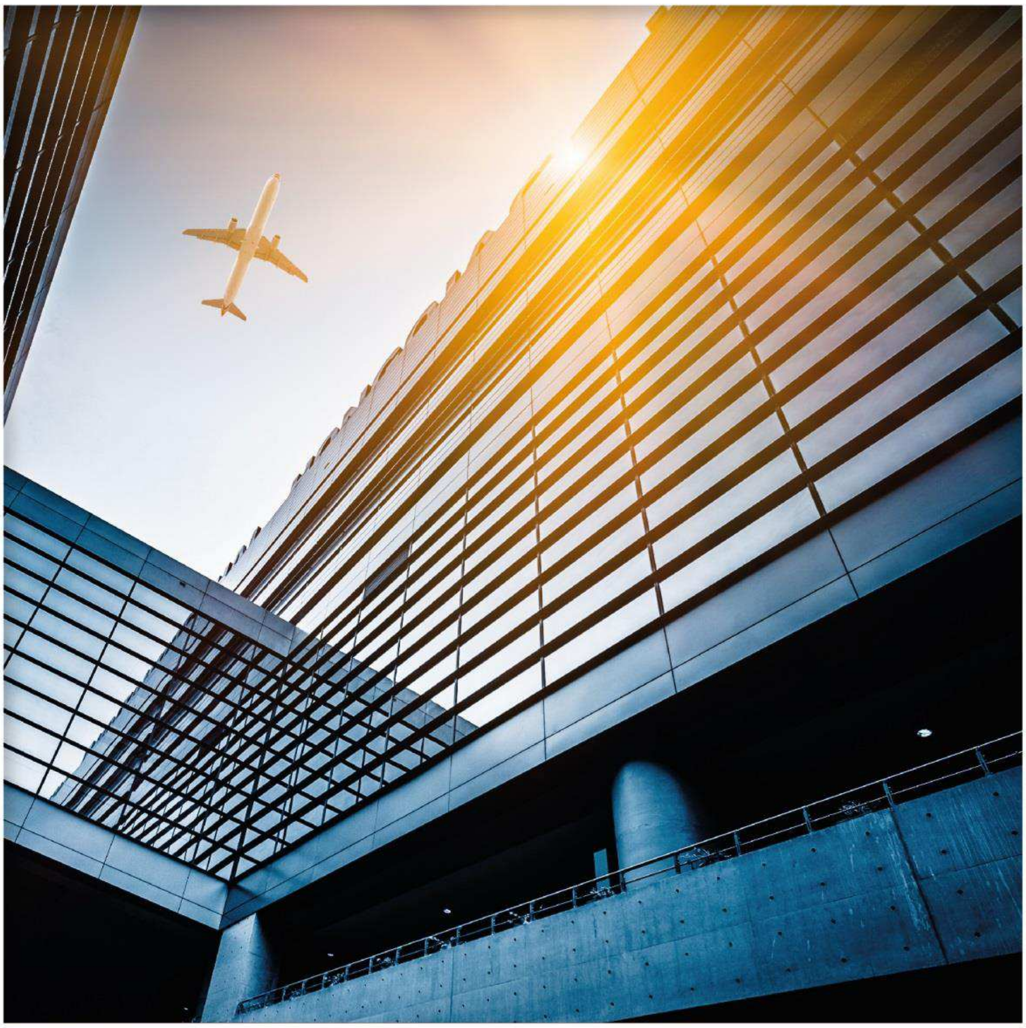
BANK GOSPODARSTWA KRAJOWEGO

Report on Risk Management and Capital Adequacy of Bank Gospodarstwa Krajowego as at 31 December 2014 (Pillar III)



PAŃSTWOWY BANK ROZWOJU

BGK LINIA 801 66 76 55 BGK.PL

Table of contents

Introduction

This document implements the provisions of Resolution No. 385/2008 of the Polish Financial Supervision Authority of 17 December 2008 on detailed rules and methods of publication of qualitative and quantitative information on capital adequacy by banks and the scope of published information (Official Journal of the PFSA, No. 8, item 39, as amended). In 2014 Bank Gospodarstwa Krajowego was not subject to the regulations of the so-called CRDIV/CRR package in consideration of Article 2(5)(18) of the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338) and Article 1 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

This report has been drafted in accordance with "The Principles of Information Policy of Bank Gospodarstwa Krajowego in the scope of publication of qualitative and quantitative information on capital adequacy"[1], approved by the Management Board and the Supervisory Board of the Bank.

Unless stated otherwise, the report was prepared as at 31 December 2014 based on data from the Bank's stand-alone financial statements. Information not covered by the certified auditor's review of the financial statements is verified by relevant organisational units of the Bank's headquarters.

[1] the document is available on the Bank's website: www.bgk.pl

Glossary

PFSA Resolution 76/2010 – resolution no. 76/2010 of the Polish Financial Supervision Authority of 10 March 2010 on the scope and detailed procedures for determining capital requirements for particular risks (Official Journal of the PFSA, No. 2, item 11, as amended)

PFSA Resolution 325/2011 – resolution no. 325/2011 of the Polish Financial Supervision Authority of 20 December 2011 on other deductions from own funds, their amount, their scope and conditions of their deduction from a bank's funds, other balance sheet items included in supplementary capital, their amount, scope and the conditions of their inclusion in supplementary capital, deductions from supplementary capital, their amount, scope and conditions of their deduction from supplementary capital and the scope and manner of treating the activity of banks that are members of capital groups in calculating own funds (Official Journal of the PFSA, No. 13, item 49)

PFSA Resolution 387/2008 – resolution no. 387/2008 of the Polish Financial Supervision Authority of 17 December 2008 on determining the credit ratings assigned by external credit ratings agencies, which can be used by a bank in order to determine capital requirements and on the scope of use of these ratings and their correspondence to credit quality levels (Official Journal of the PFSA, No. 8, item 41, as amended).

Regulation of the Minister of Finance on the principles of provisioning – Regulation of the Minister of Finance of 16 December 2008 on the principles of provisioning for risks underlying banks' activity (Journal of Laws, No. 235, item 1589, as amended)

CRDIV – Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338)

CRR – Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

ALCO – Asset and Liability Committee

BGK, Bank – Bank Gospodarstwa Krajowego

BPV – Basis Point Value

CC – Credit Committee

ChC – Change Committee

CRD – Credit Risk Department

CRMD – Credit Risk Management Department

DLD – Distressed Loans Department

FMSD – Financial Markets And Sales Department

FRD – Financial Risk Department

ICAAP – Internal Capital Adequacy Assessment Process

NHF – National Housing Fund – NHF was liquidated as of 31 May 2009 and its net assets were transferred to the Bank's statutory fund – in line with the Act of 2 April 2009 amending the Act on Sureties and Guarantees Granted by the State Treasury and Certain Legal Persons, the Act on Bank Gospodarstwa Krajowego and Certain Other Acts (Journal of Laws, No. 65, item 545)

ORC – Operational Risk Committee

PFSA – Polish Financial Supervision Authority

TD – Treasury Department

VaR – Value at Risk

WSE – Warsaw Stock Exchange

1. General information about the Bank

As a highly reliable state financial institution, Bank Gospodarstwa Krajowego specialises in services for the public sector. The Bank ensures economically efficient and operationally effective support for the government's social and economic programmes as well as local governance and regional development programmes.

The volume of support from the State Treasury is determined by the provisions of the Act of 14 March 2003 on Bank Gospodarstwa Krajowego (Journal of Laws 2014, No. 510, as amended) that oblige the Minister responsible for public finance to provide BGK with own funds at a level guaranteeing the fulfilment of the Bank's tasks and compliance with liquidity limits.

Moreover, credit rating agency Fitch Ratings has confirmed the high reliability of Bank Gospodarstwa Krajowego by assigning it a credit rating of "A-", a level equal to Poland's rating.

2. Risk management principles at the Bank

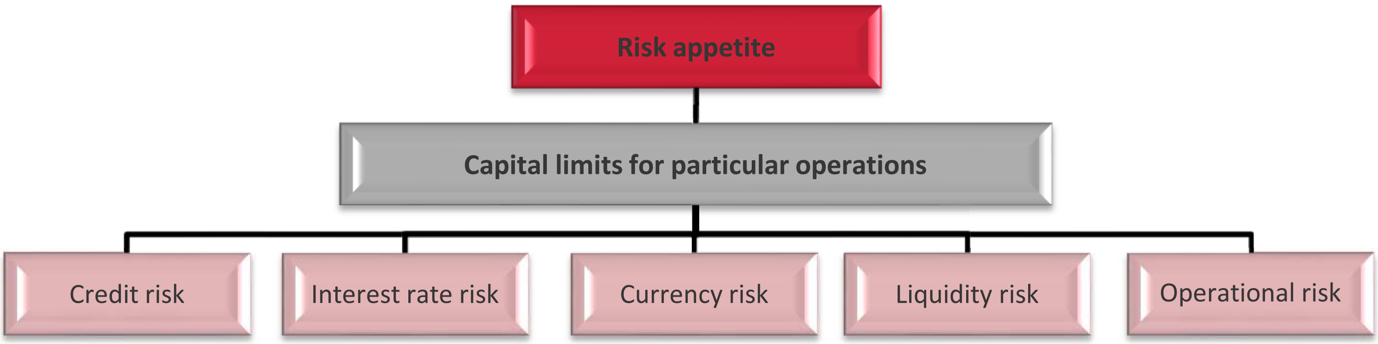
2.1. General risk management principles

The internal objective of risk management at the Bank is to maintain high quality of assets within an acceptable risk level.

The main risk management guidelines at BGK are defined in the Bank's Strategy and policies for managing particular types of risks. Risk appetite is determined by the acceptable levels of the capital adequacy ratio and internal capital ratio, as well as the acceptable level of particular risks. In the allocation process, the required capital is distributed among particular risk types, determining limits levels defined for particular risks at BGK.

A general chart of BGK limits is presented below.

Diagram 1. BGK limits



The Bank's risk management is based on:

- BGK Capital Management Policy and BGK Internal Capital Adequacy Assessment Process Principles approved by the Supervisory Board,
- risk management policies, principles, and procedures related to identification, measurement/assessment, monitoring, reporting and risk control, developed in written form and approved by the Supervisory Board or the Management Board,
- corporate governance principles, principles of selection, remuneration and monitoring of employees performing crucial functions for the Bank and Policies of variable pay of persons holding managerial positions.

Internal regulations are subject to regular review to adjust them to changes in the Bank's risk profile, the Bank’s economic environment and prudent banking practices.

The risk management system is designed to ensure a uniform and efficient process of identification, measurement/assessment, monitoring, reporting and controlling of risks, and to take safety measures.

The risk identification process includes determination of risk types, their sources (factors), significance and relationships between individual types of risk.

The risk measurement/assessment process includes methods of risk quantification, determination of the acceptable risk level, identification of relationships, patterns, and trends as well as estimation of the costs of the risk borne and performing stress tests.

The risk monitoring process includes supervision of the level of risk taken, reviews of relevance and accuracy of the applied methods of risk assessment and evaluation of efficiency of the tools used.

The risk reporting process includes information on the risk profile, identification of possible threats and information on the measures adopted.

The safety measures include regulations (policies, principles, instructions, methodologies, procedures, by-laws and emergency plans), internal limits, risk control, recommendations for organisational units of the Bank's headquarters and branches, as well as insurance and risk transfer.

Diagram 2 shows the Bank’s risk management organisation.

