

BFG

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Bankowy Fundusz Gwarancyjny

ANNUAL REPORT

2005

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prof. dr hab. Władysław Baka
President of the Council

INTRODUCTION

Ladies and Gentlemen,

We are presenting the Annual Report of the Bank Guarantee Fund for the year 2005. It should be highlighted that it was the fourth financial year without declared bankruptcy of a bank. Therefore, the core activity of the Fund was focused on providing financial assistance to banks endangered with insolvency and supporting the restructuring and merger processes of the co-operative banks. Also in that scope the situation of the banking sector was very good. Only one loan in the amount of EUR 115,809.11 thousand* was granted to a bank that undertook the responsibility for restoring the profitability of another banking institution. More credits, namely fifteen loans totalling EUR 6,582.98 thousand were granted from the co-operative banks restructuring fund. Those financial means were earmarked for merger processes, investments and purchase of shares in affiliating banks. Loans from this fund have been granted since 2001 and in this period 176 banks have taken advantage of those loans which total EUR 61,918.75 thousand.

Much effort was dedicated to ensure timely repayment of the loans and to recover funds from bankruptcy estates of banks. They constitute an important source of financial means for future BGF needs and, simultaneously, enable relatively moderate encumbrance of banks and the NBP with annual contributions in subsequent years. For many years now, the BGF has been invariably active internationally. In 2005 the Fund participated in conferences and meetings organised by two international associations of deposit insurance institutions: the European Forum of Deposit Insurers (EFDI) and the International Association of Deposit Insurers (IADI). The Fund also organised the 3rd annual meeting of the EFDI members combined with a conference dedicated to the 10th anniversary of the BGF activity. The Fund also hosted representatives of the Vietnamese Guarantee Fund, the National Bank of Georgia, the Central Bank of Montenegro and the Russian Agency of Deposit Insurance.

The close co-operation of the Fund with the National Bank of Poland, the Ministry of Finance and the Polish Bank Association is especially worth emphasising. Pursuant to the provisions of the Bank Guarantee Fund Act, the representatives of the aforementioned institutions participating in the works of the Fund Council exert direct influence on its activities and may permanently monitor the decisions adopted by the Fund.

The words of gratitude shall also be addressed to all the banks participating in the Polish deposit guarantee scheme. This co-operation not only provides the customers of the banks with a sense of security, but also strengthens a positive image of the whole banking sector.

Chairman of the Fund Council
Władysław Baka

* Pursuant to the exchange rate valid as of 30.12.2005 i.e.: PLN 3.8598



Ewa Kawecka-Włodarczak
President of the Management Board

Ladies and Gentlemen,

The Bank Guarantee Fund constitutes an important component that contributes to the financial stability of the state. This results primarily from the specific significance of the banks for appropriate functioning of the national economy. When a bank becomes insolvent then the negative effects of a bankruptcy are suffered not only by the owners and employees, but first of all by the depositors, borrowers and the whole banking system. Therefore, the mission to be fulfilled by the Bank Guarantee Fund consists in protecting deposits placed with the banks and supporting safety and stability of the banking system in Poland.

Taking into account the number of declared bankruptcies this strategic objective has been successfully achieved for many years now. Changes in the Polish banking system result from natural transformations and mergers and not due to bankruptcies that used to happen several years ago.

It is also worth pointing out the BGF activity in the field of assistance provided to those co-operative banks that present good financial standing and may obtain additional assistance for financing costs of merger with other co-operative banks and for indispensable restructuring. This has been the most popular form of assistance provided by the Fund for many years.

A good financial condition of the banking sector in Poland exerts a favourable influence on the whole national economy and also on the development opportunities of many financial institutions. After an exceptionally high profit achieved in 2004, we have another record result. Net profit above EUR 2.3 billion (comparing to EUR 1.8 billion in 2004) confirms that the economy has stabilised its development capabilities.

Presenting the activities of the BGF we cannot forget mentioning our excellent co-operation with the Ministry of Finance, the National Bank of Poland, the Polish Bank Association, and the National Association of Co-operative Banks and also with numerous commercial and co-operative banks.

President of the Fund Management Board
Ewa Kawecka-Włodarczak

Functional principles of deposit guarantee scheme

The deposit guarantee scheme ensures that in the case of a bank's bankruptcy the bank customers that comply with the criteria specified in the BGF Act will have their deposits reimbursed up to the PLN equivalent of EUR 22.5 thousand. Moreover, the banks that require financial support to function properly may use repayable loans granted by the Fund. The system constitutes one of the principal components crucial for sound operation of the whole banking sector. It provides the society with a sense of safety and builds trust towards the banking sector.

The currently binding solutions in this area in Poland fully comply with the EU regulations, and in particular with recommendations of the Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit – guarantee schemes.

The deposit guarantee scheme includes, according to uniform principles, almost all banks operating in Poland, both commercial banks in the form of joint stock companies as well as co-operative banks and state-owned banks. Since 1 May 2004, obligatory membership in the scheme does not apply to branches of banks with registered office in a member state of the European Union and banks from the EU countries operating in Poland on a cross-border basis, as these banks belong to the deposit guarantee schemes in their home countries.

Activities related to bankruptcy of banks

Pursuant to the currently valid Banking Law Act, in the event of bank insolvency, the Commission for Banking Supervision is authorised to issue a decision on suspending such bank's activity. The decision is publicly announced. During the suspension period, the bank is unable to settle its liabilities, also towards the account holders. If the Commission for Banking Supervision does not take a decision on takeover of the bank, whose activity has been suspended, by another bank, the Commission is obliged to file a petition with a competent court for declaring bankruptcy. Such a petition should be considered by the court within one month from the date of its receipt. First, the bankruptcy of the bank is declared with a possibility of an arrangement with creditors and a receiver of the bankruptcy estate is appointed¹. The receiver takes over the management of the bank's assets under bankruptcy regime. If no arrangement is made between the insolvent bank and the creditors, the court shall replace the decision on bankruptcy with the possibility of concluding an arrangement with the decision on bankruptcy with liquidation of assets, and appoints a trustee. The trustee manages and carries out the liquidation of the bank's assets, which shall be used to satisfy the claims of the creditors. The bankruptcy proceedings are supervised by a judge-commissioner, who also controls the proceedings conducted by the receiver and trustee.

¹ Such a solution was introduced by the provisions of the new Bankruptcy and Rehabilitation Law, which resulted in the amendment of the Banking Law Act in this scope. No bankruptcy of any bank has yet been declared under the rule of the new Act.

