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Bank Handlowy w Warszawie SA

Report on Activities of Bank Handlowy w Warszawie SA in 2005

March 2006

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TABLE OF CONTENTS

I. Poland's Economy in 2005

1. Main Macroeconomic Trends

In 2005, Poland's economy developed at a slower pace than in 2004. GDP rose only by 2.1% in the first quarter and although accelerated to 3.7% in the third quarter, it was still below the 5.3% rate generated in 2004.

The slowdown was caused by a weak increase in domestic demand. Despite low interest rates and access to the EU's funds, Polish companies frequently deferred new capital expenditure programs. The surprising decline of investments was combined with a decreasing trend of individual consumption. According to the Central Statistical Office, the consumption growth rate fluctuated around 2% in the first three quarters of 2005, as compared with 3.9% in the previous year. As domestic demand was weak, net exports were the key driver of growth in 2005. Exports were rising constantly faster than imports. The favorable foreign trade trends were fueled by increasing labor productivity, which contributed to the improvement of the competitive strength of Poland's economy.

Even with the slowdown, in 2005 there was a gradual recovery in the labor market. The registered unemployment rate declined to 17.6%, from 19.0% in December 2004. The number of unemployed shrunk by 226,000 (to 2.8 million) during January to December 2005.

The reduction in demand was reflected by a rapid decrease of inflation to 0.7% year on year in December 2005 (4.4% in December 2004). As a result, the CPI was below the floor of the inflation target adopted by the Monetary Policy Council (fixed at 2.5% +/-1 percentage point). The inflation pressure decreased in spite of soaring oil prices in the world markets.

The lower than expected economic growth rate and fading inflation convinced the Monetary Policy Council to cut interest rates by a total of 200 basis points during the year. Consequently, the reference rate was reduced to an all time low of 4.5%. Only the first signs of recovery in the second half of 2005 induced the Council to cease loosening monetary policy further. The decision was also supported by an increasing uncertainty about public finance after the parliamentary elections.

Although interest rates were reduced in 2005, household deposits maintained a clear growth trend. At the end of December 2005, they were higher by 3.5% than in December 2004. This was possible due to the higher wage bill resulting from rising employment. At the same time, loans granted to households increased by 22.8% (year on year), with mortgages leading the way. In 2005, the strong growth of corporate deposits was also sustained (16.7% year on year in December), mainly because of a delay in investment recovery. Simultaneously, growth of corporate loans accelerated to 2.8% year on year in December 2005.

In the first eleven months of 2005, the current account deficit amounted to EUR 3.4 billion, as compared with EUR 7.9 billion in the corresponding period of 2004. The improvement of the balance of payments was boosted by the inflow of funds transferred by the European Union and the outstandingly strong growth of exports (by 16.2% year on year), followed by a moderate increase in imports (11.9%). Positive export trends were observed despite the robust appreciation of Poland's currency.

2. Money Markets and FX Markets

In 2005, Poland's currency weakened by 9.0% against the euro and strengthened by 5.4% against the U.S. dollar.

In the first half of 2005, a wave of sales of Central Europe currencies negatively affected the zloty. In that period, the Polish currency slumped by 11% to the euro and nearly 15% to the dollar. However, the tide turned in the beginning of May, supported by a heavy inflow of foreign capital to Poland's debt market, and the zloty started to make up the losses. The situation improved significantly at the end of August and beginning of September, when a series of hurricanes in the U.S. temporarily weakened the dollar. International capital headed for emerging markets again. Only the fiasco of the coalition talks after the parliamentary elections chased part of foreign investors out of the Polish market.

After the new government was created and sworn in, investor sentiment improved. The end of the political turbulence diverted their attention to macroeconomic fundamentals, which remained positive during 2005. The zloty rose and soon made up for nearly all the losses caused by the negative impact of political factors.

For bonds, 2005 was a year of falling yields, driven by the Central Bank's interest rate cuts. On an annual basis, yields of Treasury Bonds dropped by nearly 200 basis points on the short end of the curve and by slightly more than 50 basis points for 10-year bonds. Consequently, the shape of the Polish yield curve changed radically, and its slope turned from negative to positive.

The period of prosperity for Polish bonds lasted until the middle of September, when the yield of Poland's securities hit an all time low. The market share of foreign investors in the Polish bonds market also reached a record level of 31.3% (more than PLN 75.5 billion).

In addition, political turbulences after the parliamentary and presidential elections badly hurt the national debt market. A drop in prices of Polish securities was driven by the collapse of the coalition talks between the leading parties (PiS & PO) and fears of a deterioration in public finance. At the end of 2005, the bond market improved following the rising zloty and a significant improvement in the core markets, where the fears of inflation were pushed out by speculation about the forthcoming end of the monetary policy tightening cycle in the U.S.

3. Capital Market

2005 was a successful year for the stock market. The basic index, WIG, rose by 33.7% from 26,636 as of the end of 2004 to 35,600 as of the end of 2005. WIG20 (most liquid companies) jumped by 35.4%.

In 2005, the market followed the bull trend that commenced in 2003. At the end of the first quarter, a more than 10% correction was observed, but the next wave of growth started as soon as in the middle of May which lifted WIG (main index) to its all time high.

The most significant events included the successful IPOs of PGNiG (oil and gas) and Lotos Group (oil), as well as of dozens of smaller companies. At the end of 2004, the Warsaw Stock Exchange traded 230 companies, while a year later this had risen to 255. More foreign companies entered the market. In 2005, their number increased from 5 to 7. Debuting companies significantly expanded stock market capitalization – as of the end of 2005 national companies were valued at PLN 308 billion (i.e. 44% higher than the level of PLN 214 billion as of the end of 2004). Total capitalization (including foreign companies) increased from PLN 291.7 billion (end of 2004) to PLN 424.9 billion (end of 2005).

Table 1. Stock exchange indexes – December 31, 2005 and 2004.

Index	2005	2004	change (%)
WIG	35,600.80	26,636.20	33.7
WIG-PL	35,277.70	26,540.10	32.9
WIG20	2,654.95	1,960.60	35.4
MIDWIG	2,207.74	1,730.10	27.6
TECHWIG	844.41	666.30	26.7
WIRR	5,471.33	4,738.60	15.5
NFI	104.30	98.00	6.4
Sector subindexes			
Banks	46,787.80	35,454.40	32.0
Construction	31,007.30	19,014.60	63.1
IT	13,032.90	12,996.50	0.3
Food	25,444.10	23,761.60	7.1
Telecoms	12,382.00	10,242.90	20.9

Source: Warsaw Stock Exchange, Dom Maklerski Banku Handlowego S.A.

Increasing indexes were correlated with investors' activity in the capital market. Turnover in shares rose by 61%, from PLN 109.8 billion in 2004 to PLN 176.9 billion in 2005, following the bullish trend initiated in 2003.

Turnover in bonds dropped by 35% and totaled PLN 5.06 billion in 2005 (as compared with PLN 7.82 billion in 2004).

The increasing indexes and the persistent bull trend in the stock market had a very positive impact on turnover in the futures market - in 2005 they were 49% higher than in 2004.

Table 2. Turnover on the Warsaw Stock Exchange - December 31, 2005 and 2004.

	2005	2004	Change
Stocks (in millions of PLN)	176,871	109,775	61.1
Bonds (in millions of PLN)	5,059	7,820	-35.3
Futures (pcs.)	10,757,034	7,218,250	49.0

Source: Warsaw Stock Exchange, Dom Maklerski Banku Handlowego S.A.

4. Banking Sector

In 2005, the net income of the entire banking sector was PLN 8.7 billion, i.e. it increased by 19% (PLN 1.4 billion) as compared with 2004. The excellent result reflects the strength of Poland's economy. The profitability of the sector was mainly influenced by an increase in banking activity and lower charges to provisions.

In 2005, loans to individual customers increased by 28% year on year, while deposits placed by those customers rose by 4% year on year. The gap resulted from the fact that bank deposits were relatively unattractive due to low rates and the continued transformation of the savings structure for individual customers (more assets allocated to investment funds).

The corporate loan portfolio rose by only 1%, as compared with the end of 2004. Nevertheless, the good situation continued in the market of corporate deposits (growth by 17% year on year). The situation in the market for loans and corporate deposits reflects the over liquidity of enterprises due to very good financial results and lower investment outlays.

II. Selected financial data of the Bank

1. Selected financial data of the Bank

In millions of PLN	2005	2004
Total assets	32,669.4	33,809.1
Equity*	4,582.2	5,693,5
Loans**	8,941.0	9,708.6
Deposits**	16,959.2	16,889.2
Net profit	589.2	448.5
Earnings per ordinary share or convertible	4.51	3.43
Dividend per ordinary share or convertible	3.60	11.97
Capital adequacy ratio	13.4%	18.5%

** Excluding the net profit for the current year.*

*** Due from and to the non-financial and public sectors.*

2. Financial results of the Bank for the year ended 31 December 2005

2.1 Income statement

The Bank's net profit for the year ended 31 December 2005 was PLN 589.2 million, i.e. PLN 140.7 million or 31.4 % more than in the prior year. The increase in net profit was mainly attributable to an increase in operating income that includes net interest income, dividend income, income on financial instruments, FX income and net other operating income. Operating income increased by PLN 230.3 million (i.e. 11.7%) and amounted to PLN 2,195.2 million.

The fact that the profit growth rate was lower in the current year was mainly attributable to an increase in general administrative expenses by PLN 83.6 million, i.e. 6.6 % and higher income tax expenses.

Selected income statement items

			Change	
In thousands of PLN	**2005**	**2004**	**PLN '000**	**%**
Net interest income	986,148	932,427	53,721	5.8%
Net commission income	511,966	491,606	20,360	4.1%
Net gains on financial instruments valued at fair value through profit or loss	120,998	43,782	77,216	176.4%
Net gains on investment securities	137,385	36,596	100,789	275.4%
Net profit on foreign exchange	342,891	360,352	(17,461)	(4.8%)
Overheads and general administrative expenses	(1,349,073)	(1,265,457)	(83,616)	(6.6%)
Depreciation	(139,312)	(142,179)	2,867	2.0%
Net change in impairment losses	35,214	1,771	33,443	1888,4%
Profit before tax	**748,645**	**563,244**	**185,401**	**32,9%**
Income tax expense	**(159,400)**	**(114,722)**	**(44,678)**	**(38,9%)**
Net profit for the year	**589,245**	**448,522**	**140,723**	**31.4%**

2.1.1 Revenue

The increase in operating income of PLN 230.3 million, i.e. 11.7%, compared with the prior year was mainly due to:

- An increase in net interest income of PLN 53.7 million (5.8 %), which was mainly the result of high interest income from term deposits on the interbank market and lower interest expense on repo transactions involving securities;
- An increase in net commission income of PLN 20.4 million (4.1 %), which was mainly attributable to commission income from custody services, insurance products and other retail banking products;
- An increase in net gains on financial instruments at fair value through profit or loss of PLN 77.2 million (176.4 %), which was mainly the result of higher gains on derivative transactions;
- An increase in net gains on investment (deposit) securities of PLN 137.4 million i.e. (275.4%), which was mainly the result of higher gains on treasury bonds classified as available-for-sale debt securities;
- A decrease in net profit on foreign exchange position of PLN 17.5 million (4.8%), which was mainly the result of lower gains on foreign exchange derivatives.

2.1.2 Expenses

EXPENSES

			Change	
In thousands of PLN	**2005**	**2004**	**PLN'000**	**%**
Salaries	511,695	458,470	53,225	11.6%
Employee benefits	148,316	135,057	13,259	9.8%
Total personnel costs	**660,011**	**593,527**	**66,484**	**11.2%**
Non-personnel expenses	676,530	655,724	20,806	3.2%
Taxes and fees	8,831	8,526	305	3.6%
Banking Guarantee Fund contributions and payments	3,701	7,680	(3,979)	(51.8%)
Total overheads	**1,349,073**	**1,265,457**	**83,616**	**6.6%**
Depreciation	139,312	142,179	(2,867)	(2.0%)
Total expenses	**1,488,385**	**1,407,636**	**80,749**	**5.7%**

In 2005, the Bank continued to improve its profitability through cost optimization. However, there was a 6.6 % increase in overheads and general administrative expenses in 2005 compared with the corresponding prior year. The increase was mainly attributable to an increase in the provisions for future pension benefits and an increase in long-service (jubilee) benefits, and an increase in salaries, mainly attributable to increased employment in the Consumer Bank. The fact that 22 new CitiFinancial branches were opened in the year ended 31 December 2005 also had a considerable effect on expenses.

