

REPORT ON OPERATIONS

OF THE CAPITAL GROUP

OF BANK HANDLOWY W WARSZAWIE SA

IN 2002

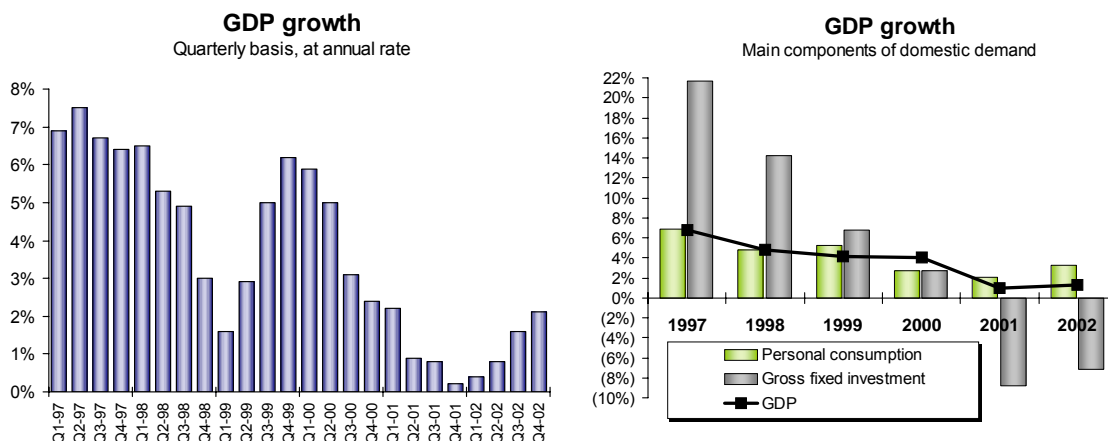
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I. The Polish economy in 2002

1. Main macroeconomic trends

In 2002, the Polish economy was marred by stagnation resulting from very slow abating of recession symptoms in the country and abroad. As a result, the growth of the Polish economy was not much faster than in the previous year. The gross domestic product grew, in real terms, by 1.3% against 1.0% in 2001. In the second half of the year, the growth of economic activity accelerated significantly – in 3Q and 4Q the GDP grew by 1.6% and 2.1% over the corresponding quarters of the previous year, as compared with 0.4% and 0.8% growth in 1Q and 2Q respectively – which can be viewed as a symptom of overcoming the stagnation tendencies.



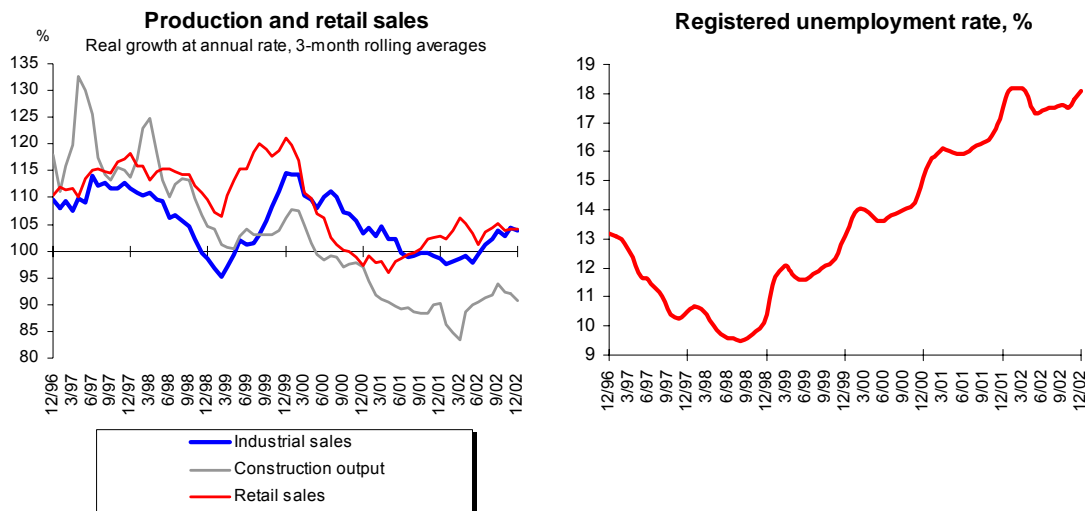
As in 2001, the slow growth resulted, first and foremost, from a contraction of investment spending. Gross accumulation decreased by 7.3% and gross fixed investment fell similarly. In view of the negative dynamics of investment spending, the main sources for maintenance of economic growth in 2002 were consumption and exports. Total consumption spending grew by 2.9%, while personal consumption rose by 3.3% against 1.7% and 2.0%, respectively, in 2001.

Recessionary tendencies in the industrial sector were counteracted only in the second half of 2002. In the first half of the year, the industrial output was still in red (-1.0%, y-o-y), whereas from the 3Q on, the production growth picked up, and due to the acceleration in the 4Q the growth of industrial output reached 1.5% in full year 2002. This was mainly due to strongly growing output of the manufacturing industry (growth by 2.1%). The construction sector continued to suffer as production fell by 10.5%, which was similar to last year's figures.

The slow economic growth connected with demographic changes did not allow any reduction of unemployment. However, the rate of registered unemployment grew slower than in 2001 – in December 2002 it reached 18.1%, 0.6% more than in the previous year. The number of registered unemployed grew by nearly 120 thousand to reach 3.2 million people. On the other hand, the unemployment rate calculated in accordance with the International Labour Organization and Eurostat methodology stood at 19.7% at the end of 2002 as against 18.5% at the end of 2001. The restructuring processes within industries resulted in an accelerated decrease in employment in the corporate sector.

In spite of the economic stagnation in the EU countries, in particular in Germany, where GDP growth in 2002 was as little as 0.2%, the foreign trade volume grew in comparison with the previous year.

Exports, on payment terms, grew by 8.8% (7.1% in 2001) and imports by 3.2% (1.3% in 2001), as expressed in USD. This resulted partially from favourable FX rate developments (strong depreciation of the dollar versus the euro in 2002), but also from the growth of competitiveness of Polish exports in consequence of restructuring of the Polish economy in the 90s.



The export growth outpacing that of imports helped to reduce the negative trade balance and consequently – the current account deficit by USD 466 million to USD 6.7 billion, i.e. down to 3.6% of the GDP from 3.9% in 2001. However, the structure of the current account deficit financing deteriorated; while in 2001 it was financed 97% with an influx of foreign direct investment, in 2002, due to slower influx of those investments resulting from weak growth and a drastic curbing of privatisation – the share of direct investments financing went down to 57%.

Official reserves grew in 2002 by USD 3.2 billion in comparison to 2001, reaching at the end of the year USD 29.8 billion. The reserves were 7.4 times higher than the average monthly import volume in 2002, i.e. at a very safe level.

In 2002, the inflation pressure abated significantly. The consumer price index growth fell to 0.8% y-o-y in December 2002, from 3.6% in December 2001, i.e. much below the revised inflation target of the central bank (2-4%). The average growth of consumer prices was 1.9% in 2002 against 5.5% in 2001. The prices of industrial production (as measured by PPI) grew by 2.2% from December 2001 to December 2002, and by 1.0% on average, as against 1.6% and minus 0.3%, respectively, in 2001. The inflation drop resulted from positive supply shocks (fuels, food) and low demand pressure. The low pay rise pressure also contributed to the curbing of inflation. The average annual wage growth in the corporate sector was nominally 3.4% in 2002, i.e. approximately 1.5% in real terms. Changes in monetary aggregates in 2002 did not translate into inflation drivers. M3 money supply fell by 2.3% (M2 by 1.6%).

In 2002, the state budget was under control. The central government budget deficit reached PLN 39.4 billion, i.e. 98.8% of the plan. In relation to the GDP, the deficit grew to 5.1% from 4.3% in 2001. The deficit of the public finance sector grew to approximately 6.7% from 5.0% in 2001.

BASIC MACROECONOMIC INDICATORS

	2002	2001	2000	Change 2002/2001
% change on the previous year				
GDP (real growth)	1.3	1.0	4.0	0.3
Personal consumption	3.3	2.0	2.7	1.3
Gross fixed investment	(7.2)	(8.8)	2.7	(1.6)
Industrial output (real growth)	1.5	(0.1)	6.7	1.6
in %				
Corporate net profitability margins	(0.2)	(0.3)	0.7	(0.9)
Unemployment rate (% , as of December)	18.1	17.4	15.1	0.7
Inflation				
December/December				
Consumer price index (CPI)	100.8	103.6	108.5	2.8
Producer price index (PPI)	102.2	101.6	105.7	0.6
% of the GDP				
Budget deficit	5.1	4.3	2.2	0.8
Current account deficit	3.6	3.9	6.0	(0.3)
in USD million				
Export of goods	32,945	30,275	28,255	8.8%
Import of goods	43,297	41,950	41,423	3.2%
Trade balance	(10,352)	(11,675)	(13,168)	(11.3)%
Current account balance	(6,700)	(7,166)	(9,952)	(6.5)%

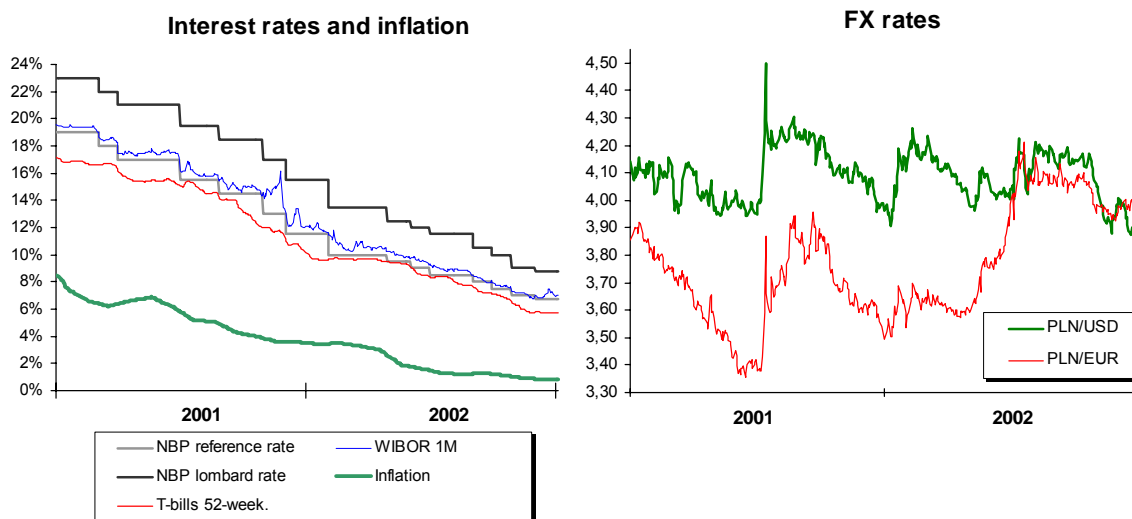
2. The money and FX markets

In view of the strong reduction of inflation pressures and the feeble economic growth, the National Bank of Poland ("NBP") continued the cycle of easing of the monetary policy. In 2002, the Monetary Policy Council cut the basic interest rates seven times; the total reduction was from 4.75 pp (in the case of the reference rate) to 6.75 pp. (for the lombard rate). At the end of 2002, the lombard rate was 8.75%, the rediscounting rate was 7.50%, and the rate for 28-day open market operation (the so-called reference rate) was 6.75%.

In spite of the significant reduction of nominal interest rates, their real level – due to the fall of inflation – was still high, especially in the 2nd half of the year, in comparison to other economies with similar investment risk, which in conjunction with successful completion of accession negotiations, bringing Poland closer to the European Union, contributed to a strong influx of foreign portfolio capital into Poland's financial market, especially to the debt securities market.

The consequence of the reduction of base rates and the sustained expectations of further cuts were rate reductions on the interbank market. The WIBOR declined by nearly 6 percentage points for the shortest rates (O/N, T/N) and by 4.5 percentage points for 1-year rates. The market rates were also under the influence of liquidity-absorbing open market operations carried out by the central bank. The main forms of said operations were basic operations, i.e. tenders for NBP's 28-day money bills performed regularly once a week. In 2002, the balance of those operations decreased significantly (the value of bills sold was PLN 140.5 billion against PLN 204.5 billion in 2001), which indicates reduction, in the operating scale, of the sector's excess liquidity. Apart from the basic operations, the NBP also performed structural operations, i.e. outright sale of converted treasury bills in order to regulate the liquidity of the banking sector in the long run. In 2002, the value of bonds offered to banks was PLN 14 billion against PLN 15.6 billion in 2001.

As in 2001, the relatively high level of real interest rates and expectations of reductions of basic rates were the main stimuli of the exceptionally keen interest in the debt securities market in 2002. In recent months that interest was additionally stimulated by expectations of convergence related to the ever-closer perspective of Poland's accession to the EU. In consequence, the demand for T-bills on the primary market reached the record-breaking level of PLN 145.8 billion and was, on average, 3 times higher than the value of the bills offered, which resulted in strengthened prices and a reduction of profitability. Profitability of the 52-week bills, dominant in supply, decreased in 2002 by over 5 percentage points. The strong downward trend in profitability remained also on the secondary T-bill and bond market.



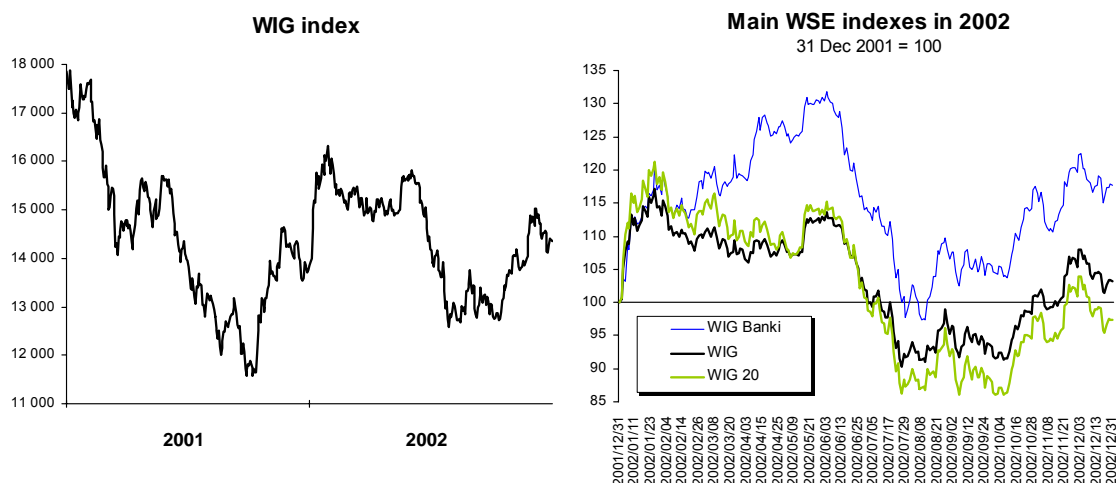
The situation on the Polish currency market was shaped in 2002 by flows of foreign capital, in particular by the influx of portfolio capital to the debt securities market. Consequently, the average nominal PLN to USD exchange rate – 4.0795 PLN/USD – was close to previous year's level (4.0939 PLN/USD). The average PLN/EUR exchange rate grew to 3.8557 PLN/EUR from 3.6685 PLN/EUR, the zloty thus weakened nominally against the euro by 5% under the influence of appreciation in 2002 of the euro against the dollar on foreign currency markets by nearly 6%. A more profound weakening of the zloty was seen at the beginning of July, resulting from an unexpected resignation of the minister of finance, Mr Marek Belka. The appreciation of the zloty was especially evident in the last quarter of 2002 as a result of a wave of foreign portfolio investments, discounting Poland's soon-to-be membership in the European Union.