Payment of guaranteed funds

From the bank customers' perspective, especially important is the procedure of paying out guaranteed funds. Pursuant to the BGF Act, the payment of guaranteed amounts to depositors should be effected at the latest within three months from the date of unavailability of the funds deposited in the bank. In the Polish legal conditions, this date should be understood as the date of suspension of bank operations by the Commission for the Banking Supervision. This decision precedes presentation of a petition filed with the court to declare bankruptcy. Upon the court's consent, the period for effecting payments may be prolonged from three to not more than nine months.

Within thirty days from the date of court's ruling on the bank's bankruptcy, the receiver or trustee of the bankruptcy estate shall be obliged to prepare and present to the Fund the list of persons authorised to obtain guaranteed funds together with specific amounts owed to them. After checking the correctness of the said list, the Fund provides the receiver or the trustee with funds for payment of guaranteed amounts to depositors. Payments are effected by the receiver or trustee of the bankruptcy estate in places and on dates publicly announced.

The depositors' receivables that exceed the guaranteed amount may be claimed exclusively from the bank's bankruptcy estate pursuant to the general rules of bankruptcy proceedings.

Financing of the payment of guaranteed funds

Financial resources for payments due to customers are obtained directly from other banks that belong to the guarantee scheme and are gathered by the bank in the form of funds for protection of guaranteed deposits.

The said funds are established by all banks participating in the Polish deposit guarantee scheme. Their amount is determined by the BGF Council that determines appropriate percentage that takes into account, first of all, the potential risk of bankruptcies in a given year. The maximum rate shall amount to 0.4% of the deposits accumulated by the bank. In 2005 the rate amounted to 0.13% of the funds that constitute a basis for calculating obligatory reserve. The fund for protection of guaranteed deposits amounted to 123,331.80 thousand.

However, it is especially important for the bank that financial means that constitute the funds for protection of guaranteed deposits are invested in treasury bonds, money bills of the National Bank of Poland or participation units in the money market funds. These assets provide the banks with interest income until the time of their possible conversion into liquid funds. This takes place only in the event of the bank bankruptcy when the BGF asks banks to transfer suitable amounts for payment of guaranteed deposits.

The amounts recovered by the Fund from the bankruptcy assets of insolvent banks constitute an additional source, from which payments of guaranteed funds are performed.

If funds for protection of guaranteed deposits and other funds gathered by the BGF (assistance fund, own funds) prove to be insufficient for discharging the Fund's obligations on account of paying out guaranteed funds, it is possible to obtain financial support by taking a credit from the NBP. After that there is a possibility of increasing the rate for establishing funds for protection of guaranteed deposit by banks up to 0.8%. However, there has been no need to obtain additional financial resources for discharging the Fund's guarantee obligations to date.

Scope and level of coverage

Pursuant to the Bank Guarantee Fund Act, the protection applies to funds deposited on registered bank accounts and receivables resulting from other banking activities of the following entities (referred to as "depositors" in the Act):

- natural persons;
- legal entities;
- organisational units without legal personality, provided that they have legal capacity;
- school savings associations and employee savings-and-loans associations.

In the event of joint accounts, each holder of the joint account is entitled to the guaranteed amount. Also the claims against the bank by virtue of a bank legacy in case of death as well as due to account holder's funeral costs are subject to the coverage, provided that the said claims became due and payable before the suspension of bank activity.

In the event that the court declares bankruptcy of the bank, the guaranteed amount is paid to the authorised persons. The upper limit of the guaranteed amount is defined as a PLN equivalent of the statutory amount expressed in EUR. It also includes interest accrued until the date on which the bankruptcy of the bank is declared. All the depositor's receivables from the bank (regardless of their type and currency in which they are denominated) are summed up and then set off against the depositor's liabilities towards the bank, thus giving the basis for calculation the depositor's guaranteed funds due.

The guaranteed funds are paid out in PLN according to the average exchange rate published by the National Bank of Poland as of the day on which the court declares bankruptcy of the bank, whereas:

- PLN equivalent to EUR 1,000 is paid out in 100%,
- PLN equivalent above EUR 1,000 up to EUR 22,500 is paid out in 90%.

Guarantee activity in 2005

In 2005, as in the three preceding years, no bank went bankrupt. Therefore, the guarantee activity of the Fund focused on paying out guaranteed funds to the customers of Bank Staropolski S.A. in Poznań (which had gone bankrupt in 2000) and Bank Spółdzielczy in Włodowice, that due to various reasons had not been able to collect the amounts due before. The payments were made on the basis of supplementary lists submitted by trustees. On 11 February 2005, due to the lapse of 5 years from the date of Bank Staropolski S.A. bankruptcy², the claims of 2,626 depositors totalling EUR 378.18 thousand became time-barred. In the case of 95 former customers of that bank, the claims totalling EUR 93.99 thousand were still considered as valid.

Pursuant to the BGF Act, payments of guaranteed funds to depositors are effected by a trustee within an indicated period after the bankruptcy of the bank has been declared. Upon lapse of that period uncollected funds are returned to the Fund. In 2005 the Fund Office made payments of guaranteed funds to 168 depositors up to the total amount of EUR 92.03 thousand.

Additionally, on the basis of supplementary lists of depositors submitted by the trustee of the Bank Staropolski S.A. bankruptcy estate for the BGF approval, 99 creditors were paid the total amount of EUR 36.14 thousand. The lists included persons not covered by the original list. The aforementioned payments were performed by the trustee from liquid funds of the bankrupt bank.

² Claims of depositors against the Fund become barred by statute of limitations within 5 years from the declaration of bank's bankruptcy.

Financial means recovered from bankruptcy estates and their settlement

In 2005 the Bank Guarantee Fund recovered the amount of EUR 255.01 thousand on account of claims made to bankruptcy estates of banks in relation to transfers of funds to trustees for payments to depositors during previous years. The said funds were recovered due to the distribution of bankruptcy estates of 11 banks. As of the end of December 2005, there were 19 pending proceedings and the BGF liabilities amounted to EUR 127,060.83 thousand.

In conformity with the BGF Act, the financial means recovered from bankruptcy estates of the bank may be used only for financing consecutive payments of guaranteed amounts. The funds recovered by the BGF bankruptcy estates of banks totalled EUR 15,762.19 thousand.

System of assistance provided to endangered banks

Objectives and principles of assistance activity

Another basic objective of the BGF activity is the support provided to restructuring of banks endangered with insolvency, which is tantamount to protection of depositors against a possible loss of deposits they placed with such banks. Pursuant to the BGF Act, the assistance may have the form of loans, guarantees or endorsements as well as acquisition of the banks' debts on more favourable conditions than those generally applied by the banks.

