

**REPORT OF THE MANAGEMENT BOARD ON THE
ACTIVITIES OF
BANK GOSPODARSTWA KRAJOWEGO
CAPITAL GROUP IN 2018**

(comprising the report of the Management Board on the
activities of Bank Gospodarstwa Krajowego)

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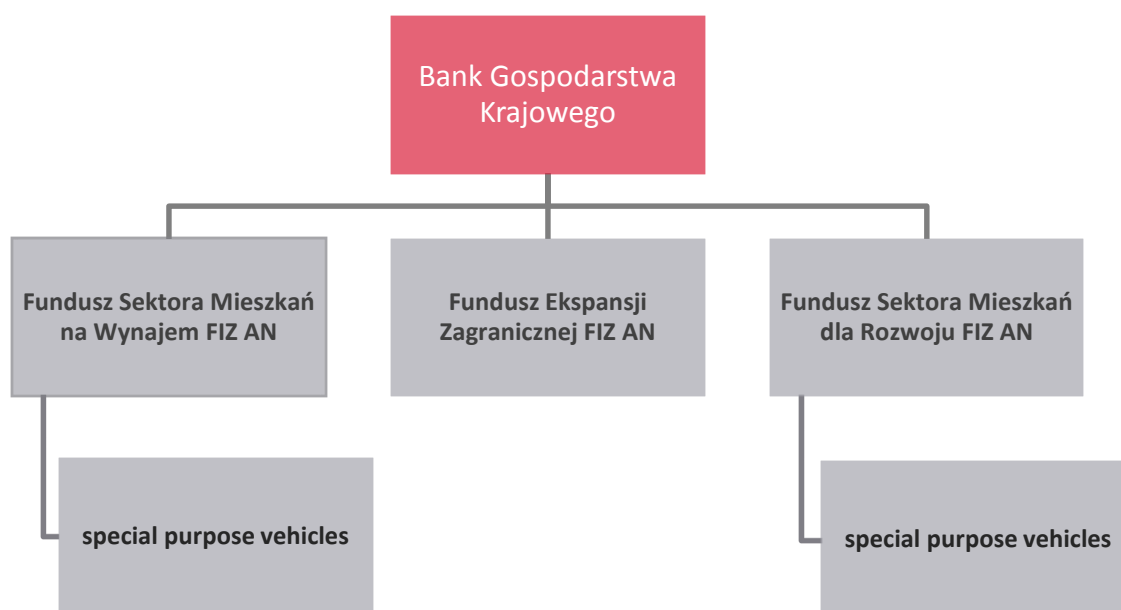
1. SUMMARY OF 2018

1.1 DESCRIPTION OF THE BGK GROUP

Bank Gospodarstwa Krajowego (BGK) is a state development bank whose mission is to support the social and economic development of Poland and the public sector in the fulfilment of its tasks. BGK and the BGK Group entities initiate and participate in cooperation between business, public sector entities and financial institutions.

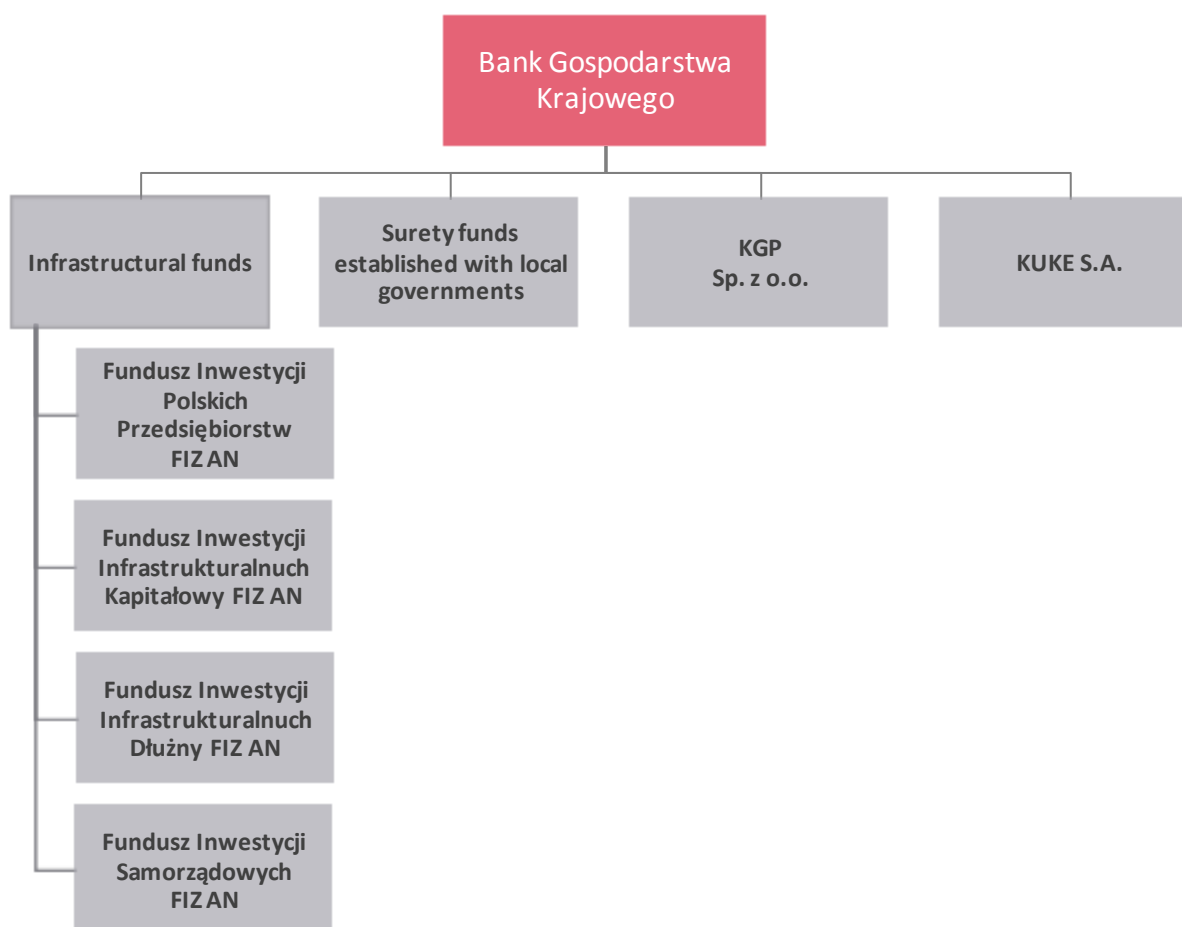
As at 31 December 2018, the Group consisted of the following entities consolidated with the full method and entities consolidated with the equity method.

Structure of the BGK Group as regards entities consolidated with the full method



- **Bank Gospodarstwa Krajowego** The only State-owned bank, which at the same time is a State development bank – the Parent of the BGK Group,
- **Fundusz Sektora Mieszkań na Wynajem FIZ AN** (Dwelling for Rent Sector Closed-End Private Equity Investment Fund) – for more information see Section 4.23.,
- **Fundusz Sektora Mieszkań dla Rozwoju FIZ AN** (Dwelling for Development Sector Closed-End Private Equity Investment Fund) – for more information see Section 4.23.,
- **Fundusz Ekspansji Zagranicznej FIZ AN** (Foreign Expansion Closed-End Private Equity Investment Fund) – Its business is to invest funds collected through a non-public offering for the purchase of investment certificates by acquiring and subscribing in shares of project companies. It supports foreign expansion by investing in shares of foreign entities owned by Polish companies.

Structure of the BGK Group as regards entities consolidated with the equity method



- **Infrastructural funds whose management has been entrusted by BGK to PFR TFI S.A., i.e.:**
 - Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN (Polish Enterprise Investments Closed-End Private Equity Investment Fund),
 - Fundusz Inwestycji Infrastrukturalnych – Kapitałowy FIZ AN (Equity Infrastructure Investment Closed-End Private Equity Investment Fund),
 - Fundusz Inwestycji Infrastrukturalnych – Dłużny FIZ AN (Debt Infrastructure Investment Closed-End Private Equity Investment Fund),
 - Fundusz Inwestycji Samorządowych FIZ AN (Local Government Investments Closed-End Private Equity Investment Fund).
- **Surety funds** established in cooperation with local government units,
- **Krajowa Grupa Poręczenia Sp. z o.o. (National Guarantee Group),**
- **Korporacja Ubezpieczeń Kredytów Eksportowych S.A. (Export Credit Insurance Corporation)**

For a detailed description and list of subsidiaries and associates, see the consolidated financial statements.

Bank Gospodarstwa Krajowego and the BGK Group entities focus their activities on four aspects:

- they carry out activities aimed at supporting the economic growth of Poland by financing infrastructure projects and local government projects and by co-financing the foreign expansion of Polish companies and export projects. BGK offers surety and guarantee schemes in order to stimulate entrepreneurship and the development of micro,

small and medium-sized enterprises. The Bank and group entities also operate programmes intended to improve the situation on the housing market;

- initiating and implementing actions aimed at supporting economic growth and enterprise development;
- mobilising capital in the economy – BGK stimulates the use of capital in the economy by participating in consortia and structuring transactions in the domestic and foreign markets. The Bank finances capital needs through cooperation with development institutions and the mobilisation of private capital through the development of guarantee and surety programmes;
- supplement the banking system by filling the market gap in key areas of the economy. BGK supplements the banking system, filling the market gap in key areas of the economy through programmes activating stagnant sectors and countercyclical initiatives. The Bank finances projects of significant importance to the market economy and associated with high risk and supports economic growth in areas where the market is inefficient. The Bank cooperates with other financial institutions on a partnership basis, complementing their offerings.

BGK is a leading institution in the process of consolidating public finances as well as the management of European programmes and the distribution of EU funds on a regional and national scale.

The Bank expands its product offer in the area of debt financing as well as surety and guarantee financing by investing in funds supporting the development of entrepreneurship of Polish enterprises and infrastructure development.

The activities carried out by the BGK Group have a wide development context. The implementation of activities in one area, such as financing reindustrialisation, has a positive impact on other areas, i.e. on labour market development, reduction of the unemployment rate or increase in state budget revenue. Infrastructure projects implemented by the BGK Group have a positive impact on improvement of quality and accessibility of services for the public, the environment and the economy.

The activities of the BGK Group are carried out in a responsible and sustainable manner, while maintaining a rational risk appetite. Projects intended to be implemented are analysed in terms of risk and their impact on the country's sustainable economic growth. In 2018, the liquidity of BGK was at a safe level and its level of capital adequacy, monitored using capital adequacy ratios determined in line with the Banking Law and CRR (Capital Requirements Regulation), was high.

Financing of housing

An important element of the Bank's and BGK Group's operations is the implementation of activities in the area of housing, debt financing, in particular of Social Housing Associations, and management of government programmes. BGK provides capital to Fundusz Sektora Mieszkań na Wynajem FIZ AN and Fundusz Sektora Mieszkań dla Rozwoju FIZ AN.

Support for exports and foreign expansion

The Bank and the BGK Group are actively supporting pro-export activities. The Bank is a shareholder of Korporacja Ubezpieczeń Kredytów Eksportowych S.A. (KUKE S.A.). Apart from its capital involvement, BGK is the main partner of KUKE S.A. in the implementation of the government export support programme, as part of which BGK grants export loans insured by KUKE S.A. In addition, BGK also finances export projects that are partially implemented at 'own risk', with supplementary security provided by KUKE S.A.

1.2 MAJOR EVENTS IN THE BGK GROUP

International Financial Reporting Standard 9

As of 1 January 2018 the Bank applies International Financial Reporting Standard 9 “Financial Instruments” (“IFRS 9”). IFRS 9 introduced significant changes in presentation and disclosure of financial instruments, changes concerning the principles for classification and measurement of financial instruments (especially financial assets) and a new model for impairment of financial assets based on expected loss.

The Bank decided to apply IFRS 9 which allowed it to be released from the obligation to transform comparative data for the previous periods with regard to changes resulting from classification and measurement (including impairment). The differences in the carrying amount of financial assets resulting from the adoption of IFRS 9 are recognised in item “Retained earnings” as at 1 January 2018.

Implementation of the requirements of MiFID II/ MiFIR

In January 2018, the Bank implemented the requirements of MiFID II/ MiFIR. The new regulations are effective in all EU Member States and relate to provision of investment and auxiliary services related to financial instruments – securities and derivatives. They also govern the provision of information to clients, recording of communication, remuneration of employees, management of conflicts of interests and transaction execution processes. Compliance with the relevant recommendations required a number of changes to be introduced at the Bank, including the implementation of several new IT systems.

Launch of the National Guarantee Fund (NGF)

The National Guarantee Fund has been operated by BGK since January 2018 under the Act of 8 May 1997 on Sureties and Guarantees Granted by the State Treasury and Certain Legal Persons (Journal of Laws of 2018, item 1808). The Fund has been operated as part of the government programme “Support of Entrepreneurship with BGK Sureties and Guarantees of Bank Gospodarstwa Krajowego”. Under the Act, in January 2018 BGK transferred PLN 900 million to the National Guarantee Fund from BGK’s authorised fund.

The commonly available guarantees for SMEs will promote the use of financial resources of Polish businesses and motivate them to invest, improving the efficiency of using EU funds. The establishment of the NGF makes it possible to use funds released from financial instruments of operational programmes at the central level of the current and previous financial perspective of the European Union, funds reallocated from BGK’s capitals and voluntary participation of stakeholders within any timeframe, thus diversifying the source of financing for de minimis guarantees.

Issue and redemption of notes for the National Road Fund

BGK arranged two issues of notes with a nominal value of EUR 500 million for the National Road Fund under the Euro Medium Term Notes (EMTN) Programme: 7-year notes maturing on 1 June 2025 with a fixed interest rate of 1.375%, and 12-year notes maturing on 1 June 2030 with a fixed interest rate of 2%.

On 24 October 2018, BGK redeemed IDS1018 notes with a total nominal value of PLN 11,652.5 million.

Sale of BGK Nieruchomości S.A.

On 3 October 2018, BGK sold BGK Nieruchomości S.A. to PFR S.A. in line with the previously adopted strategy of the Group’s reorganisation. Under the strategy, it is assumed that the funds, in which the Bank is an investor, will be managed by a single institution – Polski Fundusz Rozwoju S.A. BGK Nieruchomości S.A. successfully completed a pilot programme “Mieszkanie Plus” while still being a member of the BGK Group. BGK is still an investor in two housing funds (Fundusz Sektora Mieszkań dla Rozwoju FIZ AN and Fundusz Sektora Mieszkań na Wynajem FIZ AN).

The Bank will continue to carry out activities aimed at developing social and municipal housing in cooperation with local government units, housing cooperatives and other entities.

Changes regarding the support of the housing industry

In July 2018, the Act on State Subsidies to Household Expenses in the First Years of Tenancy was passed. It specifies the rules of awarding subsidies to cover part of the rent for an apartment. Subsidies are addressed to persons who cannot afford to rent or purchase an apartment in the market, and whose income is too high to apply for communal housing. The subsidy system also covered investments implemented as part of Social Rental Housing (SRH). The Act also amended the Act on Certain Forms of Support for Residential Construction. An amended Regulation of the Council of Ministers amending the regulation on the conditions and procedure for repayable funding provided as part of the government residential construction support programme implemented by BGK and on minimum requirements for apartments developed using such financing was signed in December 2018 and is due to become effective in February 2019.

Foreign agencies of Bank Gospodarstwa Krajowego

In May 2018, Bank Gospodarstwa Krajowego initiated an effort to establish its agencies abroad, whose primary purpose is to promote the Bank and Poland, monitor the process of international legislation, actively participate in preparation and amendment of legal acts, and support the export of Polish enterprises. The agencies are intended to support foreign expansion and attract foreign investors as a result of BGK's communication and promotional activities abroad.

In September 2018, BGK opened its first agency in Brussels. In 2019, the Bank intends to open further agencies in the EU and the United States of America.

1.3 IMPORTANT EVENTS FOR BGK GROUP IN 2018

Key events in 2018	
January	<ul style="list-style-type: none"> Launch of the Export Letter of Credit Programme in cooperation with commercial banks Launch of the final tranche of funds under the Apartment for the Young programme Obtaining an EUR 580 million loan from the European Investment Bank for funding the construction of a 157.5 kilometre section of the S19 expressway between Lublin and Rzeszów
February	<ul style="list-style-type: none"> Commencement of the call for applications under the “Credit for Technological Innovations” programme. BGK made available PLN 550 million to SMEs
March	<ul style="list-style-type: none"> PLN 300 million on regeneration and improvement of thermal efficiency in cities of the Wielkopolskie province – announcement of the call for applications for a loan
April	<ul style="list-style-type: none"> PLN 200 million on regeneration of cities of the Śląskie province – commencement of the call for applications for a loan Obtaining a EUR 500 million loan from the European Investment Bank for the National Road Fund (construction of sections of the S61 Via Baltica expressway from Ostrów Mazowiecka to the border with Lithuania in Budzisko)
May	<ul style="list-style-type: none"> Placement of a EUR 1 billion eurnotes issue for the National Road Fund! Commencement of the call for applications under the JESSICA 2 programme in the Province of Warsaw (PLN 130 million for investments related to regeneration)
June	<ul style="list-style-type: none"> Organisation of an international conference of guarantee institutions (AECM Annual Meeting) and execution – during the conference – of an agreement with the European Investment Fund on increasing aid under the COSME programme (guarantee instrument for SMEs) to PLN 4 billion
July	<ul style="list-style-type: none"> Entering into cooperation with foreign banks (from Egypt and Rwanda)
August	<ul style="list-style-type: none"> Sale of 100% of shares in Krajowy Fundusz Kapitałowy S.A. to Polski Fundusz Rozwoju S.A.
September	<ul style="list-style-type: none"> Opening of BGK’s first foreign agency in Brussels Signing of a letter of intent on the establishment of the Three Seas Fund during the summit of the Three Seas Initiative in Bucharest Execution of an agreement with the European Investment Fund on the launch of the Creative Europe programme – loan guarantees for SMEs from the creative and cultural sector
October	<ul style="list-style-type: none"> Execution of an agreement on financing the construction of a hospital in Żywiec – the first hospital project in Poland as part of a public-private partnership Presentation of BGK’s achievements on the Polish Economic Exhibition held in the initiative of the Chancellery of the President of Poland in the 100th anniversary of Poland’s independence Sale of 100% of shares in a subsidiary BGK Nieruchomości S.A. to Polski Fundusz Rozwoju S.A. Redemption of bonds issued by BGK to the National Road Fund with a nominal value of PLN 11.7 billion
November	<ul style="list-style-type: none"> Inauguration of the exhibition “History. Vision. Growth” at BGK’s registered office during the 100th anniversary of Poland’s independence
December	<ul style="list-style-type: none"> Execution by a syndicate comprising BGK and Pekao S.A. with Tramwaje Śląskie S.A. of an agreement on the financing of own contribution to the implemented investment project, co-financed by the EU from the Cohesion Fund Confirmation by Fitch, a rating agency, on 5 December 2018 of BGK’s credit rating at a level equal to the rating of Poland: long-term rating (IDR) of A- with a stable outlook

1.4 HISTORICAL OVERVIEW OF THE BGK GROUP

Establishment of BGK

Bank Gospodarstwa Krajowego is the only State-owned development bank in Poland. It was established by an order of the President of the Republic of Poland in 1924. During the interwar period, it focused on supporting public and municipal institutions as well as armament manufacturers, in addition to managing industrial plants the control of which was assumed by the State. The Bank also administered government special purpose funds and provided significant financial support to the modernisation and development of the Polish economy of that period, including the Central Industrial District and the city and sea port of Gdynia. After WWII, the operations of BGK were suspended in 1948.

Resumed operation in 1989

The Bank was reactivated in 1989 as an institution specialising in the provision of services to the public sector. The operations of BGK are governed by the Act on Bank Gospodarstwa Krajowego of 14 March 2003 with subsequent amendments and the Ordinance of the Minister of Development on the adoption of the Articles of Association of Bank Gospodarstwa Krajowego, dated 16 September 2016. Currently, BGK is the major institution supporting the State in the administration of socio-economic government programmes designed to promote entrepreneurship as well as infrastructure and residential investment at the national, regional and local level.

Establishment of the National Housing Fund (NHF)

One of the first funds implementing government programmes at BGK was the National Housing Fund, the main corporate object of which was to provide loans for the construction of social housing for rent and the auxiliary technical infrastructure. The legal basis of the NHF's operations was the Act of 26 October 1995 on Certain Forms of Support for Residential Construction. As of 31 May 2009, the National Housing Fund has been transformed into the Residential Construction Support Programme, whereas the portfolio of loans granted by the National Housing Fund is managed by BGK.

Establishment of the Subsidy Fund (SF)

The Subsidy Fund was established at BGK pursuant to the Act of 5 December 2002 on Interest Subsidies for Fixed-Rate Housing Loans. The Subsidy Fund commenced its operations in 2003 by subsidising interest on fixed-rate housing loans. In the first year of its operation, it also took over the programme of interest subsidies for loans and bonds as part of the refundable financing of investments and construction ventures carried out by BGK under a residential construction support programme operated by the government. In the following years, subsequent residential construction support programmes have been launched by the Fund. The Family's Own Home programme was launched under the Act of 8 September 2006 on the Financial Aid for Families and Other Persons Buying Their Own Apartment. A programme of financial aid for the development of social housing, assisted accommodation, lodging houses called "Budownictwo Socjalne" was launched in the same year under the Act of 8 December 2006. The Apartment for the Young programme was launched in 2013 under the Act of 27 September 2013 on State Aid Provided for the Purchase of the First Flat by Young People.

Establishment of the National Road Fund

The **National Road Fund (NRF)** was established with a view to finance the construction and reconstruction of national roads, including highways and expressways, as well as cover any expenditure due to toll motorway operators as well as expenditure related to construction and operation of toll collection systems on national roads. The Fund was established at Bank Gospodarstwa Krajowego under the Act of 27 October 1994 on Toll Motorways and the National Road Fund. The NRF started functioning as part of BGK in 2004.

Taking management of the government programme “Support of Entrepreneurship with Sureties and Guarantees of Bank Gospodarstwa Krajowego”

The support of access of micro, small and medium enterprises to financing for development needs, including investments, is carried out as part of BGK’s surety and guarantee operations. Such operations have been carried out under the government programme since 2009, in accordance with provisions laid down in the Act of 8 May 1997 on Sureties and Guarantees Granted by the State Treasury and Certain Legal Persons. The Bank carries out these operations directly in the form of surety and guarantee activities and by performing tasks related to the development of the system of regional and local surety funds.

Establishment of investment funds managed by TFI BGK S.A. (currently PFR TFI S.A.)

In carrying out the mission of supporting the economic growth of Poland, the Bank also actively carries out operations related to capital investments. These operations are carried out by closed-end investment funds and entities established by those funds. Investment funds were created by Towarzystwo Funduszy Inwestycyjnych (Investment Fund Company) established by BGK in November 2013. The first investment fund created by TFI BGK S.A. and managed by BGK Nieruchomości S.A. was Fundusz Sektora Mieszkań na Wynajem FIZ AN, which commenced its operations in November 2014. In 2015, next to commence their operations within the structure of the BGK Group were funds managed by PFR S.A., i.e. Fundusz Ekspansji Zagranicznej FIZ AN, Fundusz Inwestycji Infrastrukturalnych (Dłużny and Kapitałowy) FIZ AN, Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN, and Fundusz Inwestycji Samorządowych FIZ AN, established in mid-2015. The last fund was Fundusz Municipalny FIZ AN (Municipal Fund) created at the end of 2015, which was transformed into Fundusz Sektora Mieszkań dla Rozwoju FIZ AN. In September 2017, TFI BGK S.A. was sold to Polski Fundusz Rozwoju S.A., while retaining the right to appoint three members of the Supervisory Board.

PFR Nieruchomości S.A. manages the assets of Fundusz Sektora Mieszkań na Wynajem FIZ AN and Fundusz Sektora Mieszkań dla Rozwoju FIZ AN, whose sole investor is BGK.

1.5 KEY FINANCIAL DATA OF BGK GROUP FOR 2018

The BGK Group’s net profit for 2018 was PLN 514.1 million and was PLN 70.3 million lower compared to the profit earned in 2017. Worse performance was mainly attributable to higher impairment losses and provisions resulting from a larger loan portfolio and a conservative approach to recognition and measurement of credit risk. Net impairment losses and provisions, according to IFRS 9 was less than PLN 77.6 million, compared to the figure reported in 2017.

Administrative expenses grew slower (up 19.3%) than net banking income (up 20.4%).

TABLE 1: Key financial parameters of the BGK Group's operations

Item	Performance			Change
	2018	2017	2016	2018/2017
Profitability				
Net banking operations ¹ (in PLN million)	1,190.9	989.5	851.1	20.4%
Administrative expenses (in PLN million)	-470.3	-394.0	-354.8	19.3%
Net impairment losses and provisions (in PLN million)	-127.2	-49.6	-242.8	156.3%
Share of profit or loss of associates (in PLN million)	43.0	72.0	-55.7	-40.3%
Profit before tax (in PLN million)	601.6	690.5	263.5	-12.9%
Net profit (in PLN million)	514.1	584.4	257.0	-12.0%
Scale of activity				
Gross credit exposures (in PLN million)	32,820.6	27,223.8	24,631.5	20.6%
Investments in associates (in PLN million)	3,883.6	1,066.2	645.4	264.2%
Liabilities to customers (in PLN million)	47,637.3	33,692.3	37,109.3	41.4%
Total equity (in PLN million)	19,233.7	20,081.0	12,769.6	-4.2%
Balance sheet total (in PLN million)	84,772.3	74,314.0	66,746.6	14.1%
Operating performance²				
C/I ³ ratio on core activities	39.5%	39.8%	41.7%	-0.3 pp
C/I ⁴ ratio including other income and expenses	40.7%	37.1%	38.7%	3.6 pp
ROE (net profit / average total equity)	2.7%	4.0%	2.6%	-1.3 pp
ROA (net profit / average assets)	0.5%	0.6%	0.4%	-0.1 pp
Net interest margin (net interest income / average assets)	0.9%	0.8%	0.9%	0.0 pp

¹ Net interest and commission income, net gain/loss on financial instruments at fair value through profit or loss and net exchange differences, net gain/loss on investments in financial assets

² Carrying amounts for the period of 13 months (e.g. December 2017 – December 2018) were used as average balances used to calculate the measures.

³ C/I = (administrative expenses) / (interest income, net provisions, net gain/loss on financial instruments at fair value through profit or loss, net exchange differences and net gain/loss on investments in financial assets)

⁴ C/I same as above, with the proviso that the denominator includes other income/expenses and net modification gain/loss

The BGK Group closed the year 2018 with a balance sheet total of PLN 84,772.3 million. It went up by PLN 10,458.3 million, i.e. 14.1%, year on year. The said increase in the balance sheet total was mainly attributable to:

- an increase in credit exposures by PLN 5,596.8 million,
- an increase in investments in Group entities earmarked for investment activity by PLN 2,817.4 million,
- changes in assets and liabilities and equity resulting from the management of BGK's liquidity position.

ROE fell by 1.3 pp, to 2.7%, mostly as a result of a rise in average total equity from PLN 14,722.6 million in 2017 to PLN 19,218.5 million in 2018. ROA slipped by 0.1 pp, to 0.5%. The C/I ratio, taking into account other expenses and income, grew by 3.6 pp year on year, to 40.7%, mainly as a result of non-recurring events related to the recognition of impairment losses and provisions under other expenses, as described in detail in Section 6.3.

The C/I ratio on core activities improved from 39.8% in 2017 to 39.5% in 2018 as income grew faster than expenses.

The strong capital position of BGK Group at the end of 2018 improves the potential to achieve BGK's mission in future years and allows to increase lending and improve net interest income and expand investment activity supporting the country's economic growth.

1.6 KEY FINANCIAL DATA OF BGK FOR 2018

In 2018, the Bank reported a net profit of PLN 445.3 million, down by PLN 72.5 million as compared to the preceding year. The lower profit was attributable mainly to the change in net impairment losses (negative effect on the result amounting to PLN 115.6 million), chiefly resulting from a larger loan portfolio and a conservative approach to recognition and measurement of credit risk.

Basic performance indicators for 2018 were worse than those achieved in 2017. ROE went down by 1.2 pp to 2.3%, ROA dropped by 0.2 pp to 0.4%, while the C/I ratio improved to 34.3%, up by 1.5 pp year on year, as the increase in administrative expenses was higher than the growth in net banking income. Higher administrative expenses were owed

to the efficiency improvement projects and initiatives carried out in 2018 (including digitisation of processes and commitment of staff).

Solvency ratio remained at a high and stable level of 32.1%.

TABLE 2: Key financial parameters of BGK's operations

Item	Performance			Change 2018/2017
	2018	2017	2016	
Profitability				
Net banking operations ¹ (in PLN million)	1,173.7	978.9	849.7	19.9%
Administrative expenses (in PLN million)	-402.1	-320.9	-311.5	25.3%
Net impairment losses and provisions (in PLN million)	-165.2	-49.6	-242.7	232.7%
Profit before tax (in PLN million)	519.5	606.2	318.0	-14.3%
Net profit (in PLN million)	445.3	517.8	302.4	-14.0%
Scale of activity				
Gross credit exposures (in PLN million)	32,811.5	27,233.8	24,631.5	20.5%
Liabilities to customers (in PLN million)	47,769.3	33,808.0	37,216.9	41.3%
Total equity (in PLN million)	19,127.3	20,047.7	12,807.4	-4.6%
Balance sheet total (in PLN million)	84,746.4	74,334.2	66,861.9	14.0%
Operating performance²				
C/I ³ ratio on core activities	34.3%	32.8%	36.7%	1.5 pp
C/I ⁴ ratio including other income and expenses	37.0%	32.9%	35.7%	4.1 pp
ROE (net profit / average total equity)	2.3%	3.5%	3.1%	-1.2 pp
ROA (net profit / average assets)	0.4%	0.6%	0.4%	-0.2 pp
Net interest margin (net interest income / average assets)	0.9%	0.8%	0.9%	0.0 pp
Solvency ratio ⁵	32.1%	38.0%	30.1%	-5.9 pp

¹ Net interest and commission income, net gain/loss on financial instruments at fair value through profit or loss and net exchange differences, net gain/loss on investments in financial assets

² Carrying amounts for the period of 13 months (e.g. December 2017 – December 2018) were used as average balances used to calculate the measures.

³ C/I = (administrative expenses) / (interest income, net provisions, net gain/loss on financial instruments at fair value through profit or loss, net exchange differences and net gain/loss on investments in financial assets)

⁴ C/I same as above, with the proviso that the denominator includes other income/expenses and net modification gain/loss

⁵ Excluding cash flow funds

In 2018, the balance sheet total reported by the Bank was PLN 84,746.4 million. It went up by PLN 10,412.2 million, i.e. 14.0%, year on year. The said increase was mainly attributable to:

- increases related to the development of lending and investment activities (certificates) by nearly PLN 6 billion and PLN 3.8 billion, respectively,
- items related to the Bank's liquidity management.

2. THE ECONOMY IN 2018

2.1 DOMESTIC ECONOMY

Faster growth rate in Poland

Last year saw continued positive economic environment in Poland. In 2018, GDP growth rate increased from 4.8% to 5.1% and was the highest since 2007. In subsequent quarters, the annual growth rate stabilised around 5%. The growth structure was not significantly changed and remained relatively stable. Household consumption continued to have the biggest contribution to GDP growth. Good consumption moods were attributable to the improved condition of the labour market, which was reflected in continued drop of the unemployment rate, which was the lowest since the 1990s, and fast real growth of the payroll fund. Household satisfaction was reflected in record high levels of leading economic indicators. Concurrently, investments picked up considerably. The growth in investments was driven by, in particular in the second half of the year, high investment activity of local government units, supported by the schedule of implementation of projects co-financed by EU funds. Moreover, the strong domestic demand contributed to high growth of imports, with concurrent considerable increase in exports. In 2018, a record-high surplus in the trade in services was achieved. As a result, trade with foreign counterparties had a relatively neutral contribution to GDP growth.

Record-low budget deficit

The continued positive economic conditions resulted in further improvement of budget performance. In 2018, the budget deficit to GDP ratio went down to 0.5%. The budget deficit ratio is the lowest since 1989. Incomes from direct taxes (PIT and CIT) grew significantly, which corresponded with rapid growth in salaries and better financial performance of enterprises. A significant increase was also observed in the case of income from indirect taxes (VAT, excise duty), although it was not as that high as in 2017. Nonetheless, the effect of regulatory changes to improve the effectiveness of the tax regime, including to reduce the VAT gap, was still visible. In addition, as a result of the improved condition of the labour market, the needs of the Social Insurance Fund have declined. What played an important role in that area was the inflow of foreign nationals (mainly from Ukraine) to the Polish labour market. It made it possible to maintain an increase in employment despite unfavourable demographic trends. Positive budget performance fostered positive sentiment in the domestic debt market. We saw a marked increase in prices of Polish bonds quoted at the end of the year. Yields of Treasury securities in December oscillated at multi-year minimum.