3. The equity market

2002 was not a good year for stock investors. The promising growing trend in prices of shares quoted on the Warsaw Stock Exchange ("WGPW"), which was intensified in the 4Q 2001 based on expectations of economic recovery, was stopped in the 1st half of 2002 and the market turned bearish in the 3Q. This resulted mainly from poor financial results of the quoted companies and a general weakening of the hope for quick improvement of the economic situation in both the country and abroad. Based on publication of optimistic macroeconomic data, in particular referring to growth of industrial output and retail sales, prices went up in the last months of the year.

As a result, the main exchange index, the WIG, grew from 13,922 points at the end of 2001 to 14,367 points at the end of 2002, i.e. by 3.2%. This was possible due to increases in foodstuffs and bank shares, as reflected by growth of sector sub-indexes, WIG-SPOŻYW and WIG-BANKI, by 29.4% and

17.8%, respectively. On the other hand, shares of telecommunications companies suffered the largest price drops, by 33.4% on average.



2002 was the second year in a row when the exchange saw a significant drop in activity. The total value of transactions performed in 2002 on the stock market was PLN 67.5 billion against PLN 84.5 billion in 2001 (a drop by 20.1%). At the same time, shares turnover became more concentrated. The share of the 10 leading companies, in terms of liquidity, in the total turnover of the stock market grew from 73.2% in 2001 to 79.8% in 2002. The most liquid securities included the shares of TP S.A. (20.7%), Pekao S.A. (15.6%) and PKN Orlen S.A. (15.2% share in turnover). Turnover on the bonds market fell from PLN 5.2 billion in 2001 to PLN 4.1 billion in 2002.

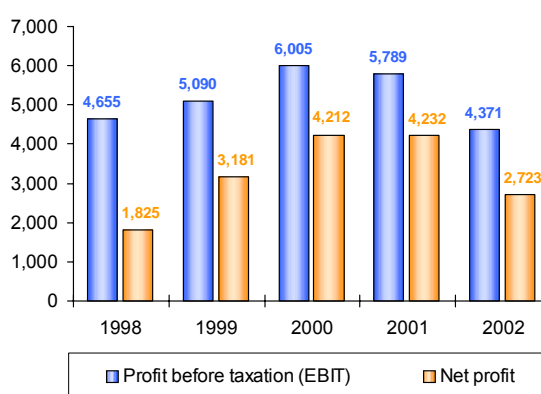
During 2002, the number of listed companies fell from 230 to 216, 18 companies left and 4 were newly listed. In 2002, the total capitalisation of listed companies was PLN 110.6 billion and 7.0% higher than one year before. The largest shares were banks (47.7% as of end of 2002) and telecommunications companies (16.4%).

2002 was very difficult for brokerage houses that, due to diminishing stock turnover, felt a strong pressure to reduce operating income. The brokerage houses were forced to significantly cut costs, and several institutions were acquired by stronger players. As a result, the number of brokers fell from 30 to 24.

4. The banking sector

Year 2002 was an exceptionally difficult period for the banking sector. The net profit earned by banks amounted to a mere PLN 2.7 billion and was 38% lower than in 2001, and the three top-10 commercial banks in terms of assets announced net losses totalling PLN 1.0 billion. The decrease in profitability of the banking sector was mostly the effect of the growth of costs related to specific provisions connected with deterioration of assets quality, especially corporate loan portfolios. In this context, the collapse of Stocznia Szczecińska S.A. (the Szczecin shipyard), the leading company of the shipyard holding, had especially painful

Financial results of the banking sector
NBP data, PLN million

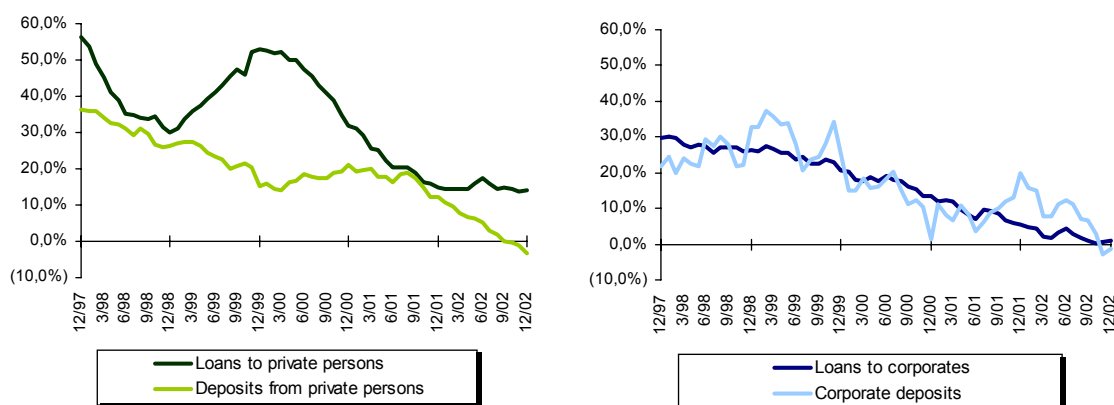


consequences for the sector for which credit exposure amounted to approximately PLN 1.4 billion. The total value of net write-offs for specific provisions and revaluation of financial assets in 2002 amounted to PLN 6.1 billion (an increase of 21% against 2001), of which PLN 0.8 billion were the provisioning costs related to the said exposure to Stocznia Szczecińska. At the end of 2002, the share of problem loans in the total gross loan portfolio of commercial banks was 21.4% (against 18.6% at the end of 2001), and the share of problem loans in the corporate portfolio and household portfolio was 24% and 15%, respectively.

The pressure on the interest margin, a consequence of the reduction of interest rates and the growth of the share of non-serviced receivables, as well as the insufficient growth of business volumes, made the profit on banking activity (PLN 29.0 billion) was not different from the 2001 figure. The income stagnation could not have been counteracted by adjustment of operating expenses, which grew by 3%.

Basic business volumes in the banking sector

(year-on-year growth)

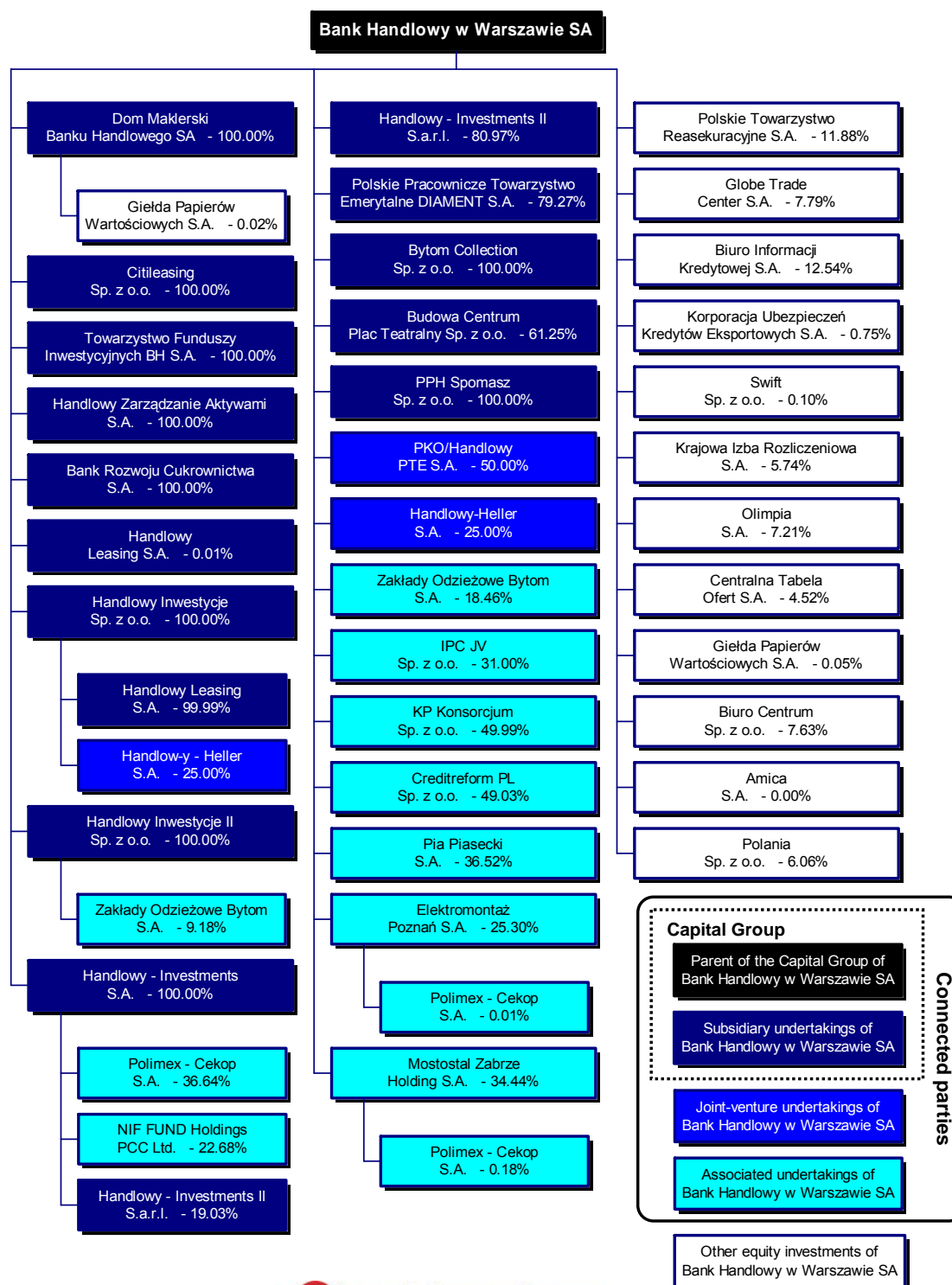


In 2002, the propensity to save among individuals dropped significantly and was reflected in a decrease of deposits by PLN 6.8 billion or 3.2% (against a growth of 12.1% in 2001). That was mainly an effect of the diminishing attractiveness of bank deposits – related to the interest rate cuts and introduction at the end of 2001 of a tax on interest income on bank deposits – as well as consumers' tendency to maintain the previous expenditure level in a situation of growing unemployment and a low wages growth rate. Additionally, those factors also sparked the growth of the share of demand deposits and a flow of part of the funds towards alternative saving or investment instruments (e.g. investment funds). In order to counterbalance the negative influence of the decrease in propensity to save on the deposit base, a few banks conducted bond issuance. As of 31 December 2002, the value of the banks' debt securities held by non-bank entities was PLN 1.78 billion, i.e. PLN 1.54 billion higher than at the end of 2001. The growth of loans to private persons in 2002 was at more or less the same level as in 2001 and amounted to 14.2%.

Reduction of investments, lack of profitability improvements (hence lack of credit capacity) and more restrictive credit policies of banks in response to the growing amount of bad debts contributed to a further slowdown of credits to business entities. Loans to this group of customers grew in 2002 by a mere 0.8% against 5.3% in 2001. Corporate deposits fell by 1.4% but that was rather the effect of a temporary growth of deposits in December 2001.

II. Organisational structure of the Bank's equity investments

The organisational structure of the equity portfolio held by Bank Handlowy w Warszawie SA ("the Bank"), as per percentage ownership of the capital on December 31, 2002, can be illustrated by the following chart:



III. Organisational structure of the Capital Group of Bank Handlowy w Warszawie SA

The Capital Group of Bank Handlowy w Warszawie S.A. ("the Group") is comprised of the **parent entity** and **subsidiary undertakings**:

Name of entity	Activity	Capital relationship	% of authorised capital owned	Accounting method	Own equity (PLN thousand)
Bank Handlowy w Warszawie SA	banking	parent	-	-	5,969,109*
Dom Maklerski Banku Handlowego S.A.	brokerage	subsidiary	100.00%	full consolidation	78,121
Handlowy Leasing S.A.	leasing	subsidiary	100.00%**	equity accounting	n.a.
Citileasing Sp. z o.o.	leasing	subsidiary	100.00%	equity accounting	141,029
Handlowy Inwestycje Sp. z o.o.	special purpose investment vehicle	subsidiary	100.00%	equity accounting	29,381
Handlowy Inwestycje II Sp. z o.o.	special purpose investment vehicle	subsidiary	100.00%	equity accounting	18,686
Handlowy Investments S.A.	special purpose investment vehicle	subsidiary	100.00%	equity accounting	6,333
Handlowy Investments II S.a.r.l.	special purpose investment vehicle	subsidiary	100.00%**	equity accounting	16,730
Handlowy Zarządzanie Aktywami S.A.	asset management	subsidiary	100.00%	equity accounting	4,806
Towarzystwo Funduszy Inwestycyjnych Banku Handlowego S.A.	investment fund company	subsidiary	100.00%	equity accounting	9,796
Bank Rozwoju Cukrownictwa S.A.	banking	subsidiary	100.00%	equity accounting	36,654
Polskie Pracownicze Towarzystwo Emerytalne DIAMENT S.A.	insurance	subsidiary	79.27%	equity accounting	894
Budowa Centrum Plac Teatralny Sp. z o.o. under liquidation	construction	subsidiary	61.25%	accounted at cost net of provisions for any permanent diminution in value	under liquidation
PPH Spomasz Sp. z o.o. under liquidation	manufacturing of trade and food production equipment	subsidiary	100.00%	accounted at cost net of provisions for any permanent diminution in value	under liquidation
Bytom Collection Sp. z o.o.	clothing	subsidiary	100.00%	accounted at cost net of provisions for any permanent diminution in value	1,122

* The capital of Bank Handlowy as reported in the unconsolidated financial statements for the year 2002.

** Including indirect interests held through other subsidiary entities.

1. Changes in the structure of the Capital Group of Bank Handlowy w Warszawie SA

The following transactions affected the structure of Capital Group of Bank Handlowy SA in 2002:

- purchase of additional shares in Bank Rozwoju Cukrownictwa S.A. („BRC”), as a result of which the Bank’s share in BRC increased from 95.77% to 100.00% of the capital and from 86.49% to 100.00% of the votes in the General Meeting of Shareholders; increase in the shares in BRC was connected with the planned sale (liquidation) of the company,
- taking possession by the Bank on June 3, 2002 of 6,000 shares in Bytom Collection Spółka z o.o. with a seat in Radzionków. The nominal value of the shares was PLN 3 million. The Bank took possession of the shares in lieu of a part of a matured and unpaid loan taken by Z.O. Bytom S.A., on the basis of an agreement signed by the Bank with ZO Bytom SA in 2001 establishing a registered pledge on these shares. As a result of the Bank becoming on June 3, 2002 the sole shareholder of Bytom Collection Spółka z o.o., now holding 6,008 shares of the company, it became a subsidiary of the Bank,
- disposal on March 26, 2002 of all shares in Cuprum Bank S.A. to Dominet S.A. owned by Merrill Lynch Global Emerging Markets Partners L.P. Prior to the transaction the Bank had a 55.26% interest in the capital of Cuprum Bank S.A., which gave it the right to 50.20% of votes at the General Meeting of Shareholders,
- disposal of the whole shareholding, constituting a 50.30% interest in Tower Service Sp. z o.o.,
- disposal on April 26, 2002 of 87,741 shares in Bank Handlowy International S.A. in Luxembourg („BHI”). The transfer of rights to the shares took place on May 6, 2002. The shares subject to the transaction represented 73.12% of share capital and gave the holder the right to exercise 73.12% votes at the General Meeting of Shareholders of BHI.

