.
As regards to changes in the Bank's Statutes, including in particular changes to the Bank's name, registered office, profile of its business activities referred to in § 5 section 2 of the Bank's Statutes, increase or decrease in the Bank's issued share capital, should be made by way of a resolution of the General Shareholders' Meeting accepted by 3/4 of total votes. (§13 section 2 of the Bank's Statutes).
Pursuant to the provisions of §20 section 1 letter ł) of the Bank's Statutes, immediately after General Shareholders' Meeting accepting changes to the Bank's Statutes, the competence of the Supervisory Board becomes determining uniform text of the Statutes and implementing other editorial changes to the Statutes defined by the Resolution of the General Shareholders' Meeting.

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

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

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

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

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

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

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

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

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

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

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

- considering and authorization of directors' report on the Bank's activities and of the financial statements for the prior financial year,

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

Apart from the above, the General Shareholders' Meeting can take resolution in the following matters:
- changes in the Bank's Statutes,
- appointment or dismissal of Supervisory Board Members,
- increase or decrease in the issued share capital of the Bank,
- issuance of convertible bonds and bonds with pre-emptive right to take up Bank's shares, as well as subscription warrants,
- redemption of shares and defining detailed terms and conditions for such redemption,
- Bank merger or liquidation, selection of liquidators and the manner of conducting liquidation,
- determining remunerating policy and determining emoluments of Supervisory Board members,
- proposed by the Supervisory or Management Board,
- proposed by the shareholders in accordance with binding regulations and the Bank's Statutes,
- other [matters] warranted by law or the Bank's Statutes.

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

The Composition of the Management and Supervisory Board of the Bank is described in Chapter 4. *Governing bodies of the parent company*

In the year 2011, the Supervisory Board fulfilled the oversight function over the activities of the Bank and approved the Bank's strategy, its financial plans, Organizational Regulations, rules, and audit plan. The Supervisory Board considered information on the significant issues of the Bank's operations, including on the execution of the financial plan, outstanding projects, types of risk and capital adequacy.

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

The Internal Audit Committee considered the results of both internal and external controls, information on implementing post-audit recommendations and recommendations of the KNF, risk compliance reports, information on the review of the types of the risk incurred by the Bank and, finally, complaint reports.

The Internal Audit Committee is composed of the following persons:
- Harry de Roo – Chairman
- Jarosław Iwanicki – Member
- Andrzej Zdebski – Member (dismissed as Member of the Internal Audit Committee based on the Resolution of the Supervisory Board as of 1 September 2011 due to his appointment as member of the Human Capital and Payroll Committee).
- Roelof Dekker – Member
- Dariusz Filar – Member (as of 1 September 2011)
- Monika Nachyła – Member (as of 1 September 2011)

The Human Capital and Payroll Committee considered the matters relating, among others, to establishing new functions (post) and determining remuneration for these functions, as well as to employee promotion. In addition, the Human Capital and Payroll Committee considered information on employee career paths/ professional development. Also, changes relating to the Bank's mission, strategy and human capital policy, Regulations of the Human Capital and Payroll Committee and Regulations on awarding employee bonus were considered.

In the year, the Human Capital and Payroll Committee was composed of the following persons:
- Jan Alexander Pruijs – Chairman

- Agata Rowińska – Member (resigned as of 31 May 2011)
- Roelof Dekker – Member
- Andrzej Zdebski – Member (as of 1 September 2011).

13. CORPORATE SOCIAL RESPONSIBILITY

For years 2011 – 2014 the Bank assumes sustainable development of the company, which means management that generates the highest profit while respecting the needs and interests of the other people (employees and customers, local communities), minimizing the negative impact on the environment (3xP principle: People, Profit, Planet). Priorities for 2011 were as follows:

- The environment al Policy of the Bank: skillful limitation of the negative impact on the environment through the rational management of resources i.e. reducing energy and paper consumption, wastage production:
- Bank with Energy - in all new branches, energy – efficient lighting was introduced, and in existing branches, there is a process of gradual replacement of existing facilities
- Less Paper! – the diagnosis of the paper utilization in the Bank was worked out and the long – term action plan was developer, which aims to reduce paper utilization in the Bank
- Green Office communication platform: database of information and Communications on the Intranet serves to build environment al awareness and proecological attitudes of employees.
- The Bank's employees:
    - „System for Professional development and the development of the Bank's employees potential" helps to realize special training programs, including „Prestiż" program for the most valuable employees.
    - The function of „private agent" and code of ethical conduct for employees was introduced
    - Consultations referring to implementation of remote working (teleworking) in the Bank were undertaken. Some pilot activities were undertaken to develop recommendations for targeted solutions.
- Society. In 2011, according to "Bank of local communities" strategy an inventory of local initiatives supported by the Bank's branches took place. In order to promote prosocial engagement, the Bank has launched "the local support program".

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

14.1. STRATEGY FOR THE YEARS 2011-2014

The strategy for the years 2011-2014 was accepted by the Bank‟s Supervisory Board on 28 January 2010. At the beginning of 2011 the Bank has revised and updated its strategy.

In accordance with the strategy the Bank shall develop as a universal bank specializing rendering services for the agricultural and food producing industry. From the perspective of the client the Bank wants to be a Bank developing long-term relations, seen as a responsible partner and engaged in local communities. In accordance with the strategy the Bank shall develop as a universal bank specializing rendering services for the agricultural and food producing industry. From the perspective of the client the Bank wants to be a Bank developing long-term relations, seen as a responsible partner and engaged in local communities.

As regards to universal banking, the strategy assumes strengthening the position of the Bank in the area of retail banking. To this end, further development has been planned of the Bank‟s network on local markets (agricultural areas, medium and small towns), as well as extension of product offer and initiatives to attract middle-class customers in order to secure financing for the main segments of

banking business. The Bank will focus on the further development of services to SMEs and to micro enterprises on local markets.
As regards banking for the agricultural – food industry sectors, the Bank intends to strengthen its position based on product offer and service model tailored to the specific needs of these sectors.
The implementation of the strategic assumptions is assisted by a number of internal project and initiatives including inter alia: the development of traditional and virtual distribution channel, optimization of internal processes and the business support functions. Special significance is attached to the development of the Customer Relationship Management (CRM) systems, the improvement of the operating effectiveness and the optimization of the human potential management.
Both the Management Board and the Shareholders of the Bank are confident of the long-term potential of the banking market in Poland and shall continue their engagement into the future development of BGŻ S.A.

15. IMPORTANT EVENTS AFTER BALANCE SHEET EVENTS

On 21 February 2012, the Moody's Investors Service rating agency has decided to start a review of BGŻ S.A. ratings in terms of their possible reduction. The review will assess the long – term deposits at Baa1 level with negative forecast and short – term deposits at Prime – 2 level.

The Bank's stand-alone financial strength rating ("BFSR") rating of D remains unchanged with a stable outlook.

Moody's action on BGŻ S.A. is part of a collective review of ratings of Central and Eastern European and Commonwealth of Independent States banks that was announced on February 21, 2012 and follows the rating action undertaken by Moody's on February 15, 2012, with respect to their parent banking groups in Europe and United States.

....
Jacek Bartkiewicz
President of the Management Board

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Gerardus Cornelis Embrechts
First Vice-President
of the Management Board

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

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

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

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

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

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

Warsaw, 5 March 2012