TABLE 3: Changes in macroeconomic indicators year on year in real terms

Item	2018				
	Q1-Q4	Q1	Q2	Q3	Q4
Gross Domestic Product	105.1	105.3	105.1	105.1	104.9
Domestic demand	105.5	106.6	104.4	106.2	104.8
Total consumption	104.3	104.3	104.5	104.2	104.2
Individual consumption	104.6	104.7	104.9	104.5	104.3
Gross capital formation	110.0	121.1	104.2	114.6	106.2
Gross fixed capital formation	107.3	108.2	104.7	109.9	106.7
Exports	106.2	103.4	107.6	104.9	108.9
Imports	107.0	105.5	106.5	106.9	109.0
Gross value added	105.0	105.3	105.0	105.0	104.8
Manufacturing	105.5	105.2	106.4	105.1	105.3
Construction	117.0	124.5	121.0	113.8	113.3
Trade and repair of motor vehicles	104.8	106.6	104.1	104.0	104.3
Transportation and warehouse management	109.2	107.5	109.5	111.9	107.6

Source: data from the Chief Statistical Office of Poland

*previous quarter = 100

Reference rate stabilisation

The acceleration in GDP growth rate was accompanied by the stabilisation of the National Bank of Poland (NBP) reference rate at the lowest level in history (1.5%). Monetary authorities did not make the decision to tighten the policy, mainly due to the insufficient force of inflationary processes. During the year, CPI clearly remained below the Monetary Policy Council's target. A noteworthy factor was the base price index (excluding food and energy prices), which was still low, despite the rise in salaries. At the same time, NBP projections indicate that there is a low risk that the annual CPI will permanently exceed the permissible range of deviations from the inflation target (1.5–3.5%). The weak price pressure, despite a strong economic growth, contributed to lower market expectations regarding the reference rate growth potential, depreciating the Polish zloty. The EUR/PLN exchange rate grew considerably in the first part of the year, to stabilise in the second half of the year within a narrow fluctuation margin at around 4.30. At the same time, due to a drop in the EUR/USD exchange rate, the rise in USD/PLN was greater and the latter currency pair closed 2018 close to 3.83.

2.2 ECONOMY ABROAD

A shift in US monetary policy in reaction to growing uncertainty

The US economy continued to grow fast in 2018. The labour market situation remained very good, stimulating internal demand. This was accompanied by normalisation of monetary policy reflected in interest rate hikes and reduction in the Fed balance sheet. In late 2018, following a rise in the interest rate by the Fed by 100bps throughout the year, the US monetary authorities decided to change the policy and take a “wait and see” approach. The change was driven by different factors, the most important of which was the uncertainty concerning global economic conditions. An additional source of uncertainty was the growing tension in trade relations between the world's largest economies. The strength of inflation also becomes insufficient to justify further monetary tightening.

Worse economic situation in the eurozone

The economic rebound in the eurozone seen in 2017 proved to be unsustainable. The year 2018 brought a deterioration of leading indicators, followed by weaker hard macroeconomic data. The eurozone, which is dependent on exports, was adversely affected by the problems of major emerging economies, including the Chinese economy, the risk associated with protectionist actions that weaken global trade and uncertainty as to the future shape of relations between EU and Great Britain after Brexit. In effect, although the ECB decided to discontinue the asset purchase programme, at the end of the year investors scrapped their expectations of further tightening of monetary policy in the eurozone, and the prices of instruments began to reflect its return to a loosening path.

3. CHANGES IN THE LEGISLATIVE ENVIRONMENT

The operations of Bank Gospodarstwa Krajowego, whose mission is to support the State in the implementation of the socio-economic growth policy, are regulated by the laws in force more than the activities of other banking sector entities. The most important amendments that affect BGK's operation concerned the following laws and regulations.

- The Act of 24 November 2017 Amending Certain Acts to Combat the Use of the Financial Sector to Commit Treasury Fraud (STIR), which entered into force on 31 January 2018.
- The Act of 8 December 2017 Amending the Public Roads Act and Certain Other Acts, which entered into force on 4 January 2018.
- Regulation of the President of the Council of Ministers of 7 February 2018 amending the regulation on legal persons replaced by the General Counsel to the Republic of Poland and fees for legal services provided by the General Counsel to the Republic of Poland, as well as fees for carrying out proceedings before the Arbitration Court at the General Counsel to the Republic of Poland.
- The Act of 1 March 2018 on Anti-Money Laundering and Countering Terrorist Financing.
- The Entrepreneurs Act of 6 March 2018.
- The Act of 22 March 2016 Amending the Payment Services Act and Certain Other Acts.
- The Personal Data Protection Act of 10 May 2018.
- The Act of 5 June 2018 Amending the Payment Services Act and Certain Other Acts.
- The Act of 6 June 2018 Amending the Act on Biocomponents and Liquid Biofuels and Certain Other Acts.
- The Act of 15 December 2017 Amending the Act on Value Added Tax and Certain Other Acts (Split Payment), which entered into force on 1 July 2018.
- The Act of 5 July 2018 on National Cyber Security System.
- The Act of 20 July 2018 on State Subsidies to Household Expenses in the First Years of Tenancy.
- The Act of 20 July 2018 on Higher Education and Science.
- Regulation of the Minister of Finance of 17 September 2018 on the de minimis aid granted by Bank Gospodarstwa Krajowego in the form of loan repayment guarantees under the "Creative Europe" (2014–2020) programme.
- Regulation of the Minister of Finance of 17 September 2018 on the de minimis aid granted by Bank Gospodarstwa Krajowego in the form of loan repayment guarantees under the Operational Programme Digital Poland 2014–2020.
- The Act of 23 October 2018 on Roads Managed by Local Governments.
 - The Act of 6 December 2018 Amending the Act on Supporting Thermomodernisation and Repairs Fund and Certain Other Acts.
- The Act of 28 December 2018 Amending the Excise Duty Act and Certain Other Acts.

Apart from the above, a number of other generally applicable laws governing the Bank's operations to a varying degree were enacted in 2018.

4. OPERATIONS OF BANK GOSPODARSTWA KRAJOWEGO AND THE BGK GROUP

4.1 DIVISION OF OPERATIONS WITHIN BANK GOSPODARSTWA KRAJOWEGO GROUP

The operations of BGK Group are carried out by the Bank and a group of institutions with organisational links to the Bank. These include primarily financial institutions or auxiliary institutions with equity links to the Bank or linked to the Bank by the fact that it exercises supervision over them, as well as subsidiaries and associates which implement BGK's mission. They supplement the Bank's operations by carrying out pro-growth investment activities based on equity financing and the best asset management practices.

Therefore, BGK Group's operations are comprised of:

- banking activity, in which a major role is played by lending and surety activities as well as maintenance of accounts and deposits,
- commissioned activities related to supporting the State as well as managing government programmes and EU programmes,
- investment activity, implemented to a large extent by Group entities.

Bank Gospodarstwa Krajowego as a state development bank is the major institution supporting the State in the administration of socio-economic government programmes designed to promote entrepreneurship as well as infrastructure and residential investment at the national, regional and local level. Apart from its banking activity, BGK actively cooperates with ministries competent for specific areas of the country's growth and Polish development institutions. BGK carries out government tasks on the basis of acts and agreements with ministries, including through funds established, entrusted or assigned to the Bank for which, by virtue of law, BGK keeps separate accounting books and prepares separate financial statements.

These include:

- cash flow funds – related to the management and administration of cash flows which are not recognised in the Bank's statement of financial position and the statement of profit or loss. Tasks in the formula of cash flow funds are carried out by the National Road Fund (NRF), Railway Fund (RF), Thermomodernisation and Repairs Fund (TRF), Subsidy Fund (SF), Student Loan and Credit Fund (since 1 January 2019 – Student Loan Fund (SLF)), Borrower Support Fund (BSF), and National Guarantee Fund (NGF).
- a credit fund the exposures of which are subject to credit risk and recognised in the Bank's statement of financial position and the statement of profit or loss, i.e. the Inland Waterways Fund (IWF).

In addition, BGK also carries out operations related to developing entrepreneurship using sureties and supporting the export of Polish enterprises through investment funds and cooperation with surety funds and KUKA S.A.

4.2 LENDING ACTIVITY OF BGK

The value of the Bank's credit exposures in 2018 reached PLN 33,881.6 million. The year-on-year increase was PLN 5,889.6 million and was related mainly to the area of financing enterprises and financial entities, financing self-government institutions and municipal companies, and financing exports and foreign expansion.

The portfolio of credit exposures broken down by business line has been presented in the table below.

TABLE 4: Gross credit exposures* (in PLN million)

Item	Performance		Change versus	
	2018	2017	in nominal terms	%
Gross credit exposures	33,881.6	27,992.0	5,889.6	21.0%
Structured finance	12,558.0	12,158.5	399.5	3.3%
Export and foreign expansion financing	2,428.0	1,689.9	738.1	43.7%
Businesses and financial entities	5,696.2	2,672.2	3,024.0	113.2%
Local government institutions and municipal companies	7,661.6	6,405.6	1,256.0	19.6%
Central government entities	16.4	18.9	-2.5	-13.2%
Healthcare entities	1,051.2	732.3	318.9	43.5%
Social housing programmes	4,136.0	4,218.5	-82.5	-2.0%
Other	334.2	96.0	238.2	248.1%

* the item includes loans measured at amortised cost and fair value through profit and loss, municipal bonds and commercial bonds measured at amortised cost

In the area of financing enterprises the Bank achieved the highest growth of nearly PLN 3,024.0 million, i.e. 113.2% in relation to the previous year. It was mainly attributable to execution of agreements with entities from the energy and extractive industries.

In the area of structured financing, BGK recorded a 3.3% rise in the portfolio value. BGK classified primarily financing related to the implementation of investment and infrastructure projects to that line.

As regards the financing of social housing, the scale of growth recorded by new programmes implemented by BGK did not manage to fully compensate repayments in the portfolio of the former National Housing Fund.

Loan portfolio statistics

In order to achieve comparability with market data, the loan portfolio of BGK has been presented in tables broken down by sector. Additionally, changes in lending activity broken down by sector have been presented below.

TABLE 5: Volume and structure of gross credit exposures* (in PLN million)

Item	2018		2017		Change versus 2017	
	Performance	Composition	Performance	Structure	in nominal terms	%
Gross credit exposures	33,881.6	100.0%	27,992.0	100.0%	5,889.6	21.0%
financial sector entities	753.9	2.2%	273.5	1.0%	480.4	175.7%
non-financial sector entities	25,000.9	73.8%	21,668.5	77.4%	3,332.4	15.4%
individuals	55.2	0.2%	50.4	0.2%	4.8	9.6%
businesses	24,945.7	73.6%	21,618.1	77.2%	3,327.6	15.4%
budget sector entities	8,126.8	24.0%	6,050.0	21.6%	2,076.7	34.3%
central government entities	352.4	1.0%	316.5	1.1%	35.9	11.3%
local government entities	7,774.3	22.9%	5,733.5	20.5%	2,040.8	35.6%

* the item includes loans measured at amortised cost and fair value through profit and loss, municipal bonds and commercial bonds measured at amortised cost

In 2018, the most considerable growth was observed in the non-financial sector. This was attributable mainly to the financing of enterprises. The volume of loans granted to public sector entities grew as well, including mainly to local government units.

TABLE 6: Share of BGK in the loan market

Item	Performance		Change versus
	2018	2017	2017 in pp
Loans	2.9%	2.5%	-0.4
financial sector entities	1.1%	1.3%	0.2
businesses	5.2%	5.1%	-0.1
individuals	0.0%	0.0%	0.0
central government entities	25.3%	31.8%	6.5
local government entities	16.8%	19.2%	2.4

Source: National Bank of Poland (NBP) data and own calculations

As at the end of 2018, the Bank's market share was slightly higher than in the previous year and amounted to 2.9%. The increase was mainly driven by the implementation of the Bank's strategy with respect to the funding of investments and corporate growth. In line with its mission, the Bank arranged financing largely through participation in syndicates formed together with commercial banks. The Bank has not been granting personal loans since 2009.

As at the end of 2018, exposures past due by more than 90 days went up by PLN 24.6 million, i.e. 10.7%, to PLN 253 million, and constituted less than 1.0% of the credit exposures portfolio.

As at the end of 2018, total debt subject to collection or restructuring was PLN 1,077 million (982 transactions), while the recoveries in 2018 totalled PLN 63.1 million.

The Bank is not involved in any litigation where the unit amount of the claim represents at least 10% of its equity. The aggregate number of claims does not exceed that threshold, either.

TABLE 7: The level and structure of amounts due that were subject to enforced collection (in PLN million)

Receivables by type	2018			2017		
	No.	exposure value	collateral value	No.	exposure value	collateral value
construction loans	8	104.9	102.9	9	120.9	18.0
investment loans	13	18.1	9.4	13	17.0	1.0
working capital loans	10	20.1	8.9	11	23.2	0.6
sureties and guarantees	242	64.7	13.0	236	65.0	6.8
other	34	17.2	17.6	35	21.6	0.8
Total	306	224.9	151.8	304	247.7	27.2

Development and structure of lending activity within the framework of implementing BGK's mission

The Bank supports the implementation of the SRD as part of priorities: knowledge-based economic growth and sustainable social and territorial development. The Bank focuses on supporting activities concerning:

- reindustrialisation and promoting infrastructure investments,
- foreign expansion and export of Polish enterprises,
- financing local government projects,
- promoting equal opportunities and housing.

Support for reindustrialisation and infrastructure investment financing

Within the framework of its lending activity, the Bank primarily finances investment and infrastructure projects. The bank's operations are focused on supporting strategic sectors of Polish economy. These operations are carried out mainly through structured transactions that enable large investments in the energy, fuel and chemical sectors. These investments are carried out primarily through the participation of BGK in consortia and by increasing the use of leverage

in financing investments of strategic importance for the State. This allows to utilise the share of financial sector funds in addition to BGK's own funds. The share of structured financing in the exposure portfolio was 37.1% as at the end of 2018, which represented balance sheet exposure of PLN 12,558.0 million.

Revolving loans and medium-value investment loans that do not require structured financing represented a smaller share in the structure of BGK's portfolio. The aforesaid types of loans are granted through BGK's regional network. In 2018, to meet the financial needs of Polish businesses, BGK significantly increased the value of financing provided to enterprises and financial entities by PLN 3,024.0 million.

As regards infrastructure investment financing, the Bank also carries out statutory activities within the framework of the National Road Fund and the Railway Fund as well as through investment funds.

Export and foreign expansion financing

One of the objectives of the Strategy for Responsible Development is to internationalise the Polish economy. A special emphasis has been placed on the development of business relationships with non-EU member states (including higher risk countries), in addition to more sophisticated forms of international cooperation.

BGK plays a crucial role in providing Polish companies with solutions allowing effective competition on international markets. Year by year, BGK has been increasing its exposure to export credit granted both under the "Finansowe Wspieranie Eksportu" (Financial Exports Support) Programme and as part of the Bank's own activities. In 2018, BGK continued to intensify its activity which is not only intended to support exports but also foreign expansion through investments made by Polish business entities on international markets. This was expressed, inter alia, by reaching the number of 60 countries in which BGK supported the transactions/projects of Polish enterprises (as at the end of January 2019, it was already 62 countries on 6 continents).

- ***"Finansowe Wspieranie Eksportu" (Financial Exports Support) Programme***

BGK supports Polish exports by granting export loans under the Financial Exports Support Government Programme adopted by the Council of Ministers in 2009. BGK provides foreign buyers (directly or through the buyer's bank) with credit facilities to finance purchases of Polish goods and/or services. The funds are transferred directly to the bank accounts of Polish exporters, which eliminates the risk of default, as the Polish business entity receives the transfer directly from BGK.

The solutions offered under the Programme are considered particularly attractive on higher risk markets (such as Belarus), where the solutions offered by commercial banks are limited and the borrowing costs charged by local banks are high.

Since its launch until the end of 2018, BGK granted loans for an aggregate amount of PLN 3.3 billion as part of the Financial Exports Support Programme. The amount disbursed by the end of 2018 was PLN 2.5 billion, while the value of supported export contracts exceeded PLN 4 billion.

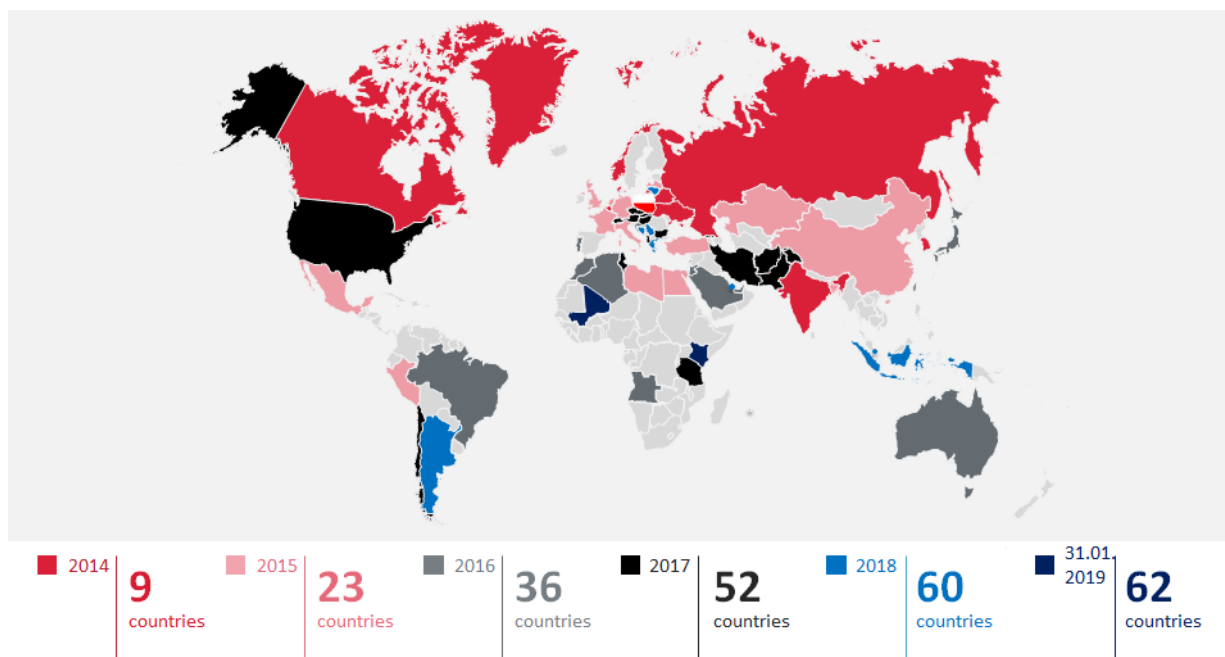
- ***Own activities of BGK in the field of export and foreign expansion support***

Since 2015, in relation to growing interest in financing expressed by Polish businesses operating on international markets, BGK expanded its product offer to include loans dedicated for foreign investments of Polish enterprises. The said financial instruments is complementary to the available export loan products and to products offered by other financial institutions. The above had a significant contribution to the increase in the value of loans granted in subsequent years and, at the same time, allowed BGK to enter the markets of highly developed countries through various forms of financing. The expansion of the product offer also had an impact on the geographical diversification of BGK's portfolio and enabled Polish businesses to secure attractive forms of support in relation to exports and when planning expansion on foreign markets.

The amount of export and foreign expansion financing provided by BGK in 2018 (under the Financial Exports Support government programme and as part of own activities) totalled PLN 2,428.0 million. BGK completed more than 200

foreign transactions/projects for Polish enterprises, including the financing of: sale of machinery to Argentina, sale of a technological line to Belarus, construction of a hotel in Greece, construction of a power plant in Indonesia, construction of a retail and recreational centre in Ukraine, and financing of acquisitions in the United Kingdom.

The geographical scope of transactions/projects of Polish enterprises supported by BGK since 2014 is presented on the figure below.



Financing of projects undertaken by local governments and healthcare entities

The volume of credit exposures of local government units and municipal companies at the end of 2018 amounted to PLN 7,661.6 million and was PLN 1,256.0 million higher compared to the previous year.

The Bank also finances healthcare sector entities. As at the end of 2018, its credit exposure was PLN 1,051.2 million.

BGK also finances local government projects by means of equity instruments through the Group entities. This applies to the Dwelling for Development Sector Fund and the Local Government Investments Fund.

Promoting equal opportunities and housing

The area of promoting equal opportunities features a whole spectrum of the BGK Group instruments related to the development of housing and ensuring access to housing for young families and persons with relatively low income as well as instruments to promote social mobility and labour market balance through the development of the institutional rental housing sector.

Within the framework of its lending activity, the Bank implemented government social rental housing construction programmes and the value of its credit exposure as at the end of 2018 amounted to PLN 4,136.0 million. The value stated in the previous sentence comprises the value of the old portfolio of the former National Housing Fund and loans granted under the new social rental housing construction programme. A detailed description of the implementation of government programmes can be found in sub-chapter 4.13 of the present report.

BGK also supports the housing industry both through government programmes administered by the Subsidy Fund (including programmes related to social housing) and through the investment activities of funds managed by PFR Nieruchomości S.A.

4.3 LENDING POLICY OF BGK

The purpose of the lending policy is to create a framework for the implementation of BGK's mission which consists in supporting social and economic growth of Poland and supporting the public finance sector in the performance of its tasks, and in particular to:

- strengthen the role of BGK as a development bank and significantly increase its current involvement in financing undertakings under the "Strategy for Responsible Development (SRD)" by:
 - supporting existing and developing new competitive advantages and specialisations of Polish economy,
 - supporting innovation and the development of high technologies,
 - supporting reindustrialisation and strategic sectors from the perspective of economic growth of Poland,
 - increasing the level of investments,
 - supporting social and regional development,
 - establishing a new guarantee system for microenterprises, small and medium-sized enterprises (SMEs) and a sustainable systemic instrument supporting the development of SMEs,
- achieving and maintaining the key role in the implementation of European programmes, in particular in the field of repayable instruments,
- implementing government social housing support programmes,
- ensuring the availability of export financing and increase the scale of operation in the field of solutions that support export-related activity of enterprises, support foreign expansion of businesses and promote Polish export and Polish products,
- providing financial support to the Polish defence system,
- carrying out tasks within the framework of government programmes other than those mentioned above,

while maintaining the high quality of assets (especially the loan portfolio) within a specific risk level.

BGK carries out a broad range of tasks specified in the Strategy for Responsible Development and defined in the Bank's mission, prioritising lending decisions based on evaluation criteria related to impact on the following five areas:

- quality of life of the community and availability of services provided to the public,
- economic development,
- state of the environment,
- improving the labour market,
- state of public finance.

Lending decisions are made based not only on the economic viability of projects and safety in terms of credit risk, but also on the investment's impact on the country's economic growth.

4.4 DEPOSIT ACTIVITIES OF BGK

In 2018, BGK saw an increase in the balance of deposits from PLN 33,808.0 million to PLN 47,769.3 million, i.e. by 41.3%. In terms of value, the most considerable increase of PLN 11,508.3 million (a change by 75.7%) was seen in the central government segment, which was driven by a strong State budget. In 2018, the value of business deposits went up in the non-financial segment (by PLN 1,615.7 million, i.e. 11.4%).

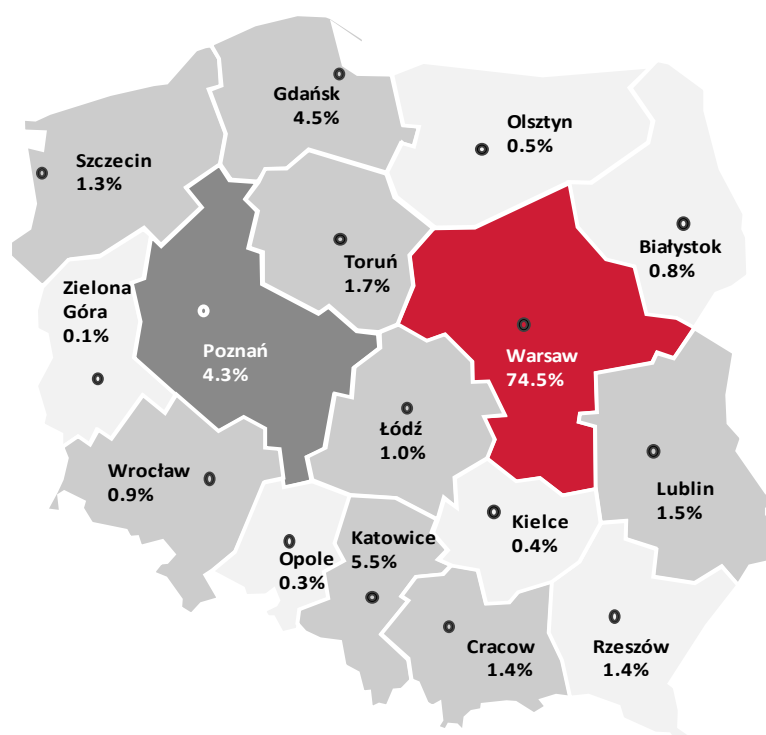
TABLE 8: Volume and customer structure of the deposit base (in PLN million)

Item	2018		2017		Change versus 2017	
	Performance	Composition	Performance	Structure	in nominal terms	%
Deposits from customers	47,769.3	100.0%	33,808.0	100.0%	13,961.3	41.3%
financial sector entities	2,463.5	5.2%	1,626.2	4.8%	837.3	51.5%
non-financial sector entities	15,819.3	33.1%	14,203.6	42.0%	1,615.7	11.4%
individuals	42.3	0.1%	37.9	0.1%	4.4	11.6%
businesses	15,777.0	33.0%	14,165.8	41.9%	1,611.2	11.4%
budget sector entities	29,486.5	61.7%	17,978.2	53.2%	11,508.3	64.0%
central government entities	26,777.9	56.1%	15,238.3	45.1%	11,539.6	75.7%
local government entities	2,708.6	5.7%	2,739.9	8.1%	-31.3	-1.1%

As at the end of December 2018, the balance of public sector deposits was 64.0% higher than as at the end of 2017. Due to the high volatility of this item at the end of the year, BGK diversifies its market sources of funds to ensure the stable financing of assets.

Customer deposits constitute an important source of financing due to the growing level of BGK's lending and investment activities and ensure a safe level of liquidity.

The territorial structure of deposits by volume as at 31 December 2018 is presented below.



4.5 ELECTRONIC BANKING

The Bank's operational excellence is one of key tools used to implement the strategy for the years 2017-2020 adopted by BGK. The Bank adapts its initiatives and projects being implemented to the needs of its customers and changing external conditions. It is demonstrated in the product management, which is oriented towards improvement and searching for the most effective solutions.

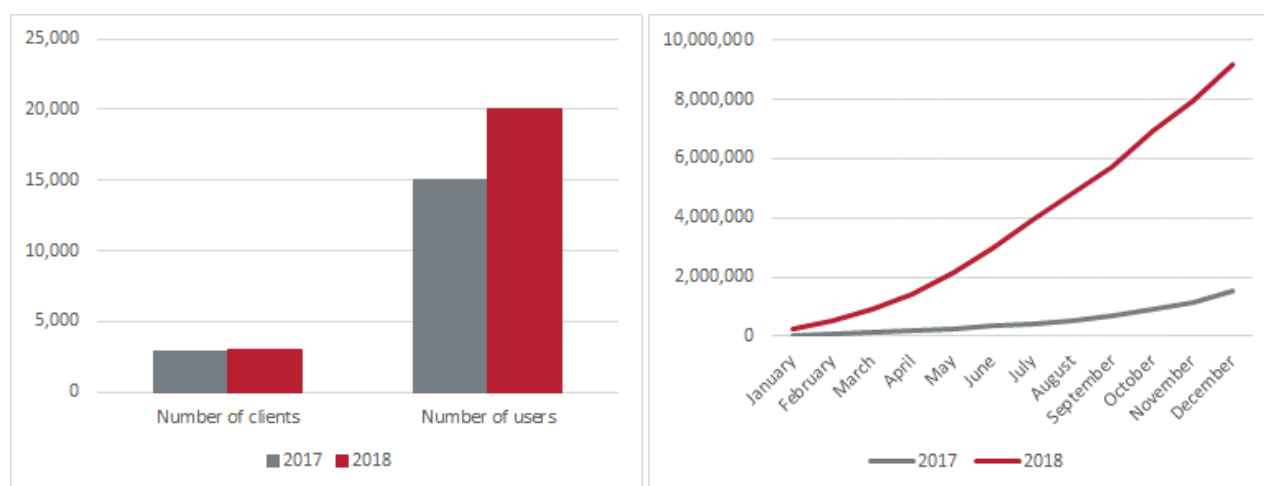
In 2018, BGK continued to implement changes to its bgk24 electronic banking system. The online banking system was adjusted to support the operation of the split payment mechanism related to VAT invoices and mass payments. Inclusion

of mass payments to the new payment system significantly facilitated the performance of everyday duties by clients and made it possible to freely manage funds through a single online platform.

Electronic banking services and electronic statements were integrated in one system, which greatly improved the comfort of work and enabled comprehensive management of processes in the system.

The new electronic banking service meets the strictest security requirements thanks to the application of market standards based on legal regulations, recommendations of the PFSA and guidelines for security of electronic banking services in Poland.

Number of clients, users and transactions in the bgk24 online system



To ensure continued and stable operation of the new bgk24 system, a technological upgrade of the system was prepared. In its production environment, significant changes were made in database configuration, which improved the efficiency of the solution. The objective of the said works was to optimise the efficiency of the bgk24 system, resulting in better system response times to user actions.

In 2018, a series of trainings was held for persons using the system: advisors, customer support representatives, hotline consultants, and clients. During the system deployment, the Bank provided support to clients in the form of training held at its registered office, while verifying its correct operation and compatibility of clients' financial and accounting systems with bgk24, ensuring support in execution of first orders. The training sessions will be consistently repeated.

The bgk24 electronic banking system features functions that are not available at other banks due to the specific nature of BGK's portfolio and clients' expectations. The new system ensures efficient execution of banking transactions by enterprises and corporations. Its functionalities, such as consolidation of public finances, deposit management, interface for data exchange with courts, advanced transaction authorisation mechanisms, match the latest requirements under the EU's PSD2 directive.

4.6 BGK'S ACTIVITY ON THE MONEY MARKET AND THE DEBT SECURITIES MARKET

The Bank's activities on the money market were designed to achieve the following two objectives:

- management of the current liquidity position (investment of excess liquidity);
- maintenance of a liquidity buffer in the longer term by holding short-term and/or highly liquid assets.

As in previous years, BGK continued to play an active role on the Polish money market, acting as the Money Market Dealer. In 2018, BGK was ranked third in the ranking of dealer activities in the money and currency market prepared by the National Bank of Poland to promote banks that are the most active in the market, to which the NBP proposes to carry out the function of a Money Market Dealer.

Current liquidity needs of BGK were regulated on the interbank market with basic liquidity instruments, mainly deposits, FX swaps, purchases of sell-back securities and sales of buy-back securities. In 2018, BGK's exposure to different types

of financial instruments was the effect of the situation on the interbank market and the implementation of the adopted investment strategy.

As BGK allocated its liquid assets in the portfolio of Treasury debt securities on an ongoing basis, its value exceeded PLN 9.3 billion as at the end of 2018.

TABLE 9: Value and composition of the debt securities portfolio (in PLN million)

Item	2018		2017		Change versus 2017	
	Performance	Composition	Performance	Structure	in nominal terms	%
Debt securities (measured at cost)	14,659.6	100.0%	35,785.1	100.0%	-21,125.5	-59.0%
NBP (money market) bills	1,412.2	9.6%	21,526.5	60.2%	-20,114.3	-93.4%
treasury bonds	9,362.8	63.9%	9,311.3	26.0%	51.5	0.6%
municipal bonds	2,187.7	14.9%	1,100.5	3.1%	1,087.2	98.8%
other securities	1,696.9	11.6%	3,846.8	10.7%	-2,149.9	-55.9%

“Other securities” mostly comprise debt securities issued by banks. As at the end of 2018, the Bank’s exposure to those securities was PLN 1.7 billion.

As part of its activity on the money market and the market of debt securities, BGK cooperated with the Ministry of Finance, e.g. by investing excess liquidity of the State Treasury.

4.7 SHARE PORTFOLIO

As at 31 December 2018, BGK’s total exposure to shares measured at carrying amount was PLN 1,214.6 million, i.e. it was reduced by PLN 190.9 million compared to the figure as at the end of December 2017. As at the end of 2018, the Bank held shares in 33 companies (including seven public companies, of which six are listed on the Warsaw Stock Exchange). The table below presents the statement of main positions in the share portfolio.