2. Changes in the structure of other connected parties

The following transaction resulted in changes in the structure of joint-venture and associated undertakings in 2002:

- disposal of the whole investment in Obsługa Funduszy Inwestycyjnych Sp. z o.o., representing a 50.00% share in the capital and entitling to 50.00% of votes in the General Meeting of Shareholders
- disposal of the whole shareholding in Polska Giełda Finansowa S.A., constituting a 22.90% interest in the company,
- disposal on September 19, 2002 of all shares (i.e. 31.09%) in Hortex Holding S.A., held together with Handlowy Investments SA, to BankAmerica International Investment Corporation.

3. Changes in the consolidation and equity accounting scope

Following the provisions of the newly amended Accounting Act and the resolution of the Minister of Finance of 12 December 2001 on preparation of the consolidated financial statements by banking

institutions and financial groups, the list of the subordinated undertakings of Bank Handlowy w Warszawie SA accounted for under the equity method has been enlarged. Since the beginning of 2002 the Capital Group of Bank Handlowy w Warszawie SA has applied the equity method for accounting for the following entities: subsidiary entities Handlowy Leasing S.A., Citileasing Sp. z o.o., Handlowy Zarządzanie Aktywami S.A., Polskie Pracownicze Towarzystwo Emerytalne „DIAMENT” S.A., Towarzystwo Funduszy Inwestycyjnych BH S.A., Bank Rozwoju Cukrownictwa S.A., financial joint-venture Handlowy Heller S.A. and financial associated subsidiary KP Konsorcjum Sp. z o.o. The equity accounting for interest held in non-financial associated undertaking Polimex-Cekop S.A. has been effective since the parent entity's unconsolidated financial statements for the year 2002.

The list of joint-venture and associated entities, excluded from the Capital Group but accounted for under the equity method, is presented below:

Name of entity	Activity	Capital relationship	% of authorised capital owned	Accounting method	Own equity (PLN thousand)
Handlowy-Heller S.A.	factoring	joint-venture	50.00%*	equity accounting	19,766
PKO/Handlowy Powszechnie Towarzystwo Emerytalne S.A.	pension fund	joint-venture	50.00%	equity accounting	30,260
KP Konsorcjum Sp. z o.o.	investment fund management	associated undertaking	49.99%	equity accounting	9,767
Polimex-Cekop S.A.	construction	associated undertaking	36.82%*	equity accounting	89,518

* Including indirect interests held through other subordinated entities.

IV. Financial results of the Capital Group of Bank Handlowy w Warszawie SA

1. Synthetic financial data of the Capital Group for the last years

PLN million	1997	1998	1999	2000	2001	2002
Assets	17,054.7	17,801.0	19,117.3	20,946.2	33,081.1	32,161.8
Own equity*	2,066.4	2,585.4	2,822.4	2,974.4	5,673.2	5,722.5
Profit on banking activity	1,347.2	1,192.3	1,254.2	1,476.6	2,052.8	2,117.4
Profit before taxation	861.3	493.9	531.3	196.7	386.5	359.1
Net profit	584.4	326.1	347.7	182.3	163.3	239.4

*Excluding net profit for the current period.

2. Financial results of the Capital Group in 2002

2.1 Income statement

In 2002, the Group generated a consolidated net profit of PLN 239.4 m, i.e. higher by PLN 76.2 m or 46.6% than in 2001.¹ The growth of net financial result for 2002 was the combined effect of the following factors:

- increase in the profit on banking activity by PLN 64.6 m
- growth of general expenses by PLN 37.1 m
- increase in net provisioning charges by PLN 18.2 m
- decrease in the income tax reported in the income statement by PLN 59.7 m
- increase in the participation in net profit (loss) of the subordinated entities accounted for under the equity method by 43.8 m.

INCOME STATEMENT

PLN '000	2002	2001	Change	
			PLN '000	%
Interest income	1,775,366	2,680,851	(905,485)	(33.8%)
Interest expense	(1,088,136)	(1,952,914)	864,778	(44.3%)
Net interest income	687,230	727,937	(40,707)	(5.6%)
Net fee and commission income	519,265	498,650	20,615	4.1%
Income on shares, other securities and other financial instruments with variable income securities	7,933	25,406	(17,473)	(68.8%)
Gains on financial operations	389,967	17,305	372,662	2153.5%
Foreign exchange profit	512,981	783,468	(270,487)	(34.5%)
Profit on banking activity	2,117,376	2,052,766	64,610	3.1%
Other operating income	68,091	81,368	(13,277)	(16.3%)
Other operating expenses	(39,920)	(30,509)	(9,411)	30.8%
General expenses	(1,102,008)	(1,064,945)	(37,063)	3.5%
Depreciation and amortisation	(163,520)	(161,588)	(1,932)	1.2%
Goodwill depreciation	(72,445)	(60,371)	(12,074)	20.0%
Net movement in provisions	(448,441)	(430,282)	(18,159)	4.2%
Operating profit	359,133	386,439	(27,306)	(7.1%)
Extraordinary items	1	13	(12)	(92.3%)
Profit before taxation	359,134	386,452	(27,318)	(7.1%)
Corporate income tax	(127,949)	(187,646)	59,697	(31.8%)
Participation in net profit/(loss) of subordinated entities accounted for under the equity method	8,258	(35,520)	43,778	(123.2%)
Net profit	239,443	163,286	76,157	46.6%

¹ The Group's income statement for 2001 does not include the income statement of Citibank (Poland) S.A. for the period January-February 2001, i.e. prior to the merger of Bank Handlowy w Warszawie SA and Citibank (Poland) S.A., hindering any direct comparability between the Group's financial results reported for 2001 and 2002. The financial result of Citibank (Poland) S.A. for January and February 2001 was included into the settlement of the merger made under the purchase method.

Relatively small difference between the consolidated net profit of the Capital Group (PLN 239.4 m) and the unconsolidated net profit of Bank Handlowy w Warszawie S.A. (PLN 242.7 m) was attributable to the application of the equity accounting for investments in subordinated undertakings reported in the unconsolidated financial statements of the Bank.

2.1.1 Profit on banking activity

The main factor that contributed to the growth of the Group's profit on banking activity in 2002 was the gains on financial operations, which amounted to PLN 390.0 million in comparison to PLN 17.3 million in 2001. The 2002 gains on financial operations consisted of the following factors:

- income on financial instruments in the amount of PLN 225.5 m including income on swaps, FRA transactions, options and other derivatives.
- income from sale or revaluation of debt securities in the amount of PLN 168.4 m; growth of this position reflects the expansion of the Group's activity on the treasury debt securities market and the increase in prices of those securities, resulting from the interest rate cuts in 2002.
- loss on minority holdings (dividends and sales result), as well as other financial operations, totalling PLN 4.0 m; this includes the result from the sale of shareholdings of Mitteleuropäische Handelsbank AG, Hortex Holding S.A. and Bank Handlowy International S.A. as well as dividend payments received by Dom Maklerski Banku Handlowego S.A.

In 2002, the Group saw a drop in net interest income by 5.6%, down to PLN 687.2 m, driven by the following phenomena:

- lower level of market interest rates, impacting the volume of interest income from the so-called free interest position, i.e. the interest-earning assets financed with non-interest bearing liabilities (including, in particular, capital funds); in the case of Bank Handlowy w Warszawie SA, this income is of importance due to the high level of the Bank's own capital; the average free interest position of the Bank in 2002 was approximately PLN 2.9 billion.
- narrowing of the interest margin – the difference between interest rate for a given item of interest assets/liabilities and the Bank's internal reference rate based on a relevant interbank rate (WIBOR, LIBOR) – related to the interest rate cuts and growth of competitiveness in the banking sector; the largest drop was for funds maintained by customers on current accounts.
- drop in profitability of interest assets in relation to smaller exposure of the Bank to loan receivables from the non-financial sector in favour of investing funds into more secure, but nominally less profitable, instruments, i.e. interbank placements and debt securities issued by the government and the NBP.
- drop in interest revenue from customers from the non-financial sector (mainly corporate sector) in relation to the deterioration of quality of the Bank's credit portfolio; this phenomenon is reflected by the increase in the balance sheet amount of interest overdue counterbalanced by a concurrent increase in the income in suspense on the liability side of balance sheet.

In comparison to 2001, the fee and commission income grew by 4.1% to PLN 519.3 m, which was driven by growth of commissions for issuance and use of credit and payment cards, increase in fees earned from the *SpeedCollect* service (mass payment settlements), growth of income from transfer fees, growth of commission on loans and reduction of costs related to fees and commissions.

FEE AND COMMISSION INCOME

PLN '000	2002	2001	PLN '000	Change %
Fee and commission income on banking activities	530,357	523,617	6,740	1.3%
Fee and commission income on brokerage activities	21,548	28,013	(6,465)	(23.1%)
Fee and commission income	551,905	551,630	275	0.0%
Fee and commission expense	(32,640)	(52,980)	20,340	(38.4%)
Net fee and commission income	519,265	498,650	20,615	4.1%

2.1.2 Expenses

OPERATING EXPENSES

PLN '000	2002	2001	Change PLN '000	%
Salaries	407,715	394,307	13,408	3.4%
Social security and other benefits	81,851	93,697	(11,846)	(12.6%)
Total personnel expenses	489,566	488,004	1,562	0.3%
Administrative expenses	542,500	530,180	12,320	2.3%
Taxes and fees	8,845	5,593	3,252	58.1%
Contributions and payments to the Bank Guarantee Fund	8,638	16,168	(7,530)	(46.6%)
Total general expenses	1,049,549	1,039,945	9,604	0.9%
Depreciation	163,520	161,588	1,932	1.2%
Total operating expenses	1,213,069	1,201,533	11,536	1.0%
Restructuring charge – for personnel costs	29,332	-	29,332	---
Restructuring charge – for material costs	23,127	-	23,127	---
Reserve for retirement severance pay and jubilee bonuses	-	25,000	(25,000)	(100.0%)
Total expenses	1,265,528	1,226,533	38,995	3.2%

In 2002, the Group continued execution of the programme of intensive cost restructuring, adopted after the merger with Citibank (Poland) S.A.² The programme consisted of the following projects:

- staff reductions, due to the centralisation of operations, unification of IT systems and elimination of overlapping positions after the merger of Bank Handlowy w Warszawie SA with Citibank (Poland) S.A.,
- limitation of growth of wages by reducing the average wage raise rate in comparison to 2001 and postponing of introduction of the raises by a quarter,
- renegotiating of the Company Collective Work Agreement and restructuring of employee benefits,
- restructuring of the branch network and the Bank's head office in order to optimise the use of real estate property and office space,
- restructuring of use of movable fixed assets and equipment (e.g. the fleet of company cars, telecommunications equipment),

² See footnote No. 1 on page 13.

- outsourcing,
- day-to-day cost discipline.

Implementation in 2002 of a savings programme allowed the Group to adapt the operating costs growth to that of the revenues, as measured by income on banking activity, and so to maintain the cost efficiency ratios at constant level in comparison to the previous year.

As a result of continuation of the employment restructuring process and the sale of a number of subsidiary undertakings, the Group's staff (as measured by the average number of full time equivalents) was reduced from 6,203 in 2001 to 5,469 in 2002. In 2002, the average staffing at the Bank was 4.882 FTEs. The second largest entity in terms of staffing was the subsidiary company Bytom Collection Sp. z o.o. (368 FTEs) with Dom Maklerski Banku Handlowego SA coming third (84 FTEs).

In 2002, the President of the Bank's Management Board signed on behalf of the Bank the Company Collective Work Agreement negotiated with the trade unions, thanks to which the staff hiring and compensation principles as well as principles for other work-related benefits have been unified. The new collective agreement has been in force effective August 1, 2002.

In December 2002, the Group created an additional reserve for the costs of restructuring in the amount of PLN 52.5 m, including PLN 29.3 million for the costs of the last stage of the employment restructuring in the process of integration of the Bank with Citibank (Poland) S.A., scheduled for the 1Q 2003, as well as PLN 23.1 million for costs of further restructuring of the Bank's branch network.

In 2002, the Group amortised goodwill as a result of the settlement of the merger with Citibank (Poland) S.A. using the purchase method, in the amount of PLN 72.4 m. The increase of PLN 12.0 million against 2001 resulted from extension of the amortisation period in 2002 by 2 months. According to the decision of the Bank's Management Board, the goodwill is to be amortised using the straight-line method over 20 years effective March 1, 2001.

2.1.3 Provisioning charges

In 2002, the total net movement in provisions and valuation allowances increased by PLN 18.2 million in comparison to 2001. The growth was the result of the increase in specific provisions for credit risk attributable to the deterioration of the quality of loan portfolio held by the Group's parent entity.

NET CHARGES TO PROVISIONS

PLN '000	2002	2001	Change:	
			PLN '000	%
Specific provisions	359,703	363,459	(3,756)	(1.0%)
- financial institutions	18,048	(14,441)	32,489	(225.0%)
- non-financial sector	320,617	278,704	41,913	15.0%
- subordinated loans	10,410	29,447	(19,037)	(64.6%)
- off-balance sheet contingent liabilities	15,048	69,911	(54,863)	(78.5%)
General risk provision	-	50,000	(50,000)	(100.0%)
Valuation allowances for permanent diminution in value of financial assets	84,318	90,352	(6,034)	(6.7%)
Total net charges to provisions	444,021	503,811	(59,789)	(11.9%)

Another significant item under provision costs were valuation allowances for permanent diminution in value of financial assets amounting to PLN 84.3 m. This was mainly the result of write-offs

revaluating the Bank's shares in three associated companies in the construction services sector totalling PLN 84.4 m.

2.1.4 Accounting for subordinated entities

In 2002, the Group's net profit increased by PLN 8.3 million by virtue of the accounting for long-term major shares in subsidiaries, using the equity method. This amount was reflected in the income statement under „Participation in net profit/(loss) of subsidiaries accounted for under the equity method” item and comprised of valuations of the following entities: Handlowy Leasing S.A., Citileasing Sp. z o.o., Handlowy Zarządzanie Aktywami S.A., Towarzystwo Funduszy Inwestycyjnych BH S.A., Handlowy Inwestycje Sp. z o.o., Handlowy Inwestycje II Sp. z o.o., Handlowy Investments S.A., Handlowy Investments II S.a.r.l., Bank Rozwoju Cukrownictwa S.A., Polskie Pracownicze Towarzystwo Emerytalne DIAMENT S.A., PKO/ Handlowy PTE S.A., Handlowy-Heller S.A., KP Konsorcjum Sp. z o.o.

2.2 Balance sheet

As of December 31, 2002, the Group's balance sheet total was PLN 32,162 million and was lower by 2.8% than at the end of 2001. The value and composition of the consolidated balance sheet is driven mainly by the balance sheet of the parent entity, i.e. Bank Handlowy w Warszawie SA.

2.2.1 Assets

The main components were receivables from the non-financial sector, which at the end of 2002 amounted to PLN 13,544 m. The following factors contributed to decrease those receivables by PLN 660.4 m, i.e. by 4.6% in comparison to the end of 2001:

- reduction of gross loans to the non-financial sector by PLN 567.4 m, i.e. by 3.8%, mainly as a result of lower demand for loans from corporate entities and a more restrictive credit policy of the Bank,
- growth of provisions for receivables from the financial sector by PLN 267.6 m, i.e. by 24.3%, related to a deterioration the loan portfolio quality,
- growth of interest due by PLN 174.6 m, i.e. by 48.8%, chiefly as a result of the growth of interest overdue on problem loans.