The Bank Guarantee Fund conducts its assistance activity in accordance with the following principles:

- equal treatment of the banks in terms of their access to assistance funds by applying uniform and transparent criteria and procedures for granting assistance.
- support of activities aimed at removing the threat of insolvency in banks with the participation of investors with solid capital;
- inspiration of the applicants to look for additional sources of financial support for the implementation of rehabilitation programs, apart from the assistance offered from the BGF funds.
- high effectiveness of the assistance, *inter alia* by determining in loan agreements specific terms and conditions the fulfilment of which by banks should contribute to the permanent reestablishment of solvency. The above terms and conditions referred to:
 - rationalised operating expenses;
 - assigning the entire profit obtained thanks to the Fund's financial assistance for coverage of losses;
 - investing funds acquired due to the obtained assistance in safe and profitable financial instruments.

Pursuant to Art. 20 of the BGF Act, the financial assistance is only possible upon fulfilment of specific terms and conditions, in particular:

- acceptance by the Management Board of the Fund of financial statements audit results concerning the activity of the bank applying for assistance, and in the case of application for assistance in the process of bank takeover, merger of banks or purchase of shares in another bank: acceptance of audit results concerning the financial statements of both banks;
- presentation by the bank of rehabilitation program that obtained a positive opinion from the Commission for Banking Supervision and in the case of bank takeover, merger of banks or purchase of shares in another bank – a positive opinion from the Commission for Banking Supervision on the purposefulness of such activities;
- proof that the amount of the requested loan, guarantee or endorsement does not exceed the total maximum amount of guaranteed funds in the bank, calculated as the total amount guaranteed funds in depositors' accounts, and in the case of an application for financial assistance aimed at takeover of or merger with another bank – the requested amount does not exceed the total guaranteed funds in depositors' accounts in the bank subject to takeover.
- proof that the hitherto own funds have been used to cover losses of the bank applying for assistance or of the bank subject to a takeover.

The Fund Council has determined the principles, forms, conditions and procedures of granting financial assistance to entities subject to obligatory deposit guarantee scheme and it has specified the criteria for assessing the insolvency threat.

Conditions of granting financial assistance in 2005

Conditions of granting financial assistance in the form of loans, binding in 2005, were as follows:

- the interest on loans were based on the rediscount rate for bills of exchange fixed by the Monetary Policy Council;
- annual interest rate at the level of 0.1 of the rediscount rate for bills of exchange;
- commission amounted to:
 - 0.3% of the loan amount for commercial banks;
 - 0.1% of the loan amount for co-operative banks;
- lending period – up to 5 years, whereas in justified cases this period could be extended up to 10 years;
- payment of loan: one-off payment or payment in tranches;
- interest: accrued and collected quarterly; repayment of principal: in quarterly or semi-annual instalments;
- in particularly justified cases the grace period for the repayment of principal was available.

Assistance provided to banks in 2005

Much effort was dedicated to activities preventing the bankruptcy of Bank Przemysłowy S.A. in Łódź. Since 2001 the bank has been incurring losses. Failure to implement a rehabilitation program caused the establishment of receivership. Getin Bank S.A. participated in the restructuring activities and in the second half of 2004 it applied for loan aimed at taking over Bank Przemysłowy S.A. Simultaneously, the restructuring program and the terms and conditions of the BGF assistance were established in co-operation with the General Inspector of Banking Supervision. Upon meeting all the formal conditions, in January 2005 the Fund granted the Bank a 6-year loan in the amount of EUR 115,809.11 thousand.

Avoidance of bankruptcy of this Bank was especially important for local government of Łódź due to the amount of their deposits, only partially covered by the BGF guarantees.

In 2005 two co-operative banks applied for financial assistance. In both cases the assistance was applied for in order to take over other co-operative banks endangered with insolvency. The banks subject to a takeover were included in the structures of the bank that decided to reform them, on the basis of the rehabilitation program. The total assistance amounted to EUR 9,220.69 thousand.

Repayment of loans

Throughout the year, 19 loans totalling EUR 185,605.39 were repaid. Among the banks that totally repaid their liabilities was Wschodni Bank Cukrownictwa S.A. and 12 other banks that undertook its restructuring in 2002. It was an atypical rehabilitation due to inability to find a strategic investor. On the initiative of the General Inspector of Banking Supervision, some activities were undertaken to avoid the bankruptcy of that Bank. To this purpose an agreement was concluded between 12 banks that bore the highest expenses (EUR 116,586.35 thousand approximately) due to necessity to pay guaranteed funds to WBC S.A. customers totalling EUR 133,400.69 thousand. Moreover, the customers would lose around EUR 49,225.35 thousand of deposits not subject to the Fund guarantees. This means that possible results of the bankruptcy would be far more ominous than in the case of bankruptcy of Bank Staropolski S.A.

The elimination of insolvency threat consisted in taking over the WBC S.A. shares by the parties to the aforementioned agreement, which also obtained financial support from the BGF in the form of loans for purchasing shares. Moreover, WBC S.A. was also granted a loan for auto-rehabilitation.

That innovative operation was totally successful. In 2005 an investor interested in purchasing the Bank's shares: Getin Bank S.A. The rehabilitation program, a basis for obtaining financial assistance from the BGF, was completed.

At the end of 2005 the Fund's assistance was used by 13 banks, which were granted 18 loans totalling EUR 366,341.05 thousand.

Loans from the co-operative banks restructuring fund

Objectives and principles of granting assistance from the CBRF

By virtue of the Act on Operation of Co-operative Banks, their Affiliation and Affiliating Banks of 7 December 2000, the Bank Guarantee Fund continued its activities consisting in offering financial assistance for merger processes of co-operative banks that were financed from the co-operative banks restructuring fund established in 2001.

According to the said Act, the BGF obtained funds amounting to EUR 31,973.08 thousand earmarked for the support of merger processes in the sector of co-operative banks and for related investment undertakings, in particular for the unification of:

- software and hardware;
- banking technology;

- financial and accounting procedures;
 - banking products and services offering;
- as well as for acquiring shares in affiliating bank.

Financial assistance from the co-operative banks restructuring fund is granted exclusively to those co-operative banks, which have merged with other banks, within the period starting from the day specified as 3 years before the effective date of the Act (i.e. after 28 January 1998) or purchased shares in affiliating banks within 3 years from the effective date of the Act (i.e. before 28 January 2004), have met the solvency criterion and possessed the capacity to repay the received loans.