Diagram 2. The Bank’s risk management organisation

	Risk management supervision	Risk appetite	Strategic risk management	Tactical risk management	Risk monitoring
Credit Risk	Supervisory Board	Supervisory Board Management Board	Management Board CC	CC	CRD CRMD DLD
Market Risk	Supervisory Board	Supervisory Board Management Board	Management Board ALCO	TD FMSD	FRD
Liquidity Risk	Supervisory Board	Supervisory Board Management Board	Management Board ALCO	TD	FRD
Operational Risk	Supervisory Board	Supervisory Board Management Board	Management Board ORC	Each internal unit	FRD
Capital adequacy	Supervisory Board	Supervisory Board Management Board	Management Board ALCO	Each business unit	FRD

2.2. Risk management organisational structure

The composition, scope of activity and competences of the Bank's bodies and the corporate object of the Bank are defined in the BGK Act, the Bank’s statutes and these bodies’ by-laws. Presented below are the Bank's bodies and leading organisational units of the Bank's headquarters that participate in the risk management process.

Supervisory Board

The Supervisory Board supervises the compliance of the Bank's policy on risk-taking with the strategy and financial plan of the Bank.

Audit Committee

The Audit Committee supports the Bank's Supervisory Board, in particular through oversight over risk management as it assesses the adequacy of the management strategy for the risks that the bank considers relevant.

Management Board

The Management Board of the Bank is responsible for organising and administering the risk management process and ensuring the efficiency of the risk management system. One of the Management Board members supervises the banking risk area that covers organisational units managing credit, financial, operational and other risks.

Asset and Liability Committee

The primary objective of the Committee is to define the short-, mid- and long-term management policy for the Bank's assets and liabilities. The aim of the policy is to optimise results and allocate the Bank’s capital efficiently. It takes into account the relevant level of exposure to the Bank's own risk and the nature of public tasks commissioned to the Bank. These include tasks fulfilled by the Bank as part of the management of funds created, entrusted or transferred to the Bank under separate regulations or other legal acts.

Operational Risk Committee

The main objective of the Committee is to ensure efficient management of the operational and compliance risks. The Committee offers opinions and decisions. The Committee is responsible for reducing the operational and compliance risks, in particular through: initiation and coordination of activities aimed to identify, measure and monitor the operational and compliance risks; providing opinions on the level of limits reducing the operational risk and assessment of the risk reduction techniques applied for such risks. The Committee coordinates the activities aimed to identify, measure and monitor the reputation risk and the related reporting.

Credit Committee

The primary tasks of the Committee include: deciding on loan applications and applications for restructuring or debt collecting. It also provides recommendations to the Bank's Management Board on matters reserved for the competence of the Board, including the Bank's credit policy and exposure limits, performing quarterly reviews of the credit portfolio and deciding on the classification and the level of special provisions, annual reviews of industry sectors and deciding on their classification to relevant investment risk categories. In its decisions, the CC accounts for the credit risk, protects the Bank's operations and strives to ensure the efficiency of the recommended transactions.

Change Committee

The Committee offers opinions and decisions. The basic tasks of the Committee include management of the portfolio of projects within the scope of competence assigned to the Committee and approving, in connection with the Bank Strategy goals, of the basic principles on banking products, services, processes, applications and IT infrastructure.

Internal Audit Department

The Internal Audit Department reports directly to the President of the Management Board and is responsible for the independent assessment of the internal control system and risk management processes at the Bank and its subsidiaries, including the relevance and effectiveness of the existing control mechanisms. It is also responsible for consulting in the form of recommendations on improvements in the control mechanisms, or implementation of new solutions increasing the efficiency of the internal control system.

Financial Risk Department

The Financial Risk Department is responsible for creation and development of the efficient management system for the financial risks (liquidity, interest rate, currency, counterparty-bank and the country and capital adequacy) and non-financial risks (operational and model) risk management systems, supervising transactions on financial markets, calculating capital requirements for market and operational risks and short-term capital, estimating the internal capital and coordinating the ICAAP process.

Credit Risk Department

The Credit Risk Department is responsible for the individual credit risk management and the correct classification of:

- a client or a group of the entities associated with the client which is not a financial institution and is not included in the portfolio managed by the Distressed Loans Department,
- a credit transaction

and the correctness of collaterals established for individual credit transactions, exclusive of collaterals provided to financial institutions as part of the Bank-assigned exposure limits for banks.

Credit Risk Management Department

The Credit Risk Management Department is in charge of designing the directions and principles of the Bank's credit policy, credit risk management for the credit portfolio of the Bank, developing principles of credit risk assessment and methods of its mitigation, preparation of data concerning credit risk-bearing assets, as well as calculation of the capital requirement for credit risk and counterparty credit risk, coordination of the budgeting process for specific provisions and monitoring of the processes of provisioning and reversals of provisions as well as optimisation of credit processes.

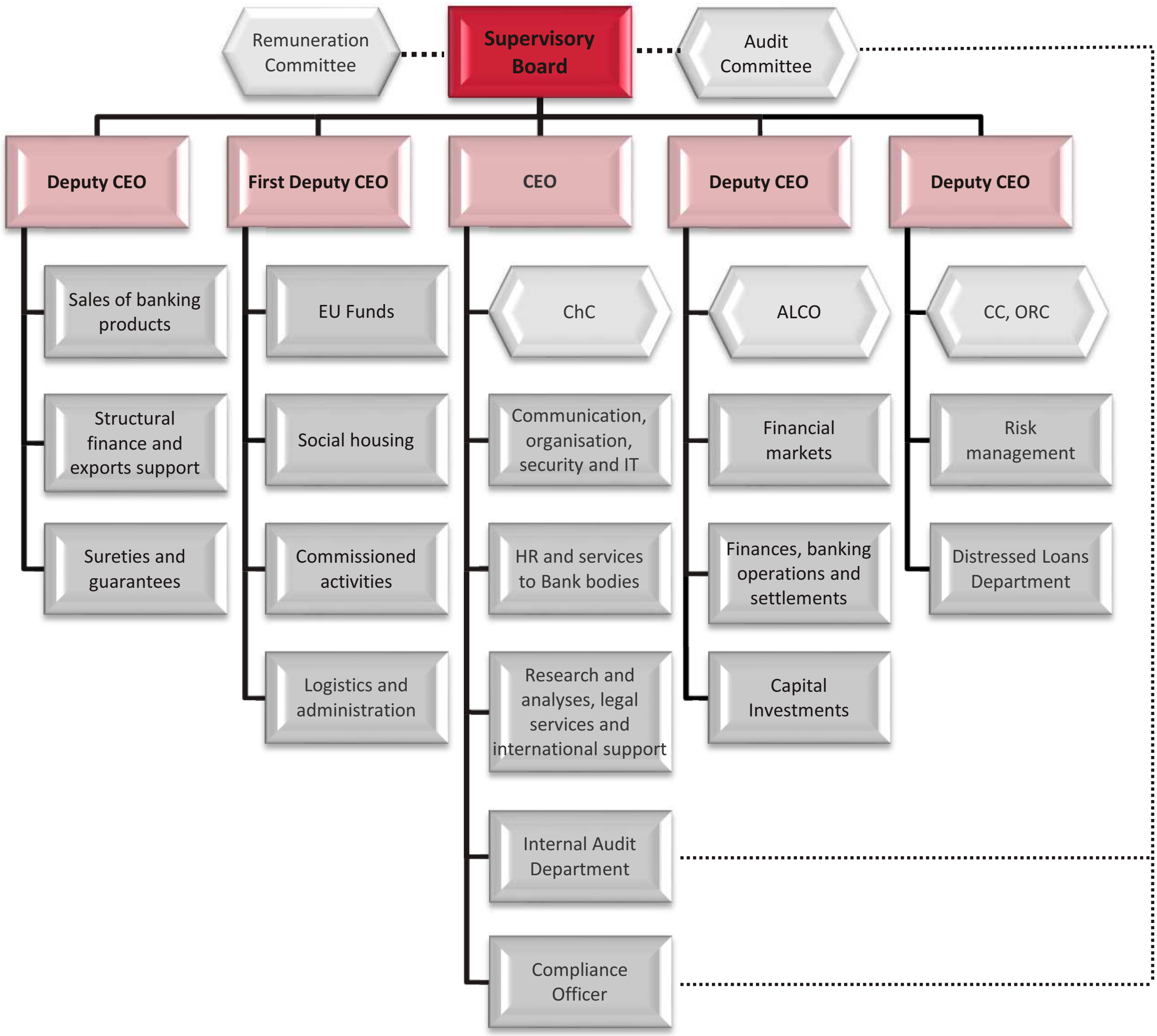
Distressed Loans Department

The Distressed Loans Department is in charge of restructuring activities and debt recovery, collection of receivables under credit agreements and collection of other receivables that require restructuring or recovery.

Compliance Unit

The Compliance Unit is responsible for the development and coordination of the compliance and reputation risk management process, carrying out compliance tests in key compliance risk areas as well as technical assistance in issues related to compliance risk. The Compliance Unit’s activities are supervised and managed by Compliance Officer, reporting directly to the President of the Management Board.

Diagram 3. General outline of the Bank's organisational structure as at 31 December 2014



On 6 February 2015 a new Vice-President of the Management Board was appointed to the Bank's Management Board. His tasks include supervision over banking operations and settlements, IT, logistics and administration.

2.3. Credit risk and counterparty risk

2.3.1. Credit Risk

Credit risk constitutes one of the most important risk types which the Bank is exposed to in its operations and which is defined as a threat of a borrower's default on the payment of liability under an agreement, i.e. failure to repay receivables under credit exposure along with the Bank's remuneration within time limits defined in the agreement. The main purposes of credit risk management are as follows:

- identification of credit risk areas and its mitigation to a level acceptable by the Bank,
- regular review of actions adopted in this risk area,
- shaping balance-sheet and off-balance-sheet items of the Bank to minimise the risk of negative deviation of the financial result from the Bank's financial plan.

The credit risk management process is carried out at the level of customer risk with individual credit exposure and credit portfolio risk taken into account, on the basis of:

- planned, targeted actions defined in the credit policy,

- internal regulations,
- available support systems and tools,
- recommendations for branches and other units of the Bank.

The Bank formalised its credit risk management approach in the Credit Risk Management Policy of Bank Gospodarstwa Krajowego and the Credit Risk Management Principles of BGK procedure. The Principles define the manner of credit risk assessment and measurement as at the conclusion of the transactions bearing the risk and during the transaction's life. The Principles also describe controls for the level of this risk in relation to individual transactions and the whole credit portfolio, including controls for the level of concentration risk.

The concentration risk is an important credit risk factor. The Bank has introduced relevant internal principles and procedures applied to concentration with particular emphasis on large exposures to singular customers and customer groups of the Bank. Concentration is monitored for individual borrowers, entities associated by capital or management, industries etc. Concentration principles concern various activities of the Bank (not only lending activity, but also investment activity or money market transactions).

The Bank applies methodologies of creditworthiness assessment for individual entities, taking into account the nature of their operation, and uses defined principles of acceptance and evaluation of legal collaterals.

The Bank monitors timeliness of repayment of liabilities under credit risk-bearing exposures and performs regular reviews of economic and financial standing of the borrowers. It classifies exposures and creates relevant specific provisions. It also maintains an adequate level of capital ensuring solvency in case of default on the part of the debtors.

The Bank controls the credit risk exposure level:

- in aggregate and for its own activities, as well as activities connected with the administration of funds established, entrusted, or transferred on the basis of separate acts,
- for concentration to one entity and/or associated by capital or management entities,
- for large exposures,
- in relation to particular economic sectors,
- separately under mortgage-backed exposures,
- in relation to selected segments and products,
- under currency or currency-indexed transactions,
- under off-balance sheet liabilities granted by the Bank (guarantees, sureties and letters of credit).