TABLE 10: Composition of the share portfolio (in PLN million)

Item	2018		2017		Change versus 2017 carrying amount		2018 BGK's share in the company
	Contribution on value	Carrying amount	Contribution on value	Carrying amount	Change in nominal term:	%	
Shares in public companies	881.9	1,068.5	881.8	1,187.5	-119.0	-10.0%	-
PKO BP S.A.	800.0	966.5	800.0	1,085.0	-118.5	-10.9%	2.0%
PZU S.A.	13.8	67.7	13.8	65.0	2.7	4.1%	0.2%
POLNORD S.A.	23.2	17.9	23.2	20.1	-2.3	-11.3%	6.4%
BIOTON S.A.	9.7	4.7	9.7	3.2	1.4	45.0%	1.1%
Polimex Mostostal S.A.	23.4	2.6	23.4	3.7	-1.1	-30.3%	0.4%
Elektrociepłownia Będzin S.A.	10.3	6.6	10.3	8.4	-1.7	-20.8%	9.9%
Visa Inc.	1.5	2.5	1.4	2.0	0.5	24.6%	< 0.1%
Shares in subsidiaries and associates*	65.0	63.4	90.5	88.9	-25.5	-28.7%	-
BGK Nieruchomosci S.A.	-	-	25.5	25.5	-25.5	-100.0%	0.0%
KUKE S.A.	63.0	63.0	63.0	63.0	-	0.0%	36.7%
Krajowa Grupa Poręczeniowa Sp. z o.o.	2.0	0.3	2.0	0.3	-	0.0%	39.3%
Other shares	24.3	26.8	67.9	70.3	-43.4	-61.8%	-
Krajowy Fundusz Kapitałowy S.A.	-	-	43.8	47.3	-47.3	-100.0%	0.0%
Polski Fundusz Rozwoju S.A.	15.0	17.3	15.0	15.0	2.3	15.5%	0.6%
European Investment Fund	8.1	9.4	7.8	7.8	1.5	19.2%	0.1%
Metanel Group S.A.	0.4	-	0.4	-	-	-	5.1%
Zakłady Sprzętu Instalacyjnego "Polam-Nakło" S.A.	0.3	-	0.3	-	-	-	19.9%
Wałbrzyski Rynek Hurtowy S.A.	0.3	-	0.3	-	-	-	10.7%
S.W.I.F.T. srl	0.1	0.2	0.1	0.1	0.0	40.5%	< 0.1%
Investment fund certificates (closed-end private equity invest	5,446.8	5,446.8	1,960.2	1,960.2	3,486.6	177.9%	-
Shares in surety funds	62.6	55.9	65.1	58.8	-2.9	-4.9%	-
Total	6,480.6	6,661.4	3,065.4	3,365.7	3,295.7	97.9%	-
Total, excluding shares in investment funds	1,033.8	1,214.6	1,105.3	1,405.5	-190.9	-13.6%	-

* excluding investment funds and surety funds

As at 31 December 2018, BGK's total exposure to shares measured at initial value was PLN 1,033.8 million, i.e. it went down by PLN 71.5 million compared to the figure as at the end of 2017.

The shares in PKO BP S.A., received by BGK free of charge from the State Treasury in 2015 for the purposes of the Bank's investment activities, represent the key item of the share portfolio in terms of value. Additionally, as at the end of 2018 the Bank also held shares in 26 non-public companies, including 18 regional and local surety funds, 14 of which were classified as associates of BGK and are consolidated with the Group's results using the equity method.

Portfolio of investment certificates

By investing in closed-end funds the Bank fulfils its mission, which is to support the socio-economic development of Poland. As at the end of 2018, the Bank was an investor in 7 closed-end investment private equity funds managed by PFR TFI S.A. The funds in which BGK had a capital involvement invest mainly in infrastructure and residential property.

TABLE 11: Information on investment funds with BGK as a shareholder

	Fund	Investment strategy assumptions	Geographical structure	Established on
1	Fundusz Sektora Mieszkań na Wynajem FIZ AN	The fund finances companies holding real properties for rent.	Investment projects in Poland.	26 Aug 2014
2	Fundusz Ekspansji Zagranicznej FIZ AN	The Fund carries out projects in cooperation with Polish enterprises undergoing expansion.	No geographical or industry focus.	25 Jun 2015
3	Fundusz Inwestycji Infrastrukturalnych – Dłużny FIZ AN	The funds support investment projects primarily in the following industries: energy, hydrocarbons (crude oil and natural gas), transport and logistics. The project may cover construction and modernisation of assets.	The main area of the funds' investments is the territory of Poland, with possible financing of cross-border investments.	2 Jul 2015
4	Fundusz Inwestycji Infrastrukturalnych – Kapitałowy FIZ AN			
5	Fundusz Inwestycji Polskich Przedsiębiorstw FIZ	The fund supports investments of companies, whose activity is closely connected to Polish economy. The fund focuses on manufacturing companies and	Manufacturing resources located or a major portion of income	2 Jul 2015
6	Fundusz Inwestycji Samorządowych FIZ AN	The fund finances investment projects implemented in cooperation with local government entities in the following industries and areas: water supply and sewage systems, heating, waste management, regional airports, infrastructure and transportation.	No geographical focus	2 Jul 2015
7	Fundusz Sektora Mieszkań dla Rozwoju FIZ AN (formerly: Fundusz Municipalny FIZ AN)	The fund invests in the segment of affordable housing and in local government infrastructure.	Investment projects in Poland.	30 Dec 2015

Compared to the figure as at the end of 2017, the total issue price of investment certificates held by the Bank increased by PLN 3,277.3 million. The most considerable growths measured at issue price were recorded by Fundusz Inwestycji Infrastrukturalnych – Kapitałowy FIZ AN – PLN 1,599.4 million, Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN – PLN 691.2 million, and Fundusz Sektora Mieszkań dla Rozwoju FIZ AN – PLN 476.9 million.

TABLE 12: List of investment certificates held by the Bank as at 31 December 2018

Item	Number of investment certificates held by the Bank	Total issue price of investment certificates (in PLN million)		Total payments to the fund made by BGK (in PLN million)		Percentage share of BGK (2018)
		2018	2017	2018	2017	
Fundusz Sektora Mieszkań na Wynajem FIZ AN	1,444,569	1,392.0	1,392.0	1,037.2	971.6	100.0%
Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN	1,296,000	1,296.0	604.8	1,296.0	474.9	86.4%
Fundusz Inwestycji Infrastrukturalnych – Kapitałowy FIZ AN	1,901,988	1,902.0	302.6	1,902.0	261.9	86.5%
Fundusz Inwestycji Samorządowych FIZ AN	310,000	310.0	75.0	310.0	32.0	50.0%
Fundusz Ekspansji Zagranicznej FIZ AN*	74,457	316.5	41.7	224.9	41.7	100.0%
Fundusz Sektora Mieszkań dla Rozwoju FIZ AN (formerly: Fundusz Municipalny FIZ AN)	2,095,256	549.8	72.9	549.8	51.1	100.0%
Fundusz Inwestycji Infrastrukturalnych – Dłużny FIZ AN	129,681	129.7	129.7	126.9	126.9	5.9%
TOTAL		5,896.0	2,618.7	5,446.8	1,960.2	-

*Translated at the EUR/PLN mid-market rate quoted by the National Bank of Poland (NBP) for 31 December 2018 and 29 December 2017, as applicable.

The Bank is also an investor in Polski Fundusz Funduszy Wzrostu (Polish Growth Fund of Funds, PGFF) established in 2013 with a five-year investment term, as part of a joint initiative pursued by BGK and the European Investment Fund. The PGFF invests funds in private equity (major share) and venture capital funds, with no branch-related specialisation, investing in Poland (dominating area) and other Central and Eastern Europe countries. In addition, the Bank made an equity investment in pan-European equity funds operating under the Luxembourg law, established to finance infrastructure investments in the energy sector, including in generation of electricity from renewable sources, transportation and digital infrastructure, i.e. *The 2020 European Fund for Energy, Climate Change and Infrastructure* and Marguerite II SCSp.

Major events in the share portfolio

- *BGK Nieruchomości S.A. (currently PFR Nieruchomości S.A.)*

In late 2018 (3 October), the Bank entered into an agreement for the sale of 100% of shares in BGK Nieruchomości S.A. to PFR S.A., as a result of which the name of the entity was changed to PFR Nieruchomości S.A.

- *Krajowy Fundusz Kapitałowy S.A.*

On 3 August 2018, the Bank entered into an agreement for the sale of 100% shares in Krajowy Fundusz Kapitałowy S.A. to Polski Fundusz Rozwoju S.A.

- *Podkarpacki Fundusz Poręczeń Kredytowych Sp. z o.o.*

On 30 May 2018, the Bank sold its entire shareholding in Podkarpacki Fundusz Poręczeń Kredytowych Sp. z o.o. to the Podkarpackie province.

4.8 PROJECTS

In 2018, the Bank pursued nearly 100 projects, focusing its activities on improvement in efficiency and operational excellence. It continued projects involving implementation of banking systems (the central banking system, the electronic banking system), activities aimed at strengthening cultural transformation, projects to ensure compliance to new regulatory requirements, and designed to develop process management at the Bank and streamline internal processes.

In the second half of the year, the Bank's Management Board decided to suspend the deployment of the central banking system and order a comprehensive strategic review of the Bank's IT infrastructure.

The project consisting in the implementation of the next stage of the expansion of the electronic banking system, the objective of which is to provide access to modern services raising the standard of service provided to strategic groups of customers, including those covered by the public finance consolidation programme, was continued. The Bank also took steps to implement an important new version of the Kondor+ (Fusion Capital) system together with its KGR (Fusion Risk) module, used in the Treasury area along with new modules, to meet regulatory requirements and new business needs.

The Bank commenced the rollout of a network of its foreign agencies as an additional effort to support Polish enterprises in foreign expansion and promote Polish economic development and the Bank. It also continued its initiatives to transform regions into regional business hubs, including to modernise their offices. Also, a decision was made to modernise the Bank's Head Office (completion of works is scheduled for 2024 – the 100th anniversary of establishment of BGK).

The Bank continued activities related to cultural transformation, stepping up engagement, responsibility and building managerial and business maturity as part of implementation of the Bank's communication strategy for 2017-2019, which will effectively support BGK in pursuit of its business objectives.

In the area of commissioned activities, the Bank pursued projects to implement subsequent modifications of the Borrower Support Fund, implement a new application for management of student loans and ensure the administration of the Off to a Good Start with a Flat government programme.

The most important projects included the implementation of changes resulting from IFRS 9 and adaptation to FINREP reporting requirements. In the regulatory area, the Bank ensured compliance with the requirements of the General Data Protection Regulation (GDPR), 3D Secure, Central Assessment Mechanism (CMO), AML/CFT and the split payment mechanism.

4.9 SURETIES AND GUARANTEES PROVIDED BY BGK UNDER GOVERNMENT PROGRAMMES

As part of its surety and guarantee operations BGK supports SMEs in financing their development needs, including investments.

BGK carries out surety and guarantee operations in compliance with the Act of 8 May 1997 on Sureties and Guarantees Granted by the State Treasury and Certain Legal Persons (Journal of Laws of 2018, item 1808).

In 2018, BGK performed tasks in five primary areas:

- **continued implementation of the government programme of de minimis guarantees** for micro enterprises and SMEs,
- **utilisation of EU funds for guarantees in the SME sector** – an initiative under the Operational Programme Smart Growth (OPSG) and the framework programme for the competitiveness of enterprises as well as SMEs for 2014-2020 (COSME),
- **establishment of the National Guarantee Fund (NGF)** - implementation of the guarantee model consistent with the Strategy for Responsible Development (SRD), i.e. an instrument of systemic strategic intervention in the SME sector that mobilises private funds for the implementation of state policy and is based on all positive experiences from the existing model,
- **management of active portfolios of sureties and guarantees, including portfolios, which have been removed from offer,**
- **cooperation with surety funds.**

Programme implementation

In 2018, BGK offered the following surety and guarantee products:

- loan repayment guarantees/sureties provided on a portfolio basis, including:
 - loan repayment guarantees as part of the Portfolio De Minimis Guarantee Facility (PDMGF) – since 1 July 2018 guarantees under the PDMGF have been provided as part of the National Guarantee Fund; additionally, de minimis guarantees combined to secure loan repayment with a surety provided by the surety fund (PDMGF PLUS) are also granted under the PDMGF;
 - loan repayment guarantees as part of the Portfolio Guarantee Facility with European Investment Fund's (EIF) counter-guarantees under the COSME Programme (PGF COSME);
 - loan repayment guarantees as part of the Guarantee Fund under the OPSG (GF OPSG);
 - student loan repayment guarantees;
- guarantees/sureties provided on a case-by-case basis, including:
 - loan repayment guarantees and sureties;
 - performance bonds.

TABLE 13: Terms and conditions for granting sureties and guarantees (in PLN million)

Item	Loan amount	Maximum guarantee value	Term of guarantee	Commission fee
Guarantees under Portfolio De Minimis Guarantee Facility				
working capital loan	up to 60%	up to PLN 3.5 million	27 months	0.5% p.a.
investment loan			99 months	
Guarantees under PGF COSME				
working capital loan	up to 80%	up to PLN 0.48 million	27 months	1.0% p.a.
investment loan			99 months	
Guarantees under PGF-GF OPSG				
working capital loan	up to 80%	up to EUR 2.5 million	240 months	0.0% p.a.
investment loan				

As part of the PDMGF PLUS, the funds sold 273 sureties for the amount of PLN 14.3 million by 31 December 2018. BGK issued guarantees under PDMGF PLUS for the amount of PLN 41.8 million.

Portfolio guarantees and sureties were offered under agreements entered into by BGK with the lending banks. As at 31 December 2018, BGK had signed 48 agreements with 19 banks – BGK cooperates with the majority of lending banks in Poland, including all large banks. Facilities opened under those agreements by the end of 2018 totalled PLN 16.1 billion.

PDMGF guarantees were made available under the de minimis aid limit for a single business entity from the micro, small and medium-sized enterprise sector. PDMGF does not generate credit risk for BGK and is recognised outside its books.

In addition, as at 31 December 2018 BGK had entered into 6 agreements with lending banks, which set out the terms and conditions for issuing guarantees/sureties on a case-by-case basis.

TABLE 14: Sales of sureties and guarantees (in PLN million)

Item	2018		2017	
	Volume	Value	Volume	Value
Sureties and guarantees provided on a portfolio basis	42,914	11,684.9	43,178	10,473.5
Portfolio De Minimis Guarantee Facility	34,619	10,169.1	39,912	9,913.7
PGF COSME	8,268	1,469.5	3,258	546.9
GF OPSG	27	46.3	8	13.0

Off- and on-balance sheet liabilities of the liquidated National Fund of Credit Guarantees (Krajowy Fundusz Poręczeń Kredytowych – KFPK) and the EU Guarantee Fund (Fundusz Poręczeń Unijnych – FPU)

KFPK and FPU are the former surety funds that were liquidated by BGK in 2009. On the date of their liquidation, the obligations of these funds were taken over by BGK. At the time when they were most active, the funds totalled ca. PLN 200 million and PLN 1,000 million, respectively. In 2018, the portfolio includes expiring or impaired items. Off-balance sheet liabilities arising from sureties provided as a security for the repayment of business loans from the former KFPK amounted to PLN 33.2 million as at 31 December 2018. Off-balance sheet liabilities arising from sureties provided from the former FPU amounted to PLN 5.6 million as at 31 December 2018. Gross receivables arising from KFPK sureties and guarantees used as at the end of 2018 totalled PLN 71.0 million.

Development of the surety and guarantee system in the EU Financial Perspective 2014-2020

In 2018, the National Guarantee Fund (NGF) was established at BGK, which made it possible to use funds released from financial instruments of operational programmes of the European Union, funds reallocated from BGK's capitals and voluntary participation of stakeholders within any timeframe, thus diversifying the source of financing for de minimis guarantees. The state budget will play a supplementary and supporting role as the guarantor of the system's liquidity.

In 2018, additional support was launched, which took the form of interest subsidies for loans covered by guarantees provided from the GF OPSG, which increased the attractiveness of guarantees and made it possible to achieve planned guarantee sales figures in a faster and safer way. Interest subsidies are an incentive to undertake tasks that contribute to the achievement of objective set by OPSG and a motivation for enterprises to utilise repayable EU funds as an alternative to grant instruments and other support instruments that do not utilise EU funds.

Surety funds

In accordance with the Act on Sureties and Guarantees, the Bank may purchase or acquire shares in regional and local surety funds which offer sureties and guarantees securing the repayment of credits or loans to micro, small and medium-sized enterprises. As at 31 December 2018, BGK's exposure to 18 surety funds, measured at cost, was PLN 62 million. The guarantee capital at their disposal totalled PLN 554.5 million.

In 2018, the funds provided 7,478 sureties with a total value of PLN 820.2 million. As at 31 December 2018, the active surety portfolio totalled PLN 1,101.8 million.

4.10 COOPERATION WITH INTERNATIONAL PUBLIC INSTITUTIONS

Internationally, in 2018 BGK regularly cooperated with three groups of public entities:

- international financial institutions,
- foreign banks and development institutions,
- international associations.

Cooperation with International Financial Institutions (IFI)

European Investment Bank (EIB)

The EIB remains BGK's main EU partner in the acquisition of funding for programmes, funds and own activities.

In 2018, BGK continued the allocation of funds under the Multi-Beneficiary Intermediated Loan V contract from 2016 for EUR 125 million. The funds secured under the EIB's global loan are used to finance investment projects implemented by local governments, SMEs as well as mid-caps.

In 2018, BGK continued its cooperation with the EIB in the area of funding secured for the National Road Fund, as part of which it entered into a EUR 580 million loan agreement for co-financing of the construction of the S19 expressway between Lublin and Rzeszów, and a EUR 500 million loan agreement for co-financing of the construction of the S61 expressway from Ostrów Mazowiecka to the state border in Budzisko, which is a part of Via Baltica. The Bank also participated, together with the EIB, in the financing of Tramwaje Śląskie and the Posejdon complex. Cooperation with the EIB also included a loan repayment guarantee provided to the EIB and continuous cooperation related to the financing of the National Road Fund.

BGK continued to cooperate with the EIB, acting as an entity granting loans for financing investments that consist in the regeneration of problem areas in the Pomorskie, Mazowieckie and Śląskie provinces (for more information see Section 4.12).

European Investment Fund (EIF)

In 2018, executed two major agreements on guarantees for the SME sector.

The first one was related to guarantees provided by BGK under the COSME programme and provided for an increase in the guarantee portfolio facility by PLN 1,600 million, to PLN 3,200 million, and extension by one year of product availability. Higher limit resulted in BGK's increased participation in the Investment Plan for Europe, the so-called Juncker Plan.

The second agreement concerned counter-guarantees and was executed as part of the "Creative Europe" programme aimed at supporting efforts to secure external financing by enterprises active in the field of culture and art, named the creative sector. The programme has also been established under the Juncker's Plan. The guarantee under the Creative Europe programme will make it possible to secure financing for Polish businesses for a total of PLN 525 million.

BGK also continued its activities within the framework of the Polish Growth Fund of Funds established together with the EIF, the value of which amounts to EUR 90 million. The Fund invests in investment funds which provide funding to business entities that are growing or expanding their operations.

Cooperation with the EIF is also implemented in the "ownership" formula. BGK holds 5 shares in EIF and is its only Polish shareholder.

Other international financial institutions

In 2018, BGK executed a loan agreement with Council of Europe Development Bank (CEB) providing for financing of the residential construction support government programme. The PLN 800 million loan incurred by BGK will be an additional source of external funding for the government programme, next to the existing loan incurred by BGK from the European Investment Bank in 2015.

Moreover, BGK regularly exchanged information on potential areas of cooperation with other international financial institutions, including the World Bank (WB), the European Bank for Reconstruction and Development (EBRD), the Nordic Investment Bank and the International Monetary Fund (IMF).

Bilateral and multilateral cooperation with foreign banks and development institutions

The Bank cooperated with a number of public development banks and institutions from other countries as part of bilateral working meetings and various working initiatives and groups.

As part of the “5+1” group (including five largest development banks in Europe: BGK, CDP of Italy, CDC of France, ICO of Spain, KfW of Germany, and the EIB), the Bank attended the meeting in Hamburg (September 2018). The meeting was devoted to the most important current matters related to activities of development banks, the next EU financial perspective (MFF) and InvestEU.

The group of its close partners includes both the major European public banks and minor banks located in Central Europe. By maintaining these relations, BGK has direct access to information concerning their operations, may exchange know-how and establish business relationships in selected areas.

In 2018, bilateral relations were strengthened, in particular with the largest European development banks and institutions – KfW in Germany, CDP in Italy and CDC in France. BGK participated in workshops on business models used by those development banks.

Further, the Bank fostered positive relations with regional institutions: SIH in Slovakia, CMZRB in the Czech Republic, EximBank in Romania, HBOR in Croatia, and with partners from outside Europe, in particular from Asia.

In 2018, further three institutions became BGK’s partners: Development Bank of Rwanda, Banque Misr and Export Development Bank of Egypt. The signed agreements are designed to strengthening mutual cooperation and offering an opportunity to share information and experience.

Cooperation with international trade associations and organisations

In 2018, BGK was a member of eight international associations, including:

- European Association of Public Banks (EAPB);
- Network of European Financial Institutions for SMEs (NEFI);
- European Association of Guarantee Institutions (AECM);
- European Long-Term Investors Association (ELTI);
- International Project Finance Association (IPFA);
- The Institute of Internal Control (The IIC), USA Branch;
- Information Systems Audit and Control Association (ISACA);
- AML/CFT Committee, Expert Group for International Sanctions of Brussels.

As a member of these associations, BGK was informed of, among other things, planned amendments to EU regulations that could affect its operations. Together with other development banks it was also a partner in a dialogue with EU institutions about instruments that support the economy as well as legal solutions, as well on InvestEU and MFF 2021–2027, which are crucial for the Bank.

In 2018, BGK organised an international conference on guarantee programmes and their impact on economic development through creation of jobs, innovation and economic growth. The event was attended by representatives of, among others, the World Bank, the European Investment Fund, the European Commission, as well as delegates of 47 foreign development institutions. The event featured the General Assembly of the AECM and a meeting of its Board of Directors.

The Three Seas Initiative

In 2018, BGK put forward a concept of establishing an investment vehicle as part of the Three Seas Initiative launched in 2015, whose members include 12 states of Europe: Austria, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia.

As part of the initiative working meetings were held in Prague (May 2018) and Luxembourg (September 2018), attended by development banks and institutions from member states, at which the establishment of the Three Seas Investment Fund was discussed. During the Three Seas Initiative's summit in Bucharest in September, BGK, together with the representatives of five institutions of Croatia, the Czech Republic, Latvia, Romania and Slovakia, signed a joint letter of intent on the establishment of the Three Seas Investment Fund.

The overriding objective of the Fund is to participate in financing of strategic infrastructure projects in the region in the area of transport, energy and digitisation. The flagship project for the region is the Via Carpatia, a route linking Klaipeda with the port in Thessaloniki. The expected budget of the Fund is EUR 3–5 billion, while the estimated value of projects in which the Fund could be engaged is approximately EUR 100 billion.

4.11 PUBLIC FINANCE CONSOLIDATION MANAGEMENT

In accordance with the Public Finance Act of 27 August 2009 (as amended), since 2011 the Bank has been administering the process of consolidation of public funds and since 1 January 2015 it has also been responsible for the management of deposit accounts of the Minister of Finance (MF).

Under the Agreement of 19 December 2014 between the Minister of Finance and BGK (as amended), BGK is responsible for:

- carrying out operations related to the acceptance of unallocated financial resources of public sector entities as deposits or under management;
- refunding the amounts provided to the Minister of Finance, with interest, to the bank accounts of those entities;
- maintaining bank accounts for the Ministry of Finance for the purposes of accepting amounts from those entities and refunding them, in addition to transferring interest accrued on such amounts;
- processing transfers initiated by the Ministry of Finance from the bank accounts maintained by BGK;
- preparing reports on the amounts accepted as deposits or under management for the Ministry of Finance.

Under the Agreement of 3 December 2014 between the Minister of Finance and Bank Gospodarstwa Krajowego (as amended), BGK is responsible for:

- carrying out operations related to the management of the deposit accounts of the Minister of Finance (analytical records of each deposit placed under the control of the court, held in each deposit account of the Minister of Finance, daily interest accrual and periodic capitalisation of interest due on each deposit placed under the control of the court);
- maintaining bank accounts for the Ministry of Finance for the purposes of accepting amounts from the deposit accounts of the Ministry of Finance as overnight deposits and refunding them, in addition to transferring interest accrued on such amounts;
- preparing reports on deposits placed under the control of the court for the Minister of Finance;
- cooperating with the heads of courts of general jurisdiction and managers of public sector entities providing services to military courts or their field divisions with respect to the management of the deposit accounts of the Minister of Finance assigned to each court.

As at 31 December 2018, the total value of consolidated funds amounted to PLN 54.9 billion and was PLN 12.7 billion higher compared to the figure as at the end of 2017.

Consolidation of public finances

As at 31 December 2018, BGK consolidated 2,243 bank accounts where public funds were deposited. In 2018, the number of transactions whereby term deposits were opened/funds were placed under management for a fixed term was 7,394. As at 31 December 2018, the value of transactions whereby term deposits were made, or funds were placed under management by public sector entities was PLN 37.9 billion. The remaining funds of the said entities were transferred to overnight deposits/placed under overnight management. As at 31 December 2018, the value of funds transferred into overnight deposits/placed under overnight management totalled PLN 11.2 billion.

Deposits placed under the control of the court

In 2015, in accordance with Article 83a of the Public Finance Act, BGK opened deposit accounts for the Ministry of Finance, dedicated for deposits placed under the control of the court for each court of general jurisdiction and each military court. As at 31 December 2018: BGK provided services to 284 courts of general jurisdiction and military courts, for which it opened 3,123 accounts dedicated for deposits placed under the control of the court. As at 31 December 2018, the consolidated amount of deposits placed under the control of the court totalled PLN 5.8 billion.

4.12 EUROPEAN PROGRAMMES

Bank Gospodarstwa Krajowego is an active partner in the implementation of European programmes. The Bank implements programmes on the national and regional level. In 2018, the Bank completed projects in cooperation with local self-governments of all provinces.

Manager of the Mutual Fund/Fund of Funds under Regional Operational Programmes for the years 2007-2013 and 2014-2020

The Bank carries out tasks related to the implementation of financial instruments under the **EU financial perspective for the years 2014-2020**, consisting in the management of funds of funds offering non-grant support for the development of micro, small and medium-sized enterprises, improving energy efficiency, regeneration and support for the unemployed in starting business activity. As at 31 December 2018, the Bank completed projects in cooperation with 15 provinces (Dolnośląskie, Kujawsko-Pomorskie, Lubelskie, Lubuskie, Łódzkie, Małopolskie, Mazowieckie, Opolskie, Podkarpackie, Podlaskie, Pomorskie, Świętokrzyskie, Warmińsko-Mazurskie, Wielkopolskie and Zachodniopomorskie). The total value of fund entrusted to BGK by the authorities of the above provinces is PLN 6,659.6 million. These funds are distributed to beneficiaries of support, mainly to SMEs in the form of loans advanced on attractive terms. This support is available from financing institutions designated by BGK in tender procedures. In 2018, the amount of loans advanced was approximately PLN 1 billion.

The value of projects broken down by region is presented below.



No.	Province	Allocation
1	Dolnośląskie	756.1
2	Kujawsko-Pomorskie	247.1
3	Lubelskie	425.9
4	Lubuskie	301.3
5	Łódzkie	671.6
6	Małopolskie	599.3
7	Mazowieckie	282.2
8	Opolskie	336.3
9	Podkarpackie	257.1
10	Podlaskie	267.0
11	Pomorskie	429.9
12	Świętokrzyskie	285.6
13	Warmińsko-Mazurskie	298.9
14	Wielkopolskie	1,033.2
15	Zachodniopomorskie	468.2
Total		6,659.6

In 2018, within the framework of the **EU financial perspective 2007-2013**, BGK followed the policy of exiting projects related to the management of JEREMIE mutual funds, including those offering non-grant support for entrepreneurship from public funds. The value of projects remaining under BGK's management in Dolnośląskie, Łódzkie and Mazowieckie provinces as at 31 December 2018 was PLN 415.8 million.

Management of funds of funds under the Operational Programme Smart Growth 2014–2020

Equity instruments are implemented through four closed-end investment private equity funds established as part of three sub-measures and one measure under OPSG 2014-2020: sub-measure 3.1.1 *Investments in innovative start-ups – Starter*; sub-measure 3.1.2 *Business angels' group investments in SMEs – Biznest*; sub-measure 3.1.4 *CNFIF – Competitive Nationwide Fund of Innovative Funds*; measure 2.1 *Open innovation – support for technology transfer*. The implementation of each of the above four projects will be based on cooperation and the assignment of functions specified in detail in the Cooperation Agreement signed by specialised entities, i.e. Bank Gospodarstwa Krajowego (BGK), PFR TFI S.A. and PFR Ventures Sp. z o.o. Under the concluded co-financing agreement, BGK is the beneficiary of OPSG funds and the entity responsible for accounting for those funds.

PFR TFI S.A. is responsible for the establishment and management of funds. PFR Ventures Sp. z o.o. acts as the manager of investment portfolios of funds.

As the sole investor in the funds, BGK retains the rights of full control and supervision of the funds that are conferred onto the meeting of investors and the board of investors, throughout the entire project implementation period. The role of the funds is to invest in SMEs through designated financial intermediaries using the proceeds from acquisition by BGK of investment certificates issued by the funds and paid for using the OPSG funds. The value of OPSG projects for equity funds amounts to PLN 784.6 million.

Loan for Technological Innovations / technological grant

Under an agreement signed with the Minister of Development, as of 30 May 2016 BGK acts as an Intermediary Institution responsible for implementing the Loan for Technological Innovations instruments under the Operational Programme Smart Growth 2014–2020. The instrument is a means of providing support to SMEs implementing innovative projects, provided in the form of a technological grant earmarked for the partial repayment of a loan granted by commercial banks for the implementation of aforementioned projects. Enterprises that place innovative products or services on the market may apply for a technological grant of up to PLN 6 million.

The funds entrusted to BGK for that purpose total approximately PLN 2 billion. The role of BGK is to organise calls for applications to provide co-financing to SMEs in the form of a technological grant.

In 2018, BGK made two calls for applications for co-financing, as part of which enterprises submitted 305 applications for the total amount of co-financing exceeding the available budget (PLN 936.5 million). Upon their evaluation, 147 projects have been selected, for which the total amount of co-financing was PLN 434.0 million. Projects were selected based on the awarded number of points – the objective was to select projects that will contribute to the achievement of OPSG objectives to the greatest possible extent.

In 2018, BGK also carried out tasks related to:

- entry into co-financing agreements with enterprises. Since the beginning of its implementation, a total of 396 agreements have been concluded for co-financing totalling approximately PLN 1.3 billion, including 52 agreements in 2018 for co-financing totalling approximately PLN 154 million,
- the payment of co-financing. The amount of payments made by BGK to enterprises totalled approximately PLN 422 million, which enabled the bank to certify eligible expenditures under projects approved for co-financing in the amount of PLN 840.0 million; the high level of payments made by BGK means that the projected level of certification of expenses to the European Commission (187%), adopted by the Council of Ministers, has been achieved,
- on-site checks on projects. In 2018, 28 checks on projects under OPSG 2014-2020 were performed (including: 19 scheduled checks performed during their implementation; 6 scheduled sustainability checks; 3 ad

hoc checks in connection with suspected irregularities in their implementation). Moreover, 21 sustainability checks were performed for projects implemented under OPIE 2007-2013 (previous financial perspective).

- implementation of technical assistance project No. POPT.01.01.00-00-0183/17. In 2018, BGK financed personal costs of the employees involved in completion of tasks related to the implementation of sub-measure 3.2.2 of OPSG Loan for technological innovations. In accordance with the special-purpose grant agreement No. 1/DC-BGK/2018 of 7 March 2018, Bank Gospodarstwa Krajowego was allocated PLN 4.1 million. The funds were earmarked for, among other things, salaries and wages, bonuses, awards and overtime payments – in 2018 a total of 28 FTEs were financed. As at 31 December 2018, PLN 3.8 million of the grant was used.
- implementation of technical assistance project No. UDA-POIR.05.01.00-00-0003/17-00. By 31 December 2018, BGK financed, among other things, the costs related to an application call, assessment of applications by external experts, maintenance of the local IT system LSI 2014-2020. In the area of furnishing institutions, BGK financed, among other things, lease of office space, running costs, purchase of computer hardware, office furniture and stationery. In the area of information and promotion and support for beneficiaries, BGK finance an online informational and promotional campaign, IT training, information posted on BGK's website, distribution of informational and promotional materials, and participation in conferences, workshops and briefings. Spending under the Project also covers the Bank's reallocated costs incurred in connection with the implementation of sub-measure 3.2.2 of OPSG Loan for technological innovations, as well as costs of 2017 that were actually incurred in 2018. As part of the project "Support for management, furnishing of institutions, information and promotion at II – BGK", for 2018 II/BGK received PLN 7.9 million. As at 31 December 2018, PLN 5.3 million of that amount was used.