Conditions of providing financial assistance in 2005

The conditions of granting assistance in support of merger processes and implementation of investments, as well as for purchasing shares in affiliating bank in 2005 are presented below.

Conditions of granting financial assistance from the co-operative banks restructuring fund in 2005.

| Conditions of granting assistance: | Objective of the assistance: | |
|--|---|--|
| | Support of merger processes and implementation of investments | Purchase of shares in affiliating bank |
| – annual interest rate on loan | 0.1 rediscount rate of bills of exchange established by the Monetary Policy Council | 0.05 rediscount rate of bills of exchange established by the Monetary Policy Council |
| – commission | 0.1% of loan amount deducted from such loan amount | |
| – lending period | maximum 5 years | |
| – grace period for principal repayment | maximum 2 years | |
| – loan payment | one-off payment | |
| – interest repayment | quarterly | |
| – principal repayment | semi-annual instalments | |

Loans granted in 2005

The applications submitted by the banks referred both to financial assistance in supporting merger processes and implementation of related investment and to purchase of shares in affiliating banks. One part of the banks that have already used loans applied for prolongation of the lending period and for grace periods concerning the principal repayment.

15 loans were granted before the end of 2005, of which 10 loans referred to applications submitted in 2004, for the total amount of EUR 6,582.98 thousand.

The structure of the above loans was as follows:

- 8 – for supporting merger processes and implementation of investments in the amount of EUR 4,882.64 thousand;
- 4 – loans granted to banks using financial assistance granted in preceding years, in relation to additional capital expenditures incurred by such banks, unforeseen in previous applications – in the amount of EUR 1,619.51 thousand;
- 3 – for purchasing shares in affiliating banks – in the amount of EUR 80.83 thousand.

Repayment of loans

Throughout 2005 the banks repaid principal of EUR 3,701.88 thousand. 12 loans were totally repaid.

Seventy nine banks were using 101 loans from the co-operative banks restructuring fund as at the end of 2005. The total value of provided financial assistance amounted to EUR 30,965.00 thousand.

Controlling use of the BGF financial assistance

Direct inspections in banks

Thirty direct inspections were carried out in the banks using assistance from the BGF in 2005.

Direct inspections in the banks using the BGF assistance in 2005.

| Number of inspections | Banks that received assistance | | |
|-----------------------|--------------------------------|--|-----------------|
| | from assistance fund | from co-operative banks restructuring fund | from both funds |
| Commercial banks | 5 | - | - |
| Co-operative banks | 2 | 22 | 1 |
| Total | 7 | 22 | 1 |

Scope of inspections carried out

The scope of direct inspections in banks that received loans from the assistance fund included the assessment of:

- conformity of the utilisation of assistance funds with statutory objectives and targets specified in loan agreements;
- effectiveness of the utilisation of assistance funds;
- implementation of rehabilitation or restructuring programs in banks taken over;
- economic and financial standing of the banks, including the tendencies of basic economic indices as compared with the averages in the sector of co-operative or commercial banks;
- fulfilment of obligations resulting from loan agreements.

In banks that used loans from the co-operative banks restructuring fund, the inspections concerned the assessment of:

- conformity of the use of the assistance funds with the Act on Operation of Co-operative Banks, their Affiliation and Affiliating Banks;
- bank solvency;
- capacity to repay loans;

- implementation of financial forecasts presented by the banks while applying for the loan;
- discharge of duties resulting from the loan agreements.

Furthermore, the effectiveness of merger processes was also analysed in those banks.

In all the inspected banks also the following aspects were subject to assessment:

- functioning of management information systems;
- organisation and efficiency of internal audit;
- provisions included in statutes and by-laws as well as basis internal regulations and their conformity with the binding law;
- fulfilment of the obligation resulting from Art. 26 of the BGF Act in the scope of investing assets used as a coverage of the fund for protection of guaranteed deposits;
- implementation of provisions included in Art. 111 of the Banking Law Act and Art. 38^b of the BGF Act, i.e.:
 - obligation to inform the bank customers on the economic and financial standing of the bank;
 - obligation to inform the bank customers on the bank's participation in the deposit guarantee scheme and on functional principles of that scheme.

Inspection results

It was found out that in all inspected banks that had received loans from the assistance fund, the granted financial means were used and protected in conformity with the provisions included in respective loan agreements. In the majority of cases, positive results of implementing rehabilitation programs were reported.

In the case of banks that had received loans from the co-operative banks restructuring fund no reservation was made as to the method of using the loans and no threat to repayment of liabilities towards the Fund was observed.

Conclusions from direct inspections allowed to state that the conducted merger process enabled banks to:

- meet the criteria stipulated in Art. 172 of the Banking Law Act in the area of equity requirements;
- increase their operational safety, including modernisation of utilised IT systems;
- extend scope of their business activity and product offering;
- improve work and customer service conditions.

Problems identified during the inspections were reflected in recommendations stipulated after the inspections. They referred especially to the necessity of limiting credit risk, increasing the costs discipline and improvement of operational effectiveness. Attention was also drawn to the necessary adjustment of internal regulation to the binding provisions of law and to the real conditions after the completed merger process. Some formulated conclusions also referred to the improvement of bank management and to the increase in the level of effectiveness in terms of internal audit.

Performing the function of curator

The Bank Guarantee Fund, by virtue of the decision taken by the Commission for Banking Supervision, performed in 2005 the function of curator supervising the implementation of rehabilitation programs by Bank Polskiej Spółdzielczości S.A. which gathers 354 co-operative banks.

The results of the curator's work were presented in quarterly reports submitted to the Commission for Banking Supervision. The aforementioned documents were also analysed by the Fund Council.

Gathering and analysing information on banks

Sources of information on banks

Financial statements received by the Bank Guarantee Fund from the National Bank of Poland by virtue of the BGF Act and agreement with the NBP concluded in 1997³ constitute a basic source of information on banks. Banks that use the financial assistance of the BGF send – pursuant to relevant loan agreements – their statements directly to the Fund.

Another source are the reports sent directly to the Fund on the basis of Ordinance 19/2000 of the NBP President of 11 December 2002 on the scope of information provided by banks to the Bank Guarantee Fund⁴. They are supplemented by the extra-reporting information obtained by the BGF.

Assessment of the situation in the banking sector

The bank's quantitative and qualitative data are used by the Bank Guarantee Fund to monitor and analyse the situation in the banking sector, including separate analysis of the commercial and co-operative segments, as well as specific banks identified as subject to risk. The basic objective of these operations is to establish whether there is any threat to solvency of specific banks, which would require the Fund and other institutions within the financial safety network to undertake special measures.