2.1.3 Specific provisions and remeasurement of financial assets

Specific provisions

In thousands of PLN	**2005**
Specific provisions for losses incurred but not reported (IBNR)	20,650
Specific provisions for loans and off-balance sheet liabilities	1,276
individually assessed	124,645
collectively assessed (on a portfolio basis)	(123,369)
Impairment of investments	11,219
Other	2,069
Total change in impairment losses	**35,214**

Due to the adoption of International Financial Reporting Standards by the Bank, a change in the calculation of impairment losses was introduced. The change was applied prospectively in accordance with IFRS 1 by exercising the option to depart from full retrospective application of that change, hence the Bank did not present comparable data for the prior year. As at 1 January 2005, an opening balance sheet was prepared in accordance with the new provisioning approach and the resulting difference between provisions calculated in accordance with Polish Accounting Standards as at the end of 2004, including the general provision and deferred interest, and provisions calculated in accordance with IAS, was recognized in retained earnings.

The movement in provisions for losses incurred but not reported and loans assessed collectively and individually of PLN 21.9 million reflects:

- Decrease in the loan portfolio and decrease in reduction of dynamics of provisions;
- Effective restructuring and vindication activity and favorable macroeconomic conditions;
- Improvement in the quality of the loan portfolio.

2.1.4 Ratio analysis

PROFITABILITY AND BUSINESS EFFECTIVENESS RATIOS OF THE BANK

	2005	**2004**
Return on equity (ROE)*	10.5%	7.5%
Return on assets (ROA)**	1.8%	1.3%
Net interest margin (NIM)***	3.0%	2.7%
Earnings per share (not in PLN '000)	4.51	3.43
Cost / Income****	67.8%	71.6%

* *Net profit to average equity (including net profit for the current year) calculated on a monthly basis*

** *Net profit to average total assets calculated on a monthly basis*

*** *Net interest income to average total assets calculated on a monthly basis*

**** *Overheads, general administrative expenses, depreciation and amortization to operating income*

Return on assets, calculated as the ratio of net profit to total assets, increased by 0.5%. The increase in ROE was mainly the result of a decrease in the equity of the bank by PLN 1,111.2 million (i.e. by 19.5%) and an increase in net profit by PLN 140.7 million (i.e. 31.4%).

2.2 Balance sheet

As at 31 December 2005, the total assets of the Bank were PLN 32,669.4 million, 3.4% less than as at the end of 2004.

Balance sheet

	As at		Change	
In thousands of PLN	**31.12.2005**	**31.12.2004**	**PLN'000**	**%**
ASSETS				
Cash and balances with central bank	922,649	841,114	81,535	9.7%
Financial assets held for trading	5,878,624	5,316,962	561,662	10.6%
Debt securities available-for-sale	7,171,157	6,091,194	1,079,963	17.7%
Equity investments	284,304	332,511	(48,207)	(14.5%)
Loans and advances	15,839,648	18,498,769	(2,659,121)	(14.4%)
to financial sector	6,898,665	8,790,190	(1,891,525)	(21.5%)
to non-financial sector	8,940,983	9,708,579	(767,596)	(7.9%)
Property and equipment	687,894	711,710	(23,816)	(3.3%)
land, buildings and equipment	646,946	711,710	(64,764)	(9.1%)
investment property	40,948	-	40,948	-
Intangible assets	1,313,418	1,309,578	3,840	0.3%
Deferred income tax assets	300,162	237,205	62,957	26.5%
Other assets	199,221	470,088	(270,867)	(57.6%)
Non - current assets held-for-sale	72,348	-	72,348	-
Total assets	**32,669,425**	**33,809,131**	**(1,139,706)**	**(3.4%)**
LIABILITIES				
Due to central bank	-	718	(718)	-
Financial liabilities held for trading	3,420,219	4,194,290	(774,071)	(18.5%)
Financial liabilities valued at amortized cost	23,223,955	21,974,328	1,249,627	5.7%
deposits from	22,768,006	20,708,902	2,059,104	9.9%
financial sector	5,808,791	3,819,676	1,989,115	52.1%
non-financial sector	16,959,215	16,889,226	69,989	0.4%
other liabilities	455,949	1,265,426	(809,477)	(64.0%)
Provisions	57,245	216,717	(159,472)	(73.6%)
Income tax liabilities	162,788	23,509	139,279	592.4%
Other liabilities	629,354	1,257,585	(628,231)	(50.0%)
Non - current liabilities held-for-sale	4,370	-	4,370	-
Total liabilities	**27,497,931**	**27,667,147**	**(169,216)**	**(0.6%)**
EQUITY				
Issued capital	522,638	522,638	-	-
Share premium	2,944,585	3,044,585	(100,000)	(3.3%)
Revaluation reserve	(64,554)	(9,371)	(55,183)	588.9%
Other reserves	1,101,418	2,116,063	(1,014,645)	(47.9%)
Retained earnings	667,407	468,069	199,338	42.6%
Total equity	**5,171,494**	**6,141,984**	**(970,490)**	**(15.8%)**
Total liabilities and equity	**32,669,425**	**33,809,131**	**(1,139,706)**	**(3.4%)**

2.2.1 Assets

Gross loan receivables*

In thousands of PLN	As at 31.12.2005	31.12.2004	Change PLN'000	%
Bank and other monetary financial institutions	5,975,623	7,398,092	(1,422,469)	(19.2%)
Non – financial sector	1,019,763	1,116,759	(96,996)	(8.7%)
Non – banking financial institutions	7,496,111	8,697,687	(1,201,576)	(13.8%)
Individuals	2,671,062	1,946,151	724,911	37.2%
Other non - financial entities	5,897	9,013	(3,116)	(34.6%)
Government units	244,414	1,276	243,138	19,054.7%
Other receivables	4,437	3,506	931	26.6%
Total	**17,417,307**	**19,172,484**	**(1,755,177)**	**(9.2%)**

*receivables without payable interest

Despite a reduction in the loan portfolio in 2005 due to the Bank's prudent lending policy, it still remained the largest component of the Bank's assets. The non-financial sector saw the greatest decrease in loan receivables, of PLN 1,201.6 million, i.e. 13.8 % of the gross loan portfolio. At the same time, there was an increase in loans to individuals, by PLN 724.9 million (37.2 %). As at 31 December 2005, the portfolio of amounts due from individuals amounted to PLN 2,671.1 million.

The balance of gross amounts due from the financial sector (excluding banks) was comparable to the balance as at 31 December 2004 and amounted to PLN 1,019.8 million (decrease by 8.7%).

The debt securities portfolio was the second largest component of assets. The fact that it is very large (particularly the treasury bonds portfolio) is mainly due to the Bank's intention to benefit from the very good performance of the market for debt securities.

Debt securities portfolio

In thousands of PLN	As at 31.12.2005	31.12.2004	Change PLN '000	%
Treasury bonds	7,076,515	6,263,335	813,180	13.0%
NBP bonds	386,934	384,287	2,647	0.7%
Treasury bills	40,002	303,770	(263,768)	(86.8%)
Certificates of deposit and banks' bonds	30,136	160,727	(130,591)	(81.3%)
Issued by non-financial entities	30,553	133,254	(102,701)	(77.1%)
Issued by financial entities	35,604	57,661	(22,057)	(38.3%)
NBP bills	1,871,225	-	1,871,225	-
T O T A L	**9,470,969**	**7,303,033**	**2,167,936**	**29.7%**

2.2.2 Liabilities

Financial liabilities valued at amortized cost

In thousands of PLN	As at 31.12.2005	31.12.2004	Change PLN'000	%
Due to financial sector	**5,782,132**	**3,814,669**	**1,967,463**	**51.6%**
Banks and other monetary financial institutions	2,349,433	1,570,315	779,118	49.6%
Due to non-banking financial sector	3,432,699	2,244,354	1,188,345	52.9%
Due to non-financial sector including:	**16,940,201**	**16,853,101**	**87,100**	**0.5%**
Corporate customers	11,086,223	10,118,193	968,030	9.6%
Individuals	4,489,733	5,356,464	(866,731)	(16.2%)
Other liabilities including accrued interest	**501,622**	**1,306,558**	**(804,936)**	**(61.6%)**
Total external funds	**23,223,955**	**21,974,328**	**1,249,627**	**5.7%**

There were no significant changes in the composition of the Bank's liabilities in 2005, which was to a large extent attributable to the stability of the Bank's deposit base.
Amounts due to clients from the non-financial sector were the major source of financing for the Bank's assets. The amounts due to clients from the corporate sector increased by PLN 968.0 million (i.e. 9.6%) compared with the end of 2004, and amounts due to the financial sector increased by PLN 1,967.5 million, i.e. 51.6%, of which deposits from non-banking entities increased the most, by PLN 1,188.3 million, i.e. 52.9 %.
Amounts due to individuals decreased the most in the year ended 31 December 2005. The decrease amounted to PLN 866.7 million, i.e. 16.2 % and was connected with transfer of client's assets to competitive investment products.
Amounts due to banks, accounting for 40.6 % of the total amounts due to the financial sector, increased in 2005 from PLN 1,570.3 million to PLN 2,349.4 million, i.e. by PLN 779.1 million (i.e. 49.6%). During amounts due to banks remained lower than amounts due from banks, which indicates that the Bank had surplus liquidity.
The fact that unrealized gains/losses on derivative transactions accounted for a considerable proportion of assets and liabilities is also significant and reflects the scale of the Bank's off-balance sheet purchase and sale transactions. The carrying amount of these instruments presented in *"Financial assets held-for-trading" and "Financial liabilities held-for-trading"*.

2.2.3 Sources and uses of funds

Source of Funds	**31 December 2005**	**31 December 2004**
Banks funds	2,506,054	1,877,231
Customers and government units funds	20,717,901	20,097,097
Own funds with net income	5,171,494	6,141,984
Other external funds	4,273,976	5,692,819
Total source of funds	**32,669,425**	**33,809,131**
Use of funds	**31 December 2005**	**31 December 2004**
Placements in banks	6,010,093	7,717,065
Receivables from customers and government units	9,829,555	10,781,704
Securities, shares and other financial assets	13,334,085	11,740,667
Other use of funds	3,495,692	3,569,695
Total use of funds	**32,669,425**	**33,809,131**

2.3 Equity and capital adequacy ratio

The Bank's equity decreased by PLN 1,111.2 million (i.e. 19.5%) compared with the end of 2004, which was mainly due to:

- Based on Resolution No. 8 of the Ordinary General Shareholders' Meeting held on 21 June 2005, PLN 1,149.8 million was approved for payment as a dividend from retained earnings and transfers from supplementary capital and reserves;
- A decrease in revaluation reserve by PLN 55.2 million, which was mainly due to a negative valuation of available-for-sale financial assets of PLN 64.6 million as at 31 December 2005;
- The adoption of International Financial Reporting Standards, primarily in respect of the calculation of impairment losses. The difference arising from the change in accounting standards contributed to an increase in own funds by PLN 58.6 million.

EQUITY

	As at		Change	
In thousands of PLN	**31.12.2005**	**31.12.2004**	**PLN '000**	**%**
Share capital	522,638	522,638	-	0.0%
Supplementary (additional) capital	2,944,585	3,044,585	(100,000)	(3.3%)
Other reserves	711,418	1,726,063	(1,014,645)	(58.8%)
Revaluation reserve	(64,554)	(9,371)	(55,183)	(588.9%)
General risk reserve	390,000	390,000	-	-
Retained earnings	78,162	19,547	58,615	299.9%
Total equity	**4,582,249**	**5,693,462**	**(1,111,213)**	**(19.5%)**
Tier 1 capital	4,568,641	5,683,286	(1,114,645)	(19.6%)
Tier 2 capital	(64,554)	(9,371)	(55,183)	(588.9%)
Retained earnings	78,162	19,547	58,615	299.9%

The Bank's capital is fully sufficient to ensure financial security to the institution and the deposits it accepts.

As at 31 December 2005, the capital adequacy ratio stood at 13.37%, down 5.12% compared with the end of 2004. The decrease in the capital adequacy ratio was mainly due to a decrease in the Bank's own funds following payment of dividend.

While, furthermore, the capital requirements were increased due to, among other things exceeding the exposure concentration and large exposure limits by PLN 136.0 million (relating to Citigroup companies) and in increase in the market risk requirement by PLN 30.0 million that was fully offset by a decrease in the capital requirement to cover credit risk by PLN 164.7 million.