Financing of regeneration and energy efficiency – 2014-2020 (Loans under JESSICA 2)

Within the framework of the financial perspective 2014-2020, BGK cooperates with regional governments and the European Investment Bank (EIB), acting as an entity granting loans for financing investments that consist in the regeneration of problem areas in provinces and improving the energy efficiency of buildings. Activity to that extent is the continuation of BGK's operations as the Urban Area Development Fund in the financial perspective 2007-2013, i.e. a financial intermediary granting loans under the JESSICA initiative.

In 2018, BGK launched first loans in the Wielkopolskie province, with which the Bank cooperates as an entity implementing a financial instrument (cooperation agreement between BGK and regional government was concluded in November 2016). Loans are granted to local governments, utilities sector entities and enterprises. As at 31 December 2018, BGK advanced 23 loans in the Wielkopolskie province for a total value of PLN 99.3 million. In 2018, PLN 290.0 million entrusted to BGK for loans in the Wielkopolskie province was increased by PLN 20.7 million.

In the process of granting loans for the financing of regeneration, BGK also cooperates with the European Investment Bank (Fund of Funds Manager). Under the operating agreements executed with the EIB, BGK acts as the Financial Intermediary in the Pomorskie (agreement executed in December 2017), Mazowieckie and Śląskie (agreements executed in February 2018) provinces. The amount of funds entrusted with BGK is, respectively, PLN 76.2 million, PLN 103.0 million, and PLN 193.3 million. Application calls in these provinces commenced in the first and second quarter of 2018, and first loan agreements were executed in the third and fourth quarter of 2018.

Apart from funds entrusted to the Bank for preferential loans in regions, BGK also contributes not less than PLN 135 million by co-financing investments (as part of its own activities). That amount will cover the following provinces: Wielkopolskie, Pomorskie, Mazowieckie and Śląskie.

Implementation of financial instruments under Priority Axis I "Universal Access to High-Speed Internet" of Operational Programme Digital Poland

In February 2017, BGK entered into a co-financing agreement with Centrum Projektów Polska Cyfrowa (Digital Poland Project Centre) whereby BGK acts as the Fund of Funds Manager responsible for the implementation of a loan instrument under the **Operational Programme Digital Poland 2014–2020**.

Funds amounting to PLN 686.8 million are made available to telecommunications enterprises through the network of selected financial intermediaries, in the form of loans for the implementation of investments related to the construction, expansion and modification of broadband Internet access networks.

Thus far, BGK has selected two financial intermediaries (ALIOR Bank S.A. and TISE S.A.), who grant loans within the territory of the entire country. By the end of 2018, financial intermediaries advanced 18 loans for nearly PLN 42.6 million.

The Co-financing Agreement provides for the implementation of the project by 31 December 2031.

Rural Areas Development Programme (RADP)

In 2009, BGK began to manage loans from the State Budget for advance funding of operations carried out as part of several measures under the Rural Development Programme 2007-2013. The system allowed local government entities and local operational groups the opportunity to implement water and sewage management projects as well as projects intended to create a system for the collection, segregation and disposal of municipal waste, generate and distribute energy from renewable sources, activate rural population, stimulate the creation of new jobs in rural areas, improve the condition of cultural and natural heritage of rural areas, and also construct, convert, renovate or furnish a permanent marketplace, in a more efficient way.

5,518 loan agreements for the amount totalling PLN 3.9 billion have been concluded under RADP 2007-2013.

Since July 2016, the advance funding mechanism has been continued under the Rural Development Programme for the years 2014-2020. Loans are granted to finance eligible costs of projects implemented by local government entities and local action groups. 372 loan agreements for the amount totalling PLN 268.4 million were concluded in 2018.

Since RADP 2014-2020 started, 938 loan agreements for a total amount of PLN 620.3 million have been concluded.

Support for businesses under the Enterprising Eastern Poland – Tourism Project

The project “*Enterprising Eastern Poland – Tourism*” is implemented by BGK using the funds of the Minister of Investment and Development (funds administrator) under an agreement of 22 December 2016. Its purpose is to provide financial support to business from Eastern Poland. The total amount earmarked for such support is approximately PLN 200 million, which is to be used in the next few years. The funds are made available on a continuous basis as they are released from debt financing instruments, offered by BGK in the 2007-2013 financial perspective as part of the Development of Eastern Poland Operational Programme. The Project, in line with the adopted Investment Strategy, will be implemented until 2027, with the option of extending this time limit by the funds administrator.

The Project funds are used to provide “Tourism Development Loans” to micro-, small- and medium-sized enterprises (SMEs) active in the tourism and related industries, conducting economic activity in provinces of Eastern Europe, i.e. the Lubelskie, Podkarpackie, Podlaskie, Świętokrzyskie and Warmińsko-Mazurskie provinces. The loans are advanced by financing institutions selected by BGK in tender procedures. As at 31 December 2018, 117 loans were advanced for approximately PLN 20.0 million.

4.13 SOCIAL RENTAL HOUSING (SRH) PROGRAMMES

With a view to implement tasks related to supporting social rental housing, the Bank provided funding and managed the following government programmes:

- a programme of repayable financing for SRH, which consists in granting loans with the intention to finance the construction of affordable rental and cooperative tenancy housing,
- a residential construction support programme implemented as part of fulfilling obligations of the liquidated National Housing Fund (NHF). The programme consisted in the provision of loans for investment and construction projects (ICP loan) related to the construction of rental and cooperative tenancy housing.

In July 2018, the Act on State Subsidies to Household Expenses in the First Years of Tenancy was passed. It specifies the rules of awarding subsidies to cover part of the rent for an apartment. Subsidies are addressed to persons who cannot afford to rent or purchase an apartment in the market, and whose income is too high to apply for communal housing. The subsidy system also covered investments implemented as part of SRH. The Act also amended the Act on Certain Forms of Support for Residential Construction. The requirement of selection by all borrowers of the contractor in a contract award procedure was removed and a new instrument was introduced – participation of an investment fund or its SPV in the cost of construction of apartments developed using proceeds from SRH loans. An amended Regulation of the Council of Ministers amending the regulation on the conditions and procedure for repayable funding provided as part of the government residential construction support programme implemented by BGK and on minimum requirements for apartments developed using such financing was signed in December 2018 and is due to become effective in February 2019. The most significant change involves a change of the date when the final building permit decision is required from the stage of submitting an application to the time when a lending decision is made. The above changes were aimed at facilitating the use of the programme by investors.

In 2018, BGK participated in meetings with associations of investors in SRH (social housing associations and housing cooperatives) and organised a cycle of regional conferences for housing cooperatives. Several dozen meetings were also held across the country, during which BGK employees presented repayable financing products and construction loans offered by the Bank.

In 2018, two application calls under the SRH programme were held. In the fourth edition of the programme (held in March) municipal social housing associations submitted 13 applications.

After applications that did not meet statutory criteria and requirements set by the Bank have been rejected and after the resignation of one applicant, 10 applications for financing intended for the construction of 477 apartments, in the amount totalling PLN 58.6 million, were designated for further processing. In the fifth edition of the programme (held in September) 23 applications were submitted. Applicants mostly included municipal social housing associations, but BGK also received one application of a municipal SPV that is not a SHA and three applications of housing cooperatives. After applications that did not meet statutory criteria and requirements set by the Bank have been rejected and after the resignation of one applicant, 19 applications for financing intended for the construction of 1,127 apartments, in the amount totalling PLN 150.9 million, were designated for further processing. BGK assumes that the vast majority of loan agreements under the fourth and fifth edition will be signed in the first quarter of 2020, whereas funds will be disbursed successively in the period from 2020 to 2022.

As part of management of applications submitted in the 2016-2018 edition, BGK granted 31 loans in the amount totalling PLN 180.1 million from funds acquired at the European Investment Bank (EIB) and own funds. They were earmarked for the implementation of projects for the construction of 1,460 apartments. 612 apartments were made available for use in 2018.

Apart from its duties related to financing the construction of rental housing arising in relation to the implementation of government programmes, BGK offers construction loans on commercial terms. In 2018, BGK granted a total of 11 construction loans for an aggregate of PLN 35,0 million for the construction of 515 affordable apartments for rent (including 7 loans for an aggregate PLN 25.0 million for the construction of 359 apartments refinanced using the proceeds from the loan advanced to BGK by the EIB).

Fulfilment of the obligations of the former National Housing Fund (NHF)

A major part of the Bank's operations focused on the management of the portfolio of loans granted from the liquidated National Housing Fund, in particular on amending contractual provisions to comply with legal regulations in force, updating legal security interests and monitoring credit exposures.

As at 31 December 2018, the on-balance-sheet exposures of the former National Housing Fund was PLN 3,785.5 million and were PLN 187.4 million lower than as at the end of 2017.

As at the end of 2018, there was still one loan amounting to PLN 31.6 million, intended to finance the construction of 283 housing units, remaining to be disbursed from the funds of the liquidated National Housing Fund.

The transfer of title to housing units

The provisions laid down in the Act of 19 August 2011 amending the Act on Certain Forms of Support for Residential Construction and the Act on Housing Cooperatives allowed for housing units constructed with the use of loans granted by BGK from the funds of the former National Housing Fund and own funds as part of fulfilling the fund's obligations to be converted into privately-owned housing units.

In 2018, 69 borrowers filed 321 applications for the transfer of title to housing units. In connection with the transfer of title to 489 housing units PLN 22.8 million of debt under the loan was repaid, and the Subsidy Fund received PLN 3.7 million on account of the partial relief of a preferential loan for investment and construction ventures (the partial loan relief was available to borrowers if a given investment project was completed within the time limit specified in external regulations, but when the title to housing units constructed with the use of loans from the former National Housing Fund there is an obligation to return the portion of the relief attributable to a given housing unit to the Subsidy Fund).

4.14 INLAND WATERWAYS FUND

The Inland Waterways Fund was created at BGK under the Act on the Inland Waterways Fund and the Reserve Fund of 28 October 2002. It is the only credit fund established at BGK and operating at the Bank's risk. The purpose of the fund is to support inland waterway transport through the provision of financial support for the modernisation of the shipping fleet as well as other projects intended to restructure inland navigation, including those implemented with a view to protect the natural environment and improve the safety of navigation. By managing the fund, the Bank manages the fund's resources from contributions made by operators of inland waterway vessels, state budget subsidies and grants from the National Fund for Environmental Protection and Water Management as well as executes disbursements from the fund's resources for granted preferential loans and to promote inland waterway transport. Preferential loans constitute de minimis aid, are granted by BGK in compliance with the terms and conditions laid down in the Commission Regulation (EU) No. 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid and are the only form of support for vessel operators granted from the Inland Waterways Fund.

Fulfilment of the Fund's tasks

In 2018, the proceeds of the Inland Waterways Fund totalled PLN 4.1 million, including PLN 1.5 million from a grant received from the National Fund for Environmental Protection and Water Management, whereas its expenditures amounted to PLN 2.9 million. The Bank granted three preferential loans totalling PLN 2 million from the Fund in 2018.

TABLE 15: Key figures relating to the Inland Waterways Fund (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
Carrying amount:				
Balance sheet total	49.7	47.8	1.9	3.9%
Gross loans	5.2	4.5	0.7	15.0%
Profit or loss and amounts disclosed in the schedule:				
Profit or loss	0.5	0.4	0.1	19.6%
Regulatory payments made and contributions paid by shipowners less any reimbursements of unused grant from the National Fund for Environmental Protection and Water	1.4	1.8	-0.4	-23.3%
Preferential loans committed	2.0	1.3	0.7	54.2%
Expenditures on promotion of inland waterway transport	0.0	0.1	-0.1	-

As at the end of 2018, the balance sheet total of the Fund totalled PLN 49.7 million and its gross loan portfolio amounted to PLN 5.2 million. The Fund generated a profit of PLN 0.5 million. Income on investing temporary cash surpluses of the Fund and interest on loans were the key sources of revenue generated by the Inland Waterways Fund.

In 2018, BGK continued to participate actively in works on the new draft Act on the Inland Waterways Fund and the Reserve Fund, carried out at the Ministry of Maritime Economy and Inland Navigation. As a result of the steps taken, in October 2018 the Ministry of Maritime Economy and Inland Navigation referred the new bill to the Standing Committee at the Council of Ministers. The draft provides for the removal of the obligation to pay contributions to the Inland Waterways Fund imposed on vessel operators, introduction of option to apply for the partial relief of a preferential loan, addition of vessel operators carrying out passenger carriage activities and vessel operators from EU Member States to the list of entities eligible for support from the fund. The draft also provides for the financing of promotional, information and scientific activities as well as vessel operator support programmes consisting in subsidies for the purchase of equipment to ensure safe navigation.

4.15 NATIONAL ROAD FUND

The largest cash flow fund managed by BGK is the National Road Fund (NRF). In accordance with the Articles of Association of BGK as well as separate legislation and other legal acts, BGK assumes responsibility for the preparation of the statement of financial position and the statement of profit or loss of each fund related to commissioned activities, including cash flow funds. The assets and liabilities of cash flow funds are not recognised in BGK's statement of financial position as they do not meet the definition of assets and liabilities. The Bank is an organisational unit which – under relevant acts – manages the financial and operating policy of cash flow funds but does not control them, as the Bank does derive economic benefits from their activities and does not bear credit risk related to those assets.

The National Road Fund (NRF), established at Bank Gospodarstwa Krajowego under the Act of 27 October 1994 on Toll Motorways and the National Road Fund, has been functioning within its structures since 2004. The purpose of the fund was to finance the construction and reconstruction of national roads, including motorways and expressways, as well as cover any expenditures related to payments due to toll motorway operators and costs of construction and maintenance of toll collection systems on national roads. By managing the fund, the Bank manages the assets contributed to the fund (proceeds from the fuel charge on motor fuels and gaseous fuels for the propulsion of motor vehicles, refunds from EU funds, proceeds from the electronic and manual toll collection system on national roads, road charges, fines and penalties), acquires external funding through the issue of bonds and taking loans (mainly from the European Investment Bank), executes disbursements from the fund to finance road infrastructure and service the fund's debt.

The NRF is the main source of financing for national roads constructed and modernised as part of multi-annual government road programmes. Currently, the fund is involved in financing *the National Road Construction Programme for the years 2014-2023 (with an outlook to 2025)* – a key document for the implementation of the “*Strategy for Responsible Development until 2020 (with an outlook to 2030)*” in the area of the State transport policy. The limit of expenditures to be financed by BGK from the National Road Fund (NRF) under the Programme was set at PLN 135.0 billion.

Fulfilment of the Fund's tasks

In 2018, the proceeds of the National Road Fund totalled PLN 24.6 **billion**. Proceeds from the key source of its funding, i.e. the fuel charge, reached PLN 5.2 billion. Proceeds from the reimbursement of expenditures incurred on investment projects co-financed from EU funds from the EU budget amounted to PLN 7.1 billion. Proceeds from tranches of loans received from the EIB amounted to PLN 5.1 billion.

TABLE 16: Cash flows of the National Road Fund (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	nominal terr	%
Proceeds from fuel charge	5,213.0	4,470.1	742.9	16.6%
Proceeds from EU funds	7,142.7	8,131.9	-989.2	-12.2%
Proceeds from loans received	5,122.6	1,030.7	4,091.9	397.0%
Proceeds from bond issues	4,286.3	3,174.5	1,111.8	35.0%
Proceeds from toll collection	2,027.5	1,890.7	136.8	7.2%
Proceeds from road tolls, fines and penalties	200.3	211.1	-10.8	-5.1%
Proceeds from toll motorway operators	304.8	234.3	70.5	30.1%
Other proceeds	349.3	178.2	171.1	96.0%
TOTAL INFLOWS	24,646.5	19,321.5	5,325.0	27.6%
Payments for road projects	10,847.4	11,847.5	-1,000.1	-8.4%
Payments for servicing loans and bonds	14,118.3	2,375.8	11,742.5	494.3%
Financing of toll collection systems	402.9	475.2	-72.3	-15.2%
Payments to the toll motorway operators	1,593.5	1,561.3	32.2	2.1%
Other payments	9.5	4.7	4.8	102.1%
TOTAL OUTFLOWS	26,971.6	16,264.5	10,707.1	65.8%

In the second quarter of 2018, the Bank arranged two issues of notes on foreign markets for the National Road Fund under the Euro Medium Term Notes (EMTN) Programme, with a nominal value of EUR 500 million each:

- 7-year notes maturing on 1 June 2025 with a fixed interest rate of 1.375%,
- 12-year notes maturing on 1 June 2030 with a fixed interest rate of 2.0%.

As a result of the issues, the proceeds transferred to the Fund amounted to EUR 992.3 million, i.e. the equivalent of PLN 4.3 billion.

In 2018, BGK concluded two financial agreements with the EIB: "Project: Expressway S19 (Lublin – Rzeszów)" for EUR 580 million, and "Project: Expressway S61 Via Baltica" for EUR 500 million.

Expenditures from the National Road Fund in 2018 totalled PLN 27.0 billion, including:

- payments related to the implementation of road projects by the General Director for National Roads and Motorways, amounted to PLN 10.8 billion;
- expenditures related to the funding of a toll collection system, amounting to PLN 0.4 billion;
- expenditures related to the servicing of bonds and loans amounting to PLN 14.1 billion (PLN 12.9 billion for servicing bonds, including PLN 11.7 billion for bond redemption, and PLN 1.2 billion for servicing loans);
- payments made to the operators of toll motorways, amounting to PLN 1.6 billion.

Statement of financial position and statement of profit or loss

As at 31 December 2018, the balance sheet total of the Fund was PLN 52.9 billion, down by 8.1% compared to the figure as at the end of 2017. Receivables from the public sector, comprising the equivalents of payments disbursed under received loans and bonds issued for the National Road Fund, totalled PLN 50.2 billion as at the end of 2018 and were PLN 2.3 billion lower than the figure as at the end of 2017. Liabilities of PLN 51.1 billion, incurred for the purposes of the National Road Fund, went down by PLN 2.0 billion as compared to the end of 2017. Apart from liabilities arising from bonds issued by BGK for the NRF, the above item included the principal and interest accrued on EIB loans as well as a loan obtained from the Nordic Investment Bank (NIB) in the total amount of PLN 32.5 billion. In 2018, the National Road Fund reported a loss of PLN 2.0 billion.

TABLE 17: Key figures relating to the National Road Fund (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
Balance sheet total	52,896.1	57,538.8	-4,642.7	-8.1%
Receivables from the State Treasury due to settlement of amo	50,219.7	52,533.4	-2,313.7	-4.4%
Liabilities incurred for the purposes of the National Road	51,124.5	53,149.6	-2,025.1	-3.8%
Profit or loss	-1,956.5	-2,010.3	53.8	-2.7%

As a result of the amendment to the Act on Toll Motorways and the National Road Fund (introduced by the Act of 8 December 2017 Amending the Act on Public Roads and Certain Other Acts), in early 2018 the General Inspector of Road Transport (GITD) became eligible to apply for payments from the fund for tasks previously carried out by the General Director of National Roads and Motorways (GDDKiA) related to the financing of preparation, deployment, construction and operation of toll collection systems. In early November 2018, the Bank made the BGK – ZLECENIA communication platform available to GITD, through which GITD can submit disbursement requests in electronic form. At that time GITD took over duties related to toll collection on national roads and motorways from GDDKiA – the proceeds are transferred to the NRF.

The amendment of the act also expanded the list of expenditures made from the National Road Fund resources at the request of the minister in charge of transport for financing the costs of consulting services concerning statutory duties of the minister related to the functioning and development of public road infrastructure.

4.16 RAILWAY FUND

The Railway Fund (RF), established at Bank Gospodarstwa Krajowego under the Act on the Railway Fund of 16 December 2005, has been functioning since 2006. Its purpose is to finance the preparation, construction and modification of railway lines, repairs and maintenance of railway lines, liquidation of superfluous railway lines, current expenses of PKP Polskie Linie Kolejowe S.A. (PKP PLK S.A.) connected with railway infrastructure management duties, and co-financing of the activities of railway infrastructure management entities, which cannot be finance from fees for the use of the railway infrastructure. The scope of expenditures covered by the Railway Fund includes also the financing of purchases and modernisation of rolling stock used for the purposes of diagnosing, maintenance, repair or construction of railway infrastructure and to carry out rescue operations, and the purchase of shares in PKP PLK S.A. from Polskie Koleje Państwowe S.A. (PKP S.A.) by the State Treasury represented by the Minister of Transport. Until the year 2020 the fund finances the tasks of regional governments related to the purchase, modernisation and repair of rolling stock used for the carriage of passengers. By managing the fund, the Bank manages assets originating from proceeds from the fuel charge on motor fuels and gaseous fuels for the propulsion of motor vehicles (in the portion – attributable to the fund) and disburses the fund’s resources to finance the aforementioned tasks.

The Railway Fund’s involvement in financing railway infrastructure managed by PKP PLK S.A. has been specified in the government programme (updated on an annual basis) titled “*National Railway Programme until 2023. Railway infrastructure managed by PKP Polskie Linie Kolejowe S.A.*”, which is a strategic document establishing financial frameworks as well as terms and conditions for the implementation of railway investments within Poland. In addition, in 2018 the Council of Ministers established a multiannual programme “*Support for financing the costs of railway infrastructure management, including its maintenance and repairs, until 2023*”, aimed at improving the availability of transport and integration of communication in different regions of Poland. The programme objectives were defined in the “*Strategy for Responsible Development until 2020 (with an outlook to 2030)*” and the “*Transport Development Strategy until 2020 (with an outlook to 2030)*.” Under the Programme, funds earmarked for its implementation will be sourced from, inter alia, the Railway Fund.

Fulfilment of the Fund’s tasks

Proceeds of the Railway Fund totalled PLN 1.8 billion in 2018 and were primarily comprised proceeds from the fuel charge. Expenditures from the Railway Fund totalled PLN 1.6 billion, including:

- expenditures on the investments of PKP PLK S.A. and PKP Szybka Kolej Miejska w Trójmieście Sp. z o.o. amounting to PLN 1.1 billion,
- payments to regional governments in relation to the purchase, modernisation and repair of rolling stock amounting to PLN 0.1 billion,
- current expenditures in relation to the duties of the infrastructure manager (PKP PLK S.A.) amounting to PLN 0.4 billion.

TABLE 18: Key figures relating to the Railway Fund (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
Carrying amount:				
Balance sheet total	485.4	282.7	202.7	71.7%
Debt securities (measured at cost)	464.4	260.6	203.8	78.2%
Profit or loss and amounts disclosed in the schedule:				
Profit or loss	14.3	20.0	-5.7	-28.5%
Inflows to the Fund:	1,818.4	1,645.9	172.5	10.5%
Proceeds from fuel charge	1,803.2	1,617.5	185.7	11.5%
Other inflows	15.1	28.4	-13.3	-46.8%
Outflows from the Fund:	1,615.7	2,205.2	-589.5	-26.7%
Payments for railway projects	1,614.9	2,204.5	-589.6	-26.7%
<i>investment projects</i>	1,148.3	1,048.8	99.5	9.5%
<i>railway infrastructure management, including maintenance and repairs</i>	5.3	0.0	5.3	-
<i>purchase, modernisation, repair of rolling stock - local governments at regional level</i>	111.3	91.6	19.7	21.5%
<i>purchase of PKP PLK SA shares by the State Treasury</i>	0.0	720.0	-720.0	-100.0%
<i>current expenditures of PKP PLK S.A.</i>	350.0	344.1	5.9	1.7%
Other payments	0.8	0.7	0.1	14.3%

Statement of financial position and statement of profit or loss

As at the end of 2018, the balance sheet total of the Railway Fund was PLN 0.5 billion, i.e. PLN 0.2 billion lower than as at the end of 2017. In 2018, the Railway Fund reported a profit of PLN 14.3 million.

4.17 SUBSIDY FUND

In 2018, BGK used the Subsidy Fund to finance tasks relating to the management of the following programmes:

- fixed-rate housing loan interest subsidy programme (DSS),
- programme of financial aid for families and other persons purchasing their own apartment (Family's Own Home),
- municipal and rental housing financial support programme (BSK),
- programme of state aid for young people in purchasing their first apartment (Apartment for the Young),
- programme of interest subsidies for loans granted by BGK to Social Housing Associations, hereinafter referred to as "residential construction support programme" (SRH).

Fulfilment of the Fund's tasks

Interest rate subsidies

Interest subsidies for fixed-rate housing loans are granted under the *Act of 5 December 2002 on Interest Subsidies for Fixed-Rate Housing Loans*. Under the Fixed-Rate Housing Loan Interest Subsidy Programme (DSS), BGK continued its cooperation with banks with regard to the settlement of interest subsidies and surplus interest paid by borrowers under fixed-rate loan agreements signed with lending banks between 2003 and 2005. BGK grants subsidies in periods when the contractual interest rate according to the fixed interest rate (6.5%) is lower than the statutory WIBOR3M rate increased by a fixed margin of 1.5%. If the contractual interest rate is higher, excess interest repaid by borrowers is subject to settlement.

The surplus interest on fixed-rate housing loans transferred to BGK in 2018 by the lending banks totalled PLN 0.2 million and increased the balance of the Subsidy Fund on that account to PLN 1.9 million.

Rodzina na Swoim (Family's Own Home)

Activities in relation to the management of the Family's Own Home programme (mortgage programme for families) were carried out on the basis of the *Act of 8 September 2006 on the Financial Aid for Families and Other Persons Buying Their Own Apartment*. They consisted in day-to-day management of preferential loan interest subsidy agreements entered into with the lending banks, maintenance of the register of target preferential loan borrowers, payment of subsidies due as well as conducting inspections at the lending banks to verify compliance of loans and subsidies granted with the regulations in force.

As at the end of 2018, the lending banks managed 191,969 preferential loans granted between 2007 and 2013. From the launch of the programme to 31 December 2018, the total subsidies transferred to the lending banks in relation to preferential loans granted were PLN 4,290.6 million, where the subsidies provided in 2018 amounted to PLN 276.4 million.

Support for development of apartments for rent

Activities related to the management of the BSK (municipal and rental housing) programme were carried out on the basis of the *Act of 8 December 2006 on the Financial Aid for the Purposes of Apartments for Rent, Assisted Accommodation, Lodging Houses, Houses for Homeless, Warming Centres and Temporary Shelters* and in 2018 consisted in the entry into and management of financial support agreements for applications accepted in the 2014-2017 edition as well as two application evaluations. The amount disbursed from the programme since its launch until 31 December 2018 totalled PLN 622.5 million, of which PLN 132.3 million was disbursed in 2018. In the spring 2018 edition, 67 applications were considered eligible for support from the Subsidy Fund in the aggregate amount of PLN 68.8 million. In the fall 2018 edition, 47 applications were considered eligible for financial support in the aggregate amount of PLN 105.1 million. In addition, in 2018 one application submitted in the fall 2017 edition was qualified following a positive review of the appeal made by the Rumia Municipality for PLN 1.9 million in support.

Since the launch of the Programme until 31 December 2018, 1,390 credit agreements, amounting to PLN 1,007.0 million have been concluded, of which 128 agreements totalling PLN 132.1 million were concluded in 2018 (terminated agreements excluded). Since the beginning of the programme until 31 December 2018, the investors completed and settled 1,194 projects, resulting in 17,687 apartments and 1,111 places in lodging houses and houses for the homeless being created. This includes a total of 164 projects settled in 2018, which created 2,641 apartments and 108 places in lodging houses and houses for the homeless.

As of 1 July 2018 BGK accepts applications for financial support according to new rules (following the entry into force as of 1 May 2018 of the *Act of 22 March 2018 Amending the Act on Financial Support for Development of Social Housing, Assisted Accommodation, Lodging Houses and Houses for Homeless, the Act on Protection of Tenants' Rights, Municipal Housing Resources and Amending the Civil Code and Certain Other Acts (Journal of Laws of 2018, item 756)*). The time limit for submission of applications in the fall 2018 edition was extended and lasted three months, i.e. from July until the end of September 2018. As of 2019 applications under the programme will be accepted on a continuous basis.

Mieszkanie dla Młodych (Apartment for the Young)

The Bank's activities related to the management of the Mieszkanie dla Młodych (Apartment for the Young) programme were carried out on the basis of the *Act on State Aid Provided for the Purchase of the First Flat by Young People (Journal of Laws of 2018, item 604)*, and in 2018 consisted in maintaining a record of buyers and their children meeting the statutory requirements to obtain the available financial support, transferring the subsidies to down-payment/partial loan repayment to buyers through lending banks, settlement of the funds disbursed and refunded with the lending banks as well as verifying compliance of the financial support provided with the statutory requirements and the terms of agreements entered into by BGK with the lending banks. Since the launch of the programme until 31 December 2018,

BGK transferred financial support totalling PLN 3,009.4 million to lending institutions as loans with a subsidy to own contribution, including PLN 779.1 million in 2018.

Residential construction support programme

Since the launch of the programme until 31 December 2018, BGK disbursed a total amount of PLN 2.0 million as interest subsidies for granted loans. Under the Tripartite Agreement (setting out detailed terms of interest subsidies for loans or bonds, as referred to in Article 15c.2 of the Act on Certain Forms of Support for Residential Construction), concluded on 23 May 2016 between BGK, the Ministry of Infrastructure and Construction and the Ministry of Finance, the proceeds of the Subsidy Fund from the repayment of a portion of forgiven loans were transferred to a separate account of the Subsidy Fund maintained for purposes of managing the Social Rental Housing Programme.

In accordance with the Act of 26 October 1995 on *Certain Forms of Support for Residential Construction* (Journal of Laws of 2018, item 1020, as amended), the title to apartments at the disposal of Social Housing Associations and housing cooperatives, built with the use of BGK loans, may be transferred onto the tenants. A contribution from the State budget, proceeds from the repayment of a portion of forgiven loans related to the aforesaid apartments and income on the Bank's investment of these funds (less disbursed interest subsidies for loans granted) increased the Subsidy Fund by PLN 11.9 million in 2018, thus increasing the balance of these funds in the Subsidy Fund to PLN 22.6 million.

New governmental programme "Mieszkanie na Start" (Off to a Good Start with a Flat)

As of 1 January 2019, under the Act of 20 July 2018 on *State Subsidies to Household Expenses in the First Years of Tenancy* (Journal of Laws of 2018, item 1540), funds from the Subsidy Fund will be used to finance a new governmental programme Off to a Good Start with a Flat. MnS is a government programme of subsidies to rent addressed to tenants of new flats developed or regenerated as an effect of cooperation of investors with municipalities. The subsidies – through municipalities participating in the programme – will be granted to persons who meet the conditions specified in the Act. *Administration activities of the MnS programme by BGK will involve execution of subsidy agreements with municipalities, keeping a record of tenants, making payments of subsidies due to tenants, monitoring the correctness of spending of funds allocated to subsidies, and reporting on programme implementation to entities indicated in the Act.*

TABLE 19: Key figures relating to the Subsidy Fund (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal term	%
Carrying amount:				
Balance sheet total	628.4	454.7	173.7	38.2%
Debt securities (measured at cost)	604.5	444.1	160.4	36.1%
Profit or loss and amounts disclosed in the schedule:				
Profit or loss	3.2	1.2	2.0	166.7%
Proceeds from regulatory payments	1,336.9	1,234.5	102.4	8.3%
Payments for the programme of state aid for the purchase of the first apartment by young people	779.1	761.2	17.9	2.4%
Payments for the Programme of financial aid for families purchasing their own apartment*	268.4	355.6	-87.2	-24.5%
Payments under the municipal and rental housing financial support programme	132.3	86.8	45.5	52.4%

* payments due from January to December 2018 (payments for December fall due in January 2019)

In 2018, the Subsidy Fund received a state budget grant of PLN 1,327.0 million, including PLN 355.0 million earmarked for the Family's Own Home programme, PLN 210.0 million to the BSK (municipal and rental housing) programme and PLN 762.0 million to the Apartment for the Young programme. In addition, in 2018 the account separated within the Subsidy Fund for the purpose of managing the social rental housing (SRH) programme received a PLN 9.9 million subsidy from the State budget.