In May 2009, the Bank withdrew the offer of loan products for individuals. The only loans granted to individuals by the Bank as part of the implementation of the government programme are loans with interest subsidies for removal of flood disasters, landslides and hurricanes consequences (pursuant to the Act of 8 July 1999 on the interest subsidies for bank loans granted for removal of flood disaster consequences (Journal of Laws, No. 62, item 690, as amended).

The Management Board of the Bank defines the credit policy taking into account the Bank's risk appetite and strategy as well as the existing level of credit risk borne by the Bank, the structure of credit portfolio, the structure of legal collaterals, repayments of credit risk-bearing transactions and external macroeconomic factors. Among other elements, the credit policy indicates the acceptable level of risk for the credit portfolio, credit purposes and recommendations, credit profiles for particular customer segments and products, risk management process and the related prudent practices.

Pursuant to applicable regulations, the Bank performs - at least once a year - stress tests of credit exposure sensitivity to changes in the exchange rates, interest rates and the value of the existing collaterals.

The main instrument used to reduce the credit risk is legal collateralisation of the Bank's receivables. The Bank applies an internal procedure for the establishment and evaluation of legal collaterals for receivables as at the conclusion of the credit risk-bearing transactions and for monitoring the collateral during the transaction's life.

The basis for the value of real (in-kind) collaterals calculation is the value verified by the Bank using a ratio for adjusting the value of a collateral. In the case of unfunded credit protection, the economic and financial standing of the protection is examined. Moreover, the fulfilment of formal and legal conditions for collateral acceptance is verified each time, as well as whether it is funded and liquid and also its correlation with the economic and financial standing of the debtor.

In the life period of a credit risk-bearing transaction, the legal collateral is periodically monitored. The condition and value of the collateral is examined along with the possibility of satisfying the Bank's receivables from the collateral and the proportion of the current collateral value to the actual amount of receivables. The frequency of collateral monitoring depends on the form of collateral, the amount of credit exposure and risk assessment of the collateralised credit transaction.

Within the credit risk, BGK uses a system of limits as one of its credit risk management tools. The limits are applied both on the operational as well as strategic levels, in accordance with relevant competences. Depending on the risk profile of the exposure, the Bank applies the following limits:

- industry limits that reflect the risk stemming from the type of activity of the customer,
- objective limits, resulting from the risk borne by the purpose of the loan,
- subjective limits, defined depending on the customer type,
- product limits.

The internal limit types and amounts are approved by the Bank's Management Board or a relevant committee appointed by the Board. In internal procedures, the Bank defines the principles for setting and updating internal limit amounts as well as the frequency of monitoring their observance and reporting the monitoring results.

The portfolio credit risk monitoring process consists in a cyclical review of the values of limited parameters and analysis of the limit usage.

The current monitoring and reporting are of key importance to the credit risk management process. The risk profile information, as well as information on the possible threats and actions undertaken, is regularly prepared and communicated.

The distribution of credit decision competences at the Bank is an additional credit risk reducing factor.

2.3.2. Counterparty Credit Risk

The following methodologies are applicable at the Bank to define the principles for:

- assessment of the financial standing of the counterparty – bank,
- setting and monitoring of exposure limits granted for the counterparty - bank and the country,
- monitoring, classification and reporting of the current exposure to the counterparty - bank and the country.

The exposure limits are set to limit risk which should be understood as:

- in relation to counterparty – banks:
    - settlement risk connected with a possible default on BGK receivable by the counterparty - bank on the settlement date, when the total amount of a contract (agreement) is at risk, whereby the risk covers all cash flows taking place between BGK and the counterparty – bank,
    - pre-settlement risk, connected with a possible counterparty - bank's partial or full default on a payment obligation within a given lifetime, as a result of which the Bank can incur losses.

- in relation to countries:
  - political risk – risk connected with a possible negative impact of political decisions, conditions or events in a given country on the financial sector as a result of which investors will incur losses or lose profits,
  - economic risk – risk that the receivables will not be recovered as a result of a deteriorated economic situation in a given country.

This risk is reduced with the use of relevant limits:

- in the case of banks, these are:
  - settlement limit for interbank market transactions,
  - pre-settlement limit for interbank market transactions,
  - trade finance transaction limit,
  - banking group limit,
- in the case of countries:
  - country exposure limit.
  - treasury security issuer limit.

The current exposure affecting the limits for banks and other counterparties includes the positive valuation and volatility of market parameters.

Table 1 shows the credit quality distribution of BGK's existing bank exposures on the basis of external rating.

Table 1. Credit quality of counterparty - banks[2]	**structure (%)**
AA and higher	0,5%
A	83,0%
BBB	4,9%
BB and lower	0,7%
no external rating assigned by ratings agencies	11,0%
TOTAL	**100,0%**

Table 2 shows data of the positive gross fair value of derivatives.

Table 2. Positive gross fair value of derivatives as at 31 December 2014.[3]

Instrument type	**positive gross fair value total (in thousands of PLN)**
IRS	135 047,32
CIRS	135 815,47
OIS	34,59
FX Forward	6 563,74
FX Swap	248 585,09
Total	**526 046,21**

[2] this account is based on external ratings by Moody's, Standard&Poor's and Fitch Ratings, mapped onto a uniform AAA-B scale

[3] since the figures in the tables are rounded, differences in totals and percentages may occur in the document

In order to reduce the counterparty - bank credit risk, the Bank concludes Framework Agreements which make it possible to offset mutual receivables in justified events (“default event" and "termination event").

2.3.3. Credit risk reduction techniques

The Bank uses the following instruments and methods to limit or reduce the credit risk:

- risk diversification,
- risk hedging,
- risk distribution,
- risk compensation.

The Bank applies the Financial Collateral Comprehensive Method.

The value of a collateral is periodically monitored during the lifetime of a credit risk-bearing transaction. Should an unfavourable change occur in value of the collateral, the Bank implements adequate procedures.

The Bank accepts the following main types of collaterals:

- real property mortgage,
- bank guarantees and State Treasury guarantees,
- surety of a local government,
- registered pledge on movables,
- promissory notes.

Specific types of collaterals are established depending on the total Bank's exposure to the customer, economic and financial standing of the customer, customer and product type and other factors.

The main guarantors in the Bank's lending activity include local governments offering loan sureties. Each time before a collateral is established in the form of a local government’s surety, the economic and financial standing of the entity is examined in accordance with the rating and creditworthiness methodology for local governments applicable at the Bank. As a rule, only those local governments may be guarantors which are deemed creditworthy and have been positively assessed by the Regional Audit Chamber in terms of budget implementation and accuracy of the total debt.

Export credit transactions with counterparty – banks as part of the Government Programme for Exports Support are fully protected under insurance agreements concluded by the Bank with Korporacja Ubezpieczeń Kredytów Eksportowych S.A. (Export Credit Insurance Corporation, KUKE S.A.). The credit protection of KUKE S.A. is carried out in line with the general conditions of export credit insurance guaranteed by the State Treasury.

Table 3 shows credit protection forms for individual exposure types.

Table 3. **Exposures with credit protection under the Standardised Approach of capital requirements calculation as at 31 December 2014 (in thousands of PLN)**

Exposure class	Exposure amount	Credit protection			
		Guarantees	Financial collaterals	Total	%
Central governments and central banks	38 262 903	0	0	0	**0,00%**
Regional governments and local authorities	6 421 700	0	0	0	**0,00%**
Administrative bodies and non-commercial undertakings	358 965	123 199	563	123 762	**34,48%**
Institutions - banks	9 331 775	563 516	4 983 317	5 546 833	**59,44%**
Corporates	16 894 798	3 890 584	161 277	4 051 861	**23,98%**
Retail	715 545	0	1 056	1 056	**0,15%**
Secured on real estate property	9 836 521	381 066	43 683	424 749	**4,32%**
Past due items	553 911	0	0	0	**0,00%**
Exposures under regulatory high-risk categories	503 354	183 104	0	183 104	**36,38%**
Other	4 527 891	0	0	0	**0,00%**
TOTAL	**87 407 363**	**5 141 469**	**5 189 896**	**10 331 365**	**11,82%**

A predominant credit protection that ensures maximum risk reduction applies to transactions with other banks, secured with Treasury securities. Other risk reductions are possible due to guarantees accepted by the Bank, whose main issuers are local governments and the State Treasury. Primarily, local governments offer sureties for exposures of affiliated Social Housing Associations and municipal companies. Healthcare entities constitute a significant share of local governments' sureties as well.

2.3.4. Reduction of a customer's credit rating

If the credit rating of a customer is reduced, or the value of their collateral decreases, the Bank may demand from the debtor, during the lifetime of the credit risk-bearing transaction, to provide an additional collateral or to replace the existing collateral, depending on the individual risk rating. Such actions are provided for in debtor agreement templates.

2.3.5. Netting

As at 31 December 2014, the Bank did not use netting of transactions to estimate the capital requirement for credit risk and counterparty credit risk.

2.3.6. Tabulated data of credit risk and counterparty credit risk

Definitions

Definition of past due receivables

In its lending activities, the Bank defines past due receivables in line with the regulation of the Minister of Finance on provisioning principles and acts in accordance with the regulation.

Definition of impaired receivables

In its lending activities, the Bank defines impaired receivables and proceeds in line with the approach defined in the regulation of the Minister of Finance on provisioning principles. Impaired receivables are exposures classified under "substandard", "doubtful" and "lost" categories. Exposures are classified under particular categories on the basis of the assessment of the economic and financial standing of the customer and timeliness of repayment.

Definition of value and provision adjustments

The Bank applies the special provisioning principles for banking book defined in the regulation of the Minister of Finance on provisioning principles. There is also an internal instruction applicable at the Bank to regulate credit exposure classification principles and special provisions that defines the rules and procedures for decisions taken in this field. The decisions under consideration are taken on a quarterly basis, by way of a detailed credit portfolio review taking account of repayment timeliness, economic and financial standing of the entities and the condition of legal collaterals taken into account in reduction of the basis of special provisioning. In the case of negative phenomena, the Bank reclassifies the receivables and special provisioning also in periods between the quarterly portfolio reviews.

In the case of counterparty – banks, the Bank ascribes categories to the exposures (pursuant to the regulation of the Minister of Finance on provisioning principles) on the basis of the economic and financial standing of the banks and repayment timeliness analysis. The Bank sets economic and financial standing categories for banks on the basis of two criteria: rating and the amount of the banks' own funds.

In addition, the Bank creates a general risk provision and a general risk fund.

General information

The total amount of exposure under credit risk as per balance-sheet valuation (after accounting adjustments), excluding the results of credit risk and counterparty credit risk reduction, totalled PLN 87 407 363 thousands as at 31 December 2014.

The average amount of exposure by classes is shown in Table 4.

Table 4. Average exposure amount in 2014 by classes (in thousands of PLN)[4]

Central governments and central banks	3 257 911
Regional governments and local authorities	6 395
Administrative bodies and non-commercial undertakings	3 505
Institutions - banks	410 690
Corporates	68 275
Retail	659
Secured on real estate property	6 996
Past due items	2 754
Exposures under regulatory high-risk categories	26 920
Other	547 908

The Bank's financial administration of government institutions' ventures results in very high exposures both in the class of "Central governments and central banks" and the class of "institutions - banks."

Table 5 shows geographic structure of credit exposures by countries, while Table 6 shows geographic structure of domestic exposures by regions.