Given the overall limited credit activity, the significance of debt securities grew. Although these instruments were characterised by a nominal interest rate lower, on average, than that of loans, they were more attractive due to a much better profile of the credit risk. Additionally, the profitability of debt securities was under the beneficial influence of market interest rate cuts, which stimulated the growth of prices of those securities and allowed the Group to earn relatively high revenue on sale or valuation of such securities. Aiming to reap the benefits of the opportunities on the debt securities market, the Group increased its debt securities portfolio from PLN 2,410 million at the end of 2001 to PLN 4,296 million at the end of 2002. The treasury bonds portfolio grew over 9 times, from PLN 340 million to PLN 3,101 m, which was related to higher attractiveness of debt securities with longer terms.

The growth of the Group's exposure to the debt security market in 2002 was at the expense of placements in financial institutions which were reduced from PLN 7,023 million to PLN 4,576 m, i.e. by 34.8%.

In comparison to the end of 2002, the amount due from subordinated undertakings accounted for under the equity method has increased significantly. It was the result of the extension of equity accounting – especially on the Group’s leasing subsidiaries financed with loans and credit lines drawn from Bank Handlowy w Warszawie SA. At the end of 2002, the Bank’s receivables from Handlowy Leasing S.A. and Citileasing Sp. z o.o. amounted to PLN 832.7 million. In comparison, at the end of 2001 the corresponding amount stood at PLN 706.3 million and was reported as due from the financial sector.

CONSOLIDATED BALANCE SHEET - ASSETS

PLN '000	As of		Change	%
	31/12/2002	31/12/2001	PLN '000	
Cash, operations with the central bank	979,308	2,322,443	(1,343,135)	(57.8%)
Due from the financial sector	4,575,967	7,022,503	(2,446,536)	(34.8%)
Due from the non-financial sector	13,543,990	14,204,392	(660,402)	(4.6%)
Due from the public sector	5,381	31,750	(26,369)	(83.1%)
Debt securities*	4,296,470	2,410,113	1,886,357	78.3%
Due from subordinated undertakings accounted for under the equity method*	1,037,040	228,642	808,398	353.6%
Equity investments in subordinated undertakings accounted for under the equity method	289,078	76,512	212,566	277.8%
Other equity investments	69,476	425,995	(356,519)	(83.7%)
Other securities and financial assets	4,527,450	3,400,742	1,126,708	33.1%
Intangible assets	1,377,688	1,454,530	(76,842)	(5.3%)
- including: goodwill	1,316,091	1,388,536	(72,445)	(5.2%)
Tangible fixed assets	817,205	915,392	(98,187)	(10.7%)
Other assets	642,702	588,103	54,599	9.3%
TOTAL ASSETS	32,161,755	33,081,117	(919,362)	(2.8%)

* Convertible bonds of Handlowy Investments have been reclassified and are shown as "Due from subordinated undertakings accounted for under the equity method".

2.2.2 Liabilities

Traditionally, the largest item that finances the Group’s assets are customers’ deposits, including liabilities to the non-financial sector and the public sector. As of the end of 2002, the total value of these items was PLN 16,733 million and was lower than in the previous year by 3.5%. That largest fall was noted in liabilities to the public sector, which decreased by 27.9%.

Effective 2001, the share of the financial sector deposits in the Group’s liabilities has been decreasing. A sufficient base of customers’ deposits and limitation of credit activity allowed the Group to limit financing with relatively expensive deposits from the financial sector, in particular from banks. As at the end of 2002, the balance of deposits from the financial sector amounted to PLN 3,114 million, in comparison to PLN 4,849 million at the end of 2001.

In comparison to the end of 2002, the share of own capital in the Group’s balance sheet has grown slightly. The large share of own capital in the Group’s balance sheet total (17.8%) is to a large extent the result of the merger with Citibank (Poland) S.A.

An important phenomenon on both sides of the Group’s balance sheet is the growth of unrealised profits/losses from operations involving derivative instruments, which reflects the significant growth of off-balance sheet purchase/sale operations. According to the current accounting regulations, balance sheet valuations of those instruments are presented under item "Other securities and other financial assets" under assets and under "Other liabilities arising from financial instruments" item on the liability side of the balance sheet.

CONSOLIDATED BALANCE SHEET – LIABILITIES AND EQUITY

PLN '000	As of		Change	
	31/12/2002	31/12/2001	PLN '000	%
Due to the Central Bank	121,940	212,486	(90,546)	(42.6%)
Due to the financial sector	3,113,905	4,849,003	(1,735,098)	(35.8%)
Due to the non-financial sector	16,096,440	16,455,339	(358,899)	(2.2%)
Due to the public sector	636,642	883,219	(246,577)	(27.9%)
Due from subordinated undertakings accounted for under the equity method	280,014	79,272	200,742	253.2%
Other liabilities arising from financial instruments	4,182,578	3,221,513	961,065	29.8%
Other liabilities	1,315,886	1,110,803	205,083	18.5%
Provisions	452,454	432,972	19,482	4.5%
Equity and retained earnings	5,722,453	5,673,224	49,229	0.9%
Net profit	239,443	163,286	76,157	46.6%
TOTAL LIABILITIES AND EQUITY	32,161,755	33,081,117	(919,362)	(2.8%)

2.3 Capital and capital adequacy

CONSOLIDATED CAPITAL FUNDS COMPOSITION

PLN '000	As of		Change	
	31/12/2002	31/12/2001	PLN '000	%
Authorised capital	500,902	430,308	70,594	16.4%
Capital surplus	3,067,344	3,059,638	7,706	0.3%
Reserve capital	1,662,469	1,615,759	46,710	2.9%
Revaluation reserve	45,968	76,958	(30,990)	(40.3%)
General risk fund	390,000	390,000	-	-
Other supplementary capital*	21,736	92,330	(70,594)	(76.5%)
FX difference on translation of subsidiary undertakings	-	8,231	(8,231)	(100.0%)
Profit (loss) of the previous years	34,034		34,034	---
Total capital	5,722,453	5,673,224	49,229	0.9%
Core capital	5,654,749	5,495,705	159,044	2.9%
Supplementary capital	67,704	177,519	(109,815)	(61.9%)

* Special Participating Convertible Bonds

In 2002 the Group's capital funds rose by PLN 49,229 thousand. The most important changes in the value of the Group's capital are accounted for by:

- the revaluation, as of December 31, 2001, of shares and holdings in subordinated entities accounted for under the equity method; the positive result of that revaluation in the amount of PLN 33,895 thousand was reflected as an adjustment to the opening balance of previous years' profit (loss),
- the revaluation, as of December 31, 2001, of debt securities available for sale by the amount of PLN 19,418 thousand; the revaluation result was reflected as an adjustment to the opening balance of the revaluation reserve
- a decrease of the revaluation reserve by PLN 4,046 thousand, which arose on the revaluation of the available-for-sale debt securities in 2002,

- an increase in reserve capital by PLN 312 thousand resulting from the distribution of the parent entity profits for 2001. The rest of that year's profits in the amount of PLN 163,324 thousand was paid out in dividends to shareholders and holders of Special Participating Convertible Bonds.

During the period, changes took place in capital structure, including:

- increasing the authorised capital equity by PLN 70,594 thousand through a share conversion of 17,648,500 Special Participating Convertible Bonds owned by the Bank's majority shareholder, Citibank Overseas Investment Corporation ("COIC"). The increase of the authorised capital was registered on May 24, 2002.
- transfer of the amount of PLN 46,362 thousand from the revaluation reserve to reserve capital in relation to the sale of fixed assets.

Overall, as at December 31, 2002 the parent entity's share in total capital of the Polish banking sector stood at 13.7% as compared to 14.2% at the end of 2001, which placed it second in terms of capital among all Polish banking institutions. The level of the Bank's capital was more than sufficient to secure the financial stability of the institution and of the deposits accepted by it.

Pursuant to the amended Banking Act and the Resolution no. 5/2001 of the Commission for Banking Supervision, since the beginning of 2002 the Group has started to calculate the consolidated capital adequacy ratio. On December 31, 2002 this ratio reached 18.76%.

CONSOLIDATED CAPITAL ADEQUACY RATIO

PLN '000	31/12/2002
Total capital funds	5,722,453
Deductions, of which:	702,627
- goodwill	394,827
- other intangible fixed assets	18,479
- equity investments in subordinated financial institutions	273,948
- other deductions	15,373
Capital eligible for the calculation of the capital adequacy ratio	5,019,826
 Risk-weighted assets and contingent liabilities	 21,581,669
 Total capital requirement, of which:	 2,140,352
- capital requirement for credit risk	1,726,534
- total capital requirements for market risk	413,819
Capital adequacy ratio*	18.76%

* Risk-weighted assets and contingent liabilities include the banking portfolio only.

3. Shareholders holding a minimum 5% of the parent entity authorised capital and of total voting rights at the General Meeting of Shareholders

At December 31, 2002, the only shareholder holding a minimum 5% of the Bank's authorised capital and of total voting rights at the General Meeting of Shareholders was Citibank Overseas Investment Corporation, New Castle, USA ("COIC"), a subsidiary of Citibank N.A., which then held 116,717,574 shares of the Bank, i.e. 93.2% interest in the Bank's authorised capital entitling it to exercise 93.2% votes at the General Meeting of Shareholders. In 2002, the holding of COIC increased as a result of the following transactions:

- the purchase of 376,650 ordinary series C bearer shares from Centaur Investment Corporation and 376,650 ordinary series C bearer shares from Foremost Investment Corporation. Both these companies were members of Citigroup.
- the conversion of 17,648,500 Special Participating Convertible Bonds into ordinary series B bearer shares.

V. Operations of the Group in 2002

1. Bank Handlowy w Warszawie SA – parent entity

1.1 Lending and other credit risk exposures

1.1.1 Lending

Lending to non-bank customers (gross)

PLN '000	As at:		Change:	
	31/12/2002	31/12/2001	PLN '000	%
Loans in PLN	10,604,932	10,802,085	(197,153)	(1.8%)
Loans in foreign currencies	4,900,307	5,022,046	(121,739)	(2.4%)
Total	15,505,239	15,824,132	(318,893)	(2.0%)
Loans to non-financial customers	14,344,867	14,903,849	(558,982)	(3.8%)
Loans to financial institutions	1,155,708	891,297	264,411	29.7%
Loans to public sector	4,664	28,986	(24,322)	(83.9%)
Total	15,505,239	15,824,132	(318,893)	(2.0%)
Non-financial corporate customers	12,874,634	13,382,300	(507,666)	(3.8%)
Non-bank financial institutions	1,155,708	891,297	264,411	29.7%
Individual customers	1,365,152	1,385,737	(20,585)	(1.5%)
Other non-financial entities	105,081	135,813	(30,732)	(22.6%)
Public sector	4,664	28,986	(24,322)	(83.9%)
Total	15,505,239	15,824,132	(318,893)	(2.0%)

Gross loans excluding accrued interest.

In 2002 the Bank's total loan portfolio decreased by PLN 318,9 million, or 2.0%, which means that with the increase in the loan portfolio of other Polish banks, mainly due to consumer loans, the Bank's market share dropped from 7.1% to 6.7%. The size of the Bank's portfolio placed it fifth among all Polish banks.

The drop in loans to non-financial corporate customers, the largest component of the total loan portfolio, was most striking. The halting of loan growth to the corporate of customers may be attributed to the following factors:

- the general fall in demand for loans on the part of corporate customers as a result of the economic slowdown, low profitability of operations and postponement of large investments pending the expected economic recovery;
- the lowering of the Bank's appetite for credit risk, which was primarily a result of its aim to improve the quality of the loan portfolio;

- the active reduction by the Bank of its credit exposure to certain customers whose financial situation of which signalled the possibility of a loan default.

The contraction of the portfolio of loans granted to non-financial corporate customers was to a certain degree offset by the 29.7% growth of loans extended to non-bank financial institutions, mainly on account of the increase in loans extended to leasing companies, in particular to those belonging to the Bank's Capital Group.

In 2002, the Bank remained an active player in the syndicated loan market, which unfortunately experienced a decline due to a drop in investments. Overall, the volume of large syndicated loans taken by Polish corporate entities in 2002 amounted to PLN 9.4 billion (of which PLN 5.6 billion came from domestic banks) compared to over 13 billion in 2001. The Bank's exposure to new contracts dropped from PLN 586.2 million in 2001 to PLN 348.3 million in 2002. The largest syndicated transactions in which the Bank participated over the reported period included:

- the EUR 170 million facility refinancing loans taken by Polskie Sieci Elektroenergetyczne S.A. (Polish Power Grid Co.) to finance its operations in the energy sector and the telecommunication sector; the Bank acted as co-arranger with own participation of EUR 35 million;
- the EUR 202.5 million facility for Polskie Koleje Państwowe S.A. (Polish Railroads Co.); the Bank acted as co-arranger with own participation of EUR 18.2 million;
- the PLN 79 million facility for Telbank S.A. (telecom company) to finance the construction of a fibre optic telecom line network; the Bank was the sole arranger with own participation of PLN 49 million;
- the facility equivalent to PLN 1,423 million (CHF 268 million and EUR 174.5 million) for Telefonika KFK SA (wire manufacturer) to finance the consolidation of the company's capital group and for investments in a cable factory; the Bank participated in the consortium with a share of CHF 31.5 million.

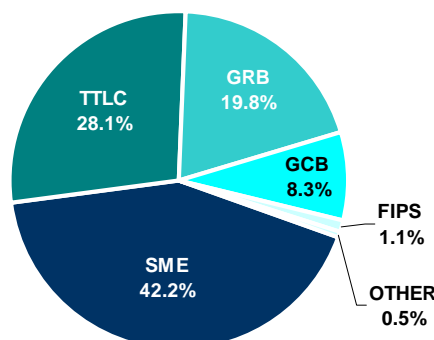
In 2002 the Bank's portfolio of loans to individual customers diminished by 1.5% on account of:

- stricter credit procedures being applied to potential new borrowers, especially self-employed individual customers; the aim was to improve the quality of the loan portfolio and this had an indirect influence over contraction of consumer and discounted loan portfolio;
- the Bank's relatively weak position in the mortgage loan market, which is now experiencing the highest growth.

At the same time, indebtedness on *Citibank* credit cards used by individual customers increased in 2002 by PLN 155 million (25.9%) achieving PLN 752.6 million.

Overall, the Bank's share in the consumer loan market dropped from 2.5% at the end of 2001 to 2.2% at the end of 2002.

Gross loan portfolio by customer segments
31/12/2002



SME - Small and Medium Enterprises
 TTLC - Top Tier Local Companies
 GRB - Global Relationship Banking
 GCB - Global Consumer Banking
 FIPS - Financial Institutions and Public Sector
 OTHER - Other non-segmented customer receivables

In 2002 the share of loans denominated in foreign currencies or indexed to foreign currencies in the Bank's total loan portfolio stabilised at 32%. The Bank is monitoring the possible effects of currency risk on credit risk of the foreign currency loan portfolio on an ongoing basis by conducting sensitivity analysis of the effects of exchange rate fluctuations on the financial situation of borrowers to which the Bank has such an FX exposure (*stress-testing*).