CAPITAL ADEQUACY RATIO

In thousands of PLN	**31.12.2005**	**31.12.2004**
Own funds, as stated on the balance sheet	**4,582,249**	**5,693,462**
Less:	1,690,181	1,683,273
- goodwill	1,245,976	1,243,645
- other intangible assets	67,442	65,933
- interests in subordinated financial entities	376,763	373,695
Own funds for the calculation of the capital adequacy ratio	**2,892,068**	**4,010,189**
Risk-weighted assets and off-balance sheet liabilities (banking portfolio)	**13,399,925**	**15,458,685**
Total capital requirement, including:	**1,731,032**	**1,735,363**
- capital requirement to cover credit risk	1,071,994	1,236,695
- capital requirement to cover excess exposure concentration and large	334,654	198,697
- total capital requirements to cover market risk	227,780	197,763
- other capital requirements	96,604	102,208
	-	-
Capital adequacy ratio	**13.37%**	**18.49%**

III. Activities of the Bank in 2005

1. Lending and other Risk Exposures

1.1 Lending

The Bank's lending policy is based on active portfolio management and precisely specified target markets, designed to facilitate exposure and credit risk analysis within the framework of a given industry of the customer. In addition, individual borrowers are continuously monitored so that signs of deterioration in creditworthiness can be detected promptly and appropriate corrective steps can be taken. The active credit policy has resulted in a minor reduction in total credit exposure in 2005.

The portfolio of receivables from individuals is managed on the basis of a model that calculates risk and return on the loan portfolio. In 2005 the lending policy was enlarged by implementation and use of scoring models. The new tools implemented strengthened controls over the loan portfolio and enabled an efficient and optimal credit decision process.

Citifinancial that sells its product through its branches as well as credit agents uses a different lending policy mainly due to different levels of risk generated by each distribution channel. The customer acceptance policy is based on the scoring card, demographic data, and customer credit history received from the Credit Information Office. The detailed requirements that the customers have to fulfill are described in this policy. The main credit criteria are job, source of income, age, job seniority, and income.

Citifinancial conducts continuous observation of sales trends and portfolio quality trends using standard management information reports and advanced analytical models. This enables a quick response to every trend variance.

Lending to non-bank customers (gross)*

	As of		**Change**	
In thousands of PLN	**31.12.2005**	**31.12.2004**	**PLN' 000**	**%**
Loans in PLN	9,573,849	9,606,296	(32,447)	(0.3%)
Loans in foreign currency	1,863,398	2,164,590	(301,192)	(13.9%)
Total	**11,437,247**	**11,770,886**	**(333,639)**	**(2.8%)**
Loans to non-financial sector	10,173,070	10,652,850	(479,780)	(4.5%)
Loans to financial sector	1,019,763	1,116,759	(96,996)	(8.7%)
Loans to public sector	244,414	1,277	243,137	19,039.7%
Total	**11,437,247**	**11,770,886**	**(333,639)**	**(2.8%)**
Non-financial corporates	7,496,111	8,697,687	(1,201,576)	(13.8%)
Individuals	2,671,062	1,946,151	724,911	37.2%
Non-bank financial entities	1,019,763	1,116,759	(96,996)	(8.7%)
Other non-financial entities	244,414	1,276	243,138	19,054.7%
Public entities	5,897	9,013	(3,116)	(34.6%)
Total	**11,437,247**	**11,770,886**	**(333,639)**	**(2.8%)**
Other receivables	4,437	3,506	931	26.6%
Total	**11,441,684**	**11,774,392**	**(332,708)**	**(2.8%)**

** Excluding accrued interest*

As at 31 December 2005, gross credit exposure to the non-financial sector amounted to PLN 11,437.2 million, representing a decrease by 2.8% as compared with 31 December 2004. The largest part of the non-financial sector credit portfolio, which is loans to non-financial corporates (65.5%) decreased by 13.8% in 2005. Loans to individuals grew in comparison with the end of 2004 by 37.2% to PLN 2,671.1 million.

As at 31 December 2005 the currency structure changed slightly as compared with the end of 2004. The share of foreign currency loans, which in December 2004 was 18.4% decreased to 16.3% in December 2005. It must be stressed that the Bank grants foreign currency loans to customers who have foreign currency cash flows or to those who, in the Bank's opinion, are able to predict or absorb the currency risk without significant deterioration of their financial position. The Bank does not grant foreign currency loans to individuals.

A substantial part of the Bank's credit exposure to non-bank financial institutions was attributable to the Bank's subordinated entities. As of 31 December 2005, the largest credit exposure amounting to PLN 546.2 million, was the funding granted to the Bank's subsidiary, Handlowy-Leasing S.A.

The Bank monitors the concentration of its exposure on a regular basis, seeking to avoid a situation where the portfolio is dependent on a limited group of customers. As of the end of December 2005 despite the reduction in the Bank's equity, the Bank's portfolio of exposure to non-bank entities did not exceed the exposure concentration limits required by the law.

Exposure concentration by customer*

In thousands of PLN	31.12.2005			31.12.2004		
	Balance Outstanding*	Off-Balance Outstanding	Total Outstanding	Balance Outstanding *	Off-Balance Outstanding	Total Outstanding
Customer 1	447,722	98,454	546,176	502,698	57,378	560,076
Group 2	257,342	286,903	544,245	153,408	356,680	510,088
Group 3	209,183	261,334	470,517	177,863	351,853	529,716
Customer 4	241,396	160,000	401,396	66	-	66
Customer 5	-	400,000	400,000	1	-	1
Group 6	1,019	376,112	377,131	3	8,251	8,254
Group 7	234,461	113,661	348,122	23,335	159,479	182,814
Group 8	80,181	203,465	283,646	127,672	164,898	292,570
Group 9	200,050	72,682	272,732	83,846	82,957	166,803
Group 10	38,848	212,455	251,303	3,801	227,468	231,269
Total 10	**1,710,202**	**2,185,066**	**3,895,268**	**1,072,693**	**1,408,964**	**2,481,657**

*Excluding commercial papers and subsidiaries

1.2 Quality of loan portfolio

Pursuant to the Resolution of the Extraordinary Meeting of the Bank's Shareholders, with effect from 1 January 2005, the Bank presents its stand alone financial statements in accordance with International Accounting Standards (IAS), International Financial Reporting Standards (IFRS), and related interpretations issued in the form of Regulations of the European Commission. The change in the standards, mainly the adoption of IAS 39, resulted in a new method of classification of the amounts due to the Bank and calculation of provisions for the risk related to credit operations.

Currently, all receivables of the Bank are attributed to two portfolios depending on the existing risk of impairment of the receivables: the portfolio of receivables not at risk of impairment and the portfolio of receivables at risk of impairment. Depending on the materiality of the receivables, the portfolio at risk of impairment is then classified into receivables accounted for individually or collectively.

As of the end of December 2005, the share of loans at risk of impairment was 18.2% of the total portfolio and was lower as compared with the restated opening balance as of 1 January 2005 by 1.1%. The decrease related to the customer portfolio accounted for individually and was related to the repayment of receivables in this customer group.

Loans to non-financial sector (gross) by the risk of impairment*

In thousands of PLN	As of 31.12.2005 PLN'000	Share in %	31.12.2004 PLN'000	Share in
Loans to non-banking sector (gross)				
Not at risk of impairment	9,358,137	81.8%	9,503,753	80.7%
At risk of impairment	2,083,547	18.2%	2,270,639	19.3%
accounted for individually	1,615,197	14.1%	1,718,560	14.6%
accounted for collectively (portfolio method)	468,350	4.1%	552,079	4.7%
Total non-banking sector (gross)	**11,441,684**	**100.0%**	**11,774,392**	**100.0%**

*Excluding accrued interest

Provisions for receivables reflect the actual impairment of the portfolio, taking into account the discounted forecast of future cash flows associated with the repayment of receivables. Moreover, the provisions are estimated for each receivable irrespective of their portfolio attribution and for probable but as yet unidentified losses.

As at 31 December 2005, the impairment of the portfolio was PLN 1,829.0 million, PLN 64.3 million of which was attributable to receivables not at risk of impairment.

Impairment of non-bank loan portfolio

In thousands of PLN	As of 31.12.2005
Impairment due to incurred but not reported (IBNR) losses	64,315
Impairment of receivables	1,764,651
accounted for individually	1,346,761
accounted for collectively	417,890
Total impairment	**1,828,966**
Impairment due to incurred but not reported (IBNR) losses	16.0%
Impairment of receivables	84.7%

1.3 Off-balance sheet exposures

As at 31 December 2005, off-balance sheet exposures amounted to PLN 11,885.3 million, representing an increase by 1% as compared with 31 December 2004. The largest change related to guarantees which represented 23.4% of off-balance sheet assets and which increased by PLN 430.6 million (18.3%). Forward placements were reduced by PLN 105.9 million to only PLN 15.4 million at the end of 2005. The fluctuation on undrawn credit lines resulted both from the adjustment of credit lines required by customers and from the use of the limits granted to customers by them.

Off-balance sheet exposures

In thousands of PLN	As of 31.12.2005	31.12.2004	Change PLN '000	%
Guarantees	2,781,872	2,351,306	430,566	18.3%
Letters of credit issued	137,423	168,073	(30,650)	(18.2%)
Third-party confirmed letters of	17,465	17,108	357	2.1%
Committed loans	8,933,061	9,105,017	(171,956)	(1.9%)
Forward placements	15,439	121,359	(105,920)	(87.3%)
Total	**11,885,260**	**11,762,863**	**122,397**	**1.0%**
Provisions for off-balance sheet liabilities	38,939	39,352	(413)	(1.0%)
Provision coverage index	0.33%	0.33%		

As at 31 December 2005 the total amount of collateral held on accounts (or assets) of credit clients amounted to PLN 4,631.0 million (31 December 2004: PLN 5,267.7 million).

In 2005 the Bank issued 4,241 enforcement titles amounting to PLN 139.1 million (2004: 4,689 enforcement titles amounting to PLN 142.8 million).

2. External Funding

As at December 31, 2005, the total value of external funding of the Bank was PLN 23,224.0 million and was higher by PLN 1,249.6 million (5.7%) as compared with December 31, 2004. Liabilities to the financial sector, which rose by PLN 1,989.1 million (52.1%), had the largest impact on changes of the external funding of the Bank's activity – their increase resulted from the growth of term deposits.

External funding

In thousands of PLN	As of 31.12.2005	31.12.2004	Change PLN'000	%
Due to financial sector	**5,808,791**	**3,819,676**	**1,989,115**	**52.1%**
Funds on current accounts, including:	725,429	721,487	3,942	0.5%
- funds on current accounts of banks and other monetary financial institutions	*724,947*	*720,855*	*4,092*	*0.6%*
Deposits, including	5,056,703	3,093,182	1,963,521	63.5%
- deposits of banks and other monetary financial institutions	*1,624,486*	*849,460*	*775,026*	*91.2%*
Accrual interest	26,659	5,007	21,652	432.4%
Due to non-financial sector	**16,959,215**	**16,889,226**	**69,989**	**0.4%**
Funds on current accounts, including	5,402,290	4,126,203	1,276,087	30.9%
- corporate customers	*3,370,841*	*2,284,398*	*1,086,443*	*47.6%*
- individuals	*1,456,282*	*1,324,039*	*132,243*	*10.0%*
Deposits, including	11,537,911	12,726,898	(1,188,987)	(9.3%)
- corporate customers	*7,715,382*	*7,833,795*	*(118,413)*	*(1.5%)*
- individuals	*3,033,451*	*4,032,425*	*(998,974)*	*(24.8%)*
Accrual interest	19,014	36,125	(17,111)	(47.4%)
Other liabilities	**455,949**	**1,265,426**	**(809,477)**	**(64.0%)**
Sell-Buy-Backs	8,174	408,361	(400,187)	(98.0%)
Accrual interest	3,056	16,588	(13,532)	(81.6%)
Total external funding	**23,223,955**	**21,974,328**	**1,249,627**	**5.7%**

Looking at all sectors as a whole, the largest growth of external funding was recorded for non-banking financial institutions by approximately 52.8% while the largest decrease was for individual customers (by PLN 908.6 million, or 16.6%). The Group recorded a decrease in term deposits while current accounts increased. The increase in deposits was compensated by the sale of investment products that is mainly due to the increasing competitiveness of alternative investments in the capital market in the environment of declining interest rates, aggressively advertised investment funds and positive trends on the stock exchange, which created an additional incentive to invest.

Liabilities to non-bank customers*

	As of		Change	
In thousands of PLN	**31.12.2005**	**31.12.2004**	**PLN'000**	**%**
Liabilities towards:				
Individuals	4,581,211	5,489,847	(908,636)	(16.6%)
Non-financial economic entities	11,699,122	10,749,745	949,377	8.8%
Non-profit institutions	471,383	424,038	47,345	11.2%
Non-bank financial institutions	3,435,240	2,247,722	1,187,518	52.8%
Public sector	430,852	531,212	(100,360)	(18.9%)
Suspense account liabilities	57,177	48,543	8,634	17.8%
Total	**20,674,985**	**19,491,107**	**1,183,878**	**6.1%**
PLN	15,638,870	14,529,334	1,109,536	7.6%
Foreign currency	5,036,115	4,961,773	74,342	1.5%
Total	**20,674,985**	**19,491,107**	**1,183,878**	**6.1%**

**Excluding interest payable*

As at 31 December 2005 the Bank used loans which amounted to PLN 142.6 million, the majority of which were to provide financing for the Bank's clients for investment projects that are financed by EU grants.