[4] the average calculated on the basis of quarterly data of exposures to individual customers of the Bank under a given class

Table 5. Structure of BGK exposures by geographic segments as at 31 December 2014 (in thousands of PLN)

Country	Central governments and central banks	Institutions - banks	Corporates	Secured on real estate property	Past due items	Other	TOTAL
Belarus	0	542 557	0	0	0	157 203	**699 760**
People's Republic of China	0	100 017	0	0	0	0	**100 017**
Russian Federation	0	34 656	176 270	0	0	0	**210 926**
France	1 231 150	453 250	0	0	0	0	**1 684 400**
Spain	617 815	0	0	0	0	0	**617 815**
Italy	304 476	0	0	0	0	0	**304 476**
Japan	0	289 842	0	0	0	0	**289 842**
Luxembourg	0	0	0	0	0	259 763	**259 763**
Germany	0	727 406	0	0	0	0	**727 406**
Poland	35 631 897	6 769 782	16 601 865	9 836 521	553 911	12 082 884	**81 476 860**
United States	477 565	196 390	0	0	0	0	**673 955**
United Kingdom	0	176 895	0	0	0	0	**176 895**
Other	0	40 979	116 663	0	0	27 606	**185 248**
TOTAL	**38 262 903**	**9 331 775**	**16 894 798**	**9 836 521**	**553 911**	**12 527 456**	**87 407 363**

Exposures to foreign entities result first of all from transactions with foreign banks as well as implementation of the Government Programme for Exports Support.

Table 6.	**Structure of BGK exposures by regions as at 31 December 2014 (in thousands of PLN)**

Province	Regional governments and local authorities	Corporates	Retail	Secured on real estate property	Past due items	Other	TOTAL
Dolnośląskie	923 078	533 721	6 720	1 049 481	14 138	20 667	**2 547 805**
Kujawsko-Pomorskie	359 631	30 912	4 756	597 318	310	39 239	**1 032 166**
Lubelskie	256 388	371 357	7 051	177 559	4 844	12 692	**829 891**
Lubuskie	235 100	1 488	5 119	3 658	62	65	**245 492**
Łódzkie	333 687	20 582	10 915	24 656	32 985	58 479	**481 304**
Małopolskie	519 740	687 668	7 535	1 262 730	127 876	39 090	**2 644 639**
Mazowieckie	1 392 546	11 965 099	616 707	2 362 113	163 088	47 080 352	**63 579 905**
Opolskie	88 171	40 032	2 782	294 638	3 009	2 563	**431 195**
Podkarpackie	153 072	25 764	2 228	57 314	46 674	7 672	**292 724**
Podlaskie	232 524	18 629	3 405	353 638	6 050	4 907	**619 153**
Pomorskie	470 149	522 187	5 254	484 820	69 603	9 715	**1 561 728**
Śląskie	178 316	1 170 151	6 457	1 232 179	16 682	3 774	**2 607 559**
Świętokrzyskie	173 320	41 436	1 498	57 452	6 062	0	**279 768**
Warmińsko-Mazurskie	474 298	25 354	11 981	26 929	2 534	21 069	**562 165**
Wielkopolskie	372 558	1 035 199	12 453	1 123 564	51 791	41 043	**2 636 608**
Zachodniopomorskie	259 122	112 286	10 684	728 472	8 203	5 991	**1 124 758**
TOTAL	**6 421 700**	**16 601 865**	**715 545**	**9 836 521**	**553 911**	**47 347 318**	**81 476 860**

Approximately 78% of the exposures are for the Mazowieckie province because of the concentration of central government bodies in this province, where the exposures constitute the greatest part of the Bank's portfolio.

Table 7 shows the structure of BGK impaired exposures by regions.

Table 7. **Structure of BGK impaired exposures and established specific provisions by regions as at 31 December 2014 (in thousands of PLN)**

Province	Impaired exposures	Structure (%)	Established special provisions
Dolnośląskie	174 228	6,55%	19 049
Kujawsko-Pomorskie	91 318	3,43%	5 497
Lubelskie	250 449	9,41%	22 633
Lubuskie	56 906	2,14%	9 146
Łódzkie	95 767	3,60%	32 481
Małopolskie	194 509	7,31%	86 290
Mazowieckie	370 723	13,93%	81 609
Opolskie	8 246	0,31%	2 116
Podkarpackie	122 643	4,61%	56 271
Podlaskie	51 695	1,94%	19 293
Pomorskie	159 139	5,98%	69 878
Śląskie	736 192	27,67%	131 990
Świętokrzyskie	43 337	1,63%	11 042
Warmińsko-Mazurskie	28 376	1,07%	7 456
Wielkopolskie	152 136	5,72%	43 723
Zachodniopomorskie	125 382	4,71%	22 964
TOTAL	**2 661 045**	**100,00%**	**621 439**

Most impaired exposures are present in Śląskie, Mazowieckie and Lubelskie provinces. Impaired exposures in Śląskie mostly result from financing of coal mining entities. In the case of Mazowieckie, to a large extent this results from a substantial share of historic developer exposures of 2006-2009 and then from exposures of the former National Housing Fund (NHF). In the case of Lubelskie, the main reason for the substantial level of impaired loans are the exposures of the former NHF and transactions with enterprises.

Tables 8 and 9 show BGK exposure structure by industries and exposure quality.

Table 8. Structure of BGK exposures by industries as at 31 December 2014 (in thousands of PLN)

	Regional governments and local authorities	Corporates	Retail	Secured on real estate property	Past due items	Other	TOTAL	Structure (%)
Public administration, national defence, compulsory social security	6 420 654	0	0	29 514	0	30 577 459	**37 027 627**	**45,45%**
Construction	0	1 041 616	4 582	6 043 506	344 398	26 442	**7 460 545**	**9,16%**
Finance	0	1 105 382	620	49 051	49	16 358 559	**17 513 660**	**21,50%**
Scientific, professional, technical, and educational activities	0	727 804	3 773	71 829	214	34 441	**838 061**	**1,03%**
Mining and extraction	0	993 316	61	591 872	66 030	449	**1 651 727**	**2,03%**
Wholesale trade	0	452 963	18 906	291 955	25 844	0	**789 668**	**0,97%**
Hotels and restaurants	0	6 098	8 170	24 208	24 772	0	**63 248**	**0,08%**
Real estate market, management	0	145 338	4 900	315 783	13 749	6 900	**486 670**	**0,60%**
Health care and social assistance	0	11 712	3 496	127 282	0	319 903	**462 392**	**0,57%**
Other services, sports, entertainment, and recreation	0	3 210	1 306	56 693	0	6 136	**67 346**	**0,08%**
Industrial processing	0	2 140 643	14 422	618 627	28 096	1 021	**2 802 810**	**3,44%**
Transport, storage and communication	0	4 733 172	7 574	264 356	21 782	12 196	**5 039 080**	**6,18%**
Electricity, gas and water supply	0	5 236 860	5 704	1 275 571	6 052	3 811	**6 527 998**	**8,01%**
Other (individuals, no Polish Classification of Activity (PKD) number)	1 046	3 752	642 032	76 273	22 926	0	**746 028**	**0,92%**
TOTAL	**6 421 700**	**16 601 865**	**715 545**	**9 836 521**	**553 911**	**47 347 317**	**81 476 860**	**100%**

The portfolio structure is dominated by public administration and finance as a result of well-developed cooperation of BGK with central and local governments, which triggers the need to cooperate with financial entities to ensure funding and liquidity. A relatively large group of exposures is also constituted by the construction industry, mainly because of loans granted as part of the former NHF.

Table 9. BGK exposure quality by industries as at 31 December 2014 (in thousands of PLN)

INDUSTRY	Impaired exposures	Structure (%)	Established special provisions
Public administration, national defence, compulsory social security	224 988	8,45%	41 851
Construction	1 232 986	46,33%	253 890
Finance	174	0,01%	180
Scientific, professional, technical, and educational activities	34 196	1,29%	2 675
Mining and extraction	666 930	25,06%	162 129
Wholesale trade	43 336	1,63%	39 734
Hotels and restaurants	32 640	1,23%	17 419
Real estate market, management	38 689	1,45%	5 662
Health care and social assistance	45 608	1,71%	3 934
Other services, sports, entertainment, and recreation	16 702	0,63%	501
Industrial processing	106 879	4,02%	51 008
Transport, storage and communication	183 608	6,90%	9 554
Electricity, gas and water supply	8 250	0,31%	10 048
Other (individuals, no Polish Classification of Activity (PKD) number)	26 059	0,98%	22 855
TOTAL	**2 661 045**	**100%**	**621 439**

The construction industry has the worst quality structure in the BGK portfolio, which results from the make-up of the industry, comprising mostly loans granted to developers (in a substantial part at risk), as well as loans granted to the former NHF with a large share of at-risk exposures – reclassified as a result of a financial assessment of the customers. Mining and extraction is another industry with a poor quality structure due to the significant share of exposures on coal-mining entities that are classified in worse risk groups due to their financial standing.

Table 10 shows BGK exposure structure by maturity.

Table 10. Structure of BGK exposures by maturity as at 31 December 2014 (in thousands of PLN)

Original maturity	Exposures								TOTAL
	up to 1 month	between 1 month and 3 months	between 3 months and 6 months	between 6 months and 1 year	between 1 year and 3 years	between 3 years and 5 years	more than 5 years	past due	
Central governments and central banks	24 599 387	224 078	0	1 399 856	8 595 117	2 618 530	825 935	0	**38 262 903**
Regional governments and local authorities	0	0	2 500	10 212	42 755	251 494	6 114 739	1	**6 421 700**
Administrative bodies and non-commercial undertakings	0	770	0	6 905	12 749	73 749	264 792	0	**358 965**
Institutions - banks	4 408 797	1 103 498	1 281 389	1 394 541	369 373	35 498	738 679	0	**9 331 775**
Corporates	334	112 762	130 365	635 065	1 966 020	2 987 306	10 888 288	174 656	**16 894 798**
Retail	0	595 618	25	50	4 908	4 811	79 193	30 940	**715 545**
Secured on real estate property	0	30 000	0	47 481	261 005	412 305	9 079 495	6 235	**9 836 521**
Past due items	0	0	0	990	205	7	94 791	457 918	**553 911**
Exposures under regulatory high-risk categories	0	28 600	139	257 830	68 131	9 928	138 602	124	**503 354**
Other	0	4 527 891	0	0	0	0	0	0	**4 527 891**
TOTAL	**29 008 519**	**6 623 216**	**1 414 418**	**3 752 930**	**11 320 264**	**6 393 628**	**28 224 514**	**669 875**	**87 407 363**
Structure (%)	**33,19%**	**7,58%**	**1,62%**	**4,29%**	**12,95%**	**7,31%**	**32,29%**	**0,77%**	**100%**

Since the Bank performs a leading role in public finance consolidation, the exposures to government institutions and also to banks on the money market, maturing within 1 month, constitute the biggest group of exposures. Corporate exposures whose original maturity exceeds 5 years constitute another significant group in the portfolio, which results from the Bank's financing of large investment projects with long implementation and payment dates. Another significant group are loans whose original maturity exceeds 5 years and which were granted to Social Housing Associations and housing cooperatives as part of the former NHF as well as loans to local governments.

Provisions

Tables 11 and 12 present the balance of provisions and adjustments and related changes in 2014.

Table 11. Reconciliation of adjustments and special provisions of BGK for 2014 (in thousands of PLN)

Item	As at 01.01.2014	Write-offs created	Write-offs released	Charged to write-offs	Other adjustments	As at 31.12.2014
Special provisions	**656 419**	**348 976**	**-307 226**	**-76 851**	**119**	**621 437**
regular	11	0	-1	0	0	10
monitored	5 171	11 466	-7 141	0	5 143	14 639
substandard	95 223	145 553	-123 024	0	-30 546	87 206
doubtful	75 885	117 715	-113 328	0	23 058	103 330
lost	480 129	74 242	-63 732	-76 851	2 464	416 252

Provisioning for loan receivables is conducted in accordance with the regulation of the Minister of Finance on provisioning principles. The level of provisions is influenced by the deferred revaluation of receivables of the former NHF performed on the date of liquidation of the fund, i.e. 31 May 2009.