The BGF has developed its own methodology of assessing the situation of banks and generated risks to the safety of deposits accumulated by the banks. Based on analysis of indicators covering all areas of the banking activity supplemented with qualitative information, the banks receive individual rating. Depending on the rating, banks are classified into high, average and low risk groups concerning safety of deposits. This is how the so-called risk matrix is created to provide quick information on the standing of each bank and on the level of risk generated in the banking sector. The banks, whose solvency risk is rated as high are subject to profound assessment aimed at identifying the source of generated risk.

³ Amended on 31 January 2005.

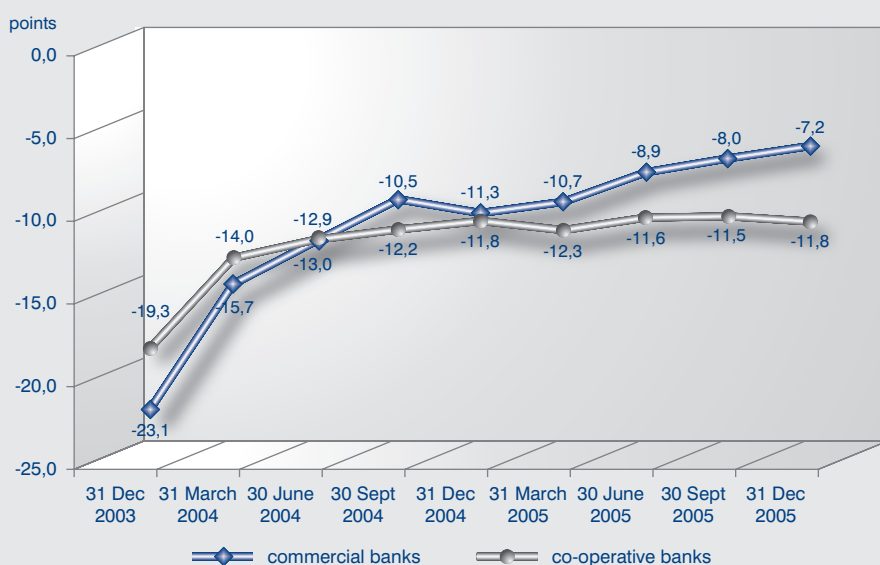
⁴ This Ordinance is to be amended.

The analysis of reporting data of all banks allows assessing the safety of the whole banking sector. A synthetic result of this appraisal is presented in the form of so called risk index⁵. Changes in the index level reflect changes in the evaluation of sector safety.

Changes in the banking sector status are also monitored by observing the positions of banks within the risk matrix during subsequent reporting periods (the so called migration matrix).

During 2005 both the index and the direction of bank migration in the matrix have undergone improvement, i.e. the majority of banks moved from higher to lower risk groups. The diagram below presents index levels in the sector of commercial banks and co-operative banks within the quarterly cycle from the end of 2003 until the end of 2005.

Risk index in commercial and co-operative bank sectors during the period from December 2003 till December 2005



Making use of conclusions from analyses concerning the banking sector status, the Fund developed a forecast about the amount and structure of deposits, risk-weighted assets and off-balance sheet liabilities in the banking sector and the volume of the BGF guarantee liabilities. Based on the said forecast, the Fund started working on a strategy of long-term accumulation of final assets, assuming their relation to the BGF guarantee liabilities resulting from the amount of deposits in the banking sector, simultaneously taking into account the low level of bank's encumbrance with the cost of financing the guarantee scheme. This is the policy pursued by deposit guarantee schemes in some European countries and in the United States.

On the basis of presented analyses and evaluations the BGF Council established the rates for creating funds for protection of guaranteed deposits by banks and the annual contribution in 2006.

It should be emphasised that the operational costs of the Polish deposits guarantee scheme that encumber the banks are among the lowest in the EU countries and they amounted to as little as 0.36% of the banks' operating costs.

⁵ The risk index presents the total standardised appraisal of effectiveness, solvency, assets quality and quality of granted off-balance sheet liabilities weighted by share of each bank in the banking sector deposits. The risk index is calculated separately for commercial and co-operative banks. The values of this index range from 0 (no risk) to 100% (maximum risk).

Monitoring of banks using the BGF financial assistance

Detailed procedures of monitoring the banks that use different forms of financial assistance provided by the BGF included:

- assessment of economic and financial standing;
- implementation of rehabilitation programs;
- evaluation of effectiveness of granted assistance;
- evaluation of obligations stipulated in loan agreements.

In the case of detected irregularities, recommendations addressed to the management boards of relevant banks were formulated.

Simplified monitoring procedures were applied in relation to the banks that used loans from the co-operative banks restructuring fund. The evaluation focused primarily on the correctness of using the financial assistance provided by the Fund.

Co-operation with national institutions

The principles of the BGF co-operation with legislative and executive authorities, as well as with the Supreme Chamber of Control and the National Bank of Poland have been stipulated in the BGF Act and other legal regulations. The President of the BGF Management Board is a member of the Commission for Banking Supervision.

Permanent co-operation between the BGF and the General Inspectorate of Banking Supervision, which is an executive body of the Commission for Banking Supervision related mainly to the exchange of information on potential risks to the banking sector.

In 2005, as in previous years, a meeting of banking circles was organised with the participation of a representative from the Polish Bank Association and the National Association of Co-operative Banks concerning planned rates for establishing funds for protection of guaranteed deposits by banks and the rates of obligatory annual contribution in 2006. Also the assumptions for financing the deposit guarantee scheme until 2010 were discussed.

The issues concerning notification of customers of the banks converted into branch offices of credit institutions from the European Economic Area was consulted with the Office of Competition and Consumer Protection. The conversion meant the transition to another deposit guarantee scheme, valid in the country of the bank's registered office.

The Fund issued opinions on numerous legal acts concerning the financial market as a part of arrangements between different governmental authorities, including the amended Union Endorsement Fund Act and Regulation of the Council of Ministers and of the Minister of Finance concerning public trading in securities. The Fund actively participated in developing the Polish standpoint on the Directive of European Parliament and European Council concerning the payment services within the Internal Market.

International co-operation

International activity constituted an important part of the Fund operations. In October 2005 a 3rd annual meeting of the European Forum of Deposit Insurers combined with the conference on the 10th anniversary of the BGF activity was organised. It was a natural opportunity to summarise the experiences and achievements of the BGF in terms of strengthening the sense of safety among bank customers.