3. Corporate and Investment Bank

3.1 Transaction Services

The Bank offers comprehensive, differentiated and attractive products in the area of trade and transaction services to corporate customers. In parallel with traditional banking services, such as bank accounts, domestic and international transfers, etc., the Bank has extensively broadened its product offer and carried out acquisition of customers in the scope of more sophisticated transaction services including flagship electronic and web-based banking proposals.

3.1.1 Transaction Servicing

The modern transaction banking offer is the result of continuous efforts to provide services that meet the needs of the Bank's customers in the most effective manner. Economic growth and new business ideas of customers stimulate the implementation of new practical solutions.

A key component of the Bank's proposal is cash management. The Bank offers many solutions, from standard bank accounts and cash and cashless transactions to electronic banking and mass payments to advanced consolidated accounts (which are used to administer liquidity between various entities of a customer) and receivables management (using leading edge solutions on the SpeedCollect platform).

In an attempt to reduce the number of paper orders processed by the Bank, the ZetaFax solution was developed. It is an "electronic form for manual transfers". Its main objective is to increase the number of instructions processed in an electronic format, as well as to reduce errors made by customers due to check tools that verify details input by a customer in the transfer form.

The Bank offers a solution that enables customers to settle mass payments (for example bills for gas, telephone, electricity, rent, etc.) at Points of Payments, operated by external partners, on behalf of creditors that have not signed separate agreements with the Bank.

Based on "SpeedCollectPlus" – a mass payment processing platform, which facilitates processing of incoming payments, the product team prepared a special service for foreign entities for supplementing missing data that has not been recognized automatically. In 2005, "SpeedCollect Plus" won a prestigious award granted by "The Banking Technology Magazine" in the category "Best business/corporate banking achievement for 2005."

In 2005, the Bank was very active in the direct debit market. During the year, the Bank's customers sent over 5.8 million transactions, which enabled the Bank to maintain its 50% market share in the direct debit market in December 2005. The Bank was able to defend its leadership position due to various promotional initiatives initiated to recommend direct debit among the Bank's customers. The active participation in the Direct Debit Coalition, which had arranged and implemented a campaign to promote direct debit, was appraised highly by the Bank's customers. In addition, the Bank continues projects to advertise and streamline that product, which is perceived by the banking community as the cheapest payment form available in the market.

The Bank is the leader in the escrow account segment in terms of the most advanced solutions. In 2005, the Bank implemented escrow accounts as a unique proposal for customers to secure their trade contracts.

In the fourth quarter of 2005, the Bank signed the first agreement for the issue of scholarship cards for the Bialystok School of Public Administration. The card has extended the range of prepaid Visa Electron cards. The solution significantly decreases costs connected with payments of scholarships to students. Simultaneously, the corporate card offer was extended by the Virtual Debit Card, which operates on the basis of the balance on the customer's account and enables Internet payments.

The range of products for management of the customer's funds includes credit, payment and prepaid cards issued by the Bank. They are a convenient tool for settlements of business expenses incurred by the customer's personnel. In search for new applications for existing products, in 2005 the Bank launched an innovative method of use of VISA Electron cards for payments of social allowances. The new card is intended to distribute benefits and scholarships.

In the beginning of 2005, the Bank introduced the Automatic Banker for customers that use corporate cards. It provides automatic access, by telephone, of card transactions. The Automatic Banker is a great convenience for users of corporate cards.

To meet the needs of its customers, the European Union Unit was established in the beginning of 2005. It prepared a special package (Europe of Undertakings) under which customers that apply for the EU's financial assistance may access a user-friendly lending program. The offer is aimed at all undertakings and self-government entities that want to take advantage of development opportunities created by the European Union and the chance to compete in international markets. In addition to the lending program, the Unit prepared various products that improve trade financing and enable effective settlements and management of funds received from the EU's grants.

Within the framework of the EU's programs, the Bank signed a cooperation agreement with Bank Gospodarstwa Krajowego and the Polish Agency for Enterprise Development.

In order to improve the flow of information about the European programs between the Unit and customers, a dedicated hot line was created and marketing activities were commenced (press releases, web site, conferences, etc.) to present the Bank's proposal.

Despite competitive prices in Poland's market, the European Union Unit contributed to a reduction in the cost of loans incurred by the Bank's customers. It was possible due to refinancing schemes that cover loans and leasing receivables of small and medium sized companies under which the Bank is able to offer more competitive and lower-cost terms of funding to its customers. Such programs are based on a credit line, granted on very attractive terms through Kreditanstalt fur Wiederaufbau – a German bank authorized by the European Commission to implement the Funding Program for Small and Medium-Sized Enterprises. The Bank uses that line to finance its loans and leases and receives subsidies from the European Commission for its utilization.

In November 2005, the Bank signed an agreement with Kreditanstalt fur Wiederaufbau for refinancing of loans granted to the public sector, which enabled the Bank to prepare a very competitive offer of financing investment projects realized by the broadly-defined public sector – municipalities, counties, regions and utility companies.

As part of development of the "Italian Desk" project, started in 2004 and supporting the Bank and its Italian partner in financing of trade between Polish and Italian businesses, the implementation of a new solution was commenced. It is a brand named "Borderless Banking" and consists of active cooperation in sales of the Bank's products through other financial institutions. The aim of the proposed cooperation model is to generate mutual benefits for the Bank and cooperating financial institutions due to an extended product range, optimized costs and increased range of operations of the partners.

In addition to product development, the Bank worked on the optimization of existing processes to ensure cost savings. The form of cross-border U.S. dollar settlements was optimized, which contributed to a reduction of operating costs and the improvement of customer service.

3.1.2 Trade Finance Products

The key objectives implemented by the Bank in 2005 in the area of trade finance products were to maintain its leading position in the market, to continue the implementation of new solutions, to develop electronic service platforms, as well as to introduce innovative structuring schemes tailored to specific needs of particular customers.

Other tasks of the Bank included the preparation and implementation of a new credit program and a comprehensive product offer for small and medium-sized enterprises, which takes into account, in particular, aspects connected with trade finance products. The new offer was supported by a marketing campaign – "Trade with Us". Additionally, the Bank initiated a project to implement a factoring service for a broader portfolio of customers of such services and, also, intensified activities to increase the number of companies that use such funding under the municipal suppliers plan.

In order to ensure that its proposal is viable in the trade finance market, the Bank launched new products – financing of trade receivables in domestic trade and documented with invoices on the basis of an insurance policy issued by Korporacja Ubezpieczeń Kredytów Eksportowych S.A. ("KUKE" – export credit insurer) and "prepaid" letters of credit.

In addition, the Bank's offer was broadened by the option to issue guarantees required within the framework of programs of the European Union, PHARE and the World Bank. The Bank also enabled its customers to generate new types of reports to meet their needs. Moreover, the Bank started electronic requests - customers may now apply for import letters of credit, guarantees and payment orders for import collection through that electronic channel.

The list of achievements includes significant funding invoiced receivables, programs of funding receivables on the basis of the KUKE policy (both in domestic and international trade), funding programs based on the PayLink card and supplier funding programs. Traditionally, the Bank issued a significant guarantees, including performance bonds and customs bonds.

3.1.3 Custody Services

The Bank operates custody services pursuant to applicable laws of Poland and international standards. As a result, its services meet the requirements of the largest and most demanding institutional customers.

The Bank is the leader in the segment of bank depositaries in Poland. It offers both custody services to foreign institutional investors and depository services to Polish financial institutions, pension funds, investment funds and investment funds with insurance options.

As a part of its statutory activities, pursuant to the relevant license of the Polish Securities and Exchange Commission, the Custody Department operates securities accounts, settles securities transactions, handles dividend and interest payments, portfolio valuations, individual reports, and arranges for customer representation at general meetings of shareholders of listed companies. It also maintains registers of foreign securities, which also involves intermediation in the settlement of transactions for domestic customers on foreign markets.

In addition, in 2005 the Bank started to offer settlements of transactions concluded by institutional customers on a new electronic platform for trade in debt securities, MTS-POLAND, organized by MTS-CeTO S.A., as well as settlements of securities transactions for remote members of the Warsaw Stock Exchange.

In March 2005 the Bank successfully completed the purchase of the organized part of ABN Amro Bank Polska SA as part of the global transaction between Citigroup and ABN Amro. This transaction resulted in a significant reinforcement of the Bank's position on the Polish custody market.

As of December 31, 2005, the Bank maintained 8,952 securities accounts. In 2005, the Bank was the depositary for seven Open Pension Funds:

- AIG OFE
- Commercial Union OFE BPH CU WBK
- Generali OFE
- ING Nationale Nederlanden Polska OFE
- OFE Pocztylion
- Pekao OFE
- SAMPO OFE

and also for:

- Employee Pension Fund "Sunny Autumn"
- Employee Pension Fund of Telekomunikacja Polska S.A.

In 2005, the Bank also acted as the depositary of 22 investment funds, managed by the following investment companies:

- BZ WBK AIB TFI S.A.
- PIONEER PEKAO TFI S.A.
- PKO/Credit Suisse TFI S.A.
- SEB TFI S.A.

3.2 Treasury

In 2005, the Bank continued operations in financial markets, both for customers and on its own account. In addition to simple FX products and intermediary trading services in the money market and capital market, the Bank offers comprehensive solutions in the area of FX and interest rate risk management, adapting them to the needs of a given entity.

For the Treasury Division, 2005 was a year of record profits, with sales of treasury products to customers as one of the most significant factors. Moreover, the Bank reinforced its position in the markets of derivative and structured products. In particular, sales of FX options and derivative instruments generated substantial earnings. The Bank also achieved a good result on sales of Market Linked Deposits (MLDs), which was boosted by additional functionalities of MLDs introduced in the first quarter of 2005.

Due to the expanding customer base, the year 2005 was another period when the Bank focused on intermediary services in the secondary market of debt securities, which resulted in trading volumes reaching historical highs. Fluctuations in the FX market enabled the Bank to obtain a high share in FX transactions in the interbank market.

3.3 Commercial and Investment Banking

The Corporate Bank Division provides comprehensive services for more than 140 largest customers, that, in addition to the basic product range, require financial engineering advice. Individual departments of the Division coordinate treasury and financial management products and prepare offers that embrace lending, debt and equity financing, as well as mergers and acquisitions.

The Bank actively supports the development of the largest companies in Poland by providing funding, on its own account or as a member of syndicates, as well as by arranging capital market funding. The list of the strategic transactions completed in 2005 includes:

- A 5-year syndicated loan facility for a leading provider of telecom services in Poland for an amount of EUR 900 million. The Bank's share in the transaction is EUR 50 million. The Bank is the authorized lead manager and agent of the facility. The agreement was signed in the second quarter of 2005;
- A 7-year syndicated loan facility for a hotel operator for an amount of PLN 500 million. The Bank's share in the transaction is PLN 150 million. The Bank acts as a co-arranger;
- A 5-year syndicated loan facility for a retailer in Poland for an amount of EUR 106 million. The Bank's share is EUR 30 million. The Bank is the authorized lead manager and agent of the facility;
- A 2-year syndicated loan facility for a strategic railway carrier for an amount of EUR 130 million. The Bank's share was EUR 15 million. The Bank was the authorized lead manager and agent of the facility. The deal was executed in the second quarter of 2005;

- A 5-year syndicated loan facility for a smelting operator for an amount of PLN 120 million. The Bank's share is PLN 40 million. The Bank acts as a co-arranger;
- A 5-year syndicated loan facility for a foreign furniture company for an amount of EUR 150 million. The Bank's share is EUR 12 million. The Bank is a member of the banking consortium;
- A bond issue program for one of the mobile phone operators for an amount of PLN 1 billion. The Bank is the lead manager, dealer, payment agent and depositary. The agreements were signed in June 2005 for 5 years;
- A revenue bond issue program for a water and sewage company for an amount of PLN 600 million. The Bank is the lead manager, dealer, payment agent and depositary. The transaction was concluded in the fourth quarter of 2005;
- A 3-year short-term bond issue program for a wood and paper company for an amount of PLN 400 million. The Bank is the lead manager, dealer, payment agent and depositary. The transaction was concluded in the third quarter of 2005;
- A medium-term bond issue program for a foodstuff company for an amount of PLN 250 million. The Bank is the manager, dealer, payment sub-agent and sub-depositary. The transaction was concluded in the third quarter of 2005;
- A 2-year bond issue program for a construction company for an amount of PLN 200 million. The Bank is the manager, payment agent and depositary. The transaction was concluded in the first quarter of 2005;
- A 1-year bond issue program for a construction company for an amount of PLN 100 million. The Bank is the manager, payment agent and depositary. The transaction was concluded in the fourth quarter of 2005.