Statement of financial position and statement of profit or loss

The balance sheet total of the Subsidy Fund as at 31 December 2018 totalled PLN 628.4 million and was PLN 173.7 million higher than as at the end of 2017. In 2018, the Subsidy Fund generated a profit of PLN 3.2 million, up PLN 2.0 million versus 2017.

4.18 STUDENT LOAN AND CREDIT FUND

The legal basis for the operation of the Student Loan and Credit Fund (as of 1 January 2019: the Student Loan Fund), which has been operated by BGK since 1 October 1998, is the Act on Student Credit and Loans of 1998, the Act on Higher Education and Science of 20 July 2018 (Journal of Laws of 2018, item 1668) and the Regulation of the Minister of Science and Higher Education of 20 December 2018 on student loans (Journal of Laws of 2018, item 2468). The statutory objective of the Fund is to provide wider access to tertiary education through a system of preferential student loans in the form of loan interest subsidies or in the form of partial or complete forgiveness of loans. The Fund also disburses funds for the repayment of loans with BGK guarantees, if claims under the loan guarantee may not be satisfied on legal grounds.

Fulfilment of the Fund's tasks

Since the launch of the preferential student loan system, over 398 thousand students have obtained such loans. In 2018, the fund disbursed PLN 15.8 million in interest subsidies for student loans, while student loans cancelled, either in whole or in part, amounted to PLN 1.8 million.

In 2018, the Student Loan and Credit Fund received a state budget grant of PLN 18.9 million. The said subsidy was sufficient to ensure ongoing and timely provision of subsidies in 2018, while the amount which was not used in 2018 (PLN 0.6 million) was refunded to the Ministry of Science and Higher Education in January 2019.

TABLE 20: Key figures relating to the Student Loan and Credit Fund (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
Carrying amount:				
Balance sheet total	0.9	0.6	0.3	50.0%
Debt securities (measured at cost)	0.0	0.0	0.0	-
Profit or loss and amounts disclosed in the schedule:				
Profit or loss	-0.6	-0.6	0.0	0.0%
Income from the state budget	18.9	21.2	-2.3	-10.8%
Payments from the Fund:	17.6	20.1	-2.5	-12.4%
Student loan interest subsidies	15.8	18.5	-2.7	-14.6%
Subsidised student loan forgiveness	1.8	1.6	0.2	12.5%

Statement of financial position and statement of profit or loss

As at 31 December 2018, the balance sheet total of the Student Loan and Credit Fund was PLN 0.9 million, up by PLN 0.3 million as compared to 2017.

The Fund reported a loss of PLN 0.6 million for 2018, similarly as in 2017.

4.19 THERMOMODERNISATION AND REPAIR FUND

The objective of the Thermomodernisation and Repairs Fund is to provide state aid in the form of the thermomodernisation bonus and the repair bonus to investors launching thermomodernisation and repairs projects capable of generating savings of energy consumed for municipal and household purposes, with the use of loans obtained from commercial banks, and the compensation bonus representing partial compensation for owners of units with rent subject to regulation between 1994 and 2005.

The thermomodernisation bonuses and the repair bonuses are granted on the basis of reviewed results of energy and repair audits and paid following the completion of the investment project. They may be used for purposes of repayment of a portion of loans obtained for the implementation of a thermomodernisation and repairs project.

Fulfilment of the Fund's tasks

In 2018, BGK granted the thermomodernisation bonus, the repair bonus and the compensation bonus in partnership with 12 lending banks.

TABLE 21: Key figures relating to the Thermomodernisation and Repairs Fund (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
Carrying amount:				
Balance sheet total	570.7	445.3	125.4	28.2%
Debt securities measured at cost	567.9	444.8	123.1	27.7%
Profit or loss and amounts disclosed in the schedule:				
Profit or loss	2.2	1.0	1.2	120.0%
Proceeds from regulatory payments	251.3	269.0	-17.7	-6.6%
Number of bonuses awarded	1,981	2,635	-654	-24.8%
Number of bonuses paid out	2,278	2,480	-202	-8.1%
Value of bonuses awarded	110.7	151.9	-41.2	-27.1%
Value of bonuses paid out	129.4	142.7	-13.3	-9.3%

The number of new applications for the thermomodernisation bonus, the repair bonus and the compensation bonus received in 2018 was 2,101. 1,981 bonuses totalling PLN 110.7 million were granted. It issued 2,278 bonus decisions for the total amount of PLN 129.4 million.

Liabilities arising from thermomodernisation, repair and compensation bonuses granted but not yet disbursed amounted to PLN 144.5 million as at the end of 2018. In 2018, the amount appropriated from the government budget to the Fund totalled PLN 251.3 million.

Statement of financial position and statement of profit or loss

As at the end of 2018, the balance sheet total of the Thermomodernisation and Repairs Fund increased by PLN 125.4 million compared to the previous year and reached PLN 570.7 million. The Fund reported a profit of PLN 2.2 million for 2018, up by PLN 1.2 million compared to the profit reported for 2017.

4.20 BORROWER SUPPORT FUND

The Borrower Support Fund has been established under the Act on Support for Housing Loan Borrowers in a Difficult Financial Condition of 9 October 2015 (Journal of Laws of 2015, item 1925).

The objective of the Fund is to provide refundable support to individuals in a difficult financial condition who are obliged to repay housing loans that constitute a considerable financial burden on their household budget. The funds are derived from payments made by lenders in proportion to the size of their portfolio of housing loans to households, where the delinquency in payment of the principal or interest exceeds 90 days, refunded support as well as income on invested cash surpluses of the Fund. The initial value of the Fund was PLN 598.7 million. As at 31 December 2018, BGK has entered into agreements with 42 lenders as regards the implementation of the aforesaid legal act.

TABLE 22: Key figures relating to the Borrower Support Fund (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
Carrying amount:				
Balance sheet total	605.8	600.8	5.0	0.8%
Debt securities (measured at cost)	604.1	599.5	4.6	0.8%
Profit or loss	7.7	6.7	1.0	14.9%
Proceeds from regulatory payments	0.0	0.0	0.0	-
Payments for support programmes	4.2	7.3	-3.1	-42.5%

The Borrower Support Fund provides support under agreements concluded between the lender and the borrower. Its amount is expressed in the Polish złoty as the equivalent of the expected 18 monthly principal and interest payments under the housing loan agreement, with the proviso that if the expected monthly principal and interest payment exceeds PLN 1,500, the amount of PLN 1,500 is used as the basis for the determination of the amount of support. The support is provided on an aggregate basis in monthly instalments to the lender's bank account.

As at 31 December 2018, the Bank registered 888 support agreements for the amount of support totalling PLN 19.5 million. As at 31 December 2018, 11,604 instalments were disbursed in the amount of PLN 14.7 million. The Fund received first instalments of support in the amount of PLN 0.2 million. Expenditures from the Fund in 2018 comprised financial support disbursements and commissions.

Statement of financial position and statement of profit or loss

As at 31 December 2018, the balance sheet total of the Borrower Support Fund was PLN 605.8 million. The Borrower Support Fund reported a profit of PLN 7.7 million in 2018.

4.21 NATIONAL GUARANTEE FUND

The National Guarantee Fund has been operated by BGK since January 2018 under the Act of 8 May 1997 on Sureties and Guarantees Granted by the State Treasury and Certain Legal Persons (Journal of Laws of 2018, item 1808) (the Act) as part of the government programme "Supporting Entrepreneurship through BGK Sureties and Guarantees". On 29 January 2018, in accordance with the Act, the National Guarantee Fund received PLN 900 million from BGK's authorised fund.

The establishment of the Fund was aimed at implementing the guarantee model in line with the Strategy for Responsible Development (SRD), i.e. an instrument of systemic strategic intervention in the SME sector that mobilises public and private funds for the implementation of state policy. In accordance with the Strategy for Responsible Development, the commonly available guarantees for SMEs on the one hand will promote the use of financial resources of Polish businesses and motivate them to invest, and on the other hand will improve the efficiency of using EU funds. The establishment of the NGF makes it possible to use funds released from financial instruments of operational programmes at the central level of the current and previous financial perspective of the European Union, funds reallocated from BGK's capitals and voluntary participation of stakeholders within any timeframe, thus diversifying the source of financing for de minimis guarantees.

Fulfilment of the Fund's tasks

In the period of the fund's operation, i.e. from 1 July 2018 to 31 December 2018, 14,390 guarantees were provided for an aggregate of PLN 4,274.2 million. In that period there no payment was made under any guarantee provided.

In 2018, the Fund received PLN 900 million from BGK's authorised fund. In 2018, the Fund did not receive any funds from EU instruments, and it was not necessary to transfer any funds to cover the costs and expenses of the Fund from the State budget.

TABLE 23: Key figures relating to the National Guarantee Fund (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
For the Fund's accounting purposes – balance at the end of the period:				
Balance sheet total	926.6	0.0	926.6	-
Inflows to the Fund in the period, cumulatively, including:	926.6	0.0	926.6	-
under EU instruments	0.0	0.0	0.0	-
other inflows	926.6	0.0	926.6	-
Outflows from the Fund in the period, cumulatively, including:	0.4	0.0	0.4	-
payments under guarantees	0.0	0.0	0.0	-
other outflows	0.4	0.0	0.4	-

Statement of financial position and statement of profit or loss

As at 31 December 2018, the balance sheet total of the Fund was PLN 926.6 million.

The Fund reported a profit of PLN 26.4 million in 2018.

4.22 OTHER PROGRAMMES AND DELEGATED TASKS

Distribution of EU funds

In accordance with the Act on Public Finance of 27 August 2009 (as amended), BGK has been processing payments from EU funds to beneficiaries since January 2010. Under the aforesaid act, payments may also be made as part of state aid distributed through BGK.

Under an agreement with the Ministry of Finance as well as agreements with the Ministry of Regional Development, the Ministry of Labour and Social Policy as well as the Ministry of Health, the Bank is obliged to:

- disburse payments from EU funds and state aid;
- maintain bank accounts in the Polish złoty for purposes of payment processing;
- prepare appropriations for purposes of making payments;
- cooperate with the Ministry of Finance, administrators of each budget function as well as institutions that submit payment instructions insofar as it is necessary for their processing, including reporting, registration of refunds and preparation of the related reports.

In 2018, the Bank processed:

- 34 payment instructions totalling PLN 83.1 million under EU funds as part of the 2007-2013 Financial Perspective;
- 105,909 payment instructions totalling PLN 48.5 billion, including 527 payment instructions for PLN 23.0 million with respect to state aid under the Financial Perspective 2014-2020.

Since the launch of the service until the end of 2018, the Bank processed:

- 741,762 payment instructions totalling PLN 275.1 billion, including 12,786 payment instructions of PLN 670.3 million with respect to state aid in the 2007-2013 Financial Perspective;
- 201,712 payment instructions totalling PLN 95.0 billion, including 945 payment instructions for PLN 40.6 million with respect to state aid under the Financial Perspective 2014-2020.

Banking services related to and the accounting for liabilities and receivables of the State Treasury

In 2018, BGK fulfilled tasks required by its cooperation with the Ministry of Finance, which consisted in the provision of banking services related to and the accounting for foreign and domestic liabilities and receivables of the State Treasury. As at the end of 2018, foreign liabilities of the State Treasury under BGK's management totalled USD 56.2 billion, and its receivables amounted to USD 1.7 billion.

Fixed-Rate Export Loan Interest Subsidy Programme

BGK manages the Fixed-Rate Export Loan Interest Subsidy Programme on behalf of the Ministry of Finance.

In 2018, BGK received one application for a commitment to enter into an agreement under the said Programme. The agreement with the applicant bank is expected to be signed by the end of the first quarter of 2019.

As at the end of 2018, the value of the export contracts supported under the Programme managed by BGK totalled EUR 244.2 million and CAD 165.3 million. They are financed by loans amounting to DKK 289.3 million, NOK 926.1 million and CAD 135.4 million.

Since the launch of the Programme in 2003, BGK has made a total of 50 commitments to provide subsidies for export loans financing export contracts totalling USD 1,446.0 million, EUR 973.3 million, NOK 380.0 million, CAD 165.7 million and GBP 15.2 million.

Programmes launched by the Minister of Family, Labour and Social Policy

In 2018, BGK managed four programmes launched by the Minister of Family, Labour and Social Policy.

Under an agreement of 25 April 2016, BGK has been offering a **refundable support instrument to Social Economy Entities (SEEs), financed by the Operational Programme Knowledge Education Development 2014–2020 (POWER)**. Assets entrusted to BGK amount to approximately PLN 158 million. That amount will be used to provide refundable preferential financing to SEEs (loans and counter-guarantees).

The Bank acts as the Fund of Funds Manager in that programme and selects financial intermediaries granting support to eligible SEEs under an open tendering procedure. Agreements with financial intermediaries have been concluded in December 2016.

Ultimately, approximately 2030 preferential loans is to be granted under the aforesaid loan instrument. On account of high demand for loans among SEEs, the 2nd tranche of POWER funds has been released for loans.

As supplementation to loan products available to SEEs, funds from the repayment of loans granted under the pilot programme, i.e. in the 2007-2013 perspective, have been used to launch a guarantee instrument for SEEs by decision of the Ministry of Development and the Ministry of Family, Labour and Social Policy. BGK offers that instrument in partnership with banks associating co-operative banks that may grant loans secured with a BGK guarantee to SEEs.

Under a partnership agreement with the Ministry of Family, Labour and Social Policy and the Nowy Staw Foundation, BGK implements a programme *Creation and development of existing quality labels for social economy entities and local government units supporting the development of social economy, POWER*. The role of BGK as a partner consists in supporting the Ministry in the preparation, implementation and settlement of the project, work of project teams and issuing opinions on documents prepared by the programme Partners. BGK participates actively in development of procedures for financial assessment/economisation of social economy entities and their modification at a later stage. BGK is involved in the application call by, among other things, supporting entities applying for a certificate. As part of the tasks it was entrusted with, BGK organises support for winners, including through purchase of third-party advisory or training services using project funds. In 2018, under the project 27 social economy entities were certified with the "Quality Label".

Payment of compensations due for real property left outside the current borders of RP

Since 2006, BGK has been processing payments relating to cash compensation for real property left outside the current borders of the Republic of Poland (the so-called Bug River Area Displaced Person Act of 8 July 2005).

In 2018 alone, the Bank made nearly 3.2 thousand payments totalling PLN 216.8 million. Since the introduction of the aforesaid compensation until the end of 2018, the Bank processed 73.5 thousand payments totalling PLN 4,500.4 million.

First Business – Start-Up Support programme

The Bank also acts as the fund operator under the “**Pierwszy Biznes – Wsparcie w Starcie**” (**First Business – Start-Up Support**) Programme implemented nationwide since 2014. The purpose of the programme is to develop entrepreneurship and create new jobs as part of labour market development, counteracting unemployment and promoting employment. Under the Programme, students, graduates and the unemployed may apply for low interest loans to start their own business or create jobs for the unemployed. Under the Programme, applicants and borrowers may use free advisory and training services, including related to setting up economic activity, keeping accounting records or marketing.

The financial intermediaries selected by the Bank in tender procedures assume responsibility for granting loans as well as the provision of training and advisory services. In the first half of 2019, a further tender procedure will be launched to select new financial intermediaries that will provide support under the programme in eight regions and three macro-regions. As at 31 December 2018, since the programme had been launched a total of 4,307 loans were provided for more than PLN 275.2 million, of which 4,195 loans for PLN 272.5 million were related to setting up economic activity and 112 loans for PLN 2.6 million were related to job creation/furnishing a workplace for the unemployed.

In 2018, BGK managed a number of smaller-scale delegated programmes.

4.23 OPERATIONS OF THE BGK GROUP ENTITIES

Investment and capital activities

In carrying out the mission of supporting the economic growth of Poland, apart from banking instruments and operations under government programmes, Bank Gospodarstwa Krajowego also actively carries out operations related to capital investments. These operations are carried out by closed-end investment funds and entities established by those funds. Investment funds were established by Towarzystwo Funduszy Inwestycyjnych (Investment Fund Company) created previously by BGK (sold to Polski Fundusz Rozwoju S.A. as of September 2017) and are managed by companies dedicated to that purpose.

In the area of reindustrialisation and infrastructure project financing, the managing authority is PFR TFI S.A., a company owned by PFR S.A., which is one of the pillars of Polish development institutions. In the area of supporting foreign expansion of Polish enterprises, the dedicated investment fund is managed directly by PFR TFI S.A. PFR TFI entrusted the implementation of investment projects in the area of housing to a specialised entity PFR Nieruchomości S.A., while in other areas – to PFR S.A. In addition, the Bank also holds shares in Korporacja Ubezpieczeń Kredytów Eksportowych S.A., with which the Bank cooperates on the implementation of a government export support programme and on securing debt financing transactions to the extent of foreign trade.

The BGK Group entities carrying out capital investment activities as at 31 December 2018 include:

- Fundusz Sektora Mieszkań na Wynajem FIZ AN,
- Fundusz Sektora Mieszkań dla Rozwoju FIZ AN,
- Fundusz Ekspansji Zagranicznej FIZ AN,
- Special purpose vehicles of Fundusz Sektora Mieszkań dla Rozwoju FIZ AN,
- Special purpose vehicles of Fundusz Sektora Mieszkań na Wynajem FIZ AN.

Reindustrialisation and infrastructure project financing

PFR S.A. is an entity which PFR TFI entrusted with management of funds established by BGK and PFR S.A., implementing equity investments in the area of reindustrialisation and infrastructure project financing.

Fundusz Inwestycji Polskich Przedsiębiorstw FIZ AN is a fund established to support investments made by entities whose activity is strongly connected to the Polish economy. The Fund specialises in manufacturing companies and companies providing services to the industrial sector. Its investment strategy stipulates that the fund will finance the investments

of entities with the majority of their production capacity or income located in the territory of the Republic of Poland. As at 31 December 2018, the issue value of fully-paid certificates held by BGK was PLN 1,296 million.

Infrastructure investment debt and equity funds finance investments in the energy, oil and gas, transport and logistics industries, among others. Financing can be provided either as debt or equity financing and can be used to finance new assets or modernise existing assets. Poland is the primary territory in which the funds focus their investments is Poland, but the financing of cross-border investments is possible as well. The issue value of certificates held by BGK as at 31 December 2018 was PLN 1,902 million for the equity fund (fully paid) and PLN 129.7 million for the debt fund (of which PLN 126.9 million was paid up).

Fundusz Inwestycji Samorządowych FIZ AN finances investment projects implemented in cooperation with local government entities in the following industries and areas: water supply and sewage systems, heating, waste management, infrastructure and transportation. As at the end of 2018, the total issue value of fully-paid certificates held by BGK was PLN 310 million.

Housing

The financing of housing development is a major task carried out by BGK Group within the framework of supporting the Strategy for Responsible Development adopted by the Council of Ministers. The purpose of pursued operations is to support social and territorial development and promote equal social opportunities. Apart from financing social rental housing construction programmes and government programmes of subsidies for the young and families, the Bank also supports housing development by constructing rental housing and investing in the segment of affordable housing, in cooperation with closed-end private equity investment funds. The funds are managed by PFR TFI S.A., which entrusted the management of the asset portfolios to PFR Nieruchomości S.A.

The area of investment funds, the Bank implements tasks related to ensuring access to housing for young families and persons with relatively low income (housing investments under the Dwelling for Development Sector Fund) as well as promoting social mobility and labour market balance through the development of the institutional rental housing sector (continuation of the Dwelling for Development Sector Fund programme).

Fundusz Sektora Mieszkań na Wynajem FIZ AN is a fund that invests in companies building real estate intended for rental. The projects implemented under this fund include real property investment projects in six largest agglomerations of Poland. It was also responsible for the pilot projects under the government programme Apartment+ which primarily focused on activities to promote the construction of rental housing in smaller urban areas to ensure access to housing for people with a relatively low income.

The operations of Fundusz Sektora Mieszkań na Wynajem FIZ AN consist in investing funds collected through non-public offering of investment certificates. The Fund will attempt to achieve its investment objective mainly by purchasing and taking up shares and debt securities issued by Special Purpose Vehicles. Special purpose vehicles implement construction projects related to the erection of buildings as well as purchase and sale of real estate at their own expense, and then they rent housing units in owned multi-family residential buildings. They also carry out real estate activities. Special purpose vehicles established to implement investments form part of the BGK Group and are subject to consolidation using the full consolidation method. As at 31 December 2018, The Fund held 13 SPVs (a detailed list of the SPVs can be found in the consolidated financial statements of the BGK Group, in the sub-chapter concerning the composition of the BGK Group).

The total value of issued certificates was PLN 1,392 million, whereas BGK's contributions totalled PLN 1,037.2 million.

Fundusz Sektora Mieszkań dla Rozwoju FIZ AN (formerly: Fundusz Muncypalny) is a fund that invests in the segment of affordable housing and in local government infrastructure. In December 2017, the fund was transformed into Fundusz Sektora Mieszkań dla Rozwoju FIZ AN, it was subject to major structural changes and is currently taking over part of the assets of Fundusz Sektora Mieszkań na Wynajem FIZ AN, which mostly include investments related to the pilot programme Apartment+.

The fund's investments consist in acquiring and subscribing for shares and debt securities issued by SPVs and advancing loans to SPVs as well as providing sureties and guarantees at the request of SPVs established for the purposes of implementation of investment projects. The Fund can also engage in real estate projects implemented under public private partnership as the financing entity. Special purpose vehicles established to implement investments also form part of the BGK Group and are subject to consolidation using the full consolidation method. As at 31 December 2018: The Fund held 32 SPVs (a detailed list of the SPVs can be found in the consolidated financial statements of the BGK Group, in the sub-chapter concerning the composition of the BGK Group).

As at the end of 2018, the total issue value of fully-paid investment certificates of the fund was PLN 549.8 million.

Foreign expansion financing

The BGK Group provides financial support for foreign expansion of Polish enterprises through Fundusz Ekspansji Zagranicznej FIZ AN managed by PFR TFI S.A. The Fund invests in investment projects related to the establishment of new or acquisition of existing companies outside the borders of the Republic of Poland together with Polish partners. The Fund does not have a narrow sector focus, making investments together with Polish expansion-stage enterprises.

Fundusz Ekspansji Zagranicznej FIZ AN invests proceeds from non-public offerings of investment certificates. The Fund seeks to achieve its investment objective mainly by purchasing and subscribing for shares and debt securities issued by project companies, advancing loans to project companies as well as providing sureties and guarantees at the request of project companies. Some of the project companies of the Fund are consolidated with the Group's results using the equity method. As at 31 December 2018, these were the following three foreign entities: Esotiq Germany GMBH (with its registered office in Germany), UAB EMP Recycling (Lithuania) and ASM Germany GmbH (Germany). The first aforementioned entity carries out activities related to retail sale of textile products, the second entity buys in bulk, processes and sells secondary raw materials, while the third provides sales support services. The fund's share in those companies does not exceed 50%.

As at 31 December 2018, the total issue value of FEZ FIZ AN certificates amounted to PLN 316.5 million, of which PLN 224.9 million was paid up.

Other operations of BGK's associates

Associates consolidated with the BGK Group's results with the equity method also include Korporacja Ubezpieczeń Kredytów Eksportowych S.A., which cooperates with the Bank to carry out activities designed to supporting exports and foreign expansion of Polish businesses, as well as entities providing sureties on a local scale in cooperation with BGK, i.e. 14 surety funds and an SPV Krajowa Grupa Poręczeniowa Sp. z o.o. The Bank also holds shares in four lower-value surety funds.

Korporacja Ubezpieczeń Kredytów Eksportowych S.A.

Korporacja Ubezpieczeń i Kredytów Eksportowych S.A. is a Polish insurance company whose shareholders are the State Treasury and Bank Gospodarstwa Krajowego. BGK holds a share of 36.69%. KUK S.A. insures commercial transactions of Polish enterprises, enabling them to safely pursue commercial trade both domestically and abroad. KUK S.A. focuses its operations on insuring receivables from the sale of goods and services with a deferred payment date and on providing insurance guarantees.

KUK S.A. is the only insurance company in Poland with the right to offer export insurance policies guaranteed by the State Treasury that provide security in trading on high-risk markets. KUK insurance policies also cover long-term export investment projects financed by a loan with a repayment period longer than 2 years.

As part of its cooperation with KUK S.A., Bank Gospodarstwa Krajowego insures the majority of debt financing provided as well as guarantee and letters of credit in the area of financing export and foreign expansion support. This applies, in particular, to the financing of transactions on high risk markets covered by State Treasury guarantees. In addition, BGK provides financing to KUK Finance S.A. in relation to factoring activity carried out by the said subsidiary (KUK S.A. holds 100% of shares).

Surety funds and the National Guarantee Group

In accordance with the Act on Sureties and Guarantees, the Bank may purchase or acquire shares in regional and local surety funds which offer sureties and guarantees securing the repayment of credits or loans to micro, small and medium-sized enterprises. As at 31 December 2018, BGK had an equity interest in 18 surety funds, of which 14 were recognised as associates. The detailed list of those funds can be found in the consolidated financial statements of the BGK Group.

The Bank and surety funds entered into an arrangement concerning the National Guarantee Group, the purpose of which was to establish a joint action platform and ensure that surety activities are pursued in compliance with the best standards and practices. A special purpose vehicle under the name Krajowa Grupa Poręczeniowa Sp. z o.o. was established for that purpose.

The vehicle's objective is to take and support actions to strengthen surety funds and raise their importance as a special instrument supporting micro, small and medium-sized enterprises. Cooperation between the Bank, surety funds and the SPV resulted in the development of an IT solution designed to streamline surety and information flow management processes, including:

- Following the takeover of the Nationwide System Supporting the Provision of Sureties (OSWUP) together with servers, the SPV maintains the operation of the system and its servers and makes its functionalities available to surety funds. The system enables registration of requests for surety, their processing and management after a surety is provided, and the preparation of reporting data.
- The SPV extended the OSWUP system with the e-SOP Reporting module, which ensures full digital management of the database on sureties and financial statements.
- Also, the system was extended by adding the e-SOP Registers module, which enables the exchange of monthly and quarterly data on sureties sourced from syndicates established by KGP Sp. z o.o. as part of cooperation with lease companies.

The SPV creates websites for surety funds and provides their content and IT support and manages the relevant e-mail accounts. At present, it manages three external websites: www.poreczenia-kredytowe.info, www.swientokrzyskifp.pl, www.pzfp.pl.

4.24 TRANSACTIONS WITH ASSOCIATES OF BGK

A detailed list of transactions with entities linked by equity or organisationally to BGK has been presented in Note 41 to separate financial statements of BGK.

5. STRATEGY AND DEVELOPMENT DIRECTIONS OF BGK AND THE BGK GROUP

5.1 STRATEGY OF BGK AND THE BGK GROUP

BGK is currently implementing its strategy for 2017–2020. The mission, vision and values defined in the strategy continue to apply. BGK's mission is to support social and economic growth of Poland and the public finance sector in the performance of its tasks. The four key pillars of the mission are based on core values: professionalism, partnership cooperation and commitment.

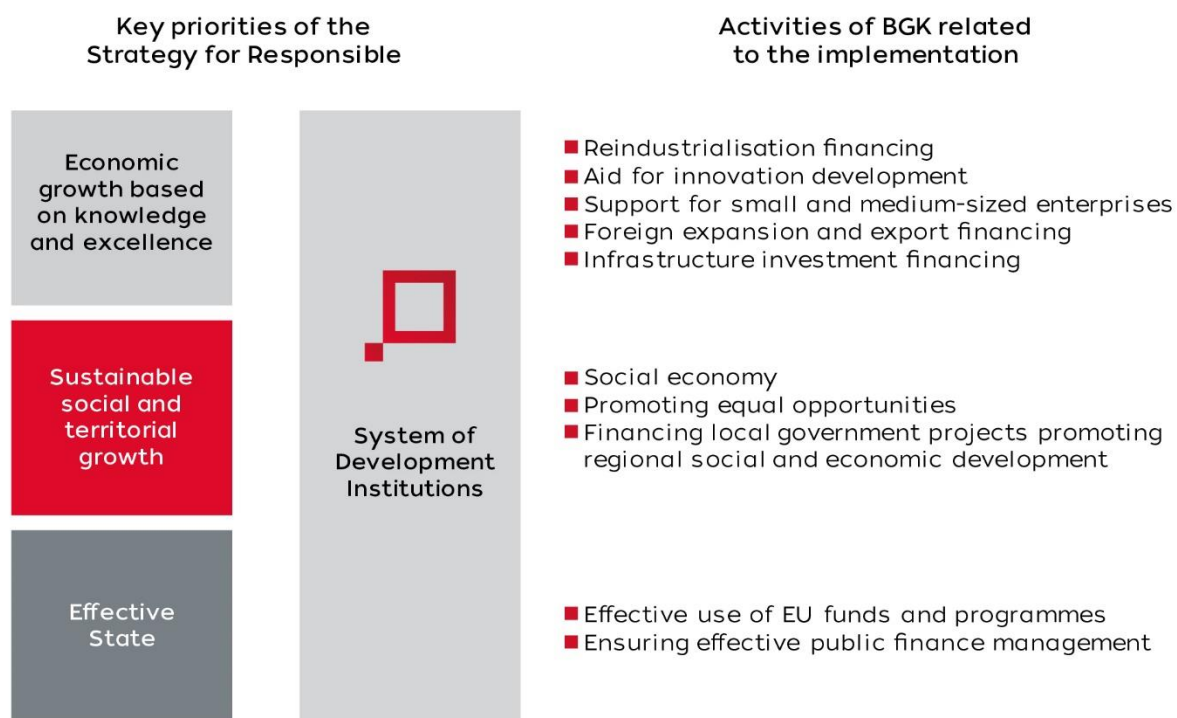
BGK's mission and its pillars



The BGK's strategy results from the challenges faced by the Polish economy and addressed, inter alia, as part of the Strategy for Responsible Development (SRD). It prioritises economic growth based on knowledge and excellence, sustainable social and territorial development and an effective State.

In the process of drafting the strategy for the years 2017-2020, BGK prepared action plans for key areas defined in the Strategy for Responsible Development.

The Bank's mission in the implementation of the Strategy for Responsible Development (SRD)



BGK's objective is to initiate and carry out activities, that are conducive to general growth, it finances infrastructure projects, provides sureties and guarantees as well as manages numerous programmes, including improving the situation on the real estate market. In 2018, the Bank opened its foreign agency in Brussels, which, among other things, will strengthen Poland's presence in foreign markets. Another five foreign agencies are to be opened in 2019.

5.2 DEVELOPMENT DIRECTIONS OF THE BGK GROUP

In its operations in the next few years the BGK Group will continue to pursue the priorities defined in the strategy for 2017–2020 based on three main pillars:

- Economic growth based on knowledge,
- Sustainable social and territorial growth,
- Effective State.

Economic growth based on knowledge

As part of supporting knowledge-based economic growth, the BGK Group will engage in financing reindustrialisation and infrastructure investments, supporting foreign expansion and export of Polish enterprises, supporting small and medium-sized enterprises, and facilitating innovation development.

Reindustrialisation and infrastructure investment financing

The Bank intends to further increase the funding for enterprises and ensure a rapid growth of guarantee operations supported by use of its specialist knowledge and experience, also with the aid of industry specialists. The Bank will be a member in bank syndicates due to the specific terms of such financing, including a very long financing period and complex financial and legal structures.

In the area of equity financing, the scale of activity is determined in cooperation with institutions supporting economic growth. The Bank will continue its efforts in international cooperation as part of Marguerite Fund and the Polish Growth Fund of Funds.

A new international initiative, implemented jointly by development institutions mostly from Central and Eastern Europe countries, in which BGK will act as an investor, is the establishment of the Three Seas Fund. The fund will support key infrastructure investments in that part of Europe.

Supporting foreign expansion and export of Polish enterprises

The Bank plans to significantly increase its involvement in financing the foreign expansion and export of Polish enterprises in the form of loans, letters of credit, purchase of debts and provision of guarantees, as well as through equity financing through Fundusz Ekspansji Zagranicznej FIZ AN.

The main pillar of BGK's operations in that area is the Financial Exports Support Programme. The Programme is intended to improve the competitive position of Polish exporters and increasing Polish exports by facilitating access and to Polish goods and services, ensuring more attractive financing terms for purchase of Polish goods and services, and significantly reducing the export risk of Polish businesses. To that end, BGK advances loans to buyers of Polish goods and services or their banks with insurance provided by Korporacja Ubezpieczeń Kredytów Eksportowych S.A. (KUKE S.A.).

Support for small and medium enterprises

In the area of SME sector support, the Bank will continue to operate the *de minimis* guarantee programme through the National Guarantee Fund and utilise EU funds to reduce the competitive gap of that sector. In 2018, the National Guarantee Fund was established, which took over the provision of *de minimis* guarantees under the previous programme implemented in 2013–2018.