1.1.2 Quality of loan portfolio

Quality of loan portfolio

PLN '000	As at:				Change:	
	31/12/2002		31/12/2001		PLN '000	%
Loans to non-bank customers						
<u>by classification:</u>						
Normal	9,245,925	59.6%	10,640,930	67.2%	(1,395,005)	(13.1%)
Watch	1,694,536	10.9%	1,116,542	7.1%	577,994	51.8%
Problem	4,564,778	29.4%	4,066,660	25.7%	498,118	12.2%
- substandard	1,096,069	7.1%	1,149,105	7.3%	(53,036)	(4.6%)
- doubtful	1,889,792	12.2%	1,622,262	10.3%	267,531	16.5%
- loss	1,578,917	10.2%	1,295,293	8.2%	283,624	21.9%
Total	15,505,239	100.0%	15,824,132	100.0%	(318,893)	(2.0%)

Gross loans excluding accrued interest.

In 2002 the Bank experienced a further deterioration of the quality of its loan portfolio as measured by the share of classified loans in total loans (gross). This share rose from 25.7% to 29.4%, leading to the increase in the specific provisions by 24.9%. The increase in the share of classified loans was a result of deteriorating financial performance of a major group of the Bank's customers, and their liquidity problems. The underlying factors include:

- the continued overall economic slowdown,
- recessionary trends observed in the heavy industry and construction sectors and the corresponding low profitability of companies active in these areas,
- the Bank's continued conservative approach to classification of exposures and provisioning.

The 51.8% increase in the watch loans was a consequence of more detailed and strict risk classification criteria introduced by the new Credit Manual for the Commercial and Investment Banking Sector in June 2002.

The coverage provided for watch and problem loans by specific provisions created by the Bank in the total amount of PLN 1,470 million, is fully compliant with the regulations of the National Bank of Poland. Additionally, the Bank was covered by a general risk provision at PLN 300 million created in past years.

Specific provisions for loans to non-bank customers

PLN '000	As at:		Change:	
	31/12/2002	31/12/2001	PLN '000	%
Specific provisions for:	1,470,434	1,177,080	293,354	24.9%
- watch loans	-	1,245	(1,245)	(100.0%)
- problem loans	1,470,434	1,175,835	294,599	25.1%
General provision	300,000	300,000	-	---
Provision coverage of the total loan portfolio	11.4%	9.3%		
Provision coverage of problem loans	38.8%	36.3%		

The increase in specific provision coverage of the whole loan portfolio to 11.4% was primarily a consequence of the increase of problem loans in the Bank's portfolio combined with a simultaneous flattening of its growth. Also, an increase in the specific provision coverage of problem loans was observed, which was mainly due to the provision coverage of loss loans growing from 64.4% to 70.8%.

As at the end of 2002, loans to Polish subsidiaries of multinational companies, the majority of which is secured with parent guarantees, made up roughly 24% of the Bank's total problem loans (33% in case of loans classified doubtful). The classification of these loans to the problem loan category was the Bank's reaction to the deteriorating financial situation of the Polish borrowers – as required by the NBP regulations – regardless whether the loan had been serviced or collateralised by the parent company.

In 2002 the Bank's Credit Risk Management Division modified twice the Bank's internal credit system by introducing even more stringent requirements for the classification of loans and provisioning. Otherwise the basic framework for managing credit risk has remained unchanged since its introduction in March 2001. The cornerstone of this framework is the principle of conducting analyses on an ongoing basis of the Bank's exposure to the different sectors of the economy with the aim of identifying areas in which this exposure should grow or contract based on expectations concerning growth and performance prospects. The result of using such a framework for monitoring credit risk, in a situation where recessionary tendencies were evident in a number of major economic sectors, especially heavy industry, was the decision to actively reduce the Bank's exposure to several sectors and large customers taken in 2002 (shipyard sector, construction and heavy industry). Furthermore, the Bank strengthened the internal unit responsible for large bad debt workout, as a result of which it achieved good results in constraining potential credit losses. This unit has also managed to secure additional collateral and to renegotiate loan repayment schedules, which further strengthened the Bank's position vis-à-vis its large customers currently experiencing financial difficulties.

Overall, the headcount in the Corporate Bank Restructuring Department as well as a similar unit responsible for managing problem loans in SME portfolio, totalled to 26 people at the end of 2002 and managed the problem portfolio of PLN 1.1 billion. In 2002 the Bank issued 4,364 warrants of execution valued at PLN 135.3 million, secured with collateral amounting to PLN 69.6 million. During 2002 the Bank wrote-off loss loans against previously created provisions amounting to PLN 30.0 million.

1.1.3 Off-balance sheet exposures

The portfolio of contingent liabilities extended by the Bank decreased in 2002 by 8.4% to PLN 9,600 million. Such a drop was primarily the result of the elimination of the forward placements item, comprising temporary bookings of placements waiting for the preparation of the respective fund transfer. The portfolios of the main off-balance sheet liabilities, covering guarantees, L/Cs issued and undrawn credit lines, remained at a relatively stable level.

Contingent liabilities granted

PLN '000	As at:		Change:	
	31/12/2002	31/12/2001	PLN '000	%
Guarantees	2,738,719	2,737,591	1,128	0.0%
Letters of credit issued	187,117	184,874	2,243	1.2%
Confirmed letters of credit	12,013	63,155	(51,142)	(81.0%)
Undrawn credit lines	6,662,409	6,779,275	(116,865)	(1.7%)
Forward placements	-	714,868	(714,868)	(100.0%)
Total contingent liabilities	9,600,258	10,479,763	(879,505)	(8.4%)
Provisions for contingent liabilities	145,308	125,913	19,395	15.4%
Provision coverage	1.51%	1.20%		

1.2 External funding**External funding**

PLN '000	As at:		Change:	
	31/12/2002	31/12/2001	PLN '000	%
Due to the central bank	121,344	208,128	(86,784)	(41.7%)
Due to financial institutions	3,430,715	4,862,810	(1,432,095)	(29.4%)
At call	1,886,237	2,029,014	(142,777)	(7.0%)
Term deposits	1,544,478	2,833,796	(1,289,318)	(45.5%)
- Interbank deposits	472,923	734,543	(261,620)	(35.6%)
- Interbank loans	522,103	1,658,303	(1,136,200)	(68.5%)
- Term deposits of non-bank financial institutions	549,452	440,950	108,502	24.6%
Due to non-financial sector	15,984,177	16,409,182	(425,005)	(2.6%)
At call	7,548,770	6,645,739	903,031	13.6%
Term deposits	8,435,407	9,763,443	(1,328,036)	(13.6%)
Due to public sector	634,792	879,611	(244,818)	(27.8%)
At call	410,686	284,093	126,593	44.6%
Term deposits	224,106	595,518	(371,411)	(62.4%)
Total external funding	20,171,029	22,359,731	(2,188,702)	(9.8%)

Excluding accrued interest.

At the end of 2002 the Bank's external funding totalled PLN 20,171 million and was lower than at the end of 2001 by 9.8%. The decline affected deposits from all customer groups. In terms of value, the most dramatic fall was observed in the liabilities due to financial institutions as a consequence of the Bank's scaling down its interbank funding caused by lower liquidity demands. 2002 was also marked by a substantial fall in term deposits from all sectors, reflecting a general drop in saving trends caused by a reduction in the rates of interest paid to depositors. Moreover, some of the customers started seeking alternative ways to optimise earnings on their funds, more and more often resolving to buy Treasury bonds or investment fund units.

The 3.2% fall in deposits from non-financial corporate customers translated into a slight decrease of the Bank's share in the corporate deposit market from 13.6% to 13.3% (this refers to liabilities to enterprises, private companies, co-operatives and sole entrepreneurs). Despite that, the Bank remained

a leader in the corporate deposit market, and its strong position is to a large extent a result of the competitive product offering in cash management and trade finance, which will be described in more detail in point 3 below.

Deposits of non-bank customers

PLN '000	As at:		Change:	
	31/12/2002	31/12/2001	PLN '000	%
Due to:				
Individual customers	6 013 546	6 085 893	(72 347)	(1.2%)
Non-financial corporate customers	9 066 496	9 365 919	(299 423)	(3.2%)
Non-profit organisations	890 373	947 710	(57 337)	(6.1%)
Non-bank financial institutions	1 363 253	1 408 116	(44 863)	(3.2%)
Public sector	634 793	879 611	(244 818)	(27.8%)
Suspense account liabilities	13 762	9 660	4 102	42.5%
Total	17 982 223	18 696 909	(714 686)	(3.8%)
PLN	12 988 460	13 087 011	(98 551)	(0.8%)
Foreign currency	4 993 763	5 609 898	(616 135)	(11.0%)
Total	17 982 223	18 696 909	(714 686)	(3.8%)

Excluding accrued interest

Balances on current accounts of individual customers and deposits placed by such customers decreased by 1.2%, but due to the general fall of deposits from individual customers in the banking sector the Bank slightly increased its market share from 2.8% to 2.9%. Growth trends were most suppressed in the area of deposits from the public sector, which to some extent resulted from increasing competition on the part of banks controlled by the State Treasury.

In 2002 the Bank has experienced a steady increase of surplus funding, which is illustrated by the widening gap between amounts due to and due from financial institutions. The strong deposit and liquidity base allows the Bank to react to new opportunities on credit market in a flexible way and provides a funding potential that may be utilised when the expected economic recovery materialises.

1.3 Cash management

In terms of cash management and trade finance the Bank is able to offer a broad range of modern and comprehensive products. In parallel with offering traditional banking services – such as current accounts, domestic and foreign money transfers, term deposits, overdrafts etc. – the Bank continued its efforts to add new products to the more refined cash management product range, especially electronic and Internet banking products, and intensified its efforts to acquire customers seeking such services. The fast changes taking place in this area were facilitated by the Bank's access to the state-of-the-art technology used by Citigroup. In 2002 the Bank offered the following cash management product groups:

- receivables management
- electronic and Internet banking
- liquidity management
- payments
- trade finance

- trade servicing

In the area of electronic banking the Bank experienced a very fast increase in the use of *CitiDirect*, a key component of the Internet cash management services for corporate customers. In total, at the end 2002 the Bank had 3,170 *CitiDirect* terminals installed compared to 860 at the beginning of the year. The most important feature of *CitiDirect* is the on-line access to accounts by customers and the possibility to initiate a number of transactions using an Internet-connected computer, without the need to leave the office. Additionally, *CitiDirect* has an expanded reporting as well as data import/export functionality. Security is maintained by the latest data encoding techniques. It is planned that within some time all corporate customers using earlier electronic banking products (such as *Goniec* and *MTMS32*, offered before the merger by Bank Handlowy w Warszawie SA and Citibank (Poland) S.A., respectively) will be serviced by *CitiDirect*. The total number of installations of all types of Internet banking platforms increased from 11.5 thousand at the end of 2001 to 12.6 thousand at the end of 2002.

Excellent quality and technological features of the Bank's Internet banking offer for corporate customers was appreciated by experts of prestigious "Global Finance" magazine, who nominated the Bank as "Best Corporate/Institutional Internet Bank in Poland 2002".

In 2002 the use of *SpeedCollect* for mass-payment handling significantly increased, resulting in growth of commission income. *SpeedCollect* enables corporate customers to automatically allocate payments made by their clients to appropriate accounts and reconcile account balance. The system is offered to such customers as telecom operators, cable TV providers, distributors of gas and power supply, or insurance companies. The number of transactions processed monthly by the Bank as part of *SpeedCollect* services increased from 5.5 million in December 2001 to 9.3 million in December 2002.

Year 2002 was marked by intense activities of the Card Products Management Department, offering *Citibank Business* cards for covering business expenses by employees of corporate customers. The Bank launched new products, namely *Visa Business Electron (Gold, Silver, Commercial and CitiBusiness)* with the Safety Package, which replaced the old Citibusiness Mastercard, and the pre-paid Visa Electron card as the first Bank in Poland. The pre-paid card may be used only to make payments in Poland and serves as a loyalty card for making money transfers and for promotions. A special advantage of the pre-paid card is the card personalisation, which means that the specific customer's logo will appear wherever he or she uses the card. In total, by the end 2002 the Department serviced over 3.8 thousand corporate customers, which overall used 16.3 thousand Citibank Business and pre-paid cards.

On May 28, 2002, in co-operation with Citibank Card Acceptance (CCA), Bank Handlowy added to its product offering the service of full payment settlement of transaction made using cards. This product is addressed to companies accepting credit cards as a form of payment.

Starting from June 2002 *CitiConnect* functionality was expanded to authorise payments made in the Wirtualna Polska Internet portal, which ultimately will give customers access to several dozen Internet shops. In general, since *CitiConnect* was launched in 2001, as many as 105 agreements were signed with companies operating Internet shops, of which 58 were signed in 2002. In mid 2002, the *CitiConnect* functionality was substantially enhanced by being implemented on the mobile platform, namely WAP and text messaging (SMS).

1.4 Trade finance

As a result of the merger with Citibank (Poland) ("CPSA") on March 1, 2001 the Bank gained a dominant position in the trade finance market. The already strong position of Bank Handlowy – dating back to the days when it enjoyed the monopoly for servicing Polish foreign trade transactions – was strengthened further through the acquisition of corporate customers serviced earlier by CPSA. An

especially valuable addition was the group of Polish subsidiaries of multinational companies, which were very active in the area of foreign trade.

The total value of the foreign trading handled by Bank Handlowy w Warszawie S.A. in 2002 amounted to USD 19.7 billion, of which USD 8,406 million referred to export and USD 11,315 million referred to import transactions. As a result the Bank's share in the trade finance market increased from 23.5% in 2001 to 25.9% in 2002, strengthening the Bank's position as the market leader. This was accounted for by the rise of the Bank's share in import transactions from 22.0% to 26.1%, while its share in export transactions fell slightly from 25.7% to 25.5%.

Apart from the large customer base and the long experience in providing financial services to Polish importers and exporters, the Bank's strong competitive advantage is the extensive range of products offered, which includes a number of types of letters of credit, documentary collections, guarantees, sureties, avals, bankers' acceptances, bill discounting and discounting of invoiced receivables. The steady growth of creditworthiness of Polish companies active in foreign trade coupled with the greater trust in the Polish economy as a whole, which to a large extent is linked to the progress of Poland's negotiations for full EU membership, results in a gradual shift by Poland's Western trading partners from the more complex types of trade finance instruments to much simpler methods like money transfers and invoice discounting. However, letters of credit remain the main form of payment in trade with the Eastern Europe.

On April 18, 2002 the Bank signed an agreement with Korporacja Ubezpieczeń Kredytów Eksportowych S.A. („KUKE”; Poland's export credit insurance corporation) on the insurance of amounts due to factors from debtors domiciled in OECD countries. Both institutions agreed to prepare jointly an insured credit product, which will give Polish exporters dealing with counterparties from OECD countries access to sources of external funding of export transactions, in the form of factoring secured with KUKE's policy. The Structured Trade Sales also implemented a pre-trade finance programme offering the clients a 180-day financing secured by assignment of the letter of credit or contract, or by a guarantee assigned or issued to the Bank. In 2002 2.8 thousand customers used the trade finance products of the Bank.

1.5 FX and money market activity

The Treasury Department is one of the key profit centres of Bank Handlowy w Warszawie SA, as manifested by the growing contribution of income on exchange position and profit on financial operations in the Bank's income on operations.