In addition, in the second quarter of 2005 the Bank signed an advisory agreement connected with the restructuring of debt of a customer from the fuel and energy sector. The Bank was the coordinator of the process and cooperated with all financial institutions that offered their services to the customer.

As at December 31, 2005, according to the Fitch Ratings 24 (208) bulletin, the Bank was a leader in the distribution of short-term debt securities (i.e. up to 1 year) and its market share was 21.44% In respect of corporate and bank bonds with time to maturity over 1 year, the Bank's share was about 14%.

As at December 31, 2005, the Bank served 30 issue programs, including two programs that covered public issues of bonds, while as at December 31, 2004 the Bank served 28 issue programs, of which two were public bond issue programs.

3.4 Commercial Banking

The Commercial Bank Division serves a variety of businesses, from small family enterprises to large companies, which expect access to the most advanced and proven banking solutions. Thanks to an evenly dispersed network of outlets – the so-called Corporate Centers, located in areas in which business customers are concentrated, customers have convenient access to the entire offer of the Bank. Such access is also facilitated by the organization of the sales network of the Bank through relationship managers and product managers assigned to branches. The sales system is supported by advanced telephone and electronic banking.

The key to the growing cooperation of the Bank with its customers from such a differentiated segment of enterprises is a range of solutions adjusted to their specific requirements and scale of operations. Banking advisory services are an important component of the Bank's offer. They enable customers to obtain what is necessary to support their business operations effectively and efficiently.

In 2005, to strengthen cooperation with customers the Bank focused on cash management and trade finance products, as well as FX and cash products.

In the fourth quarter, the Bank carried out a marketing campaign, initiated in the end of the third quarter, "Add the Bank to your selling tools – trade with us", which was aimed at prospective customers – both manufacturers and trade companies – and based on direct communication, including meetings with the Bank's advisors. The promotion concentrated on the utilization of trade finance products, such as letters of credit, guarantees, discounts of bills of exchange and invoices. Additionally, the Bank offered a unique electronic platform for the implementation of foreign currency transactions, unsecured current loans and other credit instruments, which are based on an efficient process of assessment of a customer's financial standing. The campaign was supported with attractive cooperation conditions.

4. Consumer Banking

4.1 Credit Cards

As at 31 December 2005, the credit card portfolio reached 580,000. It represents a 12% increase in comparison with the same period of the previous year. The Bank maintained it's leading position on the credit card market throughout 2005, despite the launch of many new products by other credit card issuers.

To broaden the credit card product range, the Bank launched the new, most prestigious Citibank Platinum Card (both VISA and Mastercard) with a variety of additional features and services available to cardholders such as special assistance and concierge packages as well as Citibank Platinum Club (products and services of selected, most prestigious and global brands).

In June 2005 the Bank lowered APR for cardholders making the product proposition even more attractive to customers, as well as bringing the offer closer to market pricing.

In 2005 the Bank also changed the design of cards in accordance with the global branding standards of Citigroup. The card, which is issued in Poland, now looks exactly the same as Citibank credit cards being issued worldwide, including the U.S. The main changes concern the new "Citi" logo on the card as well as a new design of the Silver Credit Card.

As part of the customer focused strategy, in 2005 the Bank started an extensive upgrade project where selected credit cardholders are receiving upgraded products (Silver to Gold and Gold to Platinum cardholders) on preferential, promotional terms.

2005 was another very good year for the "Komfort" Installment Plan in terms of number of transactions converted into the scheme, which proves that the Bank offer is well designed and meets Customers' needs.

4.2 Retail Banking

4.2.1 Bank accounts

Throughout 2005 there were several marketing activities focused on acquisition of new to the Bank CitiGold customers. Also there were promotional activities aimed to acquire new profitable CitiOne customers, who receive their salary into a Citibank Handlowy account ("Photo camera for summer"- promotion). As a result of the above activities the number of CitiGold and CitiOne customers significantly increased. In connection with several interest rate reductions the deposit rates decreased systematically. As a result alternative distributions channels have been promoted by the Bank – mainly investment products. Similar to previous years customers were encouraged to use alternative access channels to Personal Account – Citibank Online (internet banking) and CitiPhone (telephone banking). The customers were also encouraged to use non-cash debit cards. As at 31 December 2005 the Bank operated 324,000 current accounts.

4.2.2 Loan Products

2005 was a year of continuous modification of the Citibank Loan granting policy, which led to widening the group of potential borrowers.

There was also an introduction of a new innovative policy of granting loans for selected professions based only on income estimation (the customer is not required to provide documents confirming income).

During 2005 the Bank tested a new innovative system of applying for the loan. As a result, the time taken to grant a loan in Warsaw's branches was reduced to 29 minutes, from submitting an application until money transfer into the bank account.

Moreover, the Bank conducted many promotional activities for specific groups of professionals and also supporting local acquisition initiatives.

As a result of the above actions, the Bank managed to double the volume of loan acquisition in 2005 in comparison to 2004.

In addition customers could benefit from new insurance options related to Citibank Loan from August 2005. These benefits were introduced in cooperation with MetLife Limited and MetLife Insurance Limited. Now, customers are able to insure themselves against unemployment, temporary incapacity to work and permanent incapacity to work.

4.2.3 Investment products

In 2005 the Bank introduced two new Regular Savings Plans – in January with Union Investment funds, in July with ING funds. They enable investment in bonds, balanced and equity funds.

In March 2005 the Luxembourg open-end offshore funds were launched, which are offered in CitiGold branches. Currently the Bank offers 48 offshore funds in EUR, USD and GBP, managed by Citigroup Asset Management Limited, which belong to the three fund families: Citi FCP, CitiMoney FCP and CitiSicav, including CitiChoice Multi-Manager fund-of-funds.

In 2005 the Bank organized 39 subscriptions of Market Linked Deposits and 28 subscriptions of Structured Notes in USD, EUR and PLN. In June for the first time the club-deal transaction in GBP was concluded.

In 2005 the sales of Regular Savings Plans almost doubled versus 2004 sales. In 2005 the Bank organized 29 investment seminars for current and potential customers.

4.2.4 Insurance products

In February 2005 the Bank introduced to its offer life insurance for Citibank Credit Card holders, Hospitalizacja Profit. The insurance is provided by MetLife Towarzystwo Ubezpieczeń na Życie SA (previously CitiInsurance) and covers life protection, hospitalization and surgical operation benefit in case of sickness and personal accident.

In August 2005 the Bank improved its offer of insurance for installment loan, which is provided by MetLife Limited and MetLife Insurance Limited. The customer can choose simple life insurance and also a Job Loss option or Health option.

At the end of the fourth quarter the Bank introduced to its offer New Endowment Insurance "Polisa na Dobre Życie" provided by Metlife. This insurance replaced the previous endowment insurance, which was offered to the Bank's customers since 2002. The New Endowment Insurance is more flexible for customers. Besides basic life insurance it allows the customer to choose five additional insurance coverages.

In the last quarter of 2005 the Bank started cooperation with another insurance company – AIG, with whom the Bank offers a new optional package of insurance for Citibank Credit Card holders "Safety Package". The new Package with extended insurance cover replaced the previous "Safety Package".

2005 was a record year for insurance in terms of amount of written premium. Written premiums in the Single Premium Unit Linked product provided by AEGON (previously Nationwide) reached the level of PLN 600 million.

4.2.5 Internet

In 2005, the Bank continued to promote the Citibank Online Internet platform. A significant number of customers prefer to make financial transactions through this platform. The number of users that at least once logged on to Citibank Online in Q4, 2005 increased significantly compared with the end of 2004. The expansion of the distribution channel is driven by an appropriate pricing policy and special offers, for example attractive interest rates on T-Deposits, which are available only on the Internet, as well as extensive functionality.

In 2005, the CitiGSM service became more and more popular among customers. The CitiGSM service provides daily balances on current account or credit card account that are confirmed via SMS. The Citibank online electronic statement service and CitiGSM, which enable customers to be in control of their finances 24 hours a day from anywhere in the world, continue to be very popular among customers.

4.3 SME Banking and CitiBusiness

Since 2004 the Consumer Bank offers CitiBusiness services designed for small and medium-sized enterprises. The target market of CitiBusiness are business entities, regardless of their legal status, with annual sales turnover not exceeding PLN 8 million, and whose business activity has not been excluded from the Bank's target market.

The CitiBusiness offer is based on the concept of selling products and services in the form of three Product Packages. Thanks to their variety they meet all the needs of the enterprises from the target market. Packages currently available include the following: *CitiBusiness Liabilities*, for transactionally active enterprises; *CitiBusiness Finance*, for enterprises looking for sources of financing their current operations and investments; and *CitiBusiness Premium*, for enterprises expecting prestige services and a comprehensive product offering.

The current offer is being distributed through Consumer Banking distribution channels, such as CitiPhone 24 hours, Citibank Online electronic banking and the network of Consumer Banking branch offices and Citibank Online ATMs as well as corporate offices that provide service for retail consumers.

Customers can link their personal accounts and company accounts. This solution is designed for customers who conduct business activities as private individuals or who are professionals. The solution enables them to manage their company finances through their personal account. Additionally, it allows for cost reduction due to free transfers between the related accounts.

The CitiBusiness offering is aimed at building the Bank's image as a partner for entrepreneurs and companies in different stages of their development. The Bank's experience, knowledge of financial services and modern technologies translate into a comprehensible, customer-friendly offer in the form of Packages, available through various channels. The CitiBusiness offering should be perceived as competitive in terms of price and should be identified with all widely known advantages of the Bank: high quality, modern services and professionalism.

In the second half of 2005 CitiBusiness has been intensively repositioned with the aim to improve efficiency in back office, credit and distribution processes and to grow sustainability of the business. This has led to an organization that is now well positioned for enhanced services to its customers and future growth.

5. CitiFinancial

The strategic goal of CitiFinancial is to be the fastest growing and most profitable venture in Poland's retail loan market, which is being implemented on the basis of stable and strong relationships with customers. Customer needs and control of product profitability are the main pillars of its plan. The main advantage is an individual approach toward every single customer to build mutually beneficial long-term cooperation.

CitiFinancial's target market covers 15.5 million individuals representing more than 7 million households. This is a significant market, with access guaranteed by the appealing credit offer of CitiFinancial. A majority of the target customers have income not exceeding the average level for Poland and appreciate convenient access to the Bank's outlets. To this end, the network of branches located in the vicinity of shopping centers and housing districts is being developed dynamically. At the end of 2005, CitiFinancial had 61 branches, i.e. 22 new outlets more than in 2004. Sales by brokers developed at a similar pace in 2005.

The product offer of CitiFinancial includes unsecured cash loans with an insurance option. For customers who want to repay liabilities incurred in other banks CitiFinancial has a debt consolidation loan. By the end of 2005, CitiFinancial extended its product offer by mortgage-backed consumer loans. These products are characterized by higher amounts and lower risk, and are secured by mortgage on real estate. They are offered to customers who want to consolidate installments or repay other high-interest loans. The development of that product will be an important focus for CitiFinancial in the years to come.

The group of products created and sold under the CitiFinancial brand name have shown strong sales growth, which confirms that the Bank has adopted an appropriate market penetration model.

6. Branch Network

In 2005, the Bank continued efforts to reorganize its branch network in order to optimize operating costs and accessibility for both retail and corporate customers.

The number of corporate outlets decreased to 41 during the year – a reduction by one outlet as a result of merger with a retail branch. At the same time, the number of retail outlets that serve corporate customers increased to 13 (by three). In total, corporate customers are served by 54 outlets (i.e. two more as compared with the end of 2004).

As of the end of 2005, the branch network of the Consumer Bank had 86 branches (as at the end of 2004). During 2005, the Consumer Bank opened one Investment Center, one branch for CitiGold Wealth Management customers and three multipurpose branches, and closed five loss-making multipurpose outlets. In addition, 23 corporate braches also serve individual customers (the number did not change in 2005).

The rapid expansion of CitiFinancial's branch network was continued in 2005 to the level of 61 outlets (an increase by 22).

In total, at the end of 2005, the Bank had 188 outlets, i.e. 21 more as compared with the end of 2004, and increased the cross-service capacity between the segments.

7. Changes in IT

The objective of IT development is to provide optimal processes while ensuring data security and continuity, and implementation of new solutions reflecting technological progress, product needs and the Bank's regulatory environment.