In 2019, sale of guarantees provided from the Guarantee Fund under the Operational Programme Smart Growth (GF OPSG) will be continued. The guarantees offered to SMEs under the GF OPSG are designed to increase the willingness of businesses to invest, at the same time improving the efficiency of use of EU funds.

Aid for innovation development

Activities in the area of supporting innovation are carried out by BGK as part of sub-measure 3.2.2 "Loan for Technological Innovations", the Operational Programme Smart Growth 2014–2020, in the area of guarantee instruments provided in cooperation with European financial institutions, using other funds under the EU financial perspective for 2014–2020, and through establishment of investment funds financing research and development work.

In 2019, the Bank plans to execute further agreements with SMEs on co-financing and disbursement of technological grants, provide guarantees counter-guaranteed by the European Investment Fund (EIF) under the COSME programme.

Activities in the area of use of equity financial instruments are carried out through four closed-end private equity investment funds established as part of three sub-measures and one measure under OPSG 2014–2020:

- sub-measure 3.1.1 *Investments in innovative start-ups – Starter;*
- sub-measure 3.1.2 *Business angels' group investments in SMEs – Biznest;*
- sub-measure 3.1.4 *CNFIF – Competitive Nationwide Fund of Innovative Funds;*
- measure 2.1 *Open innovation – support for technology transfer.*

Additionally, the Bank is working on the establishment of the research and development fund in cooperation with the Ministry of Science and Higher Education. The projected final scale of investments will amount to PLN 500 million. The Fund will be established in the first half of 2019.

Sustainable socio-economic growth

The area of social economy and promoting equal opportunities features a whole spectrum of instruments related to the development of housing and ensuring access to housing for young families and persons with relatively low income as

well as instruments to promote social mobility and labour market balance through the development of the rental housing sector.

The Bank's operations in the area of housing involve the implementation of dedicated government programmes (cash flow fund operations) and investment activity through funds managed by PFR Nieruchomości. As part of its ongoing operations, the Bank will manage credit exposures related to the portfolio of the former NHF, including the process of transferring of title to dwellings to their existing tenants.

In the area of cash flow funds related to housing, BGK will support the financing of purchases of dwellings and houses for young families (Family's Own Home and Apartment for the Young), social housing and rent subsidies.

The "First Business – Start-Up Aid" programme supports development of entrepreneurship and creation of new jobs as part of labour market development, counteracts unemployment and promotes employment. BGK acts as the programme manager.

The Operational Programme Digital Poland 2014–2020, as part of which BGK uses the entrusted funds to support, through repayable financial instruments, projects aimed at developing, extending or altering telecommunications infrastructure ensuring access to fast broadband Internet.

Effective State

On account of the specific nature of activities carried out by BGK, a major element of the Bank's development are activities specified in the "Effective State" priority. These activities include the effective implementation of EU programmes as well as public finance and commissioned government programmes management. It is also important for BGK and the Group to utilise the bank's potential in cooperation with Polish development institutions.

The primary objectives of projects supported under Regional Operational Programmes are to: develop SME entrepreneurship, improve energy efficiency in the housing and public building sector and energy efficiency of SMEs, develop the labour market, finance renewable energy source and regenerate urban areas. The Bank will cooperate with local government partners on the best plan of actions co-financed from EU funds that is tailored to the specific nature of the region.

As part of activities carried out under the EU perspective 2014-2020, BGK will focus on increasing the pace of absorption of EU funds under Regional Operational Programmes.

Effective use of EU funds and programmes

Implementation of financial instruments as part of the Regional Operational Programme (ROP) for 2014–2020 is a continuation of the Bank's prior activity in the field of non-grant support for entrepreneurship from public funds.

The primary objectives of projects supported under ROP are to: develop SME entrepreneurship, improve energy efficiency in the housing and public building sector and energy efficiency of SMEs, develop the labour market, finance renewable energy source and regenerate urban areas. Support is provided through financial lending instruments (microloans, loans), surety instruments and equity investments.

Ensuring effective public finance management

As regards activities oriented towards public finance sector management and distribution of EU funds, BGK will carry out actions to maintain a high standard of service and aim to achieve operational excellence.

Cultural transformation at BGK and the BGK Group

Development directions defined in that way require major investments to raise the operating efficiency and deep changes to the culture of the Bank and BGK Group. Operational excellence is one of four main pillars of the strategy of BGK adopted by the Supervisory Board for the years 2017-2020. Therefore in 2019 and following years the Bank plans to increase its efforts to raise its efficiency by optimising and digitising processes as well as improving staff involvement.

*Report of the Management Board on the Activities of the Bank Gospodarstwa Krajowego Group in 2018
(comprising the report of the Management Board on the activities of Bank Gospodarstwa Krajowego)*

The year 2018 was the first full year of major changes related to the transformation of organisational culture that promotes professionalism, partnership and involvement. The change of organisational culture is a key element of implementing the strategy of BGK and enable the introduction of many necessary changes and strategic investments.

6. FINANCIAL STANDING OF THE BGK GROUP AND BGK

6.1 FINANCIAL PERFORMANCE OF THE BGK GROUP

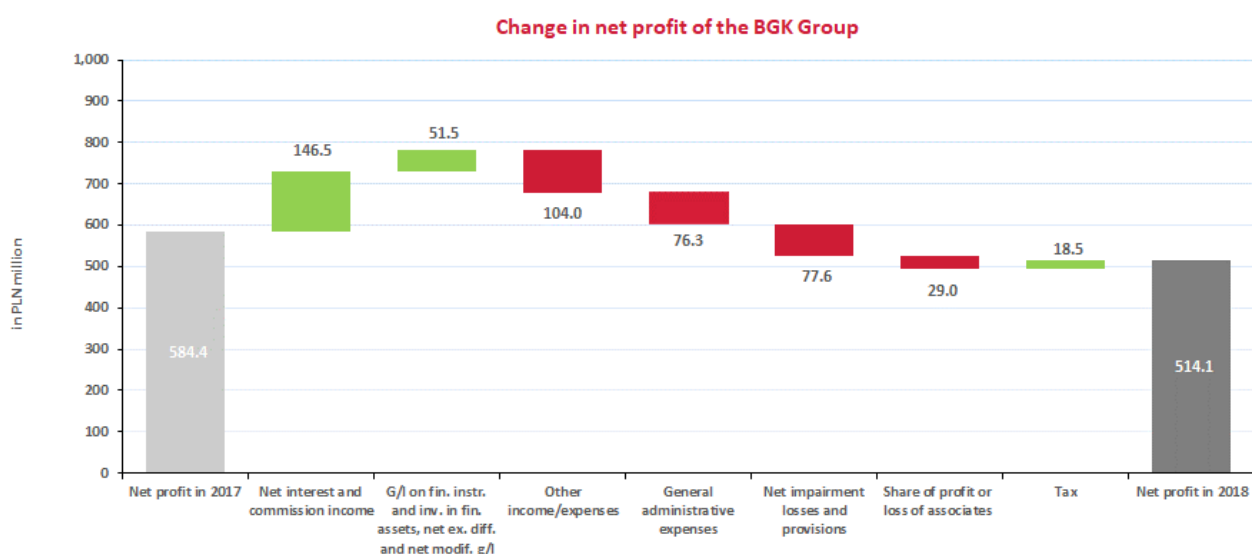
The BGK Group reported a net profit of PLN 514.1 million for 2018, down by PLN 70.3 million compared to profit reported for 2017. Worse performance was mostly attributable to non-recurring events which weighed on BGK's net profit.

TABLE 24: Statement of profit or loss of the BGK Group (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	1 nominal term	%
Interest income	889.1	776.1	113.0	14.6%
Fee and commission income	190.1	156.6	33.5	21.4%
Gain/loss on financial instruments at fair value through profit or loss and net exchange differences	51.2	26.2	25.0	95.3%
Gain/loss on investments in financial assets	60.5	30.6	29.9	97.8%
Net banking operations	1,190.9	989.5	201.4	20.4%
Other income/expenses	-31.4	72.6	-104.0	-143.2%
General administrative expenses	-470.3	-394.0	-76.3	19.4%
Net modification gain/loss	-3.4	0.0	-3.4	-
Net impairment losses and provisions	-127.2	-49.6	-77.6	156.3%
Operating profit/loss	558.6	618.5	-59.9	-9.7%
Share of profit or loss of associates	43.0	72.0	-29.0	-40.3%
Profit before tax	601.6	690.5	-88.9	-12.9%
Income tax	-87.5	-106.0	18.5	-17.5%
Net profit	514.1	584.4	-70.3	-12.0%
Net profit attributable to the owner of the Parent	514.4	584.6	-70.2	-12.0%
Net profit per non-controlling interest	-0.3	-0.1	-0.2	158.7%

The following had the greatest impact on net profit compared to the previous year:

- net interest, fee and commission income – up by PLN 146.5 million,
- net other income/expenses (taking into account non-recurring events) – down by PLN 104.0 million,
- net impairment losses and provisions – increase in provisions by PLN 77.6 million,
- share of profit or loss of associates – down by PLN 29.0 million.



Statement of profit or loss

Net interest, fee and commission income

Net interest, fee and commission income for 2018 amounted to PLN 1,079.2 million and was PLN 146.5 million higher year on year. That increase was primarily the result of an increase in profit of PLN 143.3 million reported by BGK. It was attributable primarily to the increase in interest income earned by BGK by PLN 109.7 million, which was mainly the result of increased lending and deposit activities and an increase in fee and commission income by PLN 33.6 million.

Net income on financial instruments and investments in financial assets

Net income on financial instruments and investments in financial assets for 2018 amounted to PLN 111.7 million and was PLN 54.9 million higher compared to the result achieved in 2017. The rise was primarily the result of a PLN 51.4 million increase reported by BGK. The improved performance for 2018 was significantly affected by dividends received by the Bank in 2018, amounting to PLN 17.4 million, which were PLN 15.1 million higher than a year before.

Other operating income and expenses

Net other expenses for 2018 amounted to PLN -31.4 million and the result was lower by PLN 104.0 million compared to that achieved in the previous year. The key cause of the drop were two events relating to the Bank's operational and business risk.

Following an audit, the Bank Operational Risk Committee approved the recognition of a provision for operational risk relating to the operations of financial intermediaries in connection with irregularities in performance of agreements with one of the intermediaries. The Bank terminated all agreements and filed a notification of suspected crime with the Prosecutor's Office. The Bank resolved to recognise a PLN 67.2 million provision for disputes under other expenses. In connection with the termination of the agreement with the existing integrator and with the risk that the requirements specified in the Terms of Reference may be inconsistent with the changing business needs, the Bank decided to suspend the implementation of a key IT system and engage an independent company to carry out a comprehensive audit of the Bank's IT architecture. The results of the audit will determine the Bank's further decisions in this matter. In consequence, the Bank decided to recognise an impairment loss on property, plant and equipment and intangible assets of PLN 14.2 million.

General administrative expenses

General administrative expenses of the BGK Group for 2018 amounted to PLN 470.3 million and were PLN 76.3 million higher compared to those incurred in 2017. The increase in expenses was attributable mainly to higher operating expenses of BGK, which went up by PLN 81.2 million. The rise was owed to the efficiency improvement projects and initiatives (including digitalisation of processes and commitment of staff).

Net impairment losses and provisions

Net impairment losses and provisions of the BGK Group for 2018 amounted to PLN -127.2 million and were PLN 77.6 million lower compared to the result achieved in 2017. The result is attributable to higher credit exposure and a conservative approach to credit risk as part of the Bank's core activities, with a low 2017 base.

Share of profit or loss of associates

The share of profit or loss of associates of the BGK Group in 2018 amounted to PLN 43.0 million and was PLN 29.0 million lower compared to the share reported for 2017. The change in relation to the previous year resulted from the current valuation of investments implemented by funds managed by PFR S.A.

Tax

The value of tax for 2018 was PLN 87.5 million and was PLN 18.5 million lower compared to 2017.

6.2 STATEMENT OF FINANCIAL POSITION OF BGK GROUP

In 2018, the balance sheet total reported in the statement of financial position as at the end of 2018 was PLN 84,772.3 million.

BGK Group assets

The largest item of assets were net credit exposures, with a share of 38.7%, whose carrying amount as at the end of the year totalled PLN 32,820.6 million.

The value of investments in associates as at the end of 2018 rose by PLN 2,817.4 million compared to 2017 and totalled PLN 3,883.6 million, which represents approximately 4.6% of the balance sheet total.

Changes in the remaining items recognised under assets of BGK Group were attributable mainly to the management of the liquidity position of BGK as well as changes in prepayments and accruals and settlements.

The asset structure of the BGK Group in 2017 and 2018 is presented on the figure below.

TABLE 25: Asset structure of the BGK Group (in PLN million)

Item	Performance		Change versus 2017 (pp)
	2018	2017	
Cash with the Central Bank	19.7%	1.3%	18.4
Receivables from banks	9.9%	4.4%	5.5
Net credit exposures	38.7%	36.6%	2.1
Debt instruments and derivatives	19.9%	51.7%	-31.8
Receivables under reverse repurchase agreements	4.6%	2.8%	1.8
Investments in associates	4.6%	1.4%	3.2
Other assets	2.7%	1.7%	1.0

BGK Group liabilities and equity

Liabilities to customers had the largest share in the liabilities and equity of the BGK Group, representing 56.2% of total liabilities and equity as at the end of 2018. Liabilities to customers as at the end of the year amounted to PLN 47,637.3 million, up by PLN 13,945.0 million in relation to the previous year. The higher share of liabilities to customers in liabilities and equity, which was up by 10.9 pp, resulted from the rise in liabilities and the balance sheet total of the BGK Group.

The share of total equity of the BGK Group in total liabilities and equity fell slightly by 4.3 pp, to 22.7%.

The value of liabilities arising from the issue of securities of the BGK Group amounted to PLN 5,787.2 million as at the end of 2018, i.e. went down by PLN 512.1 million in relation to 2017. As at the end of 2018, liabilities to banks stood at PLN 5,456.2 million, having grown by PLN 577.5 million year on year.

Changes in the remaining items recognised under liabilities of BGK Group were attributable mainly to the management of the liquidity position of the Bank. With capital totalling PLN 19,233.7 million, the BGK Group has significant potential to increase its involvement in lending activity, increase its investment activity, supporting the economic growth of Poland in such areas as reindustrialisation and infrastructure investments, and supporting the foreign expansion of Polish enterprises.

TABLE 26: Structure of liabilities and equity of the BGK Group (in PLN million)

Item	Performance		Change versus 2017 (pp)
	2018	2017	
Liabilities to banks	6.4%	6.6%	-0.1
Liabilities to customers	56.2%	45.3%	10.9
Liabilities under securities issued	6.8%	8.5%	-1.7
Liabilities under repurchase agreements	6.2%	10.2%	-4.0
Other equity and liabilities	1.7%	2.4%	-0.7
Total equity	22.7%	27.0%	-4.3

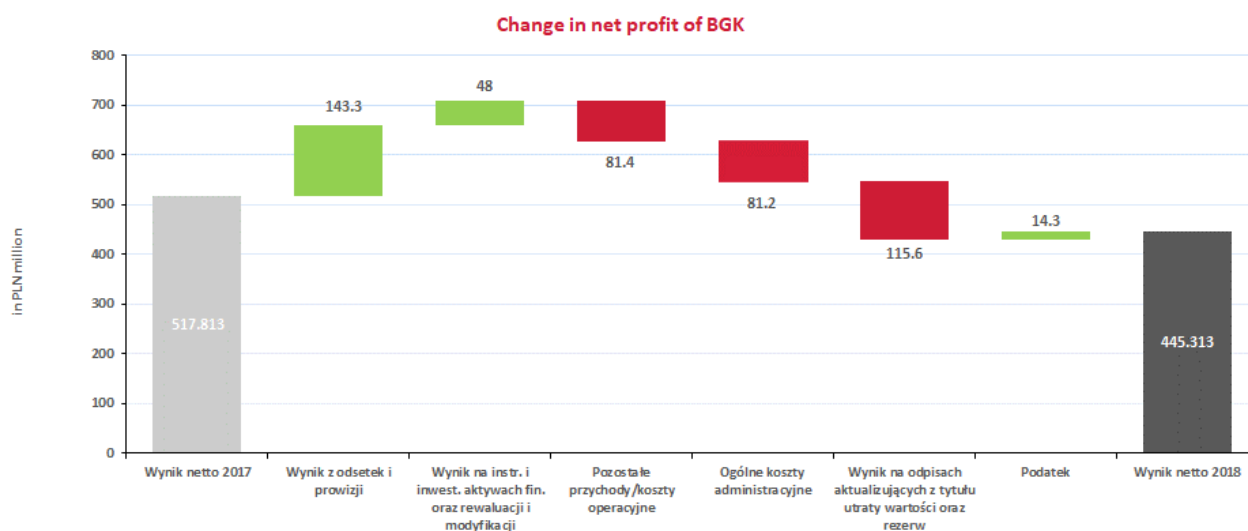
6.3 FINANCIAL PERFORMANCE OF BANK GOSPODARSTWA KRAJOWEGO

BGK reported a net profit of PLN 445.3 million for 2018, which means a decrease of PLN 72.5 million as compared to the previous year. Lower net profit was down primarily due to an increase in impairment losses compared to the relatively low amount reported in 2017, and non-recurring events charged to other expenses. The Bank's gross profit was PLN 519.5 million, down by PLN 86.7 million (14.3%) year on year.

TABLE 27: Statement of profit or loss of BGK (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
Interest income	882.8	773.1	109.7	14.2%
Fee and commission income	190.4	156.8	33.6	21.4%
Gain/loss on financial instruments at fair value through profit or loss and net exchange differences	52.1	26.2	25.9	98.7%
Gain/loss on investments in financial assets	48.4	22.8	25.6	112.2%
Net banking operations	1,173.7	978.9	194.8	19.9%
Other income/expenses	-83.6	-2.2	-81.4	3761.6%
General administrative expenses	-402.1	-320.9	-81.2	25.3%
Net modification gain/loss	-3.4	0.0	-3.4	-
Net impairment losses and provisions	-165.2	-49.6	-115.6	232.9%
Operating profit/loss	519.5	606.2	-86.7	-14.3%
Profit before tax	519.5	606.2	-86.7	-14.3%
Income tax	-74.1	-88.4	14.3	-16.2%
Net profit	445.3	517.8	-72.5	-14.0%

The item which contributed the most to the decrease in net profit by 14.0% relative to the figure reported for the previous year was net impairment losses and provisions – the charge increased by PLN 115.6 million.



Net interest income

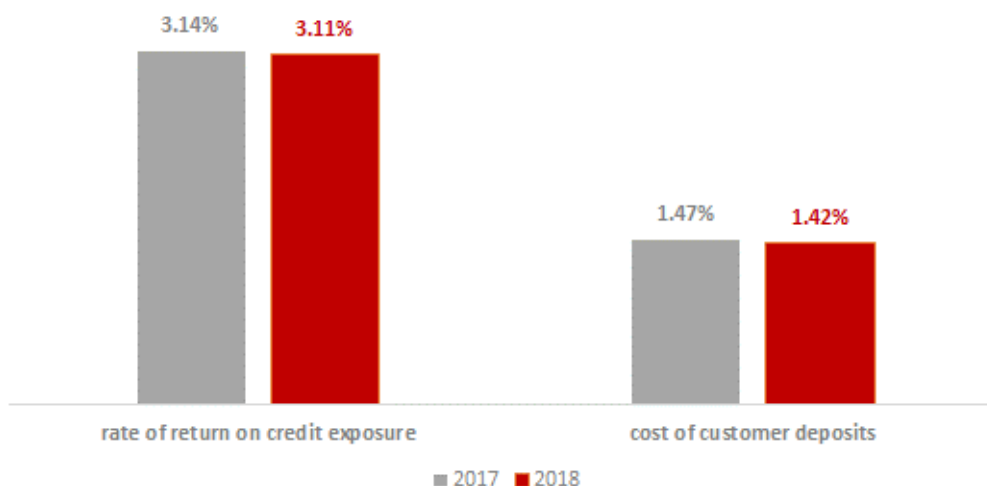
As at the end of 2018, net interest income totalled PLN 882.8 million and went up by PLN 109.7 million (14.2%) compared to the previous year.

The increase in interest income was primarily attributable to the greater scale of lending and deposit activities.

Compared to 2017, both interest income and expenses have increased – by PLN 200.7 million and PLN 90.9 million, respectively.

The average level of interest-bearing assets was PLN 89.5 billion, i.e. went up by PLN 9.1 million year on year.

The average rate of return on assets in 2018 was similar to the one achieved in 2017 and amounted to 2.12% (as compared to 2.09% in 2017).



Income on credit exposures represented the largest component of interest income and amounted to PLN 1,054.3 million, up PLN 43.1 million (4.3%) compared to the previous year. The rate of return on that portfolio was 3.11%, compared to 3.14% for 2017. The average balance of credit exposures went up by 5.3%, from PLN 32.2 billion in 2017 to PLN 33.9 billion in 2018.

The next largest component of interest income is income on debt securities that totalled PLN 721.4 million, i.e. went up by PLN 94.7 million (15.1%) in relation to the previous year. In 2018, the average balance of debt securities was PLN 42.8 billion, up by PLN 6.1 billion (16.7%).

The average balance of other interest-bearing assets (BSB, nostro accounts and interbank deposits) in 2018 was PLN 12.9 billion, which means an increase of PLN 1.1 billion on the preceding year.

In 2018, the average balance of interest-bearing liabilities was PLN 72.2 billion, up by PLN 5.8 billion (8.8%) in relation to the previous year.

An increase in interest expenses was mainly driven by an increase of 2 bps in the cost of debt as compared to 2017, up to 1.41% in 2017. That increase was attributable primarily to change in the product structure (volume of negotiated deposits went up by PLN 1.2 billion).

Customer deposits represented the biggest component of interest liabilities. The average level of customer deposits in 2018 was PLN 61 billion, i.e. it went up by PLN 6.0 billion (10.9%) compared to 2017. Cost of customer deposits was 5 bps lower than in 2017.

Interest expenses on liabilities arising from issue of debt securities and loans received went down by PLN 11.1 million, while the average balance of such liabilities was PLN 8.8 billion, down by PLN 0.5 billion than the average balance for 2017.

Net commission income

Net commission income amounted to PLN 190.4 million and was PLN 33.6 million higher than the result achieved in 2017. Commission income went up by PLN 32.7 million. The rise was mainly attributable to higher provisions on guarantee commitments, which increased by PLN 27.9 million. In addition, in 2018 BGK generated higher income on fund and programme management (up by PLN 11.4 million). The fee expense saw a drop of PLN 0.9 million.

TABLE 28: Net commission income structure (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
Net commission income	190.4	156.8	33.6	21.4%
Commission income	200.8	168.1	32.7	19.5%
- on loans and advances and securities operations	50.4	57.3	-6.9	-12.0%
- on guarantee commitments	64.1	36.2	27.9	77.2%
- on fund and programme management	58.8	47.4	11.4	24.0%
- other commission income	27.5	27.2	0.3	1.1%
Commission expense	10.4	11.3	-0.9	-8.0%

Net income on financial instruments and investments in financial assets

As at the end of 2018, income on dividends amounted to PLN 17.4 million and was PLN 15.1 million lower compared to the value from the previous year.

Foreign exchange gains amounted to PLN 26.4 million at the end of 2018. They were PLN 0.9 million higher than gains achieved in 2017.

In 2018, net income on financial instruments grew to PLN 56.7 million, up by PLN 35.4 million relative to 2017, mainly as a result of sale of a bond portfolio at a high margin.

TABLE 29: Net income on financial instruments and investments in financial assets (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
Gain/loss on financial instruments and investments in financial assets	100.5	49.1	51.4	104.8%
Dividends	17.4	2.3	15.1	660.0%
Foreign exchange gain/loss	26.4	25.5	0.9	3.5%
Gain/loss on instruments	56.7	21.3	35.4	166.4%

Other income / expenses

As at the end of 2018, net other expenses amounted to PLN 83.6 million. They were PLN 81.4 million lower compared to 2017. The key reason for the said difference was the change in provisions for disputes and receivables from sundry debtors (see Section 6.1).

TABLE 30: Other operating income and expenses (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
Other income/expenses, including:	-83.6	-2.2	81.4	-97.4%
balance of provisions for disputes and receivables from sundry debtors	-68.1	2.2	70.3	-103.3%
donations	-4.0	-8.2	-4.2	103.7%
other	-11.4	3.8	15.2	-133.1%

General administrative expenses

In 2018, general administrative expenses totalled PLN 402.1 million, which means an increase by PLN 81.2 million (25.3%) in relation to the previous year.

The rise was owed to the efficiency improvement projects and initiatives (including digitisation of processes and commitment of staff).

As regards organisational matters, a number of changes were made to prepare the organisation to effectively perform BGK's mission and multi-annual strategy. An integral element of the changes is cultural transformation, which includes

the promotion of a sense of responsibility as well as managerial and business maturity, which is the basis for the implementation of effective communication as well as process-based and project-based management. In effect, BGK is becoming an institution with state-of-the-art management tools at its disposal to effectively support the performance of the Bank's tasks both in the area of execution of government programmes and in distribution of EU funds.

TABLE 31: Operating expenses, depreciation and amortisation (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
General administrative expenses	-402.1	-320.9	-81.2	25.3%
Employee benefits	-273.0	-223.8	-49.2	22.0%
Material costs	-108.3	-74.5	-33.8	45.4%
Depreciation and amortisation	-20.8	-22.6	1.8	-8.0%

Net impairment losses and provisions

As at the end of 2018, net impairment losses and provisions amounted to PLN 165.2 million and changed by PLN 115.6 million year on year.

TABLE 32: Net impairment losses and provisions (in PLN million)

Item	Performance		Change versus 2017	
	2018	2017	in nominal terms	%
Net impairment losses and provisions	-165.2	-49.6	-115.6	233%
provisions for credit exposures	-74.5	-5.0	-69.5	1384%
impairment losses on contingent liabilities and guarantees	-49.5	-36.7	-12.8	34.8%
impairment losses on subsidiaries and associates	-41.2	-7.9	-33.3	422.9%

Net impairment losses and provisions reflect the Bank's conservative approach to measurement of credit risk. The factors that mostly contributed to the increase included higher value of the total loan portfolio, higher risk, change of scenarios for some clients and greater exposure on clients with higher credit risk, in particular in the healthcare entities sector.

Income tax

Income tax for the year 2018 totalled PLN 74.1 million, down by PLN 14.3 million year on year. The effective tax rate was 14.3% versus 14.6% as at the end of 2017.

6.4 STATEMENT OF FINANCIAL POSITION OF BANK GOSPODARSTWA KRAJOWEGO

In 2018, the balance sheet total reported by the Bank was PLN 84,746.4 million. It went up by PLN 10,412.3 million, i.e. 14.0%, year on year. The said increase was mainly attributable to:

- increases related to the development of lending and investment activities,
- higher liquid assets resulting from deposits from central budget units.

An increase in customer deposits was the key factor affecting the rise in the balance sheet total of the Bank.

Balance-sheet credit exposures (loans, municipal and commercial bonds) increased by PLN 5,889.6 million, i.e. 21.0%, over the end of 2017. That growth was mainly attributable to the development of enterprise financing.

TABLE 33: Asset structure of BGK

Item	Performance		Change versus 2017 (pp)
	2018	2017	
Cash with the Central Bank	19.7%	1.3%	18.4
Receivables from banks	9.3%	4.2%	5.1
Net credit exposures	38.7%	36.6%	2.1
Debt instruments and derivatives	19.8%	51.6%	-31.8
Receivables under reverse repurchase agreements	4.6%	2.8%	1.8
Investments in subsidiaries and associates	6.6%	2.8%	3.8
Other assets	1.3%	0.6%	0.7

Cash and balances with the Central Bank

As at the end of 2018, the balance of deposits with the Central Bank was PLN 16,668.9 million, having increased by PLN 15,618.3 million relative to the end of 2017.

Receivables from banks, including in nostro accounts (except cash deposited with the National Bank of Poland)

As at the end of 2018, the portfolio of receivables from banks amounted to PLN 7,904.4 million and was higher by PLN 4,814.7 million year on year.

Credit exposures

Gross credit exposures as at the end of 2018 amounted to PLN 33,881.6 million, i.e. went up by PLN 5,889.6 million in relation to the balance as at the end of 2017. The highest increase over the end of 2017, i.e. by PLN 3,024.0 million, was reported for corporate and financial sector loans, with the second largest rise posted for self-government units and municipal companies (up by PLN 1,256.0 million).

Debt instruments and derivatives

The item includes debt and equity securities. As at the end of 2018, the amount of such securities fell compared to the end of 2017 by PLN 21,194.4 million, to PLN 15,834.2 million. There was a change in the structure of interest-bearing assets – NBP money market bills dropped by PLN 20,114.2 million. The difference was offset by higher cash with the Central Bank and receivables from banks.

Purchase of securities under reverse repurchase agreements

Receivables due to reverse repo and buy-sell-back transactions totalled PLN 3,874.7 million as at the end of 2018 and were higher by PLN 1,769.1 million than at the end of 2017. The balance of those receivables is related to liquidity operations.

Investments in subsidiaries and associates

The value of the share investments in subsidiaries and associates portfolio measured at carrying amount grew in 2018 by PLN 3,457.9 million year on year, to PLN 5,556.8 million.

In May 2018, BGK sold 100% of shares in Podkarpacki Fundusz Poręczeń Kredytowych Sp. z o.o., in August 2018 it sold 100% of shares in Krajowy Fundusz Kapitałowy S.A., and in October 2018 the Bank sold 100% of shares in BGK Nieruchomości S.A.

In 2018, BGK held investment certificates with a total value of PLN 5,446.8 million in its portfolio (total amount paid), up PLN 3,486.6 million than in 2017.

TABLE 34: Structure of liabilities and equity of BGK

Item	Performance		Change versus 2017 (pp)
	2018	2017	
Liabilities to banks	4.6%	4.8%	-0.2
Liabilities to customers	56.4%	45.5%	10.9
Liabilities under securities issued	6.8%	8.5%	-1.7
Liabilities under repurchase agreements	6.2%	10.2%	-4.0
Other equity and liabilities	3.5%	4.1%	-0.6
Total equity	22.6%	27.0%	-4.4

Liabilities to customers

In 2018, the Bank's deposit base increased by PLN 13,961.3 million (41.3%) year on year, which was attributable to a higher balance of central government deposits, which went up by PLN 11,508.3 million (64.0%). They still accounted for the major part of the deposit portfolio of the Bank and amounted to PLN 29,486.5 million as at the end of 2018. Their share in total deposits was 61.7% versus 53.2% a year before.

Sales of securities under repurchase agreements

Liabilities under repurchase agreements totalled PLN 5,214.1 million as at the end of 2018 and were PLN 2,359.8 million lower than at the end of 2017. A lower balance as at the end of 2017 was driven by a change in the structure of the Bank's liabilities and equity as a result of liquidity management and customer transactions.

Loans incurred

As at the end of 2018, the balance of loans received from international financial institutions was PLN 2,898.7 million, i.e. went down by PLN 89.2 million (3.0%) year-on-year.

In 2018, BGK signed to agreements with the European Investment Bank providing for a new form of *Intermediation*, thus establishing a new area of cooperation between BGK and the EIB, to supplement the existing cooperation involving loans taken out for the benefit of the National Road Fund as well as *Global Loans*. These loans, named "*Posejdon Nearly Zero Energy Building*" and "*Tramwaje Śląskie II*", are project specific and are intended to finance investment loans advanced by BGK to, respectively, Porto Sp. z o.o. in connection with the execution by that company of a project consisting in construction of an office and hotel building characterised by high energy efficiency, and Tramwaje Śląskie S.A., which executes a project to upgrade and extend its tram infrastructure and to purchase and upgrade its rolling stock. The value of the agreements is EUR 29.0 million and PLN 134.2 million, respectively.

BGK also continued to obtain loans to finance investment and construction projects under a residential construction support government programme by signing a PLN 800 million agreement with the Council of Europe Development Bank. BGK may use the loan until 31 March 2025, the time limit for its repayment is 25 years.

Issue of bonds

With a view to securing stable sources of funding for its operations, BGK continued its bond issue programme.

In 2018, 3-year bonds of PLN 500 million were issued. The said bonds are based on a floating interest rate determined by reference to WIBOR 6M plus a mark-up. In 2018, the Bank also redeemed bonds of with a value of PLN 1,000 million. BGK intends to introduce all bonds issued in 2018 to trading on the CATALYST market in the first half of 2019.