The Fund representatives also participated in many conferences organised by the EFDI dedicated to various aspects of functioning of guarantee institutions and in one conference of the International Association of Deposit Insurers, on the invitation of the Central Bank of China. The Fund especially appraised the opportunity to share experiences in terms of insuring deposits with the countries undergoing systemic transformations. The Fund hosted the delegations of the Central Banks of Montenegro, Vietnam, Georgia and Russia.

The Fund has prepared the first draft agreement between the Polish and foreign deposit guarantee schemes. It concerned the co-operation of the Polish and Swedish schemes, that is especially significant for the customers of the Swedish banks operating in Poland in the form of branch offices.

Information and promotion activity

An important element for disseminating knowledge about the deposit guarantee scheme and the BGF both among the bank customers and employees constituted the publications which covered the ten years of the Fund activity and resulting achievements, in particular:

- a book entitled: "Systemy gwarantowania depozytów w Polsce i na świecie. Dziesięć lat Bankowego Funduszu Gwarancyjnego" ["Deposit Guarantee Schemes in Poland and the World; Ten Years of the Bank Guarantee Fund"];
- extended version of "Raport Roczny BFG za 2004" ["Annual BGF Report for 2004"] including the supplement entitled "10 lat działalności BFG – synteza liczbowa i kalendarium" ["10 Years of the BGF Activity – Figures Synthesis and Calendar"];
- the BGF Newsletter including, among others, information on the Fund's activity in the last 10 years;
- articles, press and radio interviews with the members of the Management Board (including releases in the Rzeczpospolita daily, the Gazeta Bankowa weekly, the Nowe Życie Gospodarcze weekly, the "Eurostudent" magazine, PIN Radio, etc.)

The Fund also continued the traditional dissemination of knowledge on deposit guarantee scheme in the form of information folders provided to bank customers.

Another important element for building knowledge about the BGF was the Fund's website (www.bfg.pl). It includes information concerning not only the most recent events, but also documents and reports from the whole period of the BGF operation. It is worth emphasising that direct connections to the aforementioned site can be found in the websites of the banks.

The electronic mail creates an opportunity of close and almost direct contact with the employees of banks and customers of financial institutions. By responding to numerous messages the information on both the manner of implementing the tasks resulting from the BGF Act and the Fund operating principles interesting from the perspective of students and scientists that specialise in financial and banking issues.

During the discussed period, the BGF signed an agreement with the National Bank of Poland on providing the NBP education portal with the documents prepared by the Fund employees.

An important way of informing the general public on the BGF activities were various presentations given by the Fund representatives during seminars and conferences in Poland and abroad. Two such seminars were organised in the Fund's office: with the participation of scientists and bankers. Those seminars focused on the evolution of the guarantee and assistance functions of the BGF and on the modifications in financing principles in the light of domestic and international experiences.

The most interesting presentations from those seminars together with theoretic considerations on the Fund's activities are published in the *Bezpieczny Bank* (The Safe Bank) magazine. In 2005 three issues of the said magazine were published. The said articles constituted an important source of information not only about the Polish deposit guarantee scheme but also about foreign solutions and the most important regulatory changes concerning the banking sector. Moreover, a special English language issue is in print, dedicated to an international seminar co-organised by the BGF and European Forum of Deposit Insurers (EFDI).

Bank Guarantee Fund Authorities

Composition of Fund Authorities

The statutory authorities of the Bank Guarantee Fund are as follows: the Fund Council (11 members) and Fund Management Board (5 members).

In 2005 the Council was composed of:

| | |
|---------------------------------|---------------------------|
| Chairman of the Council: | WŁADYSŁAW BAKA |
| Members of the Council: | JANUSZ CZARZASTY |
| | BARTOSZ DRABIKOWSKI |
| | WOJCIECH KWAŚNIAK |
| | JACEK OSIŃSKI |
| | RYSZARD PAZURA |
| | KRZYSZTOF PIETRASZKIEWICZ |
| | JAN SZAMBELAŃCZYK |
| | EWA ŚLESZYŃSKA-CHAREWICZ |
| | ANDRZEJ WIŚNIEWSKI |
| | GRZEGORZ WÓJTOWICZ |

The Management Board in its 4th term of office was composed of:

| | |
|---|---|
| President of the Management Board: | EWA KAWECKA-WŁODARCZAK |
| Vice-President of the Management Board: | HANNA KRAJEWSKA |
| Members of the Board: | MARIA PAWELSKA JERZY W. PIETREWICZ MAREK PYŁA |

Organisation of the Fund Office

The Bank Guarantee Fund implements its statutory tasks through the Office, the structure includes seven departments, internal audit post and the Fund Council Secretariat.

Specific organisational units perform the following tasks:

- **Guarantee Department** performs tasks directly related to the guarantee of bank deposits, collecting the Fund's receivables due to transfers of funds to trustees for payment of deposits to customers of bankrupt banks and to international co-operation;
- **Assistance Department** performs tasks related to providing financial assistance to banks endangered with insolvency (from assistance fund) and granting loans from the co-operative banks restructuring fund;
- **Analysis Department** gathers and analyses information on current status of banks; prepares evaluations and development forecasts concerning their situation in future as well as performs tasks related to monitoring the banks that were granted assistance by the Fund;
- **Control Department** performs tasks related to control of the standing of the banks provided with the Fund's assistance and to the implementation of the curator's functions;
- **Finance Department** performs tasks related with financial management, accounting and Fund settlements;
- **Legal Department** provides legal service to the Fund and represents the Fund in court and administrative proceedings and in other adjudging organs;
- **Organisation Department** provides organisational services to the Management Board and the Fund Office, manages the issues related to employment, work organisation, administrative services and is responsible for technical issues, IT system, premises and material infrastructure of the Office;
- **Internal Audit Post** performs the tasks related to assessing the operating correctness and conformity of the Fund Office organisational units with the provisions of law and internal regulations;
- **Council Secretariat** provides the substantial, organisational and technical service of the Fund Council in its performance of statutory tasks.

Furthermore, there are five permanent interdepartmental committees and groups:

- **Assets Management Committee** creates and supervises the policy of investment available financial resources of the Fund;
- **Committee for Assistance Applications Assessment**, whose task consists in issuing opinions on applications prepared by the Assistance Department for granting financial assistance to banks from the assistance fund and loans from the co-operative banks restructuring fund;
- **Management Information System Group** prepares, monitors and ensures efficient functioning of the system transmitting information that is crucial to Fund activity between organisation units of the Fund;
- **International Co-Operation Group** supports co-operation with foreign deposit insurance institutions;
- **Website Editing Group** provides proper functioning of the Fund's website.