The following solutions influenced the development of a leading-edge product range, improvement of its quality and efficiency, and reduction of its cost:

- Implementation of the new version of the Goniec client software containing the extensions required by the regulatory authorities;
- Implementation of distribution of the report on ZUS payment details;
- Installation of telecom and IT infrastructure in new branches of CitiFinancial;
- In transaction services, implementation of the new Customer Relationship Management (CRM) application to automate the management of customer relationships, control of execution of the anti-money laundering policy (AML), aggregation and presentation of financial and operational data;
- Implementation of P2P/FlexCube interface. P2P is a global Citigroup platform for procurement (including invoice processing, purchase automation, vendor management etc.);
- Implementation of a new version of the Unikasa system for mass payments processing, following the termination of the agreement with the previous vendor, to be more competitive on the Polish market. The new solution will enable acquisition of more customers and increase revenue;
- Initiation of new FlexCube release implementation, to improve customer service levels, reduce risks in transaction processing and comply with local/global regulatory requirements;
- Initiation of new changes within compliance. The advantages include reducing the risk of frauds within Internet banking. Disposable passwords have been implemented that allow the authorization of the clients;
- Implementation of an interface to a data warehouse system for monitoring suspect transactions made by Maestro Cards, that enables the Authorization Team to immediately restrict the cards or the accounts;
- New application for Treasury to increase customer service security by providing new process for customer verification and authorization;
- New application allowing service for a high volume of customers and transactions in the area of international investment funds;

- Implementation of new IVR system (automatic banker for telephone service) and integrated CPO desktop agent's application for 24hrs business and commercial card information service, i.e. credit, debit, Paylink, CitiConnect issued to Bank and SKOK customers/card holders. The solution allows checking recent transactions, provides card balance information and transfers do call center advisor available 24/7. The solution implemented is unique in the local market and places the Bank ahead of the competition;
- Implementation of a series of functional modifications and enhancements in IVR GCB/CitiBusiness application, including customer satisfaction survey, playback of personalised/dedicated marketing and information messages to selected customers, upfront balance information, cash transfers from credit card accounts, and automatic fax transmission with customer transaction history directly from IVR – service offered mainly to CitiBusiness customers;
- Implementation of changes in FlexCube to ensure compliance with new regulations and reporting requirements;
- Implementation of the Effective Interest Methodology, notably for loans, deposits and debt securities and to enable the Risk Management Division and Finance Division to calculate loan impairment provisions in accordance with IFRS.

The total investment in IT incurred in 2005 amounted to PLN 36 million in the Corporate and Investment Bank and PLN 13 million in the Consumer Bank.

8. Capital Commitments of the Bank

Capital commitments of the Bank are classified into the strategic commitment portfolio and the restructured commitment portfolio.

The strategic commitment portfolio includes shares in companies that enable the Bank to expand its product range, as well as to gain prestige and to strengthen its competitive position in the financial services market in Poland. In 2005, strategic commitments consisted of Dom Maklerski Banku Handlowego S.A., Handlowy Leasing S.A, Citileasing Sp. z o. o.

9. Other Information about the Bank

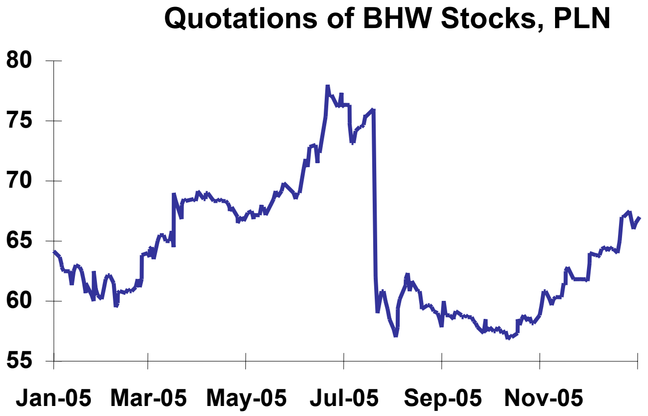
9.1 Rating

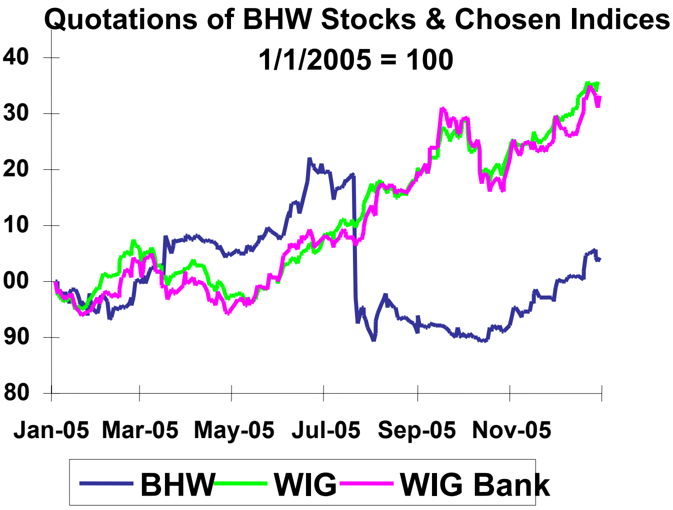
The Bank has a full rating from the international rating agency Moody's Investors Service. Since January 2003 Moody's has maintained an A2 rating for long-term deposits (investment grade 6 on the 21 point rating scale) and Prime-1 for short-term deposits (1st on the 4 point rating scale). The Bank's ratings are at the highest level available for entities domiciled in Poland.

Additionally, on 31 October 2004, the agency notified the Bank of a change in outlook of the financial strength rating, now at D+ level, from stable to positive, which was justified by the Bank's leading market position in the area of credit cards, corporate and investment banking, capital market expertise, as well as cash and trade services and the expansion of mass-market consumer banking under the CitiFinancial brand.

9.2 The Bank's Performance on the Warsaw Stock Exchange

In 2005, the price of the Bank's shares on the Warsaw Stock Exchange (WSE) rose from PLN 64.1 (December 31, 2004) to PLN 66.50 (December 30, 2005), by 4% despite the payment a dividend of 11.97 per share. In July 2005 the Bank observed a significant decrease in its share price due to the expiry of rights to its 2004 dividend.





9.3 Interest Rates

The average interest rate used by the Bank for deposits and loans in 2005 is included in explanatory notes to the Financial Statements.

9.4 Awards and Honors

In 2005, the Bank received the following awards and honors:

- Citibank Handlowy was the winner of the 5^{th} edition of the Colors of Volunteering competition in the category of Employee Volunteerism;
- SpeedCollect Plus won the award of the Banking Technology Magazine as the Best Corporate Banking Achievement for 2005;
- Citibank Handlowy was the winner of the European Clearing Survey's ranking of the Global Investor magazine as the best clearing bank for debentures and stocks;
- The Bank was honored as the Patron of the Year 2005 by the National Philharmonic in Warsaw;
- Citibank Handlowy won the Superbrands Poland title;
- Citibank Handlowy took third place in the "Dream Employer" in the financial sector, prepared by the Students Scientific Consulting Group of the Warsaw School of Economics;
- The CitiGold account won first place in the ranking of Rzeczpospolita in the category of personal accounts for affluent and demanding customers;
- The Citibank credit card was named the safest card by Rzeczpospolita;
- The promotional logo Entrepreneur Friendly Bank for Citibank Handlowy in 2004;
- Dom Maklerski Banku Handlowego S.A. received for the third time running the Golden Bull Award granted by the President of the Warsaw Stock Exchange for the largest share in the equity market turnover on the Warsaw Stock Exchange.

9.5 Sponsoring Activity and Cultural Patronage

- The Bank as the Patron of the Year 2005 of the National Philharmonic sponsored a concert by the Academy of St. Martin-in-the-Fields Orchestra and a symphonic concert by the Warsaw Philharmonic Orchestra and Female Choir, conducted by Grzegorz Nowak
- The Bank sponsored “Heaven” – a studio long play by Anna Maria Jopek;
- The Bank sponsored two “The Age of Jazz” concerts: by Jan Garbarek (saxophone) & The Hilliard Ensemble as well as The Manhattan Transfer (jazz vocal group);
- The Bank was a strategic sponsor of the “One passion, two visions” photo exhibition of David Michael Kennedy and Tomek Niewiadomski in the Cane Factory in Warsaw;
- The Bank sponsored a charity Children’s Day concert in Kraków by the Beethoven Academy in aid of the children’s home in Cholpon Ata in Kyrgyzstan;
- The Bank sponsored the concert of the Al Di Meola Group during the Wrocław Non Stop Festival.

IV. Significant Risk Factors relating to the Bank’s Operations

1. Major risk factors and threats to the Bank’s operating environment

1.1 Economy

Economic forecasts prepared by the Bank assume that Poland’s economy should accelerate in 2006. The GDP growth rate should increase to 4.2%, as compared with 3.2% in 2005. The key driver of growth should be domestic demand – both consumption and capital expenditure should recover.

Increasing consumption should be supported by the pensions indexation, planned for 2006, and an increase in the wage bill due to rising employment and wages. On the other hand, an investment recovery should be driven by high capacity utilization and very low interest rates (the Bank’s forecast assume that the Council will reduce interest rates by 50 basis points in 2006). However as in previous years, changes in investment spending are extremely hard to predict. Therefore, the main risk factor for Poland’s growth is the possibility that the investment recovery will be delayed. If so, demand pressure would weaken and the inflation rate would drop even further, despite it already being at a very low level.

In that scenario, the Monetary Policy Council could opt for deep cuts of interest rates. The fluctuation of Poland’s currency will also have a significant impact on monetary policy decisions. If the zloty strengthens beyond expectations, the scale of interest rates cuts will have to be larger in order to ease monetary policy.

Another important risk for Poland’s economy in 2006 may be the persistent uncertainty about the direction of the Government’s fiscal policy. Changes in public finance may affect the way foreign investors perceive Poland’s economy and, as a result, generate fluctuations in the FX market. An adverse FX trend could have a negative impact on financial results and general financial standing of the Bank. Simultaneously, a possible increase in political uncertainty could hinder investment recovery, which could lead to a lower demand for the Bank’s products.

It is also possible that political turbulence will create major changes in the institutional environment and operating conditions of the Bank.

1.2 Regulatory Risk

Any changes in economic policy and the legal system may significantly affect the financial situation of the Bank. Regulations of the banking sector, including regulations issued by the Finance Minister, resolutions of the Management Board of the National Bank of Poland ("NBP"), orders issued by the President of the NBP and resolutions of the Commission for Banking Supervision ("KNB"), are of utmost importance. The most relevant regulations cover:

- acceptable concentration of loans and total receivables (Banking Act);
- maximum limit of equity that may be invested in the capital market (Banking Act);
- solvency and credit risk standards (resolutions of the KNB);
- mandatory reserves (establishment and transfers) (NBP Act, Banking Act, resolutions of the KNB and resolutions of the Management Board);
- taxes and similar charges;
- the anti-usury act that determines the maximum statutory interest rates and maximum commissions and fees for consumer loans;
- restrictions in granting loans.

1.3 Competition within the Banking Sector

Competition between banks in different segments of the Polish banking sector seems to be strong. Companies will increasingly utilize financial alternatives to bank loans, such as issuance of short-term debt securities and leases, and will fund their operations from earnings. The pressure imposed by companies in good financial condition to reduce credit and non-credit margins will not come to an end in the near future.

After Poland's accession to the European Union, foreign banks have shown more interest in the Polish market of banking services. Banks from the EU now have an advantage as they do not have to start from scratch or acquire a bank. An institution based in any member state of the EU has only to notify its intent to operate in another market to the European supervision authorities. Foreign banks may operate cross-border activities in Poland, i.e. without their actual presence. By the end of 2005, the Commission for Banking Supervision received more than 100 notifications. At present, representative offices are carrying out such operations, i.e. banking institutions are opened without a registered office in Poland. They focus on large corporations, but the possibility cannot be excluded that in time foreign banks will attempt to conquer the retail market. It is highly probable that the increasing foreign investments in the banking sector and the emerging unified European market of financial services will lead to greater competition in the market for banking services, also in activities such as FX transactions, settlements of foreign trade transactions and investment banking.

Despite the large number of institutions that have notified their intent to open operations in Poland, we do not expect sizeable changes in the structure of the banking sector. Those institutions that are really interested in the Polish market, and that deem it attractive, have already been developing their presence here for several years. As a result, banks operating in Poland offer products comparable with those that are distributed in other EU countries. The competitive struggle will focus on the quality of services and the efficiency and speed of customer service. The factor that could potentially reduce competition is the continued consolidation of the banking sector.

The Bank is well prepared to face European rivals, there is, however, a risk that the increasing competition could affect its earnings.

2. Major Risk Factors connected with the Bank and its Operations

2.1 Liquidity Risk

As a typical feature of banking activity, the Bank experiences maturity mismatches between loans and the funding of deposits . They may give rise to potential problems for current liquidity, were there to be a build-up of large payments to customers. The management of the Bank's assets and liabilities, including the regulation and control of liquidity risk, is the responsibility of the Asset and Liability Committee, which defines the strategy that is implemented by the Treasury Department.

The key task of the Asset and Liability Committee is to manage the structure of the balance sheet in order to increase its profitability, to determine acceptable limits of financial risk to be accepted in particular areas of operations, to define the pricing policy and to make decisions concerning the transfer pricing system used by the Bank.