Table 12. Reconciliation of adjustments and provisions of BGK for 2014 (in thousands of PLN)

Item	Deferred income tax provision	Provisions for litigation	Provisions for pensions and other employee benefits (also for former employees)	Provisions for off-balance sheet (financial and guarantee) liabilities	General risk provisions	TOTAL
Opening balance	**43 020**	**34 848**	**14 851**	**164 685**	**297 058**	**554 462**
1. Provisions established	0	3 567	2 231	196 041	76 189	**278 028**
2. Provisions released	0	-15 043	-1 472	-178 760	-80 601	**-275 876**
3. Other value changes, of which:	65 473	-1 000	-735	-5 147	0	**58 591**
- change in the deferred income tax provision	65 473	0	0	0	0	**65 473**
- adjustment of fair value measurement of foregone loans of the former NHF	0	0	0	-5 147	0	**-5 147**
Closing balance	**108 493**	**22 372**	**14 875**	**176 819**	**292 646**	**615 205**

The Bank records each provision established and released on the basis of the purposes underlying their establishment or release – without compensation of the related costs and incomes, by individual events.

2.4. Liquidity Risk

Definition

The liquidity risk is a threat of losing the ability to pay liabilities in a timely fashion as a result of unfavourable changes in assets and liabilities, off-balance-sheet transactions, improper timing of current cash flows and the possible losses resulting from the foregoing.

The Bank applies liquidity risk management procedures which define how the risk is monitored and managed.

Liquidity risk management aims to:

- ensure and maintain the Bank's ability to meet its current and future liabilities, taking account of liquidity costs and return on equity,
- prevent liquidity crises,
- define solutions which will enable the Bank to survive a potential crisis (emergency plan).

Measurement

The Bank’s liquidity risk measurement system comprises the following methods:

- liquidity ratios, liquidity gap analysis, fund stability analyses, daily monitoring of the deposit base – applied for liquidity risk both at the operational and strategic levels,
- stress tests applied both at the operational and strategic levels – are used, among other purposes, to estimate the internal capital required to cover the liquidity risk under Pillar II.

Limits

A system of limits is an important liquidity risk management tool at BGK. Both limits and threshold values for specific liquidity ratios are applied.

The risk monitoring process consists in a cyclical review of the values of limited parameters and analysis of the limits usage.

In 2014, the Bank did not exceed the regulatory liquidity limits defined in PFSA Resolution no. 386/2008 of 17 December 2008 on the establishment of liquidity standards binding for banks (Official Journal of the PFSA, No. 8, item 40, as amended) or its internal limits of liquidity ratios.

Regulatory liquidity ratios are shown in Table 13.

Table 13. Regulatory liquidity ratios	**limit**	**31.12.2014**
M1 – short-term liquidity gap (in thousands of PLN)	0,00	7 835 318
M2 – short-term liquidity ratio	1,00	1,26
M3 – own funds to non-liquid assets ratio	1,00	29,02
M4 – own funds and stable external funds to non-liquid and limited-liquidity assets ratio	1,00	1,81

The liquidity coverage ratio (LCR)[5] calculated as at 31.12.2014 reached 359% – significantly above the limit which from 1 October 2015 will amount to 60%.

Risk reduction methods

In order to reduce risk and secure liquidity, the Bank applies the following measures:

- transactions on the money market, including deposit transactions, reverse repo, repo, purchase/sale of NBP (National Bank of Poland) money market bills, Treasury bills and bonds
- maintaining a portfolio of liquid securities,
- daily monitoring of the money balance and financing possibilities from NBP,
- facilities securing liquidity of the Bank,
- own bond issuances and deposit level management to optimise the structure of the sources of funding,
- emergency plans in case of emergency situations of reduced or endangered liquidity.

2.5. Market Risk

Definition

Market risk is understood as a threat of possible drop in the value of the Bank's financial instruments portfolio or Bank's results as a consequence of unfavourable changes in market parameters (exchange rates, interest rates and prices of debt and equity instruments).

The Bank applies market risk management procedures which define how specific risk types are monitored and managed.

The management of specific market risk types focuses on:

- for interest rate risk (including the debt securities price risk) – reducing the risk of losing a part of the interest income as a result of a change in market interest rates and the risk of an unfavourable change in the market value of the interest-bearing financial instruments held by the Bank,
- for currency risk – reducing the risk of losses as a result of changes in market exchange rates,
- for the equity securities price risk – reducing the risk of losses as a result of changes in equity prices.

[5] the ratio defined in the Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions (OJ L 11, 17.1.2015, p. 1)

Measurement

The Bank's market risk measurement system comprises the following methods:

- measures of position volumes – applied both at the operational and strategic levels, relating to the currency risk and the interest rate risk (including price risk),
- sensitivity measures for the purposes of detailed analyses (BPV, Duration, interest result sensitivity to change in interest rates) – used at the operational and strategic levels and relating to the interest rate risk and the price risk,
- value at risk (VaR) – measure used at the operational and strategic levels in relation to all categories of market risk,
- stress tests applied at the operational and strategic levels – used to estimate the internal capital required under Pillar II to cover the interest rate risk of the banking book, among other purposes.

Table 14 shows the Bank's overall currency position, the VaR for currency risk and BPV for the trading book.

Table 14. The Bank's overall currency position, VaR for currency risk and BPV for trading book as at 31.12.2104 (in thousands of PLN)

The Bank's overall position	113 885,1
VaR(1D) for the Bank's currency position	846,7
BPV for the trading book	35,0

Risk reduction methods

The Bank's system of limits is an important market risk management tool. BGK applies the following limits:

- for the interest rate risk – limits of sensitivity measures (BPV for the banking and trading book, interest income risks for the banking book) and loss limits are applied,
- for the currency risk – the Bank's overall position volume limits, trading book position limits and loss limits are applied.

The risk monitoring process consists in a cyclical review of risk measures and analysis of the limit usage.

2.6. Interest rate risk for the banking book

2.6.1 Type of interest rate risk for the banking book

The aim of interest rate risk management is to reduce the risk of losing a part of interest income as a result of a change in market interest rates and the risk of a unfavourable change in market value of the interest-bearing assets held by the Bank.

To a large extent, the interest rate risk is determined by the long-term loan portfolio (in particular of the former NHF), financed with funds leveraged from international institutions as part of long-term financing with the nearest repricing date of up to 3 months. Moreover, the interest rate risk in own activities is determined to a large extend by deposits at the Bank and the debt securities portfolio. Deposits with undetermined maturity are accounted for in interest rate risk analyses by customer group with the nearest repricing date of up to 1 month.

The customer option risk is managed in particular by the Bank's price policy and the table of fees and commissions. It is a general rule to limit the customer options with the use of zero or reduced interest rates when compared to the original arrangements in the case of early withdrawal of a deposit and a compensation commission at early loan repayment.

The interest rate risk at the Bank is managed in two fields:

- income risk understood as the risk of losing a part of interest income as a result of an unfavourable changes in market interest rates,

- price risk understood as the risk of a decrease in market value of the financial instruments portfolio held by the Bank due to an unfavourable change in market interest rates.

The income risk is managed by matching repricing dates of assets and liabilities.

The price risk is managed by relevant changes in the structure of the financial instruments portfolio, whose valuation depends on the level of market interest rates.

2.6.2 Financial result sensitivity to changes in interest rates

The Bank examines the interest rate risk in the scope of:

- income risk,
- price risk divided into banking book and trading book,
- stress tests and capital needs tests for the banking book.

The income risk is analysed on the basis of:

- gaps in interest fixing periods,
- simulation of interest result sensitivity – a method forecasting the impact of changes in market interest rates on the Bank's interest result (including various scenarios of changes in interest rates).

The Bank uses the following measures to assess its exposure to the income risk:

- interest rate gap ratio,
- aggregate interest rate gap ratio,
- anticipated amount by which the Bank's interest result can be decreased or increased at a given point in the future given an assumed change in market interest rates.

The Bank's income risk is analysed monthly based on balance-sheet and off-balance-sheet data as at the end of the last day of each month.

Table 15 shows the interest rate gap in the banking book.

Table 15. Interest rate gap in the banking book as at 31 December 2014 (in thousands of PLN)

	Interest fixing periods						
	up to 1 month	1-3 months	3-6 months	6-12 months	1-3 years	3-5 years	more than 5 years
Gap in interest fixing brackets	7 301 881	901 932	-2 715 991	-2 234 877	7 106 272	310 536	267 600
Aggregate gap	7 301 881	8 203 813	5 487 822	3 252 945	10 359 217	10 669 753	10 937 353

The change in the interest result given a ±2 p.p. change in interest rates is shown in Table 16.

Table 16.	The change in the interest result given a ±2 p.p. change in interest rates as at 31 December 2014 (in thousands of PLN)	
Book:	**change in rates by -2 p.p.**	**change in rates by +2 p.p.**
Banking	-287 539	64 717
PLN	-255 550	134 684
EUR	-18 399	-82 894
USD	-13 938	13 079
other currencies	348	-153
Trading	-1 029	1 029
Total banking and trading book	-288 568	65 746

The stress testing methodology for the interest rate risk consists in determining the change in the Bank's interest result assuming that the market interest rate curve shifts by 2 percentage points. The income risk estimated in this way determines the level of additional capital needs under the interest rate risk for the banking book.

For banking book instruments that are sensitive to the price risk, the risk is additionally measured on a daily basis with the use of BPV and VaR methods. As at 31.12.2014, BPV for the banking book amounted to PLN 1 153,1 thousand and VaR in the forecast period of one business day amounted to PLN 5 725,9 thousand.

2.7. Operational Risk

Qualitative information

The operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people or systems or as a result of external events. This definition includes the legal risk, but excludes the reputation risk and the strategic risk. The operational risk management is aimed to maintain an acceptable level of operational risk that does not pose a threat to the business operation.

The operational risk includes all important areas of the Bank's activities and all new, existing and modified products, processes and systems. It also takes account of internal factors (such as organisational structure, the nature of operation, IT systems used, customer characteristics, customer complaints, quality of staff, organisational changes and staff turnover) as well as external factors (the Bank's operational environment).

The process of operational risk management covers all branches/organisational units of the Bank's head office and a subsidiary which is supervised by relevant organisational units of the Bank's head office, in line with Organisational Regulations for BGK Head Office and their scopes of responsibility.

The operational risk is identified on the basis of:

- internal sources, including:
    - operating events,
    - self-assessment of the own risk of organisational units and branches,
    - assessment of processes within business lines,
    - assessment of high-risk products,
- external sources, including:
    - external loss data in the field of operational risk,
    - external studies.

The Bank assesses the actual threats under operational risk on the basis of:

- dynamics of key risk indicators,

- analysis of operational events.

In the field of operational risk, organisational units of the Bank's head office undertake, within the scope of their responsibility, relevant actions aimed to select and propose a method of protecting against and limiting the operational risk relevant for a given area.

Within the scope of their responsibilities, the Bank's organisational units secure operational areas at risk with the following security measures:

- emergency plans – to counteract and minimise negative impacts of unexpected events, including internal and external attacks which can negatively affect the organisation and its operation,
- insurance protection – insurance of assets against accidents and failures of electronic equipment, hardware and computer network losses resulting from forgery or fraud and civil liability,
- outsourcing selected IT, transport and or debt recovery services to external specialised companies,
- other security measures (legal, organisational, technical) such as procedures for recruitment, employee assessment and IT system access-granting, relevant contractual clauses, competence systems, training and inspections.

Should an elevated exposure level to the operational risk be recorded at the Bank, a relevant organisational unit presents an action plan to improve the existing state of affairs (taking account of individual risk operational categories), agrees it upon with the units that will implement it and submits it to the Operational Risk Committee for endorsement and then to the Bank's Management Board for approval. The Management Board of the Bank decides whether to implement, amend, or reject the plan.