Bank Handlowy is the leading participant in the Polish FX and money market, acting as a market-maker in the segment of standard FX and interest rate dealings. As before, also in 2002 the Bank acted as the Money Market Dealer. This position enables access to open market operations conducted by the central bank. This privilege was granted by the NBP to 15 banks (out of 23 candidates), which were marked by an above-the-average activity in the Treasury bills and bonds market, interest derivatives, and custody services, and maintained good relations with the central bank. The relevant agreement was signed with the National Bank of Poland on December 10, 2001. Moreover, at the end of 2002 together with 12 other banks Bank Handlowy w Warszawie SA was selected by the Ministry of Finance to act as the Treasury Securities Dealer in 2003, which facilitates access to the primary T-bill and T-bond market.

The strong position of the Bank in the FX and money market is a result of:

- the large and steadily growing number of the Bank's major customers for FX transactions (5,000 companies) and derivative products (500 companies),
- the large number and volume of operations on the Bank's own account as a result of increasing liquidity management needs,

- the wide, flexible and innovative product offering,
- the Bank's leading position in the area of trade finance,
- its dynamic and experienced team responsible for these transactions,
- Bank Handlowy's excellent reputation on the Polish FX market and the esteem shown both by domestic and foreign counterparties,
- the support and assistance of the Bank's strategic investor, Citigroup, in accessing international financial markets, implementing new products and managing market risk.

Based on estimates of the Treasury Department, the Bank's market share in transactions initiated by customers is 25% in the case of FX transactions (first place), and 25% in derivatives (first place). Also the Bank was the single largest dealer on the primary Treasury debt securities market, which involved, among other things, a substantial development of the relevant portfolio. The Bank's share in the secondary market of securities was somewhat lower – 4% in bonds and 9% in treasury bills. Its share on the interbank market was also lower – 9% in the case of FX transactions and 8% in FRA and IRS. This was due to a large number of these transactions being settled in London through foreign banks.

1.6 Commercial paper origination

For several years Bank Handlowy has been among the largest participants of the primary market for debt securities issued by corporations and financial institutions. In 2002 the Investment Banking, Securities and Capital Markets Department took part in launching new issue programmes for the following entities:

- a 5-year bond and CD issue programme for FCE Bank Polska S.A. and FCE Credit Polska S.A. with a combined value not greater than PLN 1,000 million; the Bank acted as the lead arranger, issue and payment agent, dealer and depository for the issue; the issue is to be used for funding credit, leasing and factoring programmes of Ford Motor Company with the aim of boosting its car sales in Poland,
- a 3-year bond programme for Polkomtel S.A. to an amount of PLN 500 million with the aim of providing working capital for the company, expansion of its network and development of a new product range; the Bank acted as a co-arranger, dealer, payment agent and depository for the issue,
- a 4-year debt securities programme for Volkswagen Bank Polska S.A., Volkswagen Leasing Polska S.A., Volkswagen Motor Polska Sp. z o.o., Volkswagen Poznań Sp. z o.o. and Co-ordination Centre Volkswagen N.V./S.A. to a total amount of PLN 1,000 million; the Bank was the lead arranger, payment agent, depository and dealer for the issue,
- a public bond issue program for Telekomunikacja Polska S.A. (Poland's largest telecom operator) to a total amount of PLN 1,000 million with redemption terms extending from 1 to 7 years; the bonds will be traded in the over-the-counter CeTO market; the Bank was the lead arranger and programme agent, while Dom Maklerski Banku Handlowego SA (Bank Handlowy's Brokerage House) will act as dealer of the issue in the public trading,
- a 5-year bond programme for Can Pack S.A. to an amount of PLN 100 million; Bank was the lead arranger, programme agent, payment agent, depository and dealer for the issue,
- bond programme for Echo Investment S.A. to an amount of PLN 100 million,

- bond programme for Ecco-Papier Sp. z o.o. to an amount of PLN 50 million,
- bond programme for SCA Packaging Poland Sp. z o.o. and SCA Hygiene Products Sp. z o.o. to an amount of PLN 200 million,
- debt securities programme for Jedynka Skanska S.A. (PLN 100 million),
- debt securities programme for PGF Urtica Sp. z o.o. (PLN 16 million),
- bond programme for MITEX S.A. to the amount of PLN 40 million .

At the end of 2002 the market share measured by size of debt resulting from securities placed by the Bank amounted to 22.0% compared to 18.9% at the end of 2001, giving the Bank a leading position in the market. Overall in 2002 the Bank placed securities of the total value of PLN 13,272 million, translated into a 17.1% market share.

1.7 Small enterprise banking

The Bank continues to pursue the strategy of strengthening its position in the market for services provided to small companies, defined as those having annual sales below PLN 4 million (so called Tier 0 subsegment). In 2002 the Small Enterprise Department increased the number of customers from 7.3 thousand to 9.5 thousand as a total. The overall number of SME handled by Small and Medium Enterprises Division (including Tier 0) increased from 16.5 thousand to 18.6 thousand in 2002.

The product offer addressed to this group of companies called *Inter Biznes*, built around the *Inter Konto* range of services, was in 2002 provided with full product functionality, including addition of the *CitiBusiness VISA Electron* charge card and a new credit programme, which makes it possible to offer unsecured overdrafts to new customers.

Year 2002 was also the time of intense development of service channels for Tier 0 customers. In May 2002 Inter Bankier service (Interactive Voice Response) was introduced as part of Inter Centrum, i.e. call centre for customers of the Small Enterprises Tier 0 Department. In the same month, the Bank decided to develop appropriate functionality for the Systematics retail banking system in order to enable future transfer of Tier 0 customers to the Consumer Banking Sector transaction platform. Starting from 2Q2002, the direct sales network was expanded, amounting to over 200 trained sales agents at the end of the year.

1.8 Custody services

The Bank's Custody Department in providing custody services to its customers complies with Polish as well as international standards set in respect to these services. This enables it to meet requirements of the largest and most demanding corporate clients. The Custody Department forms an integral part of the global custody network of Citibank N.A. known as Global Securities Services.

Bank Handlowy is one of the leading banks offering custody services in Poland. It offers its services both to foreign institutional investors and to domestic financial institutions, especially investment and pension funds.

The services provided by the Custody Department include operating securities and cash accounts, settling securities transactions, handling dividend and interest payments, portfolio valuation, individual reports, execution of customer proxies, and arranges 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 and safekeeping of securities abroad.

The Bank is also active in its efforts to assist in the further improvement of the broadly understood Polish securities law, taking part, through its representatives, in the workings of the Depository Council organised under the *aegis* of the Association of Polish Banks (Związek Banków Polskich). The strong position of the Bank in this market allows it to present its own drafts of amendments to the different regulations in question as well as to help establish practices bringing the Polish market even closer to international standards. Using their resources, experience and competencies employees of the Bank work closely with the Polish SEC (Komisja Papierów Wartościowych i Giełd), the National Depository of Securities (Krajowy Depozyt Papierów Wartościowych S.A.), the WSE and the insurance and pension fund regulator - Komisja Nadzoru Ubezpieczeń i Funduszy Emerytalnych – in introducing new systemic solutions.

In 4Q2002 the Bank commenced implementation of a new method of servicing foreign financial brokers, by simplifying its existing structure of securities and investment accounts used for booking transactions handled by foreign brokers on behalf of international investors. The aim of the modification of the account structure is taking advantage of possibilities provided for under Art. 34a of the current Act on Public Trading in Securities as well as secondary provisions effective from January 1, 2003. The new transaction settlement process will be fully compliant with the standards of advanced capital markets.

In the latest ranking held by an international branch periodical – Global Custodian Magazine – the Bank was ranked as first in terms of its custody services provided in Poland, achieving the highest score (Top Rated). The aim of the annual ranking for the Global Custodian Agent Bank category is to evaluate the quality of custody services offered to foreign customers by depositories operating in developing markets. The ranking is based on the results of meetings and questionnaires sent to global custodian banks, brokers, insurance companies and other financial institutions. Scoring depends on achievements in particular areas, such as settling securities transactions, customer representation at general meetings of shareholders of listed companies, reports on issuers and securities transactions, technologies and operating systems, communications on amendment of legal regulations. Especially important is the quality of customer service.

As at December 31, 2002 Bank held 4,155 securities and investment accounts.

The Bank acted as a depository for 5 open-ended pension funds: AIG OFE, SAMPO OFE, OFE Pocztynion, Pekao OFE and Zurich OFE as well as for Pracowniczy Fundusz Emerytalny Telekomunikacji Polskiej S.A. – the employee pension fund of Poland's largest telecom operator.

In addition the Bank acted as depository for 19 investment funds managed by the following investment fund societies: SKARBIEC TFI S.A., BZ WBK AIB TFI S.A., SEB TFI S.A., PIONEER PEKAO TFI S.A. and DWS Poland TFI S.A.

1.9 Agency services

Under an agreement concluded with the Ministry of Finance, entrusting Bank Handlowy with servicing the foreign receivables and payables of the Polish State Treasury, the Bank's Agency Services Department:

- handled over 400 agreements concerning loans, refinancing, debt reduction, compensatory settlements, debt-for-nature swaps and the State Treasury eurobond issues, and also operated 12 clearing, countertrade and special accounts,
- made payments on behalf of the Ministry of Finance in respect of liabilities of the State Treasury and credited the accounts of the Ministry of Finance with repayments made on the State Treasury's receivables; in the first half of 2002 the volume of transactions settled by the Bank through the Ministry of Finance accounts opened with the Regional Branch of the NBP reached PLN 13.9 billion,

- maintained in the State Debt subledger of the IBIS/AS system records of the State Treasury payables for the total amount of USD 27 billion and of receivables for the amount of USD 1 billion,
- prepared statistical and management information on Poland's receivables and payables for the Ministry of Finance and the National Bank of Poland.

It was the decision of the Ministry of Finance not to extend the agreement with Bank Handlowy on the servicing of State's foreign receivables and payables. On May 27, 2002 another agreement was signed by the Ministry of Finance, Bank Handlowy w Warszawie SA and Bank Gospodarstwa Krajowego ("BGK") on the transfer of bank services relating to State Treasury's foreign receivables and payables from Bank Handlowy to BGK.

The Agency Services Department commenced work relating to the transfer, as defined in the above mentioned agreement, of the agency function from Bank Handlowy to BGK in June 2002. On October 3, 2002, the Bank's Management Board decided to close down the Agency Services Department of Bank Handlowy w Warszawie SA effective from December 1, 2002.

1.10 Co-operation with international financial institutions

In 2002 the bank finally developed its strategy and policy for co-operation with international financial institutions having completed the merger of Bank Handlowy w Warszawie SA and Citibank (Poland) S.A.

The main element of that strategy is continued integration and closer co-operation with the global Citigroup branch network, as well as 750 correspondent banks and their branches world-wide. Owing to its existing contacts, the Bank was able to provide a broad range of innovative products and services for its corporate and individual clients and support them in their international business. Thus the Bank played a key role in providing financial services in the area of Polish foreign trade, foreign payment and foreign exchange. For that reasons, the Bank held 19 nostro accounts in 12 countries, with 10 such accounts kept by institutions belonging to Citigroup. Due to a bilateral nature of such co-operation, resulting from a number of foreign investments made in the Polish capital and money market, Bank Handlowy operated 201 vostro accounts in Polish zloty and foreign currencies, thereby settling interbank transactions and customer payments, as well as foreign trade and purchases of Polish Treasury securities by foreign financial institutions.

Bank Handlowy continued to distribute funds obtained from the European Investment Bank (EIB) and Kreditanstalt für Wiederaufbau to a total value of EUR 75 million. The loans relate to the provision of funding (also by means of leasing) for capital projects of small and medium enterprises in Poland in the areas of energy efficiency, environmental protection, investment in industry, services and tourism, and the development of infrastructure.

On February 14 and July 12, 2002 the Bank purchased on the primary market 10-year zero coupon bonds issued by EIB to a total face value of PLN 300 million and PLN 100 million, respectively. The Bank placed a part of this issue on the Warsaw Stock Exchange so that they could be available to institutional and individual investors. This was the third and fourth tranche of EIB bonds issued under debt securities programme arranged in Autumn 2001 for a combined value of PLN 3 billion, for which the Bank acted as sole arranger and underwriter.

1.11 Consumer banking

1.11.1 The Consumer Banking Sector

The Bank provides retail banking services through a separate unit called the Consumer Banking Sector. The range of products and services within that area comprises:

- personal current accounts such as:
 - CitiKonto for individual customers,
 - CitiOne for individual customers of above-average incomes,
 - CitiGold for Private Banking customers with highest incomes, declaring an account balance of more than PLN 200 thousand.
- term deposits
- ATM cards
- *Visa* and *Mastercard* credit cards
- personal instalment loans, cash advances and overdraft facilities on current account
- Internet banking services via *Citibank Online*, call centre *CitiPhone* (0 801 322 484) and text messaging information (SMS) - *CitiGSM*
- investment banking services
- insurance.

In 2002 the total number of current accounts serviced by Citibank increased from 301.5 thousand to 305.6 thousand. To a large extent the relatively low growth rate was the effect of the review undertaken in February, which resulted in a number of unused accounts being closed. Apart from this, on February 28, 2002 the process initialised at the end of 2001 of transferring the Bank's Private Banking customers, previously serviced in the *IBIS/AS* system (used by the Bank's corporate banking network) to *Systematics* (used by the Consumer Banking Sector) was completed. In total 41 thousand accounts were transferred. Some of the Bank's customers, who previously had accounts opened both in corporate banking arm of the Bank and in Citibank as a result of the transfer had one of the accounts closed. Those former Bank Handlowy's Private Banking customers served through the corporate network, which met the criteria set for this product group, were offered the *CitiGold* account.

Major product innovations launched in 2002 included long-term investment deposits linked to selected New York Stock Exchange indexes and the share prices of the largest multinational companies, and life insurance products offered jointly with CitiInsurance Polska Towarzystwo Ubezpieczeń na Życie SA, a subsidiary of CitiInsurance International Holdings, Inc. Sales of insurance products commenced on August 8, 2002 with the savings and life insurance programme; until the year end the offering was extended to include 6 products, now used by 15,000 of the Bank's retail customers. CitiInsurance started operating in Poland on May 16, 2002.

In 2002 the Bank experienced further dynamic growth of its business in the area of investment products for retail customers. Units in investment funds of Towarzystwo Funduszy Inwestycyjnych BH S.A. and portfolio management by Handlowy Zarządzanie Aktywami S.A., which were added to the *CitiGold* range in August 2001, was in 2002 expanded to 70 branches of the Consumer Banking Sector. The Bank also started distribution of units of the new *DWS Top 50 Europa* investment fund.

As at the end of 2002 the Bank's share in the market of deposits and loans to individual customers was 2.9%, and 2.2%, respectively (9th and 11th place in the market), while its share in the income generated by the banking sector on individual customers in 2002 was estimated at 4.2%. The higher share in the income compared to the deposit and loan market is explained by high profitability of credit cards.