Within the framework of liquidity management activities, the Asset and Liability Committee is responsible for the preparation and implementation of a unified policy towards liquidity risk. In addition, it approves annual liquidity plans, plans of funding of the Bank's assets and liquidity limits for the Bank, as well as contingency action plans in the area of liquidity. It also determines thresholds (limits) for particular sources of funding and carries out regular reviews of liquidity risk reports.

The Bank's deposit base is stable and diversified. In addition, the Bank has good access to interbank funding and adequate capital. The level of liquidity risk is thus low.

2.2 Foreign Exchange Risk

The Bank performs foreign exchange operations both on behalf of its customers and its own account, and holds open foreign exchange positions within established limits. As a result, the Bank is exposed to exchange rate risk and there is no certainty that future movements in exchange rates will not have an adverse effect on the Bank's financial standing. The control of foreign exchange risk is the responsibility of the Market Risk Department, which cooperates with the Treasury Department, which manages the foreign exchange position. The market risk is moderate and the limit of value at risk (VaR) arising from open foreign exchange positions is established at a level below 1% of the Bank's equity.

2.3 Interest Rate Risk

As is the case with other Polish banks, the Bank is exposed to a mismatch risk regarding the interest rate changes on its assets and the underlying liabilities. The interest rate risk can arise where it proves impossible to offset the fall in income caused by lower rates of interest on loans through a corresponding reduction in the rates of interest paid to depositors. This risk also applies to situations where a rise in deposit rates cannot be offset by a corresponding rise in lending rates. The management of interest rate risk is one of the functions of the Bank's Asset and Liability Committee, which determines the Bank's pricing policy in respect of interest rate risk. The present level of interest rate risk is low.

2.4 Credit Risk

Lending and guarantee business is inherently linked with the risk of payment delinquency (in terms of both loan principal and interest) and also with the risk that the asset represented by an outstanding loan or granted guarantee will prove impossible to recover. The Bank monitors its risk assets on an ongoing basis, classifies them in accordance with the relevant regulations and establishes provisions against loans. The Bank's Management Board is of the opinion that the current level of provisions is appropriate. In connection with the possibility of changes in the external environment that could have a negative impact on the financial situation of the Bank's customers, there is no certainty that in the future the need to provision adequately against the existing asset portfolio will not have an adverse effect on the Bank's financial condition or that the provisions and collateral in place will prove sufficient to absorb possible losses arising out of lending activity.

2.5 Equity Investment Risk

Equity investments can be divided into two categories: strategic and restructuring. The strategic portfolio includes the Bank's shares in Polish financial institutions of a strategic significance to the Bank due to their operations. Investments are owned directly by the Bank or indirectly via the Bank's wholly-owned special purpose investment vehicles. At the end of 2005, the value of net equity investments including subordinated loans and accrued interest amounted to PLN 364.2 million as compared with PLN 450.6 million as of December 31, 2004. Moreover, due to a number of macroeconomic effects, the situation in equity markets and other factors having an impact on activities of the companies in which the Bank is a shareholder may mean that the selling price of owned shares may turn out to be lower than expected, or even lower than their value in the Bank's books of account, which may have a negative impact on the financial situation of the Bank. The Bank has already created substantial provisions related to its equity investments and, hence, the risk level connected with a further drop in the value of the Bank's investment portfolio is moderate.

2.6 Operating Risk

As in other financial institutions in the market, the Bank is exposed to the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events. Following the publication of the Basel Committee's recommendations and the recommendations of the Commission for Banking Supervision, the Management Board enhanced qualitative and quantitative measurements of operating risk. The monitoring and reporting of operating losses, divided into several categories, were also implemented. Despite various tools and methods adopted by the Bank to manage operating risk (e.g. policies, procedures, checklists, limits, self-assessment process, information security systems, contingency plans and audits) such risk has only been limited, but not eliminated. However, the overall level of operating risk is moderate.

2.7 Contributions to the Bank Guarantee Fund

Pursuant to the Act on the Bank Guarantee Fund, the Bank is included in a mandatory deposit protection scheme for personal deposits. Banks included in this scheme are required to make specific contributions to the Fund.

Due to a general deterioration within the banking sector or the bankruptcy or financial distress of one of the participating institutions, the Bank and other participants in the Bank Guarantee Fund may be required to make large payments to the Fund, in proportion to the sums held within the individual deposit protection funds established for given institutions. This could adversely affect the Bank's earnings.

V. Development Prospects for the Bank

1. General Development Objectives

The Bank's objective is to systematically increase shareholder value by ensuring an appropriate return on equity and increasing the Bank's share in the key market segments.

In 2005, the Bank significantly increased its customer base in the Consumer Bank sector. In future years, the Bank wants to continue active acquisition of new customers – both individual consumers, SME customers and corporate customers in all market segments, with a special emphasis on the former.

The Bank aspires to a double digit market share in a few years (measured as the share in the result on banking activity for the entire banking sector). In 2005, its share was over 7%. The increase in market share will be achieved when the Bank is able to maintain its leading position in corporate banking and retail banking including services for affluent individuals. The high-growth areas will be developed, in particular cash loans for individuals (CitiFinancial).

The Bank's share in the total costs of the banking sector equaled 8.5% in 2005. At present the Bank's investments are advanced and in the next few years the Bank will focus on its expense management policy and on improving cost discipline. The Bank's share in the net income of the banking sector exceeded 6% in 2005.

1.1 Commercial Banking

The Bank is the leader of the commercial banking market in Poland. Its share in total corporate loans amounted to 5.0% at the end of 2005, as compared with 5.8% at the end of 2004, and in total corporate deposits was 8.9%, as compared with 10.0% at the end of 2004. The Bank's share in the issues of short-term debt securities, measured by the amount of debt, rose to 21.4% as of December 321, 2005, from 20.3% as of December 31, 2004.

In 2005, the Bank operated on the basis of a new service model for corporate customers. The new customer service model enabled the Bank to extend its product range for large and medium-sized enterprises. The Bank now offers an individual approach toward its largest customers.

The Bank believes that any company that operates in Poland, except sectors excluded permanently under the general policy of the Bank and companies included in the watch list due to international or U.S. sanctions, is its prospective corporate customer.

The Bank's position is particularly strong in servicing international corporations and the largest Polish companies. Moreover, it is the foremost institution in handling money market and foreign exchange transactions. The Bank's goal is to retain its present market share in these areas. In developing relationships with the largest customers, the Bank has the significant advantage of being a member of Citigroup. The Bank can offer to these customers unique services that blend its own knowledge of the domestic business environment with the international experience and global reach of Citigroup.

In corporate banking the Bank is aiming to increase income in the so-called middle market. The Bank is going to acquire new customers on this market as well as deepen the relations with its present customers. The Bank is going to finance SME in an active way as well as to enlarge the offer dedicated to SME customers.

The majority of the Bank's revenues will be generated by cash management, trade finance services and treasury products. The solutions and innovations in these product groups will be the key factors determining the competitive advantage of the Bank, in particular in cooperation with the most demanding international and leading Polish companies.

Investment banking services will continue to be offered in close cooperation between the Bank and Citigroup Global Markets. This will make it possible to offer servicing of large-scale international transactions as well as to provide services to domestic companies.

1.2 Consumer Banking

The Bank considers that services for customers of the consumer banking sector provide the highest growth potential in the medium term.

At the end of 2005, the Bank's share in total lending (including mortgages) to individuals rose to 2.5% from 2.3% at the end of 2004, while the market share in deposits declined to 2.2% from 2.8%, respectively.

Consumer Bank is involved in cooperation with all segments of customers. It is reflected in special tailored product offers, which take into consideration a variety of customer needs from different market segments.

It is of key importance for the Bank to maintain its top position in credit cards – the market in which Citigroup is the world leader. New card types as well as loyalty programs will be offered. The target group of customers to whom the Bank will offer its cards will be expanded.

The Bank has a very strong position in the affluent customer segment. What sets the Bank apart its competitors is that these customers are offered global services.

In 2005, the Bank gradually strengthened its position in this market segment thanks to the CitiGold Wealth Management service. The key highlight of the wealth management service is the savings and investment plan comprising investment, insurance and banking products. The products available in the Wealth Management package include current accounts, term deposits, investment deposits and dual-currency deposits, investment funds, treasury bills, domestic and international bonds, brokerage services, credit facilities, credit cards and insurance products. Customers' assets are managed in personalized investment portfolios based on their individual needs and preferences. Poland is the first European country where Citigroup introduced its CitiGold Wealth Management offer.

In respect of investment management and asset management products the Bank takes an "open architecture" approach concerning the offer for this segment. In asset management activity the Bank is going to concentrate on distribution of products that are offered by Polish investment funds and foreign investment funds. This should enlarge the offer and fulfill the customers' requirements. The independent offer of investment products that is systematically enlarged by new solutions will contribute to competitive advantage of the Bank.

The Bank is also expanding its offering to medium-income customers, holding CitiOne or CitiKonto accounts. In addition to developing classic deposit services and increasing transactional functionality of accounts, special emphasis will be placed on extending investment and insurance products. Along with the increasing customer demand for new methods of placing their savings, the Bank will expand its investment fund offering.

The Bank also continues the expansion of cash loans for low-income customers. This activity is treated as a separate business and is conducted under the CitiFinancial brand. The Bank expects a dynamic growth in this area.

Due to the fast growing retail market the Bank is going to enlarge the Citifinancial network to 100 branches up to the end of the first half of 2006. Due to the enlargement of the network the Bank will have the ability to offer its customers more convenient access to the Bank's products and to improve sales. The Bank will focus on active sale of mortgages.

1.3 Distribution Network

The Bank operates in the market under two brands: citibank handlowy for distribution of consumer, corporate and investment banking products and citi financial for CitiFinancial's distribution channels. For the Bank, the creation of the brand awareness among existing and prospective customers of particular segments is a top priority task.

The Bank's customer service is based on the network of outlets, consultants and relationship managers, third party direct sales agents and remote distribution channels, such as Internet banking, Call Center, IVR (interactive automatic telephone service) and multi-functional ATMs.

The streamlining of the branch network is being implemented by optimization of available space, closure of the least profitable outlets and merger of corporate and consumer bank outlets. In the case of corporate and CitiGold customers, the mainstay of the distribution network is consultants and relationship managers. The rapid extension of the CitiFinancial branch network will be continued.

The utilization of the Bank's distribution network takes into account plans to increase the scope of activities of the Consumer Bank and achieving synergies with the Corporate Bank. In the coming years, the Bank will aim to minimize operational activities in branches and completely transform them into service centers. The priority is to increase the functionality and availability of remote distribution channels and to further enhance the qualifications of banking consultants, in particular those handling large entities that need more sophisticated financial products. In the case of the Consumer Bank, substantial emphasis will be placed on the further growth of Internet usage (Citibank Online). As a target, the Internet is to become the basic source of conducting transactions for private individuals.

High functionality and high quality of access to call centers via CitiPhone for individuals and small businesses and CitiService for large and medium-sized enterprises will be maintained.

2. Synergies

Wide-ranging experience and diverse operations provide the Bank with strong competitive leverage and allow it to offer its customers comprehensive solutions by taking advantage of the opportunities afforded by synergies between corporate and consumer banking, between banking and brokerage services, etc.

Packages of deposit and loan products are offered to staff members of the largest corporate customers. A typical package includes personal current accounts (e.g. CitiKonto) together with payroll support facilities, credit cards and other credit products. In addition to pricing incentives, the Bank is prepared to conduct financial educational seminars for their employees.

The Bank will also continue to sell corporate products to its consumer bank customers from the CitiGold sector. In particular, specialized treasury products, brokerage services and asset management facilities will be offered. All groups of consumer customers will further be offered investment products.

VI. Corporate Governance

1. Good Corporate Practices and Principles of Management at the Bank

As declared by the Bank's Management adopted by the resolution of May 19, 2005 and included in current report no. 22/2005 of June 6, 2005, the Bank has undertaken to follow the corporate governance practices determined in the "Good Practice for Public Companies 2005."

The Supervisory Board issued a positive opinion on that statement (the Supervisory Board's resolution of May 24, 2005) and, subsequently, it was approved by the General Meeting of Shareholders of June 21, 2005 (Resolution 11).

The Bank's aim is to be the most respected financial services company in Poland, with a strong sense of business and social responsibility. Since 2003 the Bank respects the corporate governance rules adopted by the Warsaw Stock Exchange in the form of the "Best Practices in Public Companies". The main purpose for adoption of the corporate governance rules as the standard in the Bank is to build transparent relationships between all entities involved in the Company and to ensure proper and diligent management of the Company and its business and ensure fairness to all shareholders.