Quantitative information

Table 17 shows information on operational loss events reported to the internal database in 2014.

Table 17. Operational loss events reported to the internal database in 2014 (cut-off threshold: PLN 5 thousands) (in thousands of PLN)

Event type	Number of loss events	Gross loss	Net loss
External fraud	2	3 453	2 742
Customers, products and business practice	1	10	10
Losses related to fixed assets	2	36	1
Transactions, delivery and operational processes management	3	211	175
Total	**8**	**3 709**	**2 927**

In 2014, the gross loss was generated in 93% by operational events belonging to the category of "External fraud".

Within "External fraud", 21% of the loss amount was recovered as a result of activities undertaken by the Bank, i.e. agreement with the customer and establishing the amounts of paid instalments.

The Bank did not record significant individual losses. The biggest gross individual loss of PLN 2 348 thousand constituted 0,5% of the Bank's net profit for 2014 – the Bank has created a provision for the potential loss which results from the Bank's accepting of falsified documents in the process of granting a guarantee.

2.8. Compliance Risk

The compliance risk includes the risk of legal or regulatory sanctions, financial losses and loss of reputation the Bank can incur as a result of lack of compliance with legal regulations, regulatory guidelines or generally accepted business practices and ethical standards, as well as internal policies and procedures applicable to the Bank's operations.

The compliance risk is connected with the operation of each organisational unit of the head office/branches of the Bank and the employees of the organisational units of the head office/branches are obliged to undertake steps to eliminate or minimise the compliance risk. The compliance risk management process also covers the Bank's subsidiary.

The unit responsible for coordination of the compliance risk management process is the compliance unit which develops and implements compliance risk management principles and methods for investigation procedures and compliance tests.

2.9. Other risks

Apart from the risks referred to in items 2.3 to 2.8, the ICAAP process has revealed the following risks as significant: settlement risk, reputation risk, business risk, risk of changes in macroeconomic conditions and model risk.

The Bank manages the risks which have been identified as significant by developing management procedures and estimating the internal capital in relation to these risks.

2.10. Risk reporting

Risk reporting takes place in strict accordance with internal regulations, in line with the competence principles adopted at the Bank. The procedures also include principles of conduct in the event of an elevated financial risk.

Table 18. Types and scope of reports

Risk type	Report types	Scope of reports
Credit Risk	on-going	usage of internal exposure limits in accordance with regulations on maintenance and monitoring of internal limits of BGK's maximum credit exposure usage of concentration limits defined in the Banking Act (Art. 71) information on the type of exposures, risk structure for the entire credit portfolio and usage of external and internal exposure limits
	periodic	extended information on the type of exposures, risk structure for the entire credit portfolio and usage of external and internal exposure limits information about stress tests for concentration risk report on lending activity based on the own and entrusted funds in the credit portfolio, taking account of mortgage-backed exposures
Counterparty - bank and country credit risk	on-going	usage of settlement and credit limits (limits for banks and exposure limits for countries), unsettled transactions on the interbank market; banks for which BGK suspended settlement of transactions, banks which were placed on a watch-list due to increased settlement risk on a given day
	periodic	usage of limits for countries and exposure limits for foreign and domestic banks
Liquidity risk	on-going	dynamics of liquidity gaps, usage of regulatory and internal liquidity limits, balance of the Bank's deposits, stability analysis for external funds and stress tests results
	periodic	dynamics of liquidity gaps, usage of regulatory and internal liquidity limits, stability analysis for external funds and stress tests results, simulations of liquidity ratios and long-term liquidity analyses
Interest rate risk	on-going	information on the usage of internal interest rate risk limits, BPV, Duration, Modified Duration, VaR, results due to changes in interest rates for debt securities portfolios, interest rate gaps in individual interest fixing periods, sensitivity of interest income, results of stress tests
	periodic	sensitivity of interest result, usage of internal interest rate risk limits, measures: VaR, BPV and results of stress tests

Equity securities price risk	on-going	information on equity securities, exclusive of structured positions in equities (i.e. positions that are deducted from the Bank's own funds or are classified as the Bank's fixed assets, or do not have an impact on the capital requirement level under credit risk), including VaR
	periodic	information on equity securities, exclusive of structured positions in equities, including VaR
Currency risk	on-going	information about the usage of internal currency risk limits, open currency positions, VaR, results due to changes in exchange rates, results of stress tests and the Bank's exposure level to the currency risk
	periodic	usage of internal currency risk limits, VaR, results of stress tests
Capital adequacy	on-going	dynamics of capital adequacy ratios, amount of the total capital requirement, internal capital and own funds, usage of capital limits and results of stress tests
	periodic	analysis of dynamics of capital adequacy indicators, amount of the total capital requirement, internal capital and own funds, usage of capital limits and results of stress tests
Operational risk	periodic	information on individual methods of operational risk measurement, i.e. analysis of the event database in the Operational Risk Registry, analysis of losses in the external database, key operational risk indicators; information resulting from the self-assessment of processes as part of active business lines at the Bank; analysis of the level of operational risk provisions; information on the measurement of operational risk in a subsidiary
Compliance risk	periodic	information about the fulfilment of specific tasks of the compliance unit in a given period, taking account of the compliance risk assessment and information about all incidents identified in a given period, complaints and stress tests

2.11. Equity exposures – not taken into account in the trading book

Table 19 shows equity exposures outside the trading book.

Table 19. Equity exposures – not taken into account in the trading book

1. Equity exposures not taken into account in the trading book as at 31.12.2014 in thousands of PLN

	Exposure type	Amount of the Bank's exposure	Balance-sheet valuation	Fair value	Purpose of acquisition	Valuation method
A.	Strategic own investments,	197 855	179 636	179 636	strategic	Valuated at cost and decreased by potential impairment.
	including surety funds	67 067	63 577	63 577		
B.	Other own investments – mainly classified as available for sale,	63 372	98 789	98 789	capital gain	1) For the companies listed on the WSE, the valuation is based on the fair value determined on the basis of the closing price of the last day of the reporting month (monthly), 2) For other companies, the valuation is at cost (contribution) and is decreased by potential revaluation or impairment allowance.
	including Companies listed on the WSE	61 480	98 141	98 141		
Total equity exposures not included in the trading book (A+B)		**261 228**	**278 425**	**278 425**		
2. Realised gains on sales, cumulated (for companies listed on the regulated market) – as at 31.12.2014, in thousands of PLN (cumulatively from the beginning of the year)						**0**
3. Total unrealised gains (losses) on sales (for companies listed on the regulated market) total unrealised gains (losses) on revaluation – as at 31.12.2014, in thousands of PLN						**36 662**

In 2014, the Bank did not have any equity exposures in the trading book.

3. Own funds

Own funds required to calculate the capital adequacy ratio are determined pursuant to Art. 127 of the Banking Act and PFSA Resolution 325/2011.

Own funds of the Bank include Tier 1 capital and Tier 2 capital, decreased by the positions defined in the Banking Act and the said PFSA Resolution.

In accordance with its statutes, the Bank holds the following Tier 1 capital items:

- principal funds (statutory fund, surplus fund and reserve fund),
- additional items of Tier 1 capital (fund for general banking risks, prior period undistributed profit, profit under approval and net profit for the current reporting period, calculated in accordance with the applicable accounting principles, decreased by all expected charges and dividends in amounts not higher than the amounts of profit verified by a certified auditor),
- deductions from Tier 1 capital, defined in the Banking Act and comprising:
    - intangible assets measured at the carrying value,
    - accumulated loss,
    - loss under approval,
    - net loss for the current period,
    - other deductions of the Bank's Tier 1 capital – defined by the PFSA, including capital exposures to financial institutions, credit institutions, domestic and foreign banks, when the exposure exceeds 10% of the capital (own funds) of the entity – deduction is equal to 50% of the exposure value.

Tier 2 capital of the Bank includes:

- revaluation of tangible fixed assets,
- other items approved by the PFSA,
- other items defined by the PFSA, including: 80% of the amount of unrealised profits on debt and equity instruments classified as available for sale,
- deductions from Tier 2 capital – defined by the PFSA, including capital exposures to financial institutions, credit institutions, domestic and foreign banks, when the exposure exceeds 10% of the capital (own funds) of the entity – deduction is equal to 50% of the exposure value[6].

Due to its significant trading activity, in the calculation of the capital adequacy ratio the Bank takes into account its short-term capital, if positive.

Short-term capital is determined as the market profit calculated cumulatively until the reporting date, decreased by known charges, including dividends, to the extent in which it was not included in own funds or distributed in another way, as an amount not exceeding the sum of capital requirements for market risk, counterparty credit risk, settlement and delivery risk and the exposure concentration limit in the trading book.

A detailed structure of own funds is shown in Table 20.

[6] when 50% of the exposure value is higher than the amount of Tier 2 capital, the difference shall increase the reduction of the Bank's Tier 1 capital

Table 20. Own funds structure (in thousands of PLN)	31.12.2014	31.12.2013
Tier 1 capital	**8 360 127**	**7 253 547**
1. Principal funds of the bank	**8 143 759**	**7 037 483**
– Statutory fund	7 564 083	6 517 031
– Surplus fund	579 676	520 452
2. Reserve fund	**76 831**	**76 831**
– Reserves fund plus prior period undistributed profit	76 831	76 831
– Net profit for the current period and profit under approval	434 613	740 306
– Adjustments of net profit for the current period and profit under approval	-434 613	-740 306
– Accumulated loss	0	0
– Tier 1 capital from revaluation	0	0
3. General risk fund	**155 500**	**155 500**
4. Deductions from Tier 1 capital	**-15 963**	**-16 267**
– Intangible assets	-15 963	- 16 267
II. Tier 2 capital	**128 387**	**67 999**
– Revaluation adjustment of debt and equity instruments classified as available for sales, transferred from Tier 1 capital to Tier 2 capital	119 410	59 022
– Revaluation of tangible fixed assets capital (fund) created on the basis of separate regulations	8 977	8 977
III. Deductions from Tier 1 capital and Tier 2 capital	**-146 658**	**-116 034**
– Deductions from Tier 1 capital	-73 329	- 58 017
– Deductions from Tier 2 capital	-73 329	- 58 017
Total own funds	**8 341 856**	**7 205 512**
Short-term capital	**31 664**	**4 022**
Own funds plus short-term capital	**8 373 520**	**7 209 534**

The growth of own funds in 2014 resulted from:

- a growth in the statutory fund as a result of additional funding of PLN 971,7 mln provided by the State Treasury
- inclusion of the 2013 net result of PLN 133,3 mln in own funds,
- a PLN 59,0 mln upward revaluation of debt and equity instruments classified as available for sale included in Tier 2 capital,
- a PLN 30,6 mln increase in deductions from own funds resulting from capital exposures to financial institutions.

Own funds calculated as at 31.12.2014 in accordance with the CRR regulations were PLN 262 mln higher compared to the own funds determined in accordance with the PFSA Resolution 325/2011.

The Bank deducts Tier 1 capital and Tier 2 capital by significant capital exposure to entities defined in Table 21.