The Consumer Banking Sector continued efforts aimed at optimising the use of the different distribution channels by its customers. The objective is to increase the use of remote, electronic channels, improve efficiency in the use of branches and strengthen the links with the Commercial and Investment Banking Sector with the aim to increase sales of products through its branch network (*cross-selling*). Thanks to the rapid increase in the number of customers using the electronic channel *Citibank Online* („*CBOL*”) a very significant increase in the number of transaction initiated through this channel was achieved. In April 2002 for the first time ever the number of transactions initiated through *CBOL* was higher than the number of those initiated through the Bank’s call centre - *CitiPhone*. Overall shares of the Internet platform in initiating transactions grew from 28% in December 2001 to 40% in December 2002, and *CBOL* strengthened its position as the main channel for retail customer service. Growing popularity of the Internet channel brings substantial savings for the Bank, resulting from the transfer of customer relations to a more economical platform. It is the ambition of the Consumer Banking Sector to make *CBOL* the leading Internet banking platform in Poland. At the end of 2002 *CBOL* had 86.3 thousand Internet customers compared to 41.3 thousand in December 2001. The number of Internet customers of the Bank placed it second among all traditional banks offering Internet as an additional channel. In 2002 the functionality of *Citibank Online* was expanded by term deposits, forward-dated external transfers, outgoing transfers in IBAN format and free-of-charge confirmation of an external transfer. In August 2002, a new *CBOL* Internet portal was launched, combining transaction and information functionalities. High quality of the *CBOL* services was also acknowledged by specialists: “Global Finance” awarded *CBOL* with the title of Best Consumer Internet Bank in Poland 2002.

Year 2002 was also the time of a dynamic development of *CitiGSM* messaging service based on the short messaging system (SMS) though text messages sent to customers. The overall number of customers signed on to *CitiGSM* reached 21 thousand.

As at the end of 2002 the Consumer Banking Sector had a network of 104 branches (11 *Citigold* branches and 93 standard branches), 18 service points for retail customers in commercial banking outlets and 211 ATMs. Owners of Citibank ATM cards were also able to make free-of-charge withdrawals from Poland-wide network of Euronet ATMs. Also in 2002 the branch in Bydgoszcz was added to the exclusive Private Banking *Citigold* network, which was opened on May 16. Due to a reorganisation of the retail branch network, on March 30, 2002 6 branches were closed and 2 joined the new CitiFinancial network. A vital initiative that supported the development of retail sales channels was the *Bank@Work* project originated in 2001, consisting in offering consumer products to employees of corporate customers already handled by the Commercial and Investment Banking Sector.

In the loan market the Consumer Banking Sector concentrated its efforts on expanding its activities on the credit card market, in which it anyway enjoyed a dominant position measured by the customers’ credit card debt, which reached 46.5%. As at the end of 2002 the number of credit cards issued by Citibank stood at 425.7 thousand as compared to 377.5 thousand at the end of 2001, which translated into a 12.8% increase. The fast increase of the number of credit cards issued was in a large part a result of the introduction of a *MasterCard* product to the Banks offering, and especially the success of a limited edition of *Citibank MasterCard FIFA 2002*, related to the World Football Championship held in Japan and South Korea. Between April 15 and August 1, 2002, 31.5 thousand such cards were issued.

From August 19 the retroactive cover of Citibank cards was extended from 48 to 72 hours (for cards with a photo). If losses resulting from the card with a photo being lost or stolen are incurred by a customer within 72 hours before restricting the card and exceed PLN 100, the Bank covers the damage in the part exceeding PLN 100. Moreover, from October 15 the repayment time of credit cards was extended from 15 to 21 days from the date of the account statement, due to which the maximum period of interest-free credit increased to 51 days. Another attractive feature of Citibank cards was a shopping discount programme developed in cooperation with around 700 shops and available for each cardholder.

Number of active credit cards (in thousands)

Name	System	As at	
		31/12/2002	31/12/2001
Citibank Silver	Visa	284.9	269.4
Citibank Gold	Visa	42.8	39.0
Citibank-Elle	Visa	35.1	43.1
Citibank Silver	Mastercard	34.1	-
Citibank-Era Silver	Visa	24.9	24.8
Citibank Gold	Mastercard	2.1	-
Citibank-Era Gold	Visa	1.7	1.2
Total		425,7	377.5

The marketing activities in 2002 were enlivened by a series of events referring to the fifth anniversary of the Citibank cards' presence on the Polish market. The peak events took place on November 16 to 17, 2002 in the largest Polish shopping centre – Galeria Mokotów in Warsaw.

The high quality of Citibank card products offered by the Consumer Banking Sector brought the Bank several distinguishing titles in 2002:

- 1st place in credit card rating of the Rzeczpospolita daily in the Safest Card category,
- the Trusted Brand 2002 title, awarded in a poll of the Reader's Digest magazine readers, taking part in the European consumer survey organised by the magazine,
- 1st place in the credit card rating of the Gazeta Bankowa daily in the Most Effective Offering category.

However, the greatest distinction awarded to the Consumer Banking Sector personnel in 2002 was the leap of the retail customer satisfaction ratio to 86% from 67% in 2001. Such a considerable improvement of the ratio, measured within the annual Survey on the Customer Satisfaction and Loyalty, confirms the success of the retail banking model offered by Bank Handlowy w Warszawie SA and creates strong foundations for the development of the business in the future.

1.11.2 CitiFinancial

In September 2002 a new business line was launched, focused on lending services to low-income customers under the CitiFinancial brand. On October 14 in Warsaw the opening ceremony of the first CitiFinancial branch was held, and until the end of 2002 the number of active outlets rose to 4. There are plans to expand the network throughout the country, until it reaches 60 outlets in year 2006. The CitiFinancial offering includes unsecured cash loans for an unspecified purpose and "Blue Instalments" loans for private individuals, as well as insurance policies of CitiInsurance Polska Towarzystwo Ubezpieczeń na Życie S.A. In total in 2002 1.0 thousand cash loans and 4.5 thousand instalment credits were granted, and the total value of the CitiFinancial credit portfolio at the end of the year amounted to PLN 13.1 million.

Komentarz [L1]: c

1.12 Other information

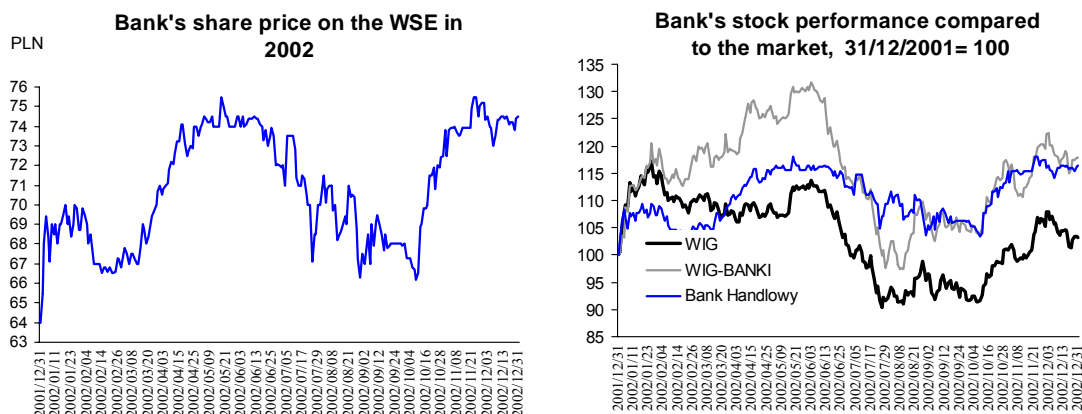
1.12.1 Rating

After the withdrawal of the full rating of Fitch Ratings upon the Bank's request on October 2, 2001, which was related to the change of the Bank's strategy of co-operation with rating agencies after the merger, the only rating conducted upon the Bank's request was that of Moody's Investors Service. In 2002 the Bank's financial credibility as evaluated by the Moody's agency remained unchanged at the following levels:

- Baa1 – rating for long-term deposits
- Prime-2 – rating for short-term deposits
- D+ – rating for financial standing

On 12 November 2002 the Moody's Agency upgraded the ratings of Poland (so called "sovereign rating") from Baa1 to A2 for long-term bonds and bank deposits, and from Prime-2 to Prime-1 for short-term debt securities and bank deposits. The decision was made due to the advanced process of Poland's integration with the EU. On the same day Moody's placed the Bank on the watch list with the option of upgrading the Bank's rating in relation to the increased sovereign rating.³

1.12.2 The Bank's share performance on the Warsaw Stock Exchange



In 2002 the share price of the Bank on the Warsaw Stock Exchange (WSE) went up from PLN 64.0 (December 31, 2001) to PLN 74.5 (December 31, 2002), i.e. by 16.4%. As a comparison, the main index of the WSE – WIG – gained 3.2%. However, Bank Handlowy's share price growth was in line with the boom seen on all bank stocks traded on the WSE (the WIG – BANKI bank index rose 17.8% over the same period).

1.12.3 Visual identification

On November 12, 2002 a new trademark of the Bank was introduced – citibank handlowy. It will be implemented for the whole Bank, which so far operated under the brand of Bank Handlowy w

³ Eventually, on 14 January 2003 Moody's upgraded the Bank's rating to A2/Prime-1.

Warszawie SA, and in retail banking under the Citibank brand. The replacement of the signage of the Bank outlets will be carried out gradually in 2003. Coupling of the two brands reflects the Bank's strategy as an institution that offers a comprehensive range of financial products for both corporate and individual customers within the same establishment. This will result in uniform visual identification of the Bank, as a result of which the awareness of the whole institution among the customers will increase (so far it was perceived as two separate entities), and so will the savings on marketing expenses.



1.13 Expansion of the Bank's product range and changes in IT technology

1.13.1 Product range

In January 2002 the range of business cards offered by the Bank's Commercial and Investment Banking Sector was extended by the addition of the *Visa Business Electron* card. It is addressed to corporate customers, which may give them to employees for making business-related payments and for withdrawing cash.

In May the Bank, together with Citibank Card Acceptance (CCA), introduced a service of full settlement of transactions paid for with the use of cards. As part of this service the Bank provides its customers with POS terminals, a 24-hour access to the technical Help Desk and authorisation service, and allows customers to view transactions in the Internet and generate electronic statements on a daily basis. This service is a significant supplement to the Bank's product offer targeted at retailers and companies providing services to individuals.

In June Bank Handlowy, as the first bank in Poland, issued pre-paid cards (*VISA Electron*), which may be used by customers as a loyalty card, for making money transfers and for promotion (in the last case the card is not personalised, i.e. does not have the name of the user embossed). After the original pre-paid limit is used, it may be again replenished by the user. In addition the Card Products Management Department implemented the so called *Kartowe Zlecenia Stale* (*Standard Card Payment*) service, which allows customers to make payments on regularly issued invoices or make purchases charged to a card issued within the Visa, Europay or MasterCard systems, and indicated by the customer in an authorisation issued by the owner of the card.

In June the Bank, together with the mobile operator Idea Centertel, launched two new services available to customers of Idea. They allow customers using the Idea mobile network to make parking payments in Warsaw by phone, and to replenish the pre-paid POP cards through text messages (SMS). Two months earlier similar services accessible through the Internet were introduced by the Bank.

The implementation of the *CitiConnect* system was another novelty in the Bank's offer. The system facilitates payments in Internet shops on a mobile platform; now two new channels were added: WAP and SMS.

In December 2002 the Bank introduced the Unikasa Payment Servicing Network (Sieć Obsługi Płatności Unikasa), which enables customers to make regular payments in the most often visited places, e.g. supermarkets, petrol stations etc. The Payment Servicing Network is a system of combined points (Unikasa), where payments are made through an automatic readout of information from the account (e.g. electricity and gas payments, phone bills, cable TV and press subscriptions, insurance premium payments). The Bank signed an agreement with the Casino Group, on the basis of which the new system will be implemented in Geant chain of hypermarkets (15 stores) and in all Leader Price supermarkets (100 stores).

In 2002 the following new products were added to the Consumer Banking Sector (Citibank) range:

- a 3-year investment deposit denominated in PLN linked to the Dow Jones Global Titans stock index,
- a 2-year investment deposit denominated in USD linked to a group of 15 major multinational companies (Siemens, Procter&Gamble, Cisco, Exxon Mobil, IBM, Walt Disney, General Electric, Philip Morris, Morgan Stanley, Bank of America, AOL Time Warner, Pfizer, Nokia, Ford, Toyota Motor),
- a 3-year investment deposit denominated in USD or EUR linked to the Dow Jones Industrial Average stock index,
- a special edition of the *Citibank MasterCard FIFA 2002* credit card issued to celebrate the Korea/Japan 2002 World Football Championship, making Citibank the first institution in Poland to issue a *MasterCard* credit card,
- distribution of units of the new *DWS Top 50 Europa* investment fund offered by DWS TFI.

1.13.2 IT systems

The year of 2002 witnessed finalisation of significant IT projects related to the Bank's integration with Citibank (Poland) S.A., and also to the Bank's incorporation into the Citigroup IT system.

The most important achievement was completion in December 2002 of the implementation of the *FlexCube* IT system, the main IT system for Commercial and Investment Banking. *FlexCube* is a modern, state-of-art real-time processing IT system. The system supplier is I-Flex, belonging to Citigroup. I-Flex is a provider of banking systems for over 280 financial institutions in 74 countries. *FlexCube* has been implemented in the Citigroup branches in the Western Europe, Asia and the Middle East.

On November 1, 2002 migration of the Bank's Regions to the new system, which began on November 30, 2001 was completed, and on December 15, 2002 the Bank's Head Office was converted to *FlexCube*. The *IBIS/AS* system became an archive system. Parallel to the process of the Bank's conversion to *FlexCube*, the implementation of the new release of *FlexCube* (3.9) enhanced by new functionalities and the new *Securities* module, was undertaken.

In 2002 *eDealer* for the Treasury Department was implemented. The system is used for quoting of FX deals carried out in the Bank's branches. *eDealer* replaced the *Autodealing* application. Simultaneously with the conversion of the Commercial and Investment Banking to *FlexCube*, other systems were disabled, such as: the already mentioned *Autodealing*, *Fastwire* and *Nostro Reconciliation*. As a result, the *AS/400* and *VAX* platforms ceased to be production platforms in the

Bank. Additionally, due to withdrawing the *IBIS/AS* system from DMBH, it was necessary to enhance functionality of the *Promak* system by teller operations as well as incoming and outgoing transfers.

The security standards and control procedures on NT servers were unified. Further centralisation of the NT platform servicing the Computer Centre in Olsztyn facilitated achieving comprehensive and centralised handling of the operating system, and therefore an increased reliability and reduced costs through the economies of scale.

Another important IT project was the implementation of a new system for archiving and storing financial data and accounting reports. The previously used system *COOL* was replaced with *AXSPoint*. In parallel with the system change, a UNIX platform (Sun Solaris) was implemented replacing WinNT platform and the data conversion to AXSPoint was performed for the whole Bank.

Parallel to implementation of specific IT systems, the Bank introduced corporate policies for IT technology management. This included implementation of corporate standards in respect of system security, problem and modification management, as well as technological projects management. The system security was also upgraded in preparation for the *Continuity of Business* environment („COB”), destined for maintaining the Bank’s activities in case of failures, and carrying out tests for systems and applications administered by the Applications Development and Maintenance Department and the Bank’s IT Integration Department.

In the area of Internet banking, centralisation of processing of orders channelled to the Bank by *Goniec* system was made and the obsolete IT equipment was removed from the Bank’s branches.