In order to ensure transparency in the Bank, including in particular relationships and processes between statutory bodies of the Company, the following Best Practices have been introduced in the Bank:

1.1 Investor Relations

An integrated part of the Bank's information policy, whose aim is to provide information to all individuals and institutions that need information about the company, are investment relations that provide the information for present and potential investors and capital market analysts. The Bank's information policy is implemented, among other things by:

- Organizing regular meetings with investors and analysts in the form of briefings and conference calls, also in the Bank's headquarters, with participation the Management Board.
- Support from Investment Relations Office during the press conferences for media that are organized during the reports publication.
- Publishing on the Bank's website current information about the Bank and its businesses, and also all current and periodical reports; the website facilitates contact with the Investor Relations office, which provides information about the Bank and its capital group.
- Enabling media representatives to participate in General Meetings.

1.2 Transparency

The Bank permanently undertakes actions to improve transparency in the Bank's organization, division of powers and functioning of particular bodies and their mutual relations as follows:

- The Bank presents its financial statements in accordance with International Financial Reporting Standards (IFRS) since 1 January 2005 including the annual consolidated financial statements.
- One half of the Bank's Supervisory Board members are independent members, including the Chairman of the Board.
- Within the Bank's Supervisory Board is the Audit Committee composed of two independent members, including the independent Chairman of the Committee.
- According to the corporate governance rules, the total value of remuneration for all members of the Management Board is included in the annual report. Remuneration of particular Management Board members reflects their scope of duties and liability.
- All significant internal regulations, information and documents related to the Company's Shareholders Meetings are available in the Company's headquarters and on its website.

1.3 Minority shareholders protection

The Bank ensures due protection of minority shareholders' rights within the limits defined by the nature of the company and primacy of the majority rule related to it.

In particular, in order to ensure equal treatment of all shareholders the Bank adheres, among others, to the following rules:

- General Meetings always take place in the Company's seat in Warsaw.
- According to the practice adopted in the Company, all important materials for the General Meeting, including draft resolutions with justification and opinion of the Supervisory Board, are made available to Shareholders not later than 7 days before the date of the General Meeting, at the Company's seat and on the Bank's website.
- General Meeting have stable regulations defining detailed principles of debate management and the passing of resolutions.
- Members of the Management Board and Supervisory Board take part in General Meetings and provide explanations and information about the Bank to participants in the meeting within the limits of their competencies.
- Participants in the General Meeting objecting to a resolution are given an opportunity to provide a brief justification of their objections. Moreover, each participant in the General Meeting is given an opportunity to submit written statements to the meeting's minutes.

2. Bank's authorities and other Corporate Governance Rules

In 2005, no principles of management used by the Bank were amended. These principles are presented in Note 3 of the Bank's Financial Statements.

2.1 Changes in the Composition of the Bank's Management Board and Supervisory Board in 2005

2.1.1 Changes in the Composition of the Management Board in 2005

As of the date of preparation the following changes in the Management accurred:

Resignations:

David J. Smith	Vice-President of the Bank's Management Board, on 3 February 2005
Sunil Sreenivasan	Vice-President of the Bank's Management Board, on 31 March 2005
Philip King	Vice-President of the Bank's Management Board, on 6 October 2005

Appointments:

Reza Ghaffari	Vice-President of the Bank's Management Board, on 4 February 2005
Sanjeeb Chaudhuri	Vice-President of the Bank's Management Board, on 28 October 2005.

In 2006 up to the date of sign of the financial statements the following changes in the Management Board occurred after the year end:

- On 1 January 2006 Mr. Witold Zieliński was appointed to the position of Vice-president of the Bank's Management Board
- On 22 February 2006 Mr. Reza Ghaffari resigned from the position of Vice-president of the Bank's Management Board

2.1.2 Changes in the Composition of the Supervisory Board in 2005

There were no changes in the composition of the Supervisory Board in 2005.

On 23 January 2006 Mr. Edward Kuczera tendered his resignation from the position of Member of the Supervisory Board to the Chairman of the Bank's Supervisory Board and ceased to be a member of the Supervisory Board of the Bank from 31 January 2005.

On 27 February 2005 the Supervisory Board of Bank Handlowy w Warszawie SA appointed Mr. Krzysztof Opolski to the position of member of the Bank's Supervisory Board.

2.2 Changes relating to Appointments and Discharges of Members of the Management Board and Powers of Members of the Management Board

Members of the Management Board are appointed by the Supervisory Board for a 3-year term. Their mandate expires:

- on the date of a General Meeting that approved the Management Board's report on the Bank's operations and the financial statements for the last full financial year during which a member sat on the Management Board;
- upon death of a member of the Management Board;
- upon the discharge of a member of the Management Board;
- upon the submission of a written resignation to the Chairman of the Supervisory Board.

2.3 Powers of Members of the Management Board

The Management Board makes decisions, by way of resolution, concerning matters that are not entrusted by law or the Articles of Association to other governing bodies of the Bank, and in particular the Management Board:

1) formulates the Bank's strategy;
2) adopts annual financial plans, investment plans and reports on their performance;
3) approves reports on operations and financial statements;
4) recommends the appropriation of profits or coverage of losses;
5) determines dividend payment dates, on the basis of limits voted by the General Meeting;
6) approves HR and credit policy, as well as legal principles of the Bank's operations;
7) approves the capital management policy;
8) approves the employment structure;
9) determines the basic organizational structure of the Bank, appoints and discharges heads of Sectors and Divisions, and defines their powers and responsibilities;
10) creates and liquidates committees and determines their powers and responsibilities;
11) determines the Bank's Regulations and submits them to the Supervisory Board for approval;
12) appoints commercial proxies, general authorized representatives and general authorized representatives entitled to substitution;
13) determines, and submits to the Supervisory Board for approval, regulations of management of special funds created from net income;
14) determines audit and control plans for the Bank and approves audit and control reports;
15) decides on other matters that, according to the Articles of Association, are to be submitted to the Supervisory Board or the General Meeting.

2.4 Salaries and awards (in cash and in kind), including bonuses from retained profit, paid or payable to persons managing and supervising the Bank

The total amount of salaries, awards and benefits paid or payable to the current and former members of the Bank Management Board in 2005 is as follows:

In thousands of PLN

Name	Salaries, awards and benefits received in the Bank			Other*
	Base salaries and awards	Other benefits	Shares awarded	
Sławomir Sikora	2,243	167	891	-
Sanjeeb Chaudhuri	24	-	-	-
Reza Ghaffari	1,175	209	204	-
Lidia Jabłonowska-Luba	1,196	12	218	16
Philip King	1,456	470	745	-
Michał Mrożek	1,506	30	343	7
David Smith	14	-	-	-
Sunil Sreenivasan	541	5	-	-
	8,155	**893**	**2,401**	**23**

*Other remuneration received for positions held in governing bodies of subordinated undertakings

The total amount of "Base salaries and awards" includes the gross amount of base salaries paid in 2005 and awards granted in 2005.
According to a decision of the Supervisory Board the remaining amount of awards granted to the members of the Bank's Management Board for 2004, paid in 2005, in total amounted to PLN 4,055 thousand.
The total amount of other benefits includes the gross amount of paid remuneration arising from indemnification for employment contract termination, managerial options granted, benefits in kind, lump-sum payment for the use of company car, insurance policy premium, holiday leave equivalent, dividend and supplementary benefits consistent with the employment contract of foreign employees.
The total amount of salaries, awards and benefits paid or payable to the current and former members of the Bank Management Board in 2004 is as follows:

In thousands of PLN

Name	Salaries, awards and benefits received in the Bank				Other*
	Base salaries and awards	Other benefits	Shares awarded	Options granted	
Sławomir Sikora	2,291	46	118	-	-
Lidia Jabłonowska-Luba	1,057	3	48	1,500	30
Wiesław Kalinowski	428	2,765	-	-	-
Philip King	2,475	216	168	8,000	-
Michał Mrożek	1,249	14	48	1,500	8
David Smith	174	3	-	-	-
Sunil Sreenivasan	3,926	1,556	404	16,000	-
	11,600	**4,603**	**786**	**27,000**	**38**

*Other remuneration received for positions held in governing bodies of subordinated undertakings

The total amount of base salaries and awards includes the gross amount of base salaries paid in 2004

According to a decision of the Supervisory Board the amount of awards granted to the members of the Bank's Management Board for 2003 and paid in 2004 in total amounted to PLN 3,294 thousand.

The total amount of other benefits includes the gross amount of paid remuneration arising from indemnification for employment contract termination, managerial options granted, benefits in kind, lump-sum payment for the use of company car, insurance policy premium, holiday leave equivalent, dividend and supplementary benefits consistent with the employment contract of foreign employees.

The total amount of salaries, awards and benefits paid or payable to the current and former members of the Supervisory Board of the Bank in 2005 and 2004 is as follows.

In thousands of PLN	2005	2004
Stanisław Sołtysiński	190	107
Göran Collert	73	71
Mirosław Gryszka	116	71
Edward Kuczera	116	71
Jarosław Myjak	73	30
Andrzej Olechowski	116	71
Andrzej Gdula	-	41
	684	**462**

In 2004 and 2005, persons having supervisory functions in the Bank did not receive any remuneration for their positions held in the governing bodies of subordinated undertakings of the Bank.

2.5 Total Volume and Nominal Value of the Bank's Shares and Shares in Affiliated Companies of the Bank that are held by Members of the Management Board and the Supervisory Board

No member of the Management Board is a shareholder of the Bank or any affiliated company of the Bank. One member of the Supervisory Board owns 752 shares of Bank Handlowy w Warszawie SA (total nominal value of PLN 3,000).

2.6 Agreements between the Bank and Members of the Management Board that provide for compensation in case of their resignation or discharge without appropriate justification or as a result of the Bank's takeover

There is one agreement between the Bank and a member of the Management Board that includes a provision for cash compensation in case of termination.

The provision states that when the member of the Management Board is discharged during the term of the agreement (i.e. during the term of office) and when the agreement is terminated upon 3-month notice, the member of the Management Board will be entitled to compensation in an amount equal to annual basic remuneration. Compensation will be paid within 14 days from the termination date. Compensation for the same amount will also be due in case of termination of the agreement without notice due to a serious illness pursuant to Article 53 of the Labor Code.

3. Other rules

3.1 Holders of Securities with Attached Special Control Powers towards the Bank

All the shares issued by the Bank are ordinary bearer shares and give no special control powers towards the Bank.

3.2 Limitations related to the Transfers of Ownership Title to the Bank's Securities and Limitations in the scope of Voting Rights connected with the Banks' Shares

In addition to the limitations set forth by the Banking Act (Article 25) – a person who takes or acquires more than 10%, 20%, 25%, 33%, 50%, 66% or 75% of the Bank's total shares must obtain a permit from the Commission for Banking Supervision. A permit is also required to dispose of shares, if the holder exceeded the above limits previously. The Articles of Association impose no other restrictions on transfers of the Bank's shares.

VII. Agreements concluded with registered audit company

On 24 May 2005, the Supervisory Board of the Bank appointed a registered audit company, KPMG Audyt Sp. z o.o. ("KPMG") having its registered office in Warsaw, at ul. Chłodna 51, registered audit company no. 458, to conduct an audit and a review of the Bank's financial statements for the year ended 31 December 2005. KPMG was selected in compliance with the applicable laws and regulations.

The contractual fees of KPMG (paid or payable) for the years ended 31 December 2005 and 2004 are presented in the table below:

In thousands of PLN	**2005**	**2004**
Audit and review fees (1)	1,337	1,195
Other assurance fees (2)	60	260
	1,397	**1,455**

(1) The contract fees for the audit include fees paid or payable to KPMG for the annual audit of the stand-alone and consolidated financial statements of the Bank - parent entity (agreement signed on 22 November 2005) and for the review of the semi-annual stand-alone and consolidated financial statements (agreement signed on 21 August 2005)

(2) The fees for assurance services include all other fees paid or payable to KPMG. These fees include assurance services related to the audit and review of financial statements of the Bank – parent entity and subsidiary entities not mentioned in points (1).

Other information that are required by the Decree of the Ministry of Finance dated 19 October 2005 on current and periodic information provided by issuers of securities (Official Journal from 2005, No 209, item 1744) and the information is consistent with the financial statements of Bank Handlowy w Warszawie SA.

Signatures of all Management Board Members

27.03.2006	Sławomir Sikora	President of Management Board	
....	....	....	....
Date	Name	Position / function	Signature
27.03.2006	Sanjeeb Chaudhuri	Vice- President of Management Board	
....	....	....	....
Date	Name	Position / function	Signature
27.03.2006	Witold Zieliński	Vice- President of Management Board	
....	....	....	....
Date	Name	Position / function	Signature
27.03.2006	Lidia Jabłonowska-Luba	Member of Management Board	
....	....	....	....
Date	Name	Position / function	Signature
27.03.2006	Michał H. Mrożek	Member of Management Board	
....	....	....	....
Date	Name	Position / function	Signature