TABLE 35: Bonds issued by the Bank as at 31 December 2018 (in PLN million)

Own bonds	Issued on	Maturing on	Amount in PLN million	Interest rate
BGK1019	5 Oct 2016	5 Oct 2019	500	6M WIBOR + 39bps
BGK0219	19 Feb 2015	19 Feb 2019	1,392	6M WIBOR + 30bps
BGK0121	25 Jan 2018	25 Jan 2021	500	6M WIBOR + 24bps
BGK0220	27 Feb 2017	27 Feb 2020	1,159	6M WIBOR + 40bps
BGK0520	19 May 2017	19 May 2020	1,200	6M WIBOR + 43bps
BGK1021	3 Oct 2017	3 Oct 2021	500	6M WIBOR + 42pbs
BGK0919	30 Sep 2014	30 Sep 2019	500	2.8%

Total equity

In the recent years, it is possible to observe a secure and high level of equity enabling the Bank to increase its lending and investing activities. As at the end of 2018, its total equity (including current and prior year profit) was PLN 19,127.3 million, having decreased by PLN 920.4 million (4.6%) year on year. The key driver of the decline was the transfer of PLN 900 million to the National Guarantee Fund operated by BGK.

TABLE 36: Value and composition of the Bank's equity (in PLN million)

Item	2018		2017		Change versus 2017	
	Performance	Composition	Performance	Structure	in nominal terms	%
Total equity	19,127.3	100.0%	20,047.7	100.0%	-920.4	-4.6%
Share capital	17,102.4	89.4%	17,950.6	89.5%	-848.2	-4.7%
Supplementary capital	1,032.8	5.4%	671.4	3.3%	361.4	53.8%
Other reserve capitals	232.3	1.2%	232.3	1.2%	0.0	0.0%
Revaluation reserve	257.3	1.3%	355.6	1.8%	-98.3	-27.6%
Prior year profit (loss)	57.1	0.3%	320.0	1.6%	-262.9	-82.2%
Net profit	445.3	2.3%	517.8	2.6%	-72.5	-14.0%

Summary of the performance and financial position of BGK

The year 2018 saw the Bank's increased activity in the area of providing financing to its customers. The total credit exposure (gross loans, commercial and municipal bonds) went up by PLN 5,889.6 million year on year. This was attributable to increased sales in lending to business entities.

As at the end of 2018, the Bank's financial standing was stable and safe, as reflected by its financial performance as well as liquidity and capital adequacy indicators.

6.5 RATING OF BGK

On 5 December 2018, the Fitch ratings agency upheld the national long-term rating of BGK at the "AAA (pol)" level with a stable outlook, and the international long-term rating at the "A-" level, also with a stable outlook. The said agency also confirmed the short-term foreign currency rating at the F2 level, long-term national currency rating at the A level (stable outlook), the support rating at 1 and the minimum support rating at the "A-" level. The national short-term rating was confirmed at the level of "F1+(pol)".

7. ORGANISATIONAL STRUCTURE OF THE BANK

At the end of 2018, the Bank carried out its operations through the Head Office and the network of 16 Regions located nationwide. The Bank has no branches or subsidiaries outside of Poland. In 2018, BGK began to open its foreign agencies. Export and foreign expansion strategies in the European Union and outside are carried out by the Head Office.

8. CORPORATE SOCIAL RESPONSIBILITY OF BGK

The Bank develops its corporate social responsibility, including by paying special attention to social responsibility initiatives and taking action to improve the living conditions of the local community. The most important initiatives to support the social development of the country undertaken by the Bank in 2018 include:

- sharing knowledge and experience,
- promoting equal opportunities;
- building social capital;
- promoting volunteer projects.

Sharing knowledge, experience and competences of BGK employees

As the only development bank in Poland, BGK has access to unique know-how and experience gained in the course of its operations. In 2018, BGK's representatives actively participated in more than 100 events, conferences and seminars addressed to private enterprises, local governments and individuals planning to start a business. These events were attended by a total of over 250 thousand participants.

BGK's social engagement

The Bank operates social responsibility programmes through the J.K. Steczkowski Foundation. The Foundation's mission is to mobilise and support citizens at various stages of their life. Strategic operations of the Foundation in the years 2017-2019 focus on promoting equal educational opportunities, supporting individuals aged 50+, reinforcing national identity and the sense of community among young citizens. In 2018, the Foundation implemented six own programmes. 2018 saw many events and projects at the Foundation. To be precise, more than 1,500 applications were submitted, and 270 projects received co-financing. The beneficiaries of the Foundation's initiatives were more than 147 thousand people across Poland. The projects were executed with the assistance of more than 370 volunteers from BGK. The Foundation provided support to children's homes, community centres, hospices, schools, libraries and hospital paediatric wards.

Effect of activities of the BGK Foundation in 2018:

- As part of all initiatives and projects carried out in 2018 there were more than 147,000 beneficiaries of co-financing provided by the BGK Foundation.
- In 2018, co-financing was provided to 48 educational projects for equal education opportunities for children from rural areas and small towns under the 10th edition of grant contest "Off to a Good Start!". The programme had over 5,000 beneficiaries, and the total amount of co-financing was PLN 0.5 million.
- In the 2nd and 3rd edition of the "Once Upon a Time... Money" programme, 36 economic education projects for children and the youth were completed, which were participated by 938 students and 52 teachers.
- The 1st edition of the "Small Town" programme covered approximately 240 students and 60 volunteers, with a total of more than 1,000 hours of general education provided.
- In the 1st edition of the "Generation 5.0" programme, in response to 155 applications submitted, co-financing was provided with respect to 28 applications for a total of PLN 0.4 million. There were approximately 1,800 beneficiaries of the programme.
- In 2018, the 2nd edition of the "My Little Homeland" programme was held, in which 37 projects received co-financing for a total of PLN 0.9 million. The programme covered a total of approximately 12,470 persons.

- In the 100th anniversary of Poland's independence a grant programme under the name "Independent in 100" was announced. 59 projects received co-financing under the programme for a total of PLN 1.1 million.
- As part of the Bank's social initiatives with the participation of its employees, in the 10th edition of the "Voluntary service is great!" programme 35 social projects received co-financing. The projects were supported by a total of 530 volunteers, including 371 BGK employees. Owing to the engagement of the volunteers, approximately 5,700 beneficiaries received support for a total of PLN 0.1 million.

Equalising educational opportunities

- *10th edition of the "Off to a Good Start!" grant contest*

As part of the "Off to a Good Start!" grant contest, the BGK Foundation encourages the beneficiaries of grants to apply innovative methods of working with pre-school and early school age children, which facilitate interaction between children, develop communication and teamwork skills, creativity, initiative, empathy and responsibility, and promote physical activity. Under the programme, in 2018 co-financing was provided to 48 projects for a total of PLN 0.4 million, covering a total of over 5,000 beneficiaries.

- *2nd and 3rd edition of the "Once Upon a Time... Money" programme*

Since 2017, the BGK Foundation has recruited for the "Once Upon a Time... Money" programme. It is addressed to children aged between 3 and 9 and its purpose is to improve awareness of financial matters and introduce the basics of finances, so that children can function better in a modern society. The programme objectives are achieved by giving internally prepared lessons on financial matters to children in specific age groups. The Lessons build awareness of, among other things, the value of money, the basics of economy, managing personal finances, the role and function of banks, as well as critical thinking, and teach how to apply this knowledge in practice and make reasonable consumer decisions.

- *1st edition of the "Small Town" programme*

The BGK Foundation launched the 1st edition of the "Small Town" programme. The project was implemented in two towns, i.e. in Łowicz – between 15 and 19 October 2018, and in Zakopane – between 19 and 23 November 2018. The initiative was participated by some 240 students, about 60 volunteers as well as community and local government authorities, public officers and dozens of entrepreneurs who support the project. "Small Town" is an educational programme developed by the BGK Foundation and addressed to children between 8 to 12 years of age. Children are given an opportunity to assume the role of an adult: they work, earn, save and spend money. Through play and action children learn the value of money, how to manage their budget, and how the economy works. At special stations, under the supervision of experienced teachers, they learn different professions and the ropes. For the work they perform they receive remuneration paid in a special currency of the "Small Town". The "Small Town" also has its own Tax Office. Everyday children pay taxes, which like in the adult world, contribute to changes in the public space of the town.

Initiatives addressed to persons over 50

- *1st edition of the "Generation 5.0" programme*

"Generation 5.0" is a programme addressed to persons over 50 year of age, whose objectives included in particular: preventing social and technological exclusion, activating and stimulating the activity of persons over 50 years of age, and building intergenerational relations between persons over 50 years of aged and children and the youth aged 6–18. The amount of co-financing granted as part of the project could be used for preparation or holding classes, courses or educational workshops, organisation of cultural events, purchase of learning aids and the necessary equipment, expert advice and project coordination. In 2018, 28 applications were selected as part of the "Generation 5.0" programme, with awarded co-financing for a total of PLN 0.4 million. The programme had more than 1,800 beneficiaries. All projects submitted in the 1st edition of the programme will be implemented in the first half of 2019.

My Little Homeland

- *2nd edition of the “My Little Homeland” programme*

In 2018, the Bank held the 2nd edition of the **“My Little Homeland”** programme. The programme is aimed at co-financing initiatives improving the infrastructure of local communities and activating them to work for the common good in the local environment, design public space and improve its visual appearance and functionality and modernise it. Under the programme, co-financing is awarded also for activities which foster local patriotism, commemorating local heroes and historical events, as well as initiatives supporting sports, recreation and educational centres. The project is addressed to all active individuals who care about the city/town where they live and have an idea how to change it. Under the programme, in 2018 co-financing was provided to 37 projects for a total of PLN 0.9 million. The initiatives had a total of approximately 12,470 beneficiaries.

Education supporting citizenship and patriotism

- *“Independent in 100”*

In 2018, in the 100th anniversary of Poland’s independence beneficiaries of grants implemented a grant programme under the name **“Independent in 100”**. The purpose of the contest was to promote national identity among young persons aged from 7 to 18. Young persons gained knowledge on the history of Poland, contributed to commemoration of historical events and cared for places of remembrance. The programme was implemented in the form of classes, workshops, one-time or regular events promoting patriotism. An additional advantage of the programme was building bonds between generations through the cooperation of children and young people with parents and seniors. 59 projects received co-financing in the total amount of PLN 1.1 million under the project.

Social initiatives implemented with the participation of Bank employees

- *The “Voluntary service is great!” programme*

The programme of voluntary employee service has been conducted at Bank Gospodarstwa Krajowego since 2009. Its key element is the **“Voluntary service is great!”** contest. In the contest BGK employees may submit their own social projects based on local problems and needs that they have identified. Ultimately, 35 social projects received co-financing for a total of PLN 0.1 million. During their implementation, BGK employees worked for over 4,925 hours. The projects were supported by a total of 530 volunteers, including 371 BGK employees. Owing to the engagement of the volunteers, approximately 5,700 people in need received support under the programme.

- *“Good – Pay it Forward!”*

In 2018, the BGK Foundation organised six projects under the **“Good – Pay it Forward!”** programme. Voluntary work for various entities was performed by six departments of Bank Gospodarstwa Krajowego. The Foundation’s voluntary service supported, among others, the Children’s Memorial Health Institute, the Children’s Home in Płońsk, the Animal Shelter in Łochów and the Kubuś Association for the Disabled in Halinów. The amount earmarked for the **“Good – Pay it Forward!”** programme was PLN 29.7 thousand.

- *Volunteer campaigns*

In 2018, the BGK Foundation in partnership with the employees of Bank Gospodarstwa Krajowego organised six volunteer campaigns:

- sale of Easter and Christmas cards,
- collection of Braille paper for the centre for blind children run by Polish nuns in Kibeho,
- “Back to School” volunteer campaign,
- Collection for Burek,

- “Making Little Wishes Come True.”

Cooperation with other organisations

The BGK Foundation has been an ordinary member of the Donors’ Forum, an association of independent and financially self-sufficient organisations granting donations for socially responsible causes.

Bankers for Financial Education of the Young – BAKCYL is a project launched by the Polish banking sector and organised by the Warsaw Institute of Banking. In 2018, BGK volunteers taught 50 hours of classes dedicated to young people in relation to the Project.

9. HR POLICY PURSUED BY BGK

Employment

As at 31 December 2018, the headcount at BGK was 1,611 FTEs. Compared to the end of 2017, the number of FTEs increased by 167 (i.e. by 11.4%). Growth in FTEs was observed mainly in the sales and products area, the European Funds Division, IT Division, Finance and Markets Division, HR and Communication Division.

The headcount at the BGK Group was the same as at the Bank.

Remuneration system

The Bank pursues a remuneration policy compliant with the strategy and values of BGK and aiming to mitigate risks. The remuneration policy meets legal requirements, compliance principles as well as external guidelines and regulations which BGK is obligated to follow.

The primary internal regulation in the area of the remuneration policy applicable to BGK employees is the “Remuneration Regulations for Bank Gospodarstwa Krajowego Employees”, which sets out the terms and conditions that govern the employee remuneration system and the granting of other work-related benefits.

BGK has adopted a remuneration system that includes base remuneration and variable remuneration components, including bonuses and performance bonuses. It is a comprehensive system of key employee remuneration tools and regulations. Additionally, BGK offers other non-cash benefits.

As a rule, the Bank maintains remunerations at a level that is comparable to remunerations in the private sector and does not constitute an incentive to take excessive risks in BGK operations.

The Bank keeps a list of persons whose professional activity has a significant impact on the risk profile of BGK. The principles that govern the award and payment of variable remuneration to those employees are regulated in the “Policy governing variable remuneration components of employees identified to have a significant impact on the risk profile of Bank Gospodarstwa Krajowego”.

At the same time, the principles that govern the remuneration of persons acting in the capacity of Members of the Management Board are based on the Act of 9 June 2016 on Remuneration of the Management of Certain Entities.

Employee development

In 2018, staff development policy in the Bank was carried out in the form of large development projects, closed (external and internal) training courses, open training courses, language classes and post-graduate studies. Most training and development initiatives, including all development projects, were organised as closed training courses that allowed to tailor the training programme to the Bank’s needs, train a higher number of people and use funds in a more efficient way. The Bank organised professional training courses to expand knowledge in areas related to a given job and develop competences aligned with the general development strategy of the Bank.

Employees in the risk area and the sales and products area participated in the Loan Academy, which involved, among other things, a series of trainings on analysis and assessment of credit standing of enterprises, local governments and SHA. Participation in these trainings was one of the elements required for certification of credit skills by BGK.

In 2018, managers took part in continued development initiatives based on management skills (strategic thinking, advancement and motivation of employees, change management, communication, business awareness). The initiatives included: Leadership GRID, Aware Leadership, Maxwell's Leadership Academy, Manager's Handbook, and Manager's ABCs. In addition, we carried out a 360-degree feedback process for managers holding the positions of Heads of Departments, Offices and Regions.

Employees on expert positions participated in a number of general development training courses, which covered six training areas: 7 habits of highly effective people, assertiveness, negotiations, dealing with stress, public speaking, and change management.

In 2018, for the third time an employee satisfaction survey was conducted to analyse employee opinions and insights on the Bank's employer brand.

Also, the onboarding process was modified, which enabled us to integrate procedures, tasks and goals, culture and relations.

The year 2018 was also important due to modification of the Employee Assessment Process, which at BGK serves not only to evaluate employees, but mostly to provide opportunities for professional advancement.

Diversity policy

The Bank follows diversity management principles in its recruitment practices and ensures equal treatment of staff. In line with the Work Regulations of BGK, Bank employees are treated equally with respect to commencing and terminating employment, employment terms, promotion, access to training and development, irrespective of their sex, age, physical identity, race, religion, nationality, political beliefs, trade union membership, ethnic identity, religion, sexual orientation or employment contract (for a limited or unlimited term, full-time and part-time contract). Employees have the right to equal remuneration for the same job or its equivalent. In 2018, the resolution of the Management Board introducing the employee relations policy "Respect in the workplace" entered into force.

The Bank's staff are diverse in terms of sex, age, experience and education both at the executive and less senior levels. Statistical data as at 31 December 2018 are presented below.

TABLE 37: BGK staff structure by age

	under 25	between 26 and 30	between 31 and 40	between 41 and 50	between 51 and 60	over 60
Management staff		4	65	144	48	8
Other staff	52	140	471	469	193	57
TOTAL	52	144	536	613	241	65

TABLE 38: BGK staff structure by years in service

	less than 5 years	between 5 and 10 years	between 10 and 15 years	between 15 and 20 years	between 20 and 25 years	over 25 years
Management staff	113	54	59	18	13	12
Other staff	683	270	194	109	86	40
TOTAL	796	324	253	127	99	52

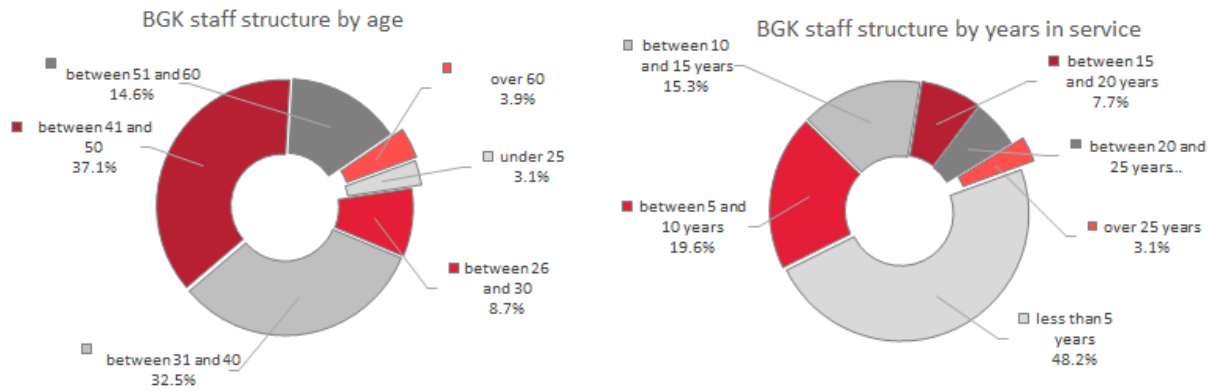
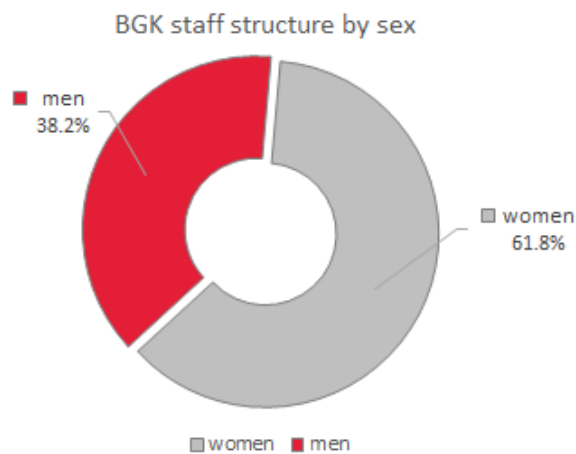


TABLE 39: BGK staff structure by sex

	Women	Men	Total
Management staff	126	143	269
Other staff	894	488	1382
TOTAL	1,020	631	1,651



10. INFORMATION ON THE ENTITY AUTHORISED TO AUDIT THE FINANCIAL STATEMENTS

Details of the audit agreement date and fees of the entity authorised to audit the financial statements have been presented in Note 53 to the separate financial statements of Bank Gospodarstwa Krajowego for the 2018.

11. DISCLOSURES REQUIRED UNDER BANKING LAW SUBJECT TO AUDIT BY CERTIFIED AUDITOR

In performance of the requirements of Article 111a of the Banking Law (Journal of Laws of 2018, item 2187, as amended), BGK represents that:

- Bank Gospodarstwa Krajowego acts only on the territory of the Republic of Poland as the only state-owned Bank and does not have any foreign subsidiaries,
- BGK did not enter into the agreement referred to in Article 141t.1 of the Banking Law,
- in accordance with its financial statements, in 2018 the Bank's turnover, (calculated as the total of interest income, commission income, net gain on financial instruments at fair value through profit or loss, net exchange differences, and net gain on investments in financial assets) was PLN 2,203.9 million, profit before tax amounted to PLN 519.5 million, and income tax totalled PLN 74.1 million,
- as at the end of 2018 headcount at the Bank was 1,611 FTEs,
- the Bank did not receive any financial support on the basis of the Act on Support from the State Treasury to the Financial Institutions dated 12 February 2009 (Journal of Laws of 2016, item 1436).

The aforementioned information were subject to the audit by the certified auditor.

12. STATEMENT OF NON-FINANCIAL INFORMATION

As an entity operating as a state bank, Bank Gospodarstwa Krajowego does not submit a statement of financial information as part of the financial statements, in accordance with Article 49b.1 of the Accounting Act (consolidated text: Journal of Laws of 2019, item 351, as amended).

13. STATEMENT OF COMPLIANCE WITH THE PRINCIPLES OF CORPORATE GOVERNANCE

13.1 GENERAL PRINCIPLES

Bank Gospodarstwa Krajowego complies with the "Principles of Corporate Governance for Supervised Institutions" of the Polish Financial Supervision Authority, which entered into force on 1 January 2015. They were incorporated into the "Principles of Corporate Governance at Bank Gospodarstwa Krajowego" as well as other internal regulations of the Bank. Additionally, the corporate governance framework of BGK is defined by other external legal acts:

- the Act on Bank Gospodarstwa Krajowego of 14 March 2003,
- the Articles of Association of Bank Gospodarstwa Krajowego, attached as an appendix to the Ordinance of the Minister of Development of 16 September 2016 on the adoption of the Articles of Association of Bank Gospodarstwa Krajowego,
- the Banking Law of 29 August 1997,
- the Ordinance of the Minister of Development and Finance of 6 March 2017 regarding the risk management system and internal control system, remuneration policy and detailed procedure for measuring internal capital in banks,
- resolution No. 141/2017 of the Polish Financial Supervision Authority of 25 April 2017 regarding the issue of Recommendation H concerning the internal control system in banks,

In the application of the Principles of the Polish Financial Supervision Authority BGK took into account the legal form of Bank Gospodarstwa Krajowego as a state bank whose sole owner is the State Treasury as well as its characteristics:

- the lack of a General Meeting of Shareholders and no candidates appointed from among minority interest;
- additional activity of members of the management and supervisory bodies, as set out in separate legislation;
- the lack of services consisting in asset management at the risk of the customer in the Bank's offering.

The "Principles of Corporate Governance at Bank Gospodarstwa Krajowego" are adopted by the Management Board and require the approval of the Supervisory Board. They are published by the Bank on its website at: www.bgk.pl.

13.2 FUNCTIONS, SCOPE OF ACTIVITY AND ORGANISATION OF BGK

The Act on Bank Gospodarstwa Krajowego sets out the functions, scope of activity and organisation of BGK. The key priorities around which BGK is organised, as defined in the Act on Bank Gospodarstwa Krajowego and separate legislation, include supporting the economic policy of the Council of Ministers, socio-economic government programmes as well as local government and regional development programmes, specifically:

- projects financed by EU funds and international financial institutions, as defined by Article 4.1.3 of the Banking Law of 29 August 1997;
- infrastructure projects;
- projects related to the development of the small and medium-sized enterprise sector, including those financed with public funds.

The functions fulfilled by BGK include:

- functions specified in the Banking Law of 29 August 1997;
- administration of funds created, entrusted or transferred to BGK under separate legislation;
- export transaction handling with the use of export support instruments, in addition to supporting exports of Polish goods and services under separate legislation or government programmes;
- functions relating to credit institutions which were liquidated or regarded as liquidated under three acts (decrees) of 25 October 1948;
- offering, whether directly or indirectly, guarantee and/or surety services under government programmes or on behalf of and for the account of the State Treasury in accordance with the Act on Sureties and Guarantees of the State Treasury and Certain Legal Persons of 8 May 1997, in particular to the small and medium-sized enterprise sector;
- issuing declarations which have the power of official documents and enable the deletion of entries made in Sections III and IV of Land and Mortgage Registers or document sets for:
 - credit institutions which were liquidated or regarded as liquidated under the aforesaid decrees;
 - the State Treasury in relation to:
 - purchases of land and property from the National Land Fund established by the agricultural reform decree of 6 September 1944;
 - credit facilities and loans granted between 1945 and 1990 for purposes of demolition, repair and completion of construction, superstructures, renovation and reconstruction of buildings, sale of development land and sale of single- and multi-family residential buildings by the state;
 - the State Treasury or entities whose successor is the State Treasury, made before 1 September 1939;
- supporting residential construction, in particular construction aimed to build apartments for rent, in accordance with separate legislation or under government programmes.

The Bank may also fulfil the function of an entity responsible for the implementation of a financial instrument or a fund of funds as referred to in Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006.

The Articles of Association of BGK are adopted, by way of an ordinance, by the Minister of Economy. In particular, the Articles of Association of BGK set out the internal organisation and a detailed scope of the Bank's activities, detailed roles of the Supervisory Board and the Management Board, powers and duties of the President of the Management Board, the Bank's own funds and its financial management principles.

The Act on Bank Gospodarstwa Krajowego and the Articles of Association of BGK ensure the division of duties between the Supervisory Board, which is a supervisory body, and the Management Board, which is a managing body of the Bank.

Unless otherwise provided for by the applicable laws, the activities of the Bank are governed by the Banking Law of 29 August 1997.

13.3 COMPOSITION AND REGULATIONS OF BGK'S GOVERNING BODIES AND COMMITTEES, REPRESENTATION AND POWERS VESTED IN THE PRESIDENT OF THE MANAGEMENT BOARD

The Management Board and the Supervisory Board are the Bank's governing bodies.

The representation method is defined by the Act on Bank Gospodarstwa Krajowego and the articles of association of BGK, whereby declarations concerning the financial rights and obligations of the Bank may be made by:

- two members of the Management Board acting jointly;
- attorneys-in-fact – within the scope of their powers of attorney, acting severally or jointly with another attorney-in-fact or a member of the Management Board.

Supervisory Board

The Supervisory Board exercises permanent supervision of the activities of BGK in all areas of its operations. The term of office of the Supervisory Board is four years. The 9th term of office of the Supervisory Board began on 1 September 2016.

In line with the Act on Bank Gospodarstwa Krajowego, the Supervisory Board is composed of 11 members, including the Chairman, appointed from among candidates having the necessary qualifications. Candidates for the Supervisory Board of BGK must be approved by the Council for Companies with State Treasury Shareholding and State Legal Persons operating at the Chancellery of the Prime Minister of Poland. The Chairman of the Supervisory Board is appointed and removed by the President of the Council of Ministers at the request of the Minister of Economy. The remaining members of the Supervisory Board are appointed and removed by the President of the Council of Ministers at the request of the competent ministers. A member of the Supervisory Board may not be a member of the Management Board.

Information concerning the current composition of the Supervisory Board is available at www.bgk.pl.

Meetings of the Supervisory Board are held when needed but no less frequently than every quarter. Resolutions of the Supervisory Board are adopted by absolute majority of votes in the presence of at least a half of its members, including the Chairman or a member of the Supervisory Board acting as a Deputy Chairman on a permanent basis. Resolutions of the Supervisory Board are provided to the Management Board for implementation or for information purposes.

Composition of the Supervisory Board as at 31 December 2018 was as follows:

- Paweł Borys – Chairman;
- Kamil Mrocza – Deputy Chairman;
- Jarosław Nowacki – Secretary;
- Artur Adamski – Member;
- Beata Gorajek – Member;
- Mariusz Gruda – Member;
- Jan Filip Staniłko – Member;
- Jerzy Szmit – Member;
- Łukasz Robert Śmigasiewicz – Member.

Composition of the Bank's Supervisory Board as well as information concerning the term of office and remuneration of the Supervisory Board members in 2018 are presented below.

TABLE 40: Supervisory Board of BGK in 2018

Full name	Term in office in the Supervisory Board	Position in the Supervisory Board	remuneration in PLN
Paweł Borys	1 Jan 2018 – 31 Dec 2018	Chairman	93,842
Witold Słowik	1 Jan 2018 – 31 Oct 2018	Deputy Chairman	10,166
Kamil Mroczka	1 Jan 2018 – 12 Dec 2018	Member	85,509
	13 Dec 2018 – 31 Dec 2018	Deputy Chairman	
Jakub Modrzejewski	1 Jan 2018 – 31 Aug 2018	Secretary	59,718
Jarosław Nowacki	1 Jan 2018 – 12 Dec 2018	Member	93,842
	13 Dec 2018 – 31 Dec 2018	Secretary	
Artur Adamski	1 Jan 2018 – 31 Dec 2018	Member	93,842
Mariusz Gruda	6 Feb 2018 – 31 Dec 2018	Member	80,992
Beata Gorajek	1 Jan 2018 – 31 Dec 2018	Member	85,509
Jan Filip Staniłko	1 Jan 2018 – 31 Dec 2018	Member	93,842
Łukasz Robert Śmigasiewicz	1 Jan 2018 – 31 Dec 2018	Member	92,808
Jerzy Szmit	1 Jan 2018 – 31 Dec 2018	Member	89,577

Mateusz Morawiecki, the President of the Council of Ministers, appointed Mr Mariusz Gruda as Member of the Supervisory Board as of 6 February 2018.

In 2018, the following members have resigned as members of the Supervisory Board:

- 1) Jakub Modrzejewski – as of 31 August 2018,
- 2) Witold Słowik – as of 31 October 2018.

Remuneration of Members of the Supervisory Board of BGK

Members of the Supervisory Board of Bank Gospodarstwa Krajowego are remunerated in accordance with Article 10.1.5 of the Act on Remuneration of the Management of Certain Entities (Journal of Laws of 2016, item 1202) and the Declaration of the Minister of Development and Finance of 14 October 2016 on remuneration of Members of the Supervisory Board of Bank Gospodarstwa Krajowego.

Management Board

The basis and the scope of functions of the Management Board are set out in the Act on Bank Gospodarstwa Krajowego, the Articles of Association of BGK, the Banking Law and the Regulations of the Management Board of BGK approved by a resolution of the Supervisory Board. The Management Board has the power to decide on any matters related to the management of BGK, except those which have been assigned to the Supervisory Board and President of the Management Board. The term of office of the Management Board is five years.

In accordance with the Act on Bank Gospodarstwa Krajowego, the Management Board is composed of six members, including the President, First Vice-President and Vice-President. The President, First Vice-President and Vice-President as well as the remaining members of the Management Board are appointed and removed by the President of the Council of Ministers at the request of the competent ministers. In addition, the President of the Management Board and one member of the Management Board entrusted with the management of risk relevant to the operations pursued by BGK are appointed subject to approval by the Polish Financial Supervision Authority. The provisions of Articles 22a.2 and 22b of the Banking Law of 29 August 1997 apply accordingly.

The Management Board holds meetings in accordance with the schedule of Management Board meetings or as needed. The schedule of Management Board meetings is determined at the end of each year and specifies planned meeting dates. The Management Board adopts resolutions at its meetings or in writing. In both cases resolutions may be passed using means of remote communication. Resolutions adopted by the Management Board are passed by a simple majority

of votes in the presence of at least a half of its members. In the case of a tied vote, the President of the Management Board or, if absent, the First Vice-President has the deciding vote.

In 2018, there were no changes to the composition of the Management Board of BGK. The composition of the Management Board of BGK and the terms of office of its members have been presented below.

TABLE 41: Composition of the Management Board of BGK in 2018

Full name	Term in office in the Management Board	Position in the Management Board
Beata Daszyńska-Muzyczka	1 Jan 2018 – 31 Dec 2018	President of the Management Board
Paweł Nierada	1 Jan 2018 – 31 Dec 2018	First Vice-President of the Management Board
Włodzimierz Kocon	1 Jan 2018 – 31 Dec 2018	Vice-President of the Management Board
Przemysław Cieszyński	1 Jan 2018 – 31 Dec 2018	Members of the Management Board
Wojciech Hann	1 Jan 2018 – 31 Dec 2018	Members of the Management Board
Radosław Kwiecień	1 Jan 2018 – 31 Dec 2018	Members of the Management Board

Information concerning the current composition of the Management Board is available at www.bgk.pl.

The President of the Management Board represents the Bank in external relations, chairs Management Board meetings, organises the activities of the Bank and ensures that resolutions of the Management Board are enforced. All BGK employees report to the President of the Management Board. The powers vested in the First Vice-President, the Vice-President and members of the Management Board have been defined in the Act on Bank Gospodarstwa Krajowego.

Remuneration of Members of the Management Board of BGK

Members of the Management Board of BGK are remunerated in accordance with the Act on Remuneration of the Management of Certain Entities of 9 June 2016 (Journal of Laws of 2016, item 1202), the Declaration of the Minister of Development and Finance of 14 October 2016 on remuneration of Members of the Management Board of Bank Gospodarstwa Krajowego as well as the Remuneration Policy for Members of the Management Board of BGK, attached as an appendix to Resolution No. 57/2016/IX of the Supervisory Board dated 3 November 2016, as amended, and the “Policy governing variable remuneration components of BGK managers”, adopted by way of Resolution No. 58/2016/IX of the Supervisory Board of BGK dated 3 November 2016.