Table 21. Shares deducted from own funds as at 31 December 2014 (in thousands of PLN)

Entity	Core corporate object	Share in capital (%)	Carrying value of shares
Krajowy Fundusz Kapitałowy S.A. (National Capital Fund)	Supporting activities for financial services	100,00%	20 500
Korporacja Ubezpieczeń Kredytów Eksportowych S.A. (Export Credit Insurance Corporation)	Insurance activity	36,69%	63 025
Towarzystwo Funduszy Inwestycyjnych BGK S.A.	Establishment and management of investment funds	100,00%	3 016
Lubuski Fundusz Poręczeń Kredytowych Sp. z o.o.	Surety activities	37,97%	3 000
Śląski Regionalny Fundusz Poręczeniowy Sp. z o.o.	Surety activities	46,08%	3 000
Fundusz Rozwoju i Promocji Województwa Wielkopolskiego S.A.	Surety activities	22,47%	3 000
Poznański Fundusz Poręczeń Kredytowych Sp. z o.o.	Surety activities	44,44%	2 000
Kujawsko-Pomorski Fundusz Poręczeń Kredytowych Sp. z o.o.	Surety activities	49,38%	2 950
Dolnośląski Fundusz Gospodarczy Sp. z o.o.	Surety activities	42,62%	7 800
Opolski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o.	Surety activities	48,27%	2 300
Bydgoski Fundusz Poręczeń Kredytowych Sp. z o.o.	Surety activities	31,09%	633
Fundusz Poręczeń Kredytowych Sp. z o.o. in Jelenia Góra	Surety activities	44,60%	640
Samorządowy Fundusz Poręczeń Kredytowych Sp. z o.o. in Gostyń	Surety activities	46,77%	6 730
Fundusz Poręczeń Kredytowych Sp. z o.o. in Jastrzębie Zdrój in liquidation	Surety activities	33,00%	746
Podkarpacki Fundusz Poręczeń Kredytowych Sp. z o.o.	Surety activities	49,99%	1 540
Zachodniopomorski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o.	Surety activities	47,39%	5 000
Toruński Fundusz Poręczeń Kredytowych Sp. z o.o.	Surety activities	35,56%	1 490
Bielski Fundusz Poręczeń Kredytowych Sp. z o.o.	Surety activities	24,24%	960
Warmińsko - Mazurski Fundusz „Poręczenia Kredytowe” Sp. z o.o.	Surety activities	36,19%	2 490
Małopolski Fundusz Poręczeń Kredytowych Sp. z o.o.	Surety activities	32,86%	839
Świętokrzyski Fundusz Poręczeniowy Sp. z o.o.	Surety activities	49,99%	4 999
Małopolski Regionalny Fundusz Poręczeniowy Sp. z o.o.	Surety activities	36,87%	8 000
Pomorski Regionalny Fundusz Poręczeń Kredytowych Sp. z o.o.	Surety activities	10,06%	2 000
TOTAL			**146 658**

Moreover, the Bank holds shares shown in Table 22 which do not require a deduction from own funds.

Table 22. Shares which do not require a deduction from own funds as at 31 December 2014 (in thousands of PLN)

Entity	Core corporate object	Share in capital (%)	Carrying value of shares
Mazowiecki Fundusz Poręczeń Kredytowych Sp. z o.o.	Surety activities	8,70%	3 460
European Investment Fund	Provision of guarantees, trading, holding and management of shares	0,11%	8 021
PZU S.A.	Insurance activity	0,18%	74 974
S.W.I.F.T	IT services	0,00%	3
Huta Jedność in liquidation	Metallurgy	0,59%	0
POLIMEX-MOSTOSTAL S.A.	Construction	1,06%	3 207
Elektrociepłownia BĘDZIN	Power industry	9,89%	3 811
PEKAES S.A.	Transport, forwarding	3,71%	12 196
POLNORD S.A.	Real estate development	1,96%	3 954
Polskie Inwestycje Rozwojowe S.A. (Polish Investments for Development)	Supporting activities for financial services	1,29%	15 000
BGK Nieruchomości S.A.	Services for the real estate market	100%	6 042
METANEL S.A.	Mining	5,97%	0
Wałbrzyski Rynek Hurtowy S.A.	Wholesale trade	10,74%	307
Fabryka Dywanów KOWARY S.A. in bankruptcy	Light industry	7,91%	0
Zakłady Sprzętu Instalacyjnego POLAM-NAKŁO S.A.	Electrical industry	19,92%	341
Krajowa Grupa Poręczeniowa Sp. z o.o.	Advertising	42,31%	452
TOTAL			**131 768**

4. Capital adequacy

Capital adequacy of the Bank is monitored with the use of the capital adequacy ratios defined in Art. 128, paragraph 1, points 2 and 3 of the Banking Act, i.e.:

- capital adequacy ratios (CAR),
- internal capital ratio understood as the proportion of internal capital to own funds increased by short-term capital.

Additionally, the Bank calculates the ratios in accordance with the CRR regulations, i.e.:

- Common Equity Tier 1 capital ratio (CET1 ratio),
- Tier 1 capital ratio,
- total capital ratio,
- leverage ratio.

In 2014, the Bank fulfilled capital adequacy limits defined in the Banking Act (capital adequacy ratio at a level of at least 8% and internal capital ratio at a level of 100% at most) as well as limits defined in the CRR.

Changes in values of the capital adequacy ratio and the internal capital ratio resulted mainly from:

- a growth in the amount of own funds referred to in part 3,

- development of the Bank's activity in the area of business financing.

Dynamics of capital adequacy ratios defined in the Banking Act and their components are shown in Charts 1 and 2.

Chart 1. Capital adequacy ratios

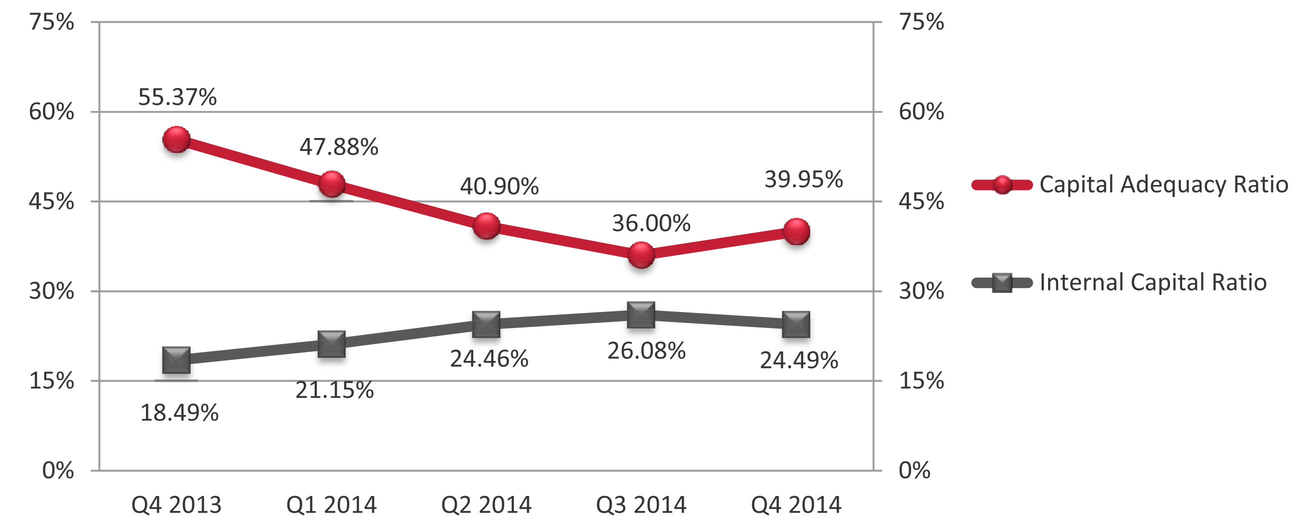
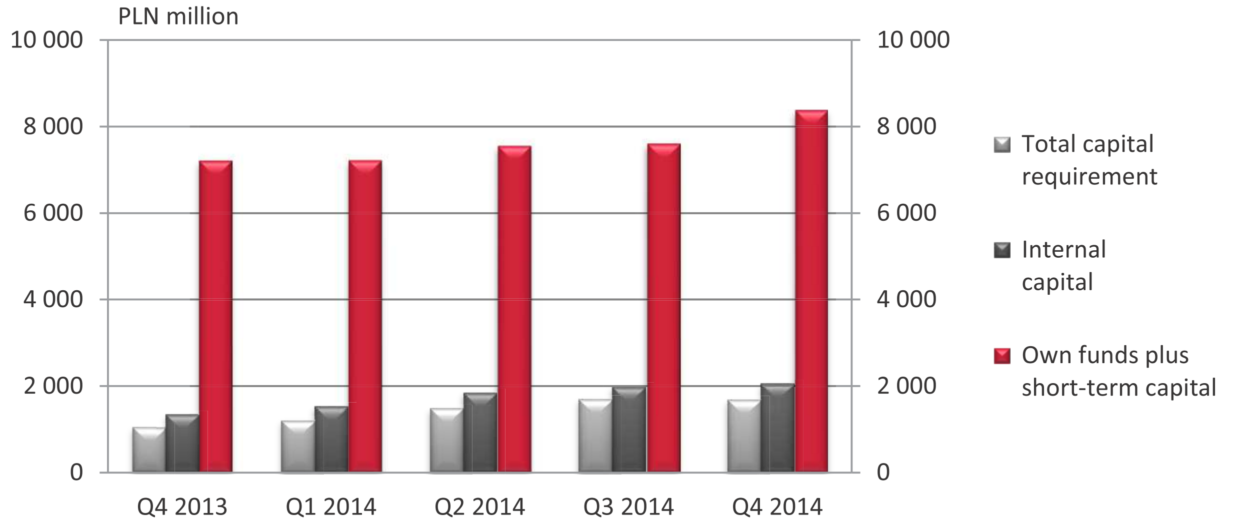


Chart 2. Components of capital adequacy ratios



Capital adequacy ratios under the CRR have been presented in Table 23.

Table 23. Capital adequacy ratios under the CRR as at 31 December 2014.

Ratio	Limit under the CRR applicable in 2014	Ratio level
CET1 ratio	4 - 4,5%	37,71%
Tier 1 ratio	5,5 - 6%	37,71%
total capital ratio	8%	38,85%
leverage ratio[7]	n/a	14,22%

[7] the ratio defined in the Commission Delegated Regulation (EU) 2015/62 of 10 October 2014 amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to leverage ratio (OJ L 11, 17.1.2015, p. 37) as Tier 1 capital divided by the total exposure measure as at 31.12.2014.

4.1. Capital requirements

In order to define minimum capital requirements for individual risk types (Pillar I), the Bank applies methods described in Table 24.

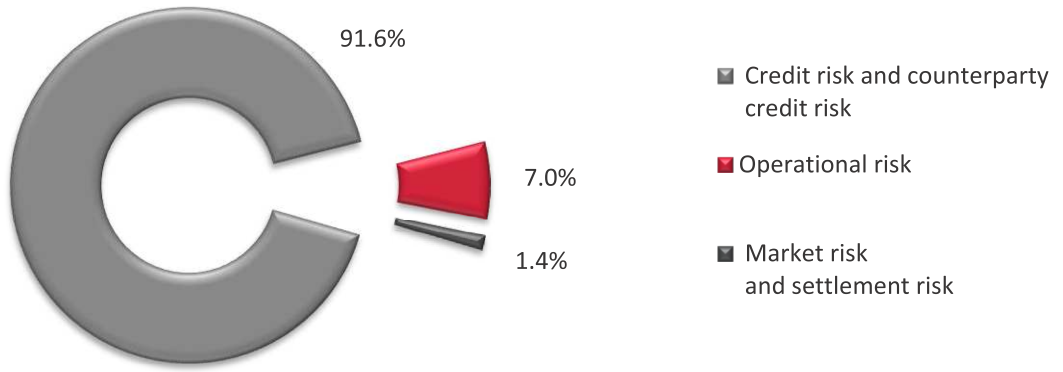
Table 24. Methods applied to define capital requirements

Capital requirement for:	Method
credit risk in banking book	standardised (part II of Appendix 4 to PFSA Resolution 76/2010) and financial collateral comprehensive method (Articles 67-78 of Appendix 17 to PFSA Resolution 76/2010)
currency risk in trading book and banking book combined	basic (part II Article 15 of Appendix 6 to PFSA Resolution 76/2010)
commodity price risk in trading book and banking book combined	simplified (part II Article 13 of Appendix 7 to PFSA Resolution 76/2010)
equity securities price risk in trading book	simplified (part III Article 10 of Appendix 8 to PFSA Resolution 76/2010) and in accordance with parts II and V of Appendix 8 to PFSA Resolution 76/2010
specific risk of debt instruments prices in trading book	basic (part II Article 14 of Appendix 9 to PFSA Resolution 76/2010)
general interest rate risk in trading book	maturity-based (part II Article 6 of Appendix 10 to PFSA Resolution 76/2010)
settlement risk and delivery risk in trading book and banking book combined and counterparty credit risk in trading book	in accordance with Appendix 11 to PFSA Resolution 76/2010, balance-sheet equivalent of derivative transactions with the use of MtM method (part III Article 10 of Appendix 16 to PFSA Resolution 76/2010)
exceeding the exposure concentration limit	in accordance with Appendix 12 to PFSA Resolution 76/2010
exceeding the capital concentration threshold	in accordance with Appendix 13 to PFSA Resolution 76/2010
operational risk	basic indicator (part II of Appendix 14 to PFSA Resolution 76/2010)

The amounts of capital requirements for individual risk types are shown in Table 25 and graphically – in Chart 3.