Employment

Average annual employment in the Fund's Office amounted to 83.5 full-time jobs. Seventy four persons, i.e. 82.2% of the staff had higher education. Nine persons have been upgrading their professional skills and qualifications, continuing their education on Ph.D., postgraduate and graduate studies. Average age of the employees was 42.

Review of the Directive 94/19/EC of the European Parliament and of the Council of the European Union on deposit-guarantee schemes

In 2005, the Bank Guarantee Fund actively participated in the review process regarding the Directive 94/19/EC of the European Parliament and of the Council on deposit-guarantee schemes, which was being conducted by the European Commission. The review encompasses the following issues: minimum coverage level (currently 20.000 EUR), deposit definition, financing of deposit guarantee schemes, division of responsibilities between home country and host country, relations between deposit guarantee schemes and central banks.

In the context of the above mentioned review the Bank Guarantee Fund prepared a document entitled "Comments from the Czech Republic, Hungary, Lithuania, Poland and Slovakia on the planned review of the Directive on deposit-guarantee schemes (94/19/EC)", which resulted from consultations conducted by the representatives of the Ministry of Finance and the BGF with representatives of the respective institutions from interested countries. Subsequently, the common position of the Middle European countries was presented to the European Commission by the Polish Ministry of Finance. The works connected with the review of the Directive will be continued in 2006.



Bankowy Fundusz Gwarancyjny

FINANCIAL STATEMENTS

2005

REGISTERED AUDITOR'S OPINION ON THE ABBREVIATED FINANCIAL REPORT TO THE SEJM OF THE REPUBLIC OF POLAND, COUNCIL OF MINISTERS, FUND COUNCIL AND MANAGEMENT BOARD OF BANKOWY FUNDUSZ GWARANYCJNY

The attached abbreviated financial report of Bankowy Fundusz Gwarancyjny, Warsaw, ul. ks. Ignacego Jana Skorupki 4 (hereafter referred as "the Fund") was prepared by the Management Board of the Fund based on the audited annual financial statements of the Fund for the year ended 31 December 2005 ("the financial statement").

We have audited the annual financial statements of the Fund originally prepared in the Polish language, from which the abbreviated financial report was derived. On 3 March 2006 we issued an unqualified audit opinion on these financial statements.

In our opinion, the accompanying abbreviated financial report is consistent, in all material respects, with the Fund's annual financial statements from which it was derived.

For a fuller understanding of the Fund's financial position and the results of its operation for the year ended 31 December 2005, the abbreviated financial report should be read in conjunction with the financial statements from which it was derived and our opinion and audit report thereon.

On behalf of PricewaterhouseCoopers Sp. z o.o.:



Antoni F. Reczek
President of the Management Board
Registered auditor
No. 90011/503



Registered Audit Company No. 144

Warsaw, 17 July 2006

BALANCE SHEET AS OF 31 DECEMBER 2005.

| ASSETS | Additional information | in PLN | |
|---|---------------------------|-------------------------|-------------------------|
| | | 31.12.2005 | 31.12.2004 |
| I. Cash | | 487,064.69 | 306,099,408.16 |
| 1. Cash in hand | | 2,931.45 | 3,983.61 |
| 2. Cash in current account | | 316,509.64 | 983,355.14 |
| 3. Cash in special guarantee settlement account | | 1,798.65 | 1,798.65 |
| 4. Cash in term deposit account | | 0.00 | 305,000,000.00 |
| 5. Cash on Company Social Benefits Fund | | 165,824.95 | 110,270.76 |
| II. Receivables from financial institutions | 3. | 1,534,680,605.82 | 1,793,375,819.06 |
| 1. Receivables from banks, due to: | | | |
| a) obligatory contributions to special guarantee settlement account | | – | – |
| b) annual contributions to assistance fund | | – | – |
| c) loans granted from assistance fund | | 1,415,109,725.36 | 1,684,907,797.82 |
| d) loans granted from cooperative banks restructuring fund | | 119,570,880.46 | 108,468,021.24 |
| e) realised guarantees and endorsements | | – | – |
| f) purchased receivables | | – | – |
| 2. Receivables from other financial institutions | | – | – |
| III. Receivables from state budget | | – | – |
| IV. Other receivables and claims | 4. | 0.00 | 107.27 |
| V. Securities | 5. | 3,322,105,411.00 | 2,471,344,532.00 |
| 1. Debt securities: | | | |
| a) of state issuers | | 3,322,105,411.00 | 2,471,344,532.00 |
| b) of other issuers | | – | – |
| 2. Stocks and shares | | | |
| a) in financial institutions | | – | – |
| b) in other entities | | – | – |
| VI. Intangible assets | 6. | 0.00 | 5,199.30 |
| VII. Tangible assets | 6. | 68,599,588.53 | 70,605,793.27 |
| VIII. Other assets | | – | – |
| IX. Prepayments and accruals | | – | – |
| TOTAL ASSETS | | 4,925,872,670.04 | 4,641,430,859.06 |
| Contingent receivables | 12. | 490,429,379.23 | 494,711,628.62 |
| a) debts claimed from bankruptcy estate | | 490,429,379.23 | 494,711,628.62 |
| b) other receivables | | – | – |

BALANCE SHEET AS OF 31 DECEMBER 2005.

| LIABILITIES | | in PLN | | |
|--------------------------|--|---------------------------|-------------------------|-------------------------|
| | | Additional information | 31.12.2005 | 31.12.2004 |
| I. | Liabilities | 8. | 49,109,583.77 | 49,888,857.87 |
| 1. | Liabilities towards trustee of bankruptcy estate due to payments arising from the guaranteed funds system | | – | – |
| 2. | Other liabilities | | 49,109,583.77 | 49,888,857.87 |
| II. | Accruals and deferred income | 9. | 1,158,710.82 | 1,574,730.06 |
| III. | Provisions | 10. | 250,000.00 | 250,000.00 |
| 1. | Provisions for risk related to granted guarantees | | – | – |
| 2. | Provisions for risk related to granted endorsements | | – | – |
| 3. | Other provisions for risk | | 250,000.00 | 250,000.00 |
| IV. | Statutory fund | 7. | 1,282,711,688.72 | 1,171,074,526.39 |
| V. | Reserve fund | 7. | 510,000,000.00 | 470,000,000.00 |
| VI. | Assistance fund | 7. | 2,797,732,634.55 | 2,673,485,622.78 |
| 1. | Assistance fund to be used | | 1,383,729,489.55 | 990,082,733.78 |
| 2. | Used assistance fund | | 1,414,003,145.00 | 1,683,402,889.00 |
| VII. | Co-operative banks restructuring fund | 7. | 123,409,688.87 | 123,409,688.87 |
| 1. | Co-operative banks restructuring fund to be used | | 3,890,938.87 | 15,011,488.87 |
| 2. | Used co-operative banks restructuring fund | | 119,518,750.00 | 108,398,200.00 |
| VIII. | Revaluation fund | | – | – |
| IX. | Special funds and other liabilities | 11. | 165,824.95 | 110,270.76 |
| X. | Financial profit (loss) | | 161,334,538.36 | 151,637,162.33 |
| 1. | Profit (positive value) | | 161,334,538.36 | 151,637,162.33 |
| 2. | Loss (negative value) | | – | – |
| TOTAL LIABILITIES | | | 4,925,872,670.04 | 4,641,430,859.06 |
| Contingent liabilities | | | – | – |