Remuneration of Members of the Management Board has been presented below.

TABLE 42: Remuneration of Members of the Management Board of BGK in 2018 (in PLN)

Full name	Position held in 2018	Base pay	Supplementary pay**
Beata Daszyńska-Muzyczka	President of the Management Board	792,000	
Paweł Nierada	First Vice-President of the Management Board	624,000	7,467
Włodzimierz Kocou	Vice-President of the Management Board	624,000	7,467
Przemysław Cieszyński	Members of the Management Board	624,000	7,467
Wojciech Hann	Members of the Management Board	624,000	7,467
Radosław Kwiecień	Members of the Management Board	624,000	
TOTAL		3,912,000	29,867

* Members of the Management Board of BGK are remunerated in accordance with the Act on remuneration of the management of certain entities of 9 June 2016 (Journal of Laws of 2016, item 1202, as amended), the Declaration of the Minister of Development and Finance of 14 October 2016 on remuneration of Members of the Management Board of Bank Gospodarstwa Krajowego as well as the Remuneration Policy for Members of the Management Board of BGK, as amended, attached as an appendix to Resolution No. 57/2016/IX of the Supervisory Board, dated 3 November 2016.

** The second instalment of deferred part of supplementary remuneration awarded in 2017 for 2016 was paid in 2018.

The Supervisory Board and the Management Board of Bank Gospodarstwa Krajowego have established committees which perform control or advisory and review functions. Committees set up by the Supervisory Board:

- Audit Committee;
- Risk Committee;
- Remuneration Committee.

Within its competence, the Management Board has set up two obligatory committees: the Bank's Finance Committee and the Bank's Credit Committee, in addition to five committees in charge of specific areas of the activities pursued by BGK, namely the Operational Risk Committee, Change Committee, Architecture Committee, Expenditure Authorisation Committee, Data Quality Management Committee. These Committees are collegial bodies that carry out review and decision-making functions and whose composition and duties are set out by way of a resolution of the Management Board. The aforementioned Committees operate based on Regulations adopted by the Management Board.

Audit Committee

The Audit Committee was established in December 2007 by a Resolution of the Supervisory Board of the Bank. Its members are appointed from among members of the Supervisory Board of the Bank. As at 31 December 2018, the Audit Committee was composed of five Members of the Supervisory Board. In accordance with the Act of 11 May 2017 on Statutory Auditors, Audit Firms and Public Supervision:

- three Supervisory Board Members appointed as members of the Audit Committee met the independence criteria, i.e. Jarosław Nowacki, Beata Gorajek and Łukasz Śmigasiewicz,
- three Supervisory Board Members met the criterion of possessing the knowledge and skills in accounting or audit of financial statements, i.e. Jarosław Nowacki, Mariusz Gruda and Łukasz Śmigasiewicz,
- four Supervisory Board Members met the criterion of possessing the knowledge of the industry, i.e. Jarosław Nowacki, Mariusz Gruda, Jan Filip Staniłko and Beata Gorajek.

The Bank assessed whether the Supervisory Board Members meet the criteria of possessing the knowledge and skills in accounting or audit of financial statements and the knowledge of the industry based in the information included in the "Survey of independence and qualifications of Members of the Supervisory Board of Bank Gospodarstwa Krajowego" regarding their education, completed training and professional experience.

In particular, the Committee's duties are:

- to supervise the organisation of the internal audit function and compliance function at the Bank,
- to monitor the financial reporting process, the management reporting process and audit procedures at BGK,
- to monitor the area of internal control and risk management systems at BGK.
- to develop an audit firm selection policy, policy governing the performance of any additional non-audit services by entities related to the audit firm and by a member of the audit firm's network, and the procedure to be followed by BGK when selecting an audit firm,
- to control and monitor the independence of the audit firm and certified auditor.

A detailed scope of duties of and procedures followed by the Audit Committee have been defined in the Regulations of the Audit Committee adopted by the Supervisory Board.

In 2018, the Audit Committee did not approve the provision nor engage the auditor of BGK's financial statements to perform permitted non-audit services.

In 2018, 10 meetings of the Audit Committee and five joint meetings of the Audit Committee and the Risk Committee were held.

Risk Committee

The Risk Committee was established in December 2015 by a Resolution of the Supervisory Board of the Bank. Its members are appointed from among members of the Supervisory Board of the Bank. The Committee is composed of three to five members.

In particular, the Committee's duties are:

- to review overall current and future readiness of BGK to accept risk,
- to review the strategy for risk management at BGK developed by the Management Board,
- to review the information provided by the Management Board on the implementation of policies governing the management of specific risks,
- to support the Supervisory Board in supervising the implementation of the strategy for management of risks inherent in the operations BGK by the senior management,
- to review reports on the prices of assets and liabilities on a periodic basis in the context of the Bank's multi-annual development plan and the risk management model.

Remuneration Committee

The Remuneration Committee has been established by a Resolution of the Supervisory Board of the Bank. Its members are appointed from among members of the Supervisory Board of the Bank. The Committee is composed of three to five members.

In particular, the Committee's duties are:

- monitoring of and issuing opinions on:
 - the policy for variable components of remuneration for persons whose professional activity has a significant impact on the Bank's risk profile,
 - the list of identified employees having a significant impact on the risk profile at BGK,
 - variable components of remuneration for persons whose professional activity has a significant impact on the Bank's risk profile, who are responsible for level two risk management, holding positions or operating within organisational units that were created specifically for this purpose, for management of the compliance unit and for management of the internal audit unit,
- preparation of recommendations for the Management Board and the Supervisory Board regarding the remuneration package and amounts of remuneration for persons responsible for management of the internal audit unit and the compliance unit,

- assessment of the achievement of management goals by the Management Board and presentation of recommendations concerning payment of variable remuneration components to the Supervisory Board,
- issuing opinions on agreements on the provision of management services or other agreements under the civil law executed with Management Board Members.

Bank Financial Committee

The primary objective of the Bank's Finance Committee is to determine the current, mid-term and long-term asset and liability management policy of the Bank. Its purpose is to improve the Bank's performance and the efficiency of capital allocation, while considering an appropriate level of the exposure to banking risk and the nature of tasks fulfilled by the Bank with respect to the administration of funds created, entrusted or transferred to the Bank under separate legislation or other legal acts.

Bank Credit Committee

The scope of competence of the Bank's Credit Committee covers activities exposed to credit risk that are pursued by BGK under its own activities or under activities commissioned to BGK, in particular those that concern making decisions regarding credit applications, applications for restructuring or debt enforcement operations and the acquisition of assets that fall within the committee's competence, as well as the performance of quarterly credit portfolio reviews and making decisions regarding the classification and level of specific reserves;

Operational Risk Committee

The Operational Risk Committee has been established with a view to ensure effective operational and compliance risk management. The Committee carries out review and decision-making functions.

Change Committee

The primary objective of the Committee is to manage the portfolio of projects (including projects, programmes and initiatives) within its competence, in particular to ensure that projects are implemented in accordance with the Strategy of the Bank.

Architecture Committee

The objective of the Architecture Committee established in 2017 is to ensure effective and efficient IT infrastructure management at BGK.

Expenditure Authorisation Committee

The primary objective of the Expenditure Authorisation Committee is to ensure the high cost efficiency of current activities and projects supporting the implementation of the Strategy of the Bank.

Data Quality Management Committee

The Data Quality Management Committee has been established in 2017 to support the data quality management process at BGK.

13.4 INTERNAL CONTROLS, RISK AND CAPITAL MANAGEMENT AND FINANCIAL REPORTING AT THE BANK

Internal audit system

BGK has an internal control system in place, the objective of which is to ensure effective and efficient operation, reliability of its financial reporting, compliance with risk management policies as well as conformity with the applicable laws, internal regulations and market standards. The internal control system also encompasses the functioning of subsidiaries and external enterprises, to whom the Bank has entrusted the performance of banking operations and activities related to banking operations.

The internal control system at BGK is organised around three independent levels (lines of defence):

- the first level (first line of defence) comprises the management of risk in operating activities,
- the second level (second line of defence) comprises:
 - risk management by employees at positions or in organisational units established specifically for that purpose, independent from risk management under the first line of defence,
 - Compliance Department operations,
- the third level (third line of defence) comprises operations carried out by the Internal Audit Department.

The internal control system is governed by the BGK Internal Control Regulations adopted by the Management Board and then approved by the Supervisory Board. The Regulations were drafted in accordance with the Banking Law, the Act on Bank Gospodarstwa Krajowego, the Ordinance of the Minister of Development and Finance of 6 March 2017 regarding the risk management system and internal control system, remuneration policy and detailed procedure for measuring internal capital in banks, Resolution No. 141/2017 of the Polish Financial Supervision Authority regarding the issue of Recommendation H concerning the internal control system in banks, and international standards and good practices. BGK Internal Control Regulations are supplemented by the Principles of organising the control function at BGK.

The Regulations define the objectives, scope and the rules applicable to the organisation and functioning of internal controls in the organisational units of the head office and branches of the Bank as well as rules for monitoring the risk inherent in the operations of subsidiaries.

BGK has an internal audit function that reports directly to the President of the Management Board, in accordance with the Articles of Association of the Bank. Its task is to investigate and evaluate, independently and objectively, the adequacy and effectiveness of the internal audit system and the risk management system. In compliance with external requirements and best practices, all the operations of BGK are subject to audit. The internal audit function at BGK follows the IIA's International Standards for the Professional Practice of Internal Auditing, which is confirmed by regular independent external reviews (the results of the most recent review were presented to the Supervisory Board in early 2018). In line with regulatory requirements, the Bank has mechanisms in place which guarantee independence of the internal audit function, including but not limited to supervision of the internal audit function by the Supervisory Board, approval of the appointment of the internal audit head by the Supervisory Board, approval of the function's plans and reports by the Supervisory Board as well as direct communication between the internal audit head and the Chairman of the Audit Committee.

The compliance function at BGK is carried out by the Compliance Department (CD). The objective of the Compliance Department is to monitor the process of ensuring the compliance of BGK with applicable laws, internal regulations and market standards. That monitoring is carried out in particular through:

- independent monitoring and reporting of the compliance of control mechanisms, especially through continuous vertical review and vertical testing in dedicated areas,
- implementation of the compliance risk management process (identification, assessment, control, monitoring and reporting).

Powers, obligations and the scope of duties of the Compliance Departments have been set out in the Compliance Policy of BGK, Organisational Regulations of the Compliance Department, and the Internal Control Regulations of BGK. The head of the Compliance Department, i.e. Compliance Officer, and CD employees have been granted appropriate powers. Additionally, in line with regulatory requirements, BGK has mechanisms in place which guarantee independence of the compliance function, including but not limited to the subordination of the compliance function directly to the Chairman of the Management Board, supervision of the Compliance Department's operations by the Audit Committee, approval of changes on the position of Compliance Officer by the Supervisory Board, approval of the function's plans and reports by the Supervisory Board as well as direct communication between the Compliance Officer and the Chairman of the Audit Committee.

Risk and capital management

The Bank's risk management is based on its internal regulations. The organisation of the risk management process is described in detail in Section 14.1.

Preparation of the financial statements of the Bank

The financial statements of Bank Gospodarstwa Krajowego were prepared in conformity with International Financial Reporting Standards endorsed by the European Union as at 31 December 2018, and the related interpretations published as Commission Regulations (IFRS), and to the extent not regulated by the aforesaid standards, in compliance with the requirements of the Accounting Act of 29 September 1994 (Journal of Laws of 2019, item 351) and implementing provisions issued on the basis of that Act. The final form of the financial statements of BGK, adopted by a resolution of the Management Board, is provided by the Management Board for approval to the Supervisory Board by 31 May of the year immediately following the financial year for which the financial statements were prepared. The annual financial statements of BGK are audited by an entity authorised to audit the financial statements of BGK. That entity is selected by the Supervisory Board.

14. MANAGING AND ASSESSING CREDIT, FINANCIAL, OPERATIONAL AND OTHER RISKS

14.1 ORGANISATION OF THE RISK MANAGEMENT PROCESS

The risk management system in place at BGK is organised on three independent levels. The first level (first line of defence) comprises the management of risk in operating activities of BGK. The second level (second line of defence) comprises risk management by employees at positions or in organisational units established specifically for that purpose (independent from risk management under the first line of defence) and the compliance function. The third level (third line of defence) comprises operations carried out by the Internal Audit Department.

The internal objective of risk management at BGK is to maintain stability and security of operations as well as to maintain the high quality of assets and achieve the anticipated financial result within an acceptable risk level.

The risk management is based on:

- Strategy for Risk Management at BGK endorsed by the Supervisory Board of the Bank,
- Capital Management and Internal Capital Assessment Policy at BGK endorsed by the Supervisory Board of the Bank,
- risk management policies, principles, and procedures related to risk identification, measurement or assessment, monitoring, reporting, and control, developed in written form and endorsed by the Supervisory Board or Management Board of the Bank,
- corporate governance principles, principles of selection, remuneration and monitoring of employees performing crucial functions for the Bank and the Policy governing variable remuneration components of persons holding managerial positions endorsed by the Supervisory Board of the Bank or Management Board of the Bank,
- regulations on risk management at subsidiaries.

The risk management system in place at the Bank includes the following tasks:

- **risk identification**, which comprises the determination of: risk types, their sources (risk factors), significance and relationships between individual types of risk,
- **risk measurement/assessment**, which comprises the determination and enforcement of risk quantification methods and stress test performance,
- **risk control**, which comprises the determination and enforcement of risk control mechanisms (including limit systems, ensuring independence between first-level risk management and second-level risk management, insurance, risk transfer, financing plans),
- **risk monitoring**, which comprises the monitoring of risk levels, review of relevance and accuracy of the applied risk assessment methods and the evaluation of efficiency of the tools used,
- **risk reporting**, which comprises information on the risk profile, identification of possible threats, and information on the measures adopted.

The Strategy for risk management at BGK covers all identified risks to which BGK is exposed as part of its activities. The Strategy also defined the general acceptable level of risk, whereas acceptable risk levels in relation to specific risks have been specified in risk management policies applicable to those risks. In 2018, the policies and rules were adjusted to Recommendation H of the PFSA and the Strategy for Risk Management at BGK by, among other things, defining risk control mechanisms, the associated control mechanisms and the manner of monitoring compliance with the control mechanisms.

The Strategy also defined the principles of risk culture. Through its actions and conduct, the Management Board of BGK promotes the awareness about the relevance of risk in the activities pursued by BGK, the principles of assuming risk and its management, i.e. the so-called risk culture. Next, these practices cascade down to individual levels the organisational structure of BGK and to subsidiaries.

14.2 ORGANISATION OF THE CREDIT RISK MANAGEMENT PROCESS

Credit risk is the most important element of financial risk to which the Bank is exposed in the pursuit of its activities. The Bank uses a credit risk management process that comprises risk identification, measurement and assessment, control, monitoring and reporting to identify credit risk and mitigate it to an acceptable level, and for the purposes of controlling the effectiveness of actions taken on a continuous basis.

Credit risk management is carried out at two levels:

- client risk accounting for an individual credit exposure;
- loan portfolio risk.

The Bank identifies and assesses the existing credit risk based on:

- the implementation of internal procedures enabling the assessment of creditworthiness for individual borrowers and classification of credit exposures into relevant risk groups,
- the results of control and monitoring measures taken with regard to asset items managed by the organisational units of BGK.

The Bank applies a prudential approach to the credit risk management process. Key characteristics of the current risk management system are:

- the separation of sales functions from client risk assessment at both branch and Head Office levels of BGK,
- comprehensive individual credit risk assessment for all customers and transactions, so as to assign them to a specific credit risk category,
- the application of expert and statistical methods for measuring credit risk arising from an individual transaction of customer, supporting the estimation of the probability that the customer will default on their obligation towards BGK, and when the customer has problems with repaying their debt – measuring the impairment of granted credit exposures,
- a system for measuring portfolio risk by assessing its concentration by industry, entity and type of product,
- a system of decision-making competencies,
- the regular verification of the risk of past transactions, including changes in the financial condition of borrowers and in the Bank's environment;
- diversification of industry sectors, borrowers and types of loans, within the resource exposure limits set out by the Bank,
- the determination of impairment losses for credit exposures,
- the analysis and verification of valuation principles related to loan collaterals,
- a system for monitoring exposures and their collaterals that allows for early threat identification.

The system of limits constitutes one of the basic tools for credit risk management at BGK. Limits are established at both operational and strategic levels in line with relevant responsibilities.

The following limit groups are used with respect to credit risk:

- industry limits reflecting the risk arising from the customer's core business;
- objective limits, resulting from the risk borne by the purpose of the loan,
- subjective limits, defined depending on the customer type,
- product limits.

One of the most important credit risk factors is concentration risk. At BGK, it is monitored in line with the provisions of the Banking Law and the recommendations of the Polish Financial Supervisory Authority in this respect, the Act on Bank Gospodarstwa Krajowego and the Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms. In accordance with the resolution of the Management Board, irrespective of statutory concentration limits, BGK has additional exposure limits applicable at the stage of making financial decisions.

The risk monitoring process consists in periodic reviews of the parameter levels which are subject to limits in addition to analysing the utilisation of those limits.

The Bank drafts regular credit risk and concentration risk reports presented to the Credit Committee of the Bank, Management Board of BGK and in semi-annual periods to the Supervisory Board.

The Bank has in place procedures that specify the rules to be followed in the event of an increased level of credit risk.

The Bank also adjusted its credit risk management principles to new accounting rules and the rules for identifying expected credit losses following the Bank's transition to International Financial Reporting Standard 9.

14.3 OVERVIEW OF KEY CREDIT AND CONCENTRATION RISKS

Credit risk is defined as a risk that a borrower will default on their contractual obligations, i.e. fail to repay receivables under credit exposure along with the Bank's fee, either in whole or in part, within time limits defined in the agreement.

The Bank mitigates credit risk at the micro level by assessing and monitoring individual customers and transactions, and at the macro level – for the entire portfolio – by establishing limits for the various segments and products.

Although the credit risk is uniform in nature, its basic subtypes can be distinguished.

Concentration risk

The risk of exposure concentration is an important aspect of credit risk. The Bank has adopted appropriate internal rules and procedures applicable to exposure concentration, with a particular focus on large exposures to single customers and customer groups. Portfolio concentration is monitored at the level of individual borrowers, entities with equity or organisational relationships, industries etc. The exposure concentration policies address different areas of the Bank's operations (not only lending but also investing activities or money market transactions).

Risk of partial or total default

The risk of default is a situation where a customer fails to meet the contractual repayment deadlines, or no payments are made. The materialisation of that risk is associated with an increase in costs by generating loss allowances which in the case of total non-payment turn into a loss incurred.

The Bank mitigates the risk of default by:

- assessing a customer's credit rating based on financial models, including predictive models based on which the customer is assigned a credit rating adequate to the level of associated risk,
- periodically monitoring a customer's economic and financial situation.

Collateral risk

Collateral risk occurs when taken collateral of a credit exposure is inadequate to the financing granted or when the value of the collateral fluctuates significantly.

Collateral risk is mitigated by:

- collateral policy adopted by a resolution of the Management Board, which sets the boundary conditions of collateral's adequacy for a particular type of exposure, customer and collateral,
- monitoring the value of collateral, in particular mortgages, through periodic verification of property valuation,
- stress tests, including simulations of changes in the value of collaterals.

Interest rate risk and foreign exchange risk

Interest rate risk and foreign exchange risk are associated with the risk of default, because the rise in the former considerably increases the probability of the latter. This risk causes increased payments due from a customer due to the increase in interest rates or negative change in currency exchange rates, which results in higher instalment commitments.

The Bank mitigates interest rate risk and foreign exchange risk by:

- applying appropriate procedures for financing in foreign currencies, in particular when verifying the repayment sources of the Bank's receivables,
- stress tests, including, but not limited to, simulations of interest rate and foreign exchange rate fluctuations and their impact on the customer's creditworthiness.

14.4 ORGANISATION OF THE FINANCIAL RISK MANAGEMENT PROCESS

The system of financial risk measurement used at BGK includes, in particular, the following approaches and tools:

- liquidity ratios, liquidity gap analysis, fund stability analyses, daily monitoring of the deposit base – applied in relation to the liquidity risk,
- measures of position volumes (such as foreign exchange position, interest rate gap) – applied to foreign exchange risk and interest rate risk, measures of sensitivity used for detailed analyses (BPV, duration, sensitivity of net interest income to fluctuations in interest rates, sensitivity of the economic value) – applied to interest rate risk;
- Value at Risk (VaR) – applied to market risk;
- capital adequacy ratios – measures related to the requirements of external regulations, determining the adjustment of equity to the level and nature of risks of the Bank, including the size and structure of risk-weighted assets;
- leverage ratios – applied to excessive leverage risk;
- stress tests – applied to the financial risk.

The system of limits is the main financial risk management tool at BGK. BGK uses the following limits:

- for liquidity risk – limits and threshold values of liquidity ratios;
- for interest rate risk – sensitivity limits, position limits and loss limits;
- for foreign exchange risk – position limits and loss limits;
- for capital adequacy – capital adequacy limits and capital limits in the particular types of activity;
- for excessive leverage risk – internal limits for regulatory leverage ratio.

The risk monitoring process consists in periodic control of the limited parameter levels in addition to analysing utilisation of limits. Financial risk reports are submitted to the Bank's Finance Committee, the Management Board and the Risk Committee as well as to the Bank's Supervisory Board. Procedures additionally specify the rules to be followed in the event of an increased level of financial risk.

14.5 OVERVIEW OF KEY FINANCIAL RISKS

Liquidity risk

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

The purpose of liquidity risk management is to:

- ensure and maintain the Bank's ability to meet both current and planned future liabilities, including costs of liquidity and return on equity;
- prevent crisis;
- define business continuity solutions for potential crisis.

Liquidity risk level is presented in regular liquidity reports including, in particular, information on the utilisation of regulatory and internal liquidity limits, the stability of external funding and stress tests results as well as additional analyses concerning, inter alia, long-term liquidity.

Quarterly reports also present information about the assessment of the size and profile of the Bank's liquidity risk related to the operations of its subsidiaries. In 2018, cash flows generated by subsidiaries were insignificant from the

perspective of the liquidity of BGK. Following the sale of shares in subsidiaries in 2018, at present BGK does not have any subsidiaries.

The Bank controls liquidity risk using a system of limits and liquidity ratio thresholds. The limit system covers current, short-term, medium-term and long-term liquidity.

In 2018, BGK developed its liquidity risk management, including by modifying the calculation of selected liquidity ratios and calculation of stability for individual categories of liabilities.

In the entire year 2018, the liquidity of BGK was at a safe level. Supervisory liquidity measures defined in Resolution 386/2008 of the Polish Financial Supervision Authority of 17 December 2008 on development of the liquidity standards for banks (as amended) and in 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, 17.01.2015, p. 1) and internal liquidity standards were not breached.

TABLE 43: Regulatory liquidity measures

Item	limit	as at 31 Dec 2018	as at 31 Dec 2017	Additional information –	
				as at 31 Dec 2018	as at 31 Dec 2017
M3—own funds to non-liquid assets	1.0	2.6	5.4	2.5	5.4
M4 – total equity and stable external funds to non-liquid and limited-liquidity assets	1.0	1.3	1.3	1.6	1.7
LCR—liquidity coverage ratio	100.0%*	241%	207%	310%	272%

* the limit applicable as at 31 December 2018

A change in the liquidity measures was mainly driven by expansion of equity investments and the growth of the deposit base of non-financial entities.

Market risk

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

The objectives of market risk management are:

- for interest rate risk (including the price risk of debt securities) — to reduce 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 foreign exchange risk – to mitigate the risk of losses that may be incurred as a result of changes in market foreign exchange rates;
- for equity price risk – to mitigate the risk of losses that may be incurred as a result of changes in equity instruments prices.
- In 2018, BGK modified the VaR model to increase the level of adjustments made as part of this measure.
- In 2018, BGK maintained the acceptable level of market risk approved by the Supervisory Board (risk appetite).

Interest rate risk

The Bank monitored interest rate risk using:

- BPV limits for the trading book and the banking book;
- loss limits;
- limits for income risk in the banking book;
- other risk measures, such as duration and VaR.

The internal reporting system for interest rate risk includes, in particular, information on the utilisation of limits and the threshold values for interest rate risk, gains/losses on interest rate movements, measures (VaR, BPV, duration,

modified duration), interest rate gap analysis, interest income sensitivity, sensitivity of the economic value, and results of stress tests.

In 2018, interest income risk over a period of 12 months remained at a moderate level. The exposure to interest rate risk was limited through the ongoing management of the liquid asset portfolio.

Near the end of the reporting period, the sensitivity of interest income dropped due to acquisition by the Bank of non-interest-bearing assets (mostly investment certificates).

TABLE 44: Basic interest rate risk measures (in PLN thousand)

Item	as at 31 Dec 2018	as at 31 Dec 2017
BPV (Treasury portfolio)	-1,396	-1,457
VAR (Treasury portfolio)	5,585	5,346

Foreign exchange risk

In 2018, BGK reported low foreign exchange risk. The risk was measured in accordance with the applicable principles, including based on measurement of foreign exchange positions, VaR and foreign exchange gains or losses. The utilisation of internal limits was also constantly monitored with respect to currency position and loss.

Currency risk reports include, in particular, information on the utilisation of currency risk limits, performance, VaR and results of stress tests.

The total foreign currency position as at 31 December 2018 amounted to PLN 85.3 million, whereas VaR for that item totalled PLN 922.4 thousand.

Equity price risk

In 2018, the equity price risk at BGK was moderate. Compared to 2017, the share portfolio value fell by PLN 119 million (in relation to a drop in the price of PKO BP S.A. shares and a high volume of those shares in the portfolio of BGK). The portfolio of investment certificates continued to grow as well.

Risk was measured in accordance with the applicable principles, mainly through measuring equity instruments portfolio and VaR. As at 31 December 2018, VaR of the equity instruments portfolio amounted to PLN 46.8 million.

14.6 ORGANISATION OF THE OPERATIONAL RISK MANAGEMENT PROCESS

Operational risk is inherent in all major areas of operations pursued by BGK, including any new, existing and modified products, processes and systems, and it takes account of internal factors (such as the organisational structure, business profile, IT systems used, client profile, client complaints, HR quality, organisational changes and employee turnover) and external factors (external environment of the Bank).

Operational risk management covers all regions/organisational units of the head office of BGK and subsidiaries supervised by appropriate organisational units of the Bank's head office in line with the Head Office Organisational Regulations and their responsibilities.

The Bank manages operational risk through:

- the function of Operational Risk Coordinator;
- process-based approach to the assessment of business lines, increased risk products the risk posed by branches of BGK and organisational units of its head office,
- operational risk ratios.

The Operational Risk and Internal Control Committee functions at the Bank as an opinion-forming and decision-making body, assisting the Bank's Management Board in the oversight and control of the operational risk, compliance risk, and the audit function at BGK, as well as the effectiveness of the risk management system.

Reporting of operational risk is based on the information entered into the application Operational Risk Registry by operational risk coordinators from all regions/organisational units of the head office of BGK and transferred from subsidiaries.

14.7 OVERVIEW OF OPERATIONAL RISK

The net loss (including provisions) arising from operational risk events in 2018 amounted to PLN 67.3 million. Provisions for operational risk events reached PLN 68.1 million as at the end of 2018.

14.8 OVERVIEW OF BUSINESS RISK

Business risk is understood as the risk of failure to achieve key business goals, in particular financial result, due to changes in economic, social, legal, business and market environment or failure to achieve the business and social goals implemented by the Bank as part of missions and tasks defined by the owner. Business risk involves strategic risk.

The objective of business risk management is to mitigate a negative financial impact of adverse changes in business environment, inappropriate decisions, inadequate implementation of decisions or inadequate response to changes in the business environment.

14.9 OTHER RISKS

Additionally, BGK manages hard-to-measure risks, especially compliance risk, adopting similar principles as in the case of management of operational risk, model risk and risk of changes in macroeconomic conditions, in accordance with relevant internal procedures.

14.10 CAPITAL ADEQUACY

The Bank monitors the level of capital adequacy using capital adequacy ratios determined in line with the Banking Law and CRR¹.

In 2018, BGK expanded its capital adequacy management, including by developing methods and updating principles related to capital adequacy. The methods of setting capital limits and selected methods of determining internal capital were changed.

In 2018, the capital adequacy standards set out in Article 128.1 of the Banking Law and in Article 92.1 of CRR were met (CET1 of at least 4.5%, the Tier 1 capital ratio of at least 6%, the solvency ratio of at least 8%, and the internal capital ratio of less than 100%).

The above indicators are specified individually due to the lack of need to carry out prudential consolidation in line with the CRR.

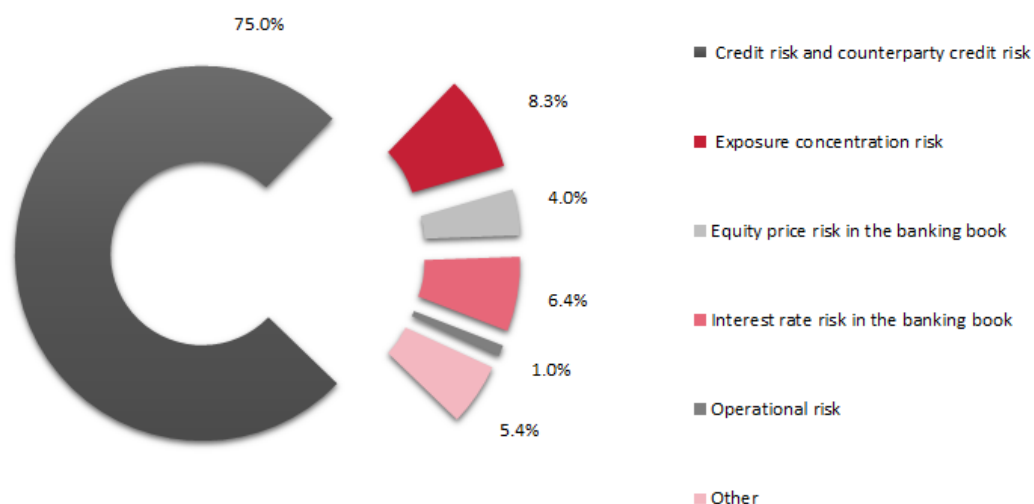
¹ Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (OJ L 176, 27.6.2013, p. 1)

TABLE 45: Capital adequacy ratios

Item	as at 31 Dec 2018	as at 31 Dec 2017	change PLN million / pp	Additional information – excluding cash flow funds		
				as at 31 Dec 2018	as at 31 Dec 2017	change PLN million / pp
Total capital requirement (in PLN million)	4,642.2	3,976.3	665.9	4,555.6	3,975.8	579.8
Internal capital (in PLN million)	5,829.8	4,648.9	1,180.9	5,742.4	4,648.3	1,094.1
Total equity (in PLN million), including:	18,275.9	18,864.2	-588.3	18,275.9	18,864.2	-588.3
Tier 1 capital, including:	18,275.9	18,864.2	-588.3	18,275.9	18,864.2	-588.3
Common Equity Tier 1	18,275.9	18,864.2	-588.3	18,275.9	18,864.2	-588.3
Tier 2 capital	0.0	0.0	0.0	0.0	0.0	0.0
CET1	31.5%	38.0%	-6.5	32.1%	38.0%	-5.9
Tier1 capital ratio	31.5%	38.0%	-6.5	32.1%	38.0%	-5.9
Solvency ratio	31.5%	38.0%	-6.5	32.1%	38.0%	-5.9
Internal capital ratio	31.9%	24.6%	7.3	31.4%	24.6%	6.8

An increase in the total capital requirement and internal capital in 2018 was mainly related to the purchase of investment certificates of Closed-Ended Investment Funds, higher risk weight in connection with the end of the transition period for preferential treatment of exposures to the State Treasury in currencies of EU Member States, and an increase in exposures to banks and enterprises. A decrease in own funds resulted from a drop in the BGK's authorised fund due to allocation of PLN 0.9 billion to the National Guarantee Fund (NGF) and an increase in the BGK's authorised fund attributable to accounting for PLN 0.4 billion of profit for 2017.

Internal capital is determined in respect of the risks identified by the Bank as significant. The largest part of it is represented by internal capital for credit risk and counterparty credit risk. Internal capital structure has been presented below.



MANAGEMENT BOARD OF BANK GOSPODARSTWA KRAJOWEGO

President of the Management Board
Beata Daszyńska-Muzyczka

.....

First Vice-President of the Management Board
Paweł Nierada

.....

Vice President of the Management Board
Włodzimierz Kocon

.....

Member of the Management Board
Przemysław Cieszyński

.....

Member of the Management Board
Wojciech Hann

.....

Member of the Management Board
Radosław Kwiecień

.....

Warsaw, 15 April 2019