Table 25. Structure of BGK capital requirements (in thousands of PLN)	**31.12.2014**
Capital requirement for credit risk	1 527 475
Capital requirement for market, settlement, delivery and counterparty credit risk, exceeding the exposure concentration limit and capital concentration threshold	31 664
Capital requirement for market risk	22 595
Capital requirement for counterparty credit risk	8 931
Capital requirement for settlement and delivery risk	138
Capital requirement for exceeding the exposure concentration limit	0
Capital requirement for exceeding the capital concentration threshold	0
Capital requirement for operational risk	117 839
TOTAL	**1 676 978**

Chart 3. Structure of BGK capital requirements as at 31 December 2014



The total capital requirement calculated as at 31.12.2014 in accordance with the CRR regulations was PLN 95 mln higher compared to the total capital requirement determined in accordance with PFSA Resolution 76/2010.

4.1.1. Capital requirements – credit risk and counterparty credit risk

In order to assign risk weights to exposures, the Bank combines credit ratings with credit quality degrees, in accordance with PFSA Resolution 76/2010 and PFSA Resolution 387/2008. The bank uses credit ratings assigned by the following external ratings agencies:

- Fitch Ratings,
- Moody's Investors Service,
- Standard and Poor's Ratings Services.

The bank applies credit ratings assigned by external ratings agencies to the following exposure classes:

- Central governments and banks,
- Institutions - banks

Table 26 shows the value of exposures before and after application of credit risk reduction techniques for individual risk weights with the use of Standardised Approach of capital requirement calculation for credit risk.

Table 26. Exposures covered with credit protection under the Standardised Approach of capital requirements calculation as at 31 December 2014 (in thousands of PLN)

Risk weight	Exposure amount	Credit protection				Exposure after deductions
		Guarantees	Financial collaterals	Total	%	
0%	41 338 453	0	0	0	0,00%	41 338 453
20%	14 658 536	0	4 653 521	4 653 521	31,75%	10 005 015
35%	14 254	0	0	0	0,00%	14 254
50%	1 869 612	157 805	340 359	498 164	26,65%	1 371 448
75%	1 150 853	0	1 251	1 251	0,11%	1 149 602
100%	27 873 969	4 800 560	194 765	4 995 325	17,92%	22 878 644
150%	501 687	183 104	0	183 104	36,50%	318 583
Total	**87 407 363**	**5 141 469**	**5 189 896**	**10 331 365**	**11,82%**	**77 075 998**

Tables 27 and 28 show detailed information on capital requirements for credit risk and counterparty credit risk.

Table 27.	Capital requirement for credit risk and counterparty credit risk by risk weights (in thousands of PLN)	31.12.2014
risk weight	**capital requirement**	**Structure (%)**
0%	0	0,00%
20%	167 905	10,93%
35%	399	0,03%
50%	49 626	3,23%
75%	48 190	3,14%
100%	1 232 106	80,19%
150%	38 180	2,49%
TOTAL	**1 536 406**	**100,00%**

Table 28. Capital requirement for credit risk and counterparty credit risk by exposure classes (in thousands of PLN)	31.12.2014
Exposure class	**capital requirement**
Central governments and central banks	20 026
Regional governments and local authorities	110 275
Administrative bodies and non-commercial undertakings	7 117
Institutions - banks	81 656
Corporates	669 094
Retail	40 582
Secured on real estate property	548 814
Past due items	1 608
Exposures under regulatory high-risk categories	38 083
Other	19 152
TOTAL	**1 536 406**

The structure of capital requirements both in terms of risk weights as well as exposure class types reflects two main segments of the Bank's activity: loans for Social Housing Associations and housing cooperatives, granted from the funds of the former NHF – the exposure class: "secured on real estate property" (dominant risk weight of 100%) and loans and issues of corporate bonds – the exposure class: "Corporates" (dominant risk weight 100%).

4.1.2. Capital requirements - market risk

Table 29 shows the structure of capital requirements for market risk.

Table 29. Structure of capital requirements for market risk (in thousands of PLN)	31.12.2014
Capital requirement for currency risk	0
Capital requirement for commodity price risk	0
Capital requirement for equity securities price risk	0
Capital requirement for specific risk of debt instruments prices	0
Capital requirement for general interest rate risk	22 595
TOTAL	**22 595**

Due to the Bank's limited activity in this scope, the capital requirement for market risk was limited to the general interest rate risk in trading book determined for debt securities and derivative transactions.

4.2. Internal capital

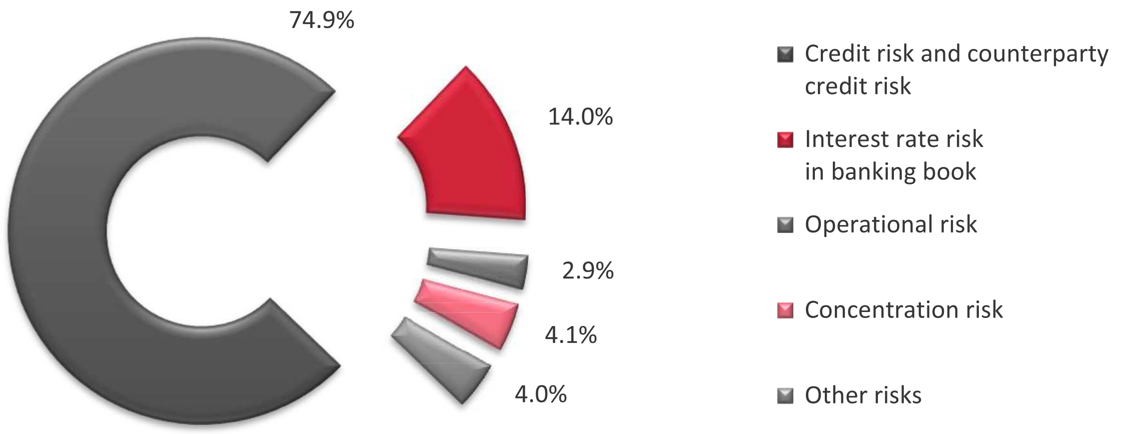
Internal capital (Pillar II) is an amount estimated by the Bank which is necessary to cover all identified significant risk types occurring in the Bank's operation as well as changes in the economic environment, and which takes account of the expected risk level.

The internal capital is estimated to cover risks identified as significant. For insignificant risks, the Bank does not establish internal capital to cover them.

The total amount of internal capital is determined as the sum of internal capital for individual types of risk.

As at 31 December 2014, internal capital totalled PLN 2 050 314 thousands and the internal capital ratio – 24,49%. The percentage structure of internal capital is presented in Chart 4.

Chart 4. Structure of internal capital as at 31 December 2014



5. Information on policy on variable components of remuneration of persons holding managerial positions

General principles of determining, awarding and payment of variable components of remuneration of persons in managerial positions at the Bank are defined in the Policy on Variable Components of Remuneration of Persons Holding Managerial Positions in Bank Gospodarstwa Krajowego, developed pursuant to Resolution no. 258/2011 of the Polish Financial Supervision Authority of 4 October 2011 and approved by the Supervisory Board of the Bank.

The process of development and implementation of the Policy on Variable Components of Remuneration of Persons Holding Managerial Positions in Bank Gospodarstwa Krajowego involves the Remuneration. The Committee's tasks include:

- monitoring and providing opinions on the policy on variable components of remuneration and its implementation, including the amounts and types of remuneration components for persons holding managerial positions at the Bank,
- preparation of recommendations for the Management Board on remuneration of persons holding managerial positions at the Bank,
- issuing opinions and monitoring variable components of remuneration of persons holding managerial positions at the Bank that are connected with risk management and compliance with the law and internal regulations,

- issuing opinions on the Bank’s internal audit unit reports on the review of implementation and execution of the principles of the variable components of remuneration of persons holding managerial positions.

Within the meaning of the Policy on Variable Components of Remuneration, managerial positions include:

- members of the Management Board,
- Managing Director responsible for the Bank's finance, whose duties are connected with the maintenance of the Bank's accounting books
- Managing Directors in charge of the following divisions:
    - financial markets,
    - risk management,
    - bank products management and sales,
- Compliance Officer,
- department heads responsible for:
    - credit and financial risks,
    - equity and infrastructure investments,
- heads of the following departments:
    - Internal Audit,
    - Legal,
    - HR.

Variable components of remuneration include in particular: quarterly bonuses, annual awards and recognition awards, paid to the above mentioned persons on the basis of the Bank’s regulations applicable to them due to employment relationship with the Bank in a given position, including regulations for bonuses and regulations for awards.

The annual variable remuneration of an employee holding a managerial position at the Bank cannot exceed 100% of the fixed component of the total remuneration.

Variable remuneration is awarded and paid depending on the financial situation of the Bank and when it is justified by the Bank's results, performance of a organisational unit of the Bank's head office and performance of the person holding a managerial position at the Bank.

The type and amount of variable remuneration is awarded based on the degree to which the employee fulfilled their tasks as well as work quality and performance. Variable remuneration also depends on whether the Bank has achieved a positive net financial result cumulatively from the beginning of the year.

Heads of the internal audit unit, the compliance risk management unit and organisational units in charge of risk management and HR matters are offered variable remuneration for the fulfilment of goals resulting from the functions they perform and their remuneration does not depend on economic results of the Bank's operation in areas controlled by them.

Tables 30 and 31 show the remuneration paid in 2014 to persons holding managerial positions within the meaning of the Policy on Variable Components of Remuneration of Persons Holding Managerial Positions in Bank Gospodarstwa Krajowego.

Table 30. Remuneration in main activity areas[8] (in thousands of PLN)

business line	fixed remuneration	variable remuneration
sales	1 425	416
risk management	801	218
other activity	1 086	394

Table 31. Remunerations in positions[8] (in thousands of PLN)

	members of the Management Board (7 persons)	persons reporting directly to a Management Board member and chief accountant (11 persons)	other persons holding managerial positions at BGK (2 persons)
fixed remuneration	1 273	2 763	549
variable remuneration[9]:	187	858	171
paid in cash	187	858	171
paid in financial instruments	0	0	0
variable remuneration with deferred payments, awarded	0	0	0
variable remuneration with deferred payments, paid out	0	0	0
payments related to starting and terminating employment relationship	0	0	0

[8] taking into account changes during the year

[9] including a simulation of the annual award for 2014 (as at the table preparation date, the annual award has not been paid out)