PROFIT & LOSS ACCOUNT FOR THE PERIOD ENDING ON 31 DECEMBER 2005

| | | in PLN | |
|---|---------------------------|--------------------------------------|--------------------------------------|
| | Additional information | 12 months ending on 31.12.2005 | 12 months ending on 31.12.2004 |
| I. Income from statutory activity | 13. | 18,361,942.40 | 22,407,094.65 |
| 1. Interest income | | 16,995,452.44 | 20,985,957.83 |
| 2. Commission income | | 1,366,409.00 | 1,420,190.70 |
| 3. Income from interest for delayed contributions by banks for effecting guarantee payment. | | - | - |
| 4. Income from interest for delayed annual contributions paid by banks | | 0.41 | 66.53 |
| 5. Income from interest for delayed repayments of loans and interest on loans by banks | | 80.55 | 879.59 |
| II. Cost of statutory activity | 14. | - | - |
| 1. Interest on credits received from the NBP | | - | - |
| 2. Other | | - | - |
| III. Profit (loss) on statutory activity (I-II) | | 18.361.942,40 | 22,407,094.65 |
| IV. Profit (loss) on financial operations | | 160.416.437,37 | 148,216,512.75 |
| 1. Securities | | 158,926,706.02 | 146,893,523.03 |
| 2. Other | | 1,489,731.35 | 1,322,989.72 |
| V. Operational costs of the Fund | | 16.621.353,09 | 16,587,990.67 |
| 1. Third-party services | | 3,243,595.42 | 3,452,703.35 |
| 2. Payroll | | 10,694,552.74 | 10,633,376.06 |
| 3. Payroll margins | | 1,340,206.37 | 1,298,709.76 |
| 4. Other | | 1,342,998.56 | 1,203,201.50 |
| VI. Depreciation of fixed and intangible assets | | 2.301.673,63 | 2,509,456.29 |
| VII. Write-offs for provisions and revaluation | | 0,00 | 150,000.00 |
| VIII. Liquidation of provisions and revaluation decreases | | - | - |
| IX. Other income | | 1.587.137,20 | 425,987.57 |
| X. Other costs | | 107.951,89 | 164,985.68 |
| XI. Profit (loss) on operational activity (III+IV-V-VI-VII+VIII+IX-X) | | 161.334.538,36 | 151,637,162.33 |
| XII. Profit (loss) on extraordinary operations | | - | - |
| 1. Extraordinary profit | | - | - |
| 2. Extraordinary loss | | - | - |
| XIII. Financial result of the Fund (XI+XII) | | 161.334.538,36 | 151,637,162.33 |
| 1. Profit (positive value) | | 161,334,538.36 | 151,637,162.33 |
| 2. Loss (negative value) | | - | - |

CASH FLOW STATEMENT FOR THE PERIOD ENDING ON 31 DECEMBER 2005

| | in PLN | |
|---|--------------------------------------|--------------------------------------|
| | 12 months ending on 31.12.2005 | 12 months ending on 31.12.2004 |
| A. Cash flow from operating activity | | |
| I. Net financial profit/loss | 161,334,538.36 | 151,637,162.33 |
| II. Adjusted by items | | |
| 1. Depreciation | 2,301,673.63 | 2,509,456.29 |
| 2. Provisions for endangered receivables created as costs | – | – |
| 3. Other provisions created as costs of the Fund's activity | – | 150,000.00 |
| 4. Change in receivables and claims | 107.27 | 470.25 |
| 5. Change in short-term liabilities (except loans and credits) and special funds | (723,719.91) | 1,607,401.17 |
| 6. Change in prepayments and accruals | – | 74,650.60 |
| 7. Change in deferred income | – | – |
| 8. Other items | 3,676.00 | – |
| III. Net cash from operating activity (I±II) | 162,916,275.35 | 155,979,140.64 |
| B. Cash flow from investment activity | | |
| I. Purchase/sale of intangible assets | | |
| II. Purchase/sale of tangible fixed assets | (293,945.59) | (411,499.34) |
| III. Purchase/sale of treasury bonds, NBP money bills, bonds | (816,971,437.92) | 86,614,429.64 |
| IV. Granted/repaid loans from the assistance fund | 269,399,744.00 | (84,432,556.00) |
| V. Granted/repaid loans from the co-operative banks restructuring fund | (11,120,550.00) | (29,581,947.00) |
| VI. Purchased/sold receivables | – | – |
| VII. Interest received/repaid | (33,789,441.08) | (8,859,255.64) |
| VIII. Other items | – | – |
| IX. Net cash from investment activity (I±II±III±IV±V±VI±VII±VIII) | (592,775,630.59) | (36,670,828.34) |
| C. Cash flow from financial activity | | |
| I. Change in statutory fund | – | – |
| II. Change in assistance fund (payment of annual contribution) | 124,247,011.77 | 186,197,235.98 |
| III. Change in cooperative banks restructuring fund | | |
| IV. Receiving/repayment of short-term bank credits and loans | | |
| V. Interest repaid/returned | – | – |
| VI. Other items | – | – |
| VII. Net cash from financial activity (I±II±III±IV±V±VI) | 124,247,011.77 | 186,197,235.98 |
| D. Change in net cash (A+B+C) | (305,612,343.47) | 305,505,548.28 |
| E. Cash at the beginning of the accounting year | 306,099,408.16 | 593,859.88 |
| F. Cash at the end of the accounting year (D+E) | 487,064.69 | 306,099,408.16 |



Bankowy Fundusz Gwarancyjny

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