Intensive research was also conducted concerning the expansion and adjustment of the Bank’s IT network infrastructure to the Citigroup standards, with particular emphasis placed on the network security requirements. In June 2002 the project on data encoding in Bank Handlowy’s Wide Area Network, which began in November 2001, came to an end. Execution of this project, which consisted of implementation of modern data encoding techniques and adjustment of personnel’s computer workstations to the standards of Citigroup Information Security Office, assured safe data transmission within the network and was a cornerstone to full network integration of the merged Bank. Carried out from June to September 2002, the new e-mail system project enabled unification of the e-mail platform installed in Warsaw. Another project aimed at creation of an integrated network environment was installation of the *FireWall* technology for the purpose of isolating external services (such as Reuters, KIR, Sorbnet etc.) from the Bank’s network while ensuring safe access to these services from the Bank’s network. The project ran from September to December 2002. In September 2002 the final project of network integration began, the purpose of which was to create a single IT and telecommunication network in the Bank. The ultimate network will be an integral part of the Citigroup corporate Wide Area Network, and migration to the new network structures will be performed gradually for each Region of the Bank. Additionally, in October 2002 the project of reconstruction of the telephone exchange network commenced with the aim to introduce security mechanisms and create billing and telephone exchange management systems.

In April a new version of the main treasury front-office system, *Kondor+ 2.0*, was installed. The most important new features available now include the *Credit Net* module for tracking credit limits and multi-currency bookings of securities transactions.

The Risk Management Division implemented the *CAPS* application, which supports management of credit exposure to corporate customers. The application combines features of a data warehouse for the Bank’s loan portfolio (a range of data from credit agreements, classification of borrowers and collateral) with those of a system for calculating required provisioning levels. *CAPS* also allows the Bank to automatically generate reports based on NBP requirements.

The Finance Division obtained a new tool for profitability analysis of particular clients and client segments, products and product groups, and also for monitoring implementation of financial plans. The *eMIS* system is based on intranet technology, so that authorised employees will be able to use the

system directly from their workstations. A special management accounts application was implemented in the Treasury Section under the name of *MIS/Treasury*.

2. Entities constituting the Group and fully consolidated

Dom Maklerski Banku Handlowego SA

The Group operates in the capital market through its wholly owned brokerage subsidiary - Dom Maklerski Banku Handlowego S.A. („DMBH”). DMBH was established on April 1, 2001 as a result of the transfer of all assets of Centrum Operacji Kapitałowych Banku Handlowego (Capital Markets Centre, previously a unit within Bank Handlowy) to Citibrokerage S.A., which as of that day changed its name to that used currently. DMBH provides a full range of brokerage services available in the market; additionally, it offers a unique product called Investor Package. This offering combines an investment account in DMBH with a current account handled by the Bank's Consumer Banking Sector, and is addressed to those who want to invest in the capital market.

The Investor Package includes such services as:

- handling instructions related to brokerage activities (e.g. purchase of shares or bonds) with the use of funds deposited in the account with the Bank,
- automatic and free-of-charge funds transfer between DMBH and the Bank,
- sending all instructions via single telephone access number.

Additionally, the Investor Package allows for a simple and convenient use of a full range of services related to investment account with DMBH as well as current account with Citibank. As at the end of December 2002 DMBH held 18,693 investment accounts, which was 5,310 more than at the end of 2001.

In 2002 DMBH provided brokerage services through its 6 own offices as well as the branch network of the Consumer Banking Sector of Bank Handlowy w Warszawie SA and the *CitiPhone* call centre. At the end of 2002 the brokerage house had 89 employees.

Name of undertaking	Location	Bank Handlowy's share in authorised capital	Total Assets*	Capital*	Net profit *
		%		PLN '000	
Dom Maklerski Banku Handlowego SA	Warsaw	100.00	153,212	76,390	1,785

* Prior to consolidation adjustments.

Operating under deteriorating market condition in the share market and dramatically low trading on the Warsaw Stock Exchange in 2002, DMBH managed to remain second among all brokerage houses in terms of turnover of securities by value (11.1% market share compared to 11.4% in 2001). The combined value of share and bond trades settled via DMBH in 2002 amounted to PLN 5,753 million, compared to PLN 7,494 million in 2001 (total turnover of Centrum Operacji Kapitałowych, Citibrokerage and DMBH in 2001). The amount included share trading at PLN 5,267 million (third place with 11.0% market share) and bond trades at PLN 485 million (second place with 12.2% market

share). At the same time DMBH was the twelfth largest broker in futures contracts on the WIG 20 index accounting for 3.5% of turnover by volume (221,800 contracts).

In 2002 DMBH continued to be the leading market maker for shares listed on the Warsaw Stock Exchange. DMBH was the market maker for 44 stocks listed on the WSE (1/5 of the total listed), futures contracts on the WIG 20 index and index units, as well as for two stocks traded on the over-the-counter CeTO market. In 2002 DMBH's share in total market-maker trading turnover on the Warsaw Stock Exchange reached 32.4%. DMBH was also most the active arranger of trading on the CeTO market. The total value of turnover in 2002 reached PLN 257 million, with a market share of 41%.

At the same time DMBH successfully organised trading in shares of non-listed companies. A major development, which should drive volume growth in the coming months, was the commencement by DMBH of trading in employee shares of Polskie Linie Lotnicze LOT S.A. (the Polish national air carrier) on May 27, 2002 as well as of Elektrociepłownie Warszawskie S.A.

Strong market position, especially in the institutional investors segment, helped DMBH increase income on brokerage activities from PLN 20,531 thousand in 2001 to PLN 20,887 thousand in 2002, i.e. by 1.7%. Given the concurrent decrease in brokerage related expenses from PLN 21,247 thousand to PLN 20,657 thousand respectively, the company's net income on brokerage activities amounted to PLN 229 thousand in 2002 as compared to the net loss on brokerage activities of PLN 715 thousand in 2001.

Comparatively, the total income on brokerage activities of all brokerage houses in Poland fell from PLN 635.1 million in 2001 to PLN 573.8 million in 2002 (i.e. by 9.7%), while brokerage related expenses decreased from PLN 801.1 million to PLN 647.4 million respectively (i.e. by 19.2%). As a result, the net loss on brokerage activities narrowed from PLN 166.0 million to PLN 73.6 million.

Despite the increase in profitability of brokerage operations, the net profit of DMBH for 2002 was lower than a year earlier and amounted to PLN 1,785 thousand (PLN 7,706 thousand in 2001). To a large extent, a contributing factor in this was the cost of provisions made for receivables related to underwriting agreements, amounting to PLN 4,252 thousand.

On July 25, 2002, DMBH withdrew from the underwriting agreement with PIA Piasecki S.A. and transferred 600,000 series H shares of PIA Piasecki S.A. onto the company's brokerage account. Prior to the withdrawal, DMBH held 600,000 shares of PIA Piasecki, representing 5.48% share in the company's authorised capital and giving the holder the right to exercise 5.48% votes at the General Meeting of Shareholders. The withdrawal did not impact Bank Handlowy's direct interest in PIA Piasecki S.A., which remained unchanged at 4,000,000 shares representing 36.52% of the company's authorised capital and giving the holder the right to exercise 36.52% votes at the General Meeting of Shareholders.

3. *Subsidiary undertakings constituting the Group and other subordinated undertakings excluded from consolidation but accounted for under the equity method*

Handlowy Leasing S.A. i Citileasing Sp. z o.o.

Leasing services are provided by two subsidiary companies of the Bank: Handlowy-Leasing S.A. and Citileasing S.A. The merger of the two companies is planned to take place in the nearest future and the combined institution is to operate under the name of Handlowy-Leasing S.A. To this end, both subsidiaries worked on unification of the internal procedures as well as on improvement of the rules of co-operation with branches of Bank Handlowy w Warszawie SA. Apart from the capital injection,

Handlowy Leasing S.A. and Citileasing Sp. z o.o. are funded by means of credit lines drawn from Bank Handlowy w Warszawie SA.

In 2002 the range of products included financial and operating leases as well as lease-back in PLN, USD, EUR and CHF. This facilitated the leasing of machinery and equipment (including complete manufacturing and processing lines), passenger cars, delivery vans and trucks, as well as printing, construction and agriculture machines. Work was conducted on launching real estate leasing. The offering of Handlowy-Leasing S.A. and Citileasing Sp. z o.o. was primarily aimed at corporate customers serviced by Bank Handlowy w Warszawie SA., while other corporate customers were offered four product programmes and a simplified application acceptance procedure. The programmes covered leasing of transport vehicles, construction machinery, printing equipment and John Deere agricultural machines. The main channel for acquisition of new business was the network of relationship managers of Bank Handlowy Warszawa SA, supported by leasing salesmen of Handlowy-Leasing S.A., and a network of dealers and financial brokers. At the end of 2002 both leasing companies employed 63 staff overall.

The value of assets leased by the leasing companies in 2002 stood at PLN 415.9 million, a 1.5% increase from PLN 409.8 million in the previous year. As many as 1,228 leasing contracts were signed, including 1,097 operating and 131 financial leasing contracts. At the end of the year the combined net value of assets under lease of the two companies stood at PLN 946.8 million (this translates to a total market share of ca. 5%), compared to PLN 733 million at the end of 2001. On a combined basis, in terms of the value of assets under lease Handlowy-Leasing and Citileasing ranked sixth.

In June 2002 the Bank extended the agreement signed with the German bank Kreditanstalt für Wiederaufbau („KfW”) on refinancing of loans for the development of small and medium enterprises to include refinancing of lease finance transactions concluded with such companies by Handlowy Leasing S.A. using funding provided from aid programmes of the European Union. The size of one-time refinancing is limited to EUR 250 thousand. The funding provided by KfW should help the Bank's new leasing company grow its operation in the future.

Handlowy-Heller S.A.

Bank Handlowy w Warszawie SA owns a 50% interest in factoring company of Handlowy-Heller S.A. (of which 25% indirectly through Handlowy Inwestycje Sp. z o.o.). The remaining shares are held by the Dutch NMB Heller Holding N.V.(50% interest).

The financial results of the company in 2002 were largely determined by the adverse macroeconomic factors, especially the low turnover resulting from poor demand. The lower demand affected especially the businesses of particular importance for the Bank's factoring activities, i.e. electronics, IT, clothing, toys and stationery. As a consequence in 2002 the company suffered a 29% decline in income on its activities, which was offset by reducing costs of operation by 7% and financial costs by 36%. In addition the company had to establish specific provisions for uncollectable factoring receivables in the amount of PLN 3.9 million.

In total receivables acquired by Handlowy Heller in 2002 were PLN 949.2 million as compared to PLN 973.4 million acquired in 2001. The number of customers fell slightly from 117 at the end of 2001 to 116. In spite of this a record number of new agreements was signed in 2002 (53 compared to 38 in 2001). The company's market share remained unchanged at 12%.

Faced with a drop in business volumes and deterioration in the quality of its portfolio the company undertook remedial actions to counter these tendencies. A regional representative office was opened in Poznań, a new product was introduced (factoring on a non-recourse basis) and credit risk management enhanced, *inter alia* through the introduction of internal limits for customers. The company began working on the establishment of a call centre and the introduction of a new product for companies

with annual sales below PLN 5 million. As a result, the second half of 2002 brought about an improvement manifested through an increase in the monthly purchase of invoices from PLN 49 million in January to a record PLN 111 million in October.

PKO/Handlowy Powszechne Towarzystwo Emerytalne S.A.

The bank has a 50% interest in the pension fund company PKO/Handlowy Powszechne Towarzystwo Emerytalne S.A., which manages the Bankowy open-ended pension fund ("OFE Bankowy").

In 2002 OFE Bankowy experienced a net outflow of customers, with their number dropping from 389.1 thousand to 383.6 thousand (3.6% market share). By the end of 2002 assets under management rose to PLN 967.9 million (an increase of 56.3% as compared to the end of 2001), making OFE Bankowy the sixth largest pension fund with a market share of 3.1%. In April, as a result of the fund not meeting the minimum 24-month rate of return published quarterly by KNUiFE, PKO/Handlowy PTE was forced to make a cash contribution to the fund in the amount of PLN 16.4 million. The contribution resulted in a 21.936% rate of return (6th place among 17 OFE) in a 24-month period ending on December 31, 2002 with weighted average rate of return for all OFE at 21.965% and the minimum required rate of return at 10.983%. At the end of 2002 the investment portfolio of OFE Bankowy was consisted of debt securities (bonds and Treasury bills) 64%, and investment in shares 31%, compared to 74% and 22%, respectively, at the end of 2001.

In March 2002 Bank Handlowy together with the other shareholder of the PKO/Handlowy pension fund company – PKO BP S.A. made the choice of the financial advisor to prepare an analysis of strategic options available to both shareholders of the PKO/Handlowy fund.

Handlowy Zarządzanie Aktywami S.A.

In 2002 the Group experienced further dynamic growth of its asset management business. Assets entrusted to Handlowy Zarządzanie Aktywami SA ("HanZA") increased from PLN 767.4 million at the end of December 2001 to PLN 1,438.4 million as at December 31, 2002, which represented a 87.4% growth and an increase in HanZA's asset management market share from 2.7% to 3.0% placing the company in eighth position. Of this amount, PLN 782.7 million came from *CitiFundusze*, PLN 204.6 million from individual customers, PLN 434.5 million from insurance companies and other financial institutions, and the remaining PLN 16.6 million from other corporate customers. If advisory services also offered by HanZA are included, total assets under asset management and advisory services rose in 2002 from PLN 1.2 billion to PLN 2.4 billion, i.e. by 100.2%. Particularly fast growth was observed in assets entrusted by financial institutions (growth by 188%) and individual customers (growth by as much as 1433%). In the case of individual customers, the large number of new customers acquired and the resultant high growth of asset volumes was the combined effect of HanZA introducing a new debt securities portfolio – the optimisation portfolio – and the closer and more effective co-operation with *CitiGold* branches in the distribution of investment products offered by HanZA. A great achievement of HanZA in 2002 was overcoming benchmarks by all investment strategies, pursuant to which the company managed the customers' portfolios.

Towarzystwo Funduszy Inwestycyjnych Banku Handlowego S.A.

The year 2002 was particularly good for the Bank's investment fund society Towarzystwo Funduszy Inwestycyjnych Banku Handlowego SA ("TFI BH"). Assets entrusted to TFI BH rose from PLN 404 million at the end of December 2001 to PLN 783 million at the end of 2002. Over last year the assets increased by approximately 94 %. The value of the assets under management as at December 31, 2002 placed TFI BH at 8th position with a 3.4% market share.

An important development in the area of asset management was the change of name of the Bank's investment funds from *Kapitał Handlowy* to *CitiFundusze* (*CitiFunds*), effected on March 26, 2002. This move was to underscore the links of TFI BH with Citigroup and unify the branding used for TFI

BH products with names of products offered by Citibank. It also improved brand awareness among potential customers of the Bank's funds.

The fastest growth was experienced by the CitiObligacji FIO fund. Investment in the fund was more attractive than a bank deposit – the unit value rose over 2002 by 12.46%. The assets of CitiObligacji FIO increased over the year by PLN 303 million and on December 31, 2002 amounted to PLN 594 million, which placed the fund in ninth position in the market in respect of the value of assets. The considerable growth of assets in 2002 was, among other things, influenced by the increased availability of *CitiFundusze*. The number of retail branches of Bank Handlowy w Warszawie SA adapted to sell *CitiFundusze* units grew to 70, which made the Consumer Banking Sector the principal and most effective channel of *CitiFundusze* distribution.

The year of 2002 was also successful in respect of management results. The value of a CitiZrównoważony FIO unit grew by 9.50% over 2002 while CitiAkcja FIO grew by 7.54%. The results achieved by both funds place them as second in respect of profitability gained over the last year among the funds of a given category. In respect of the unit value growth, the CitiSenior SFIO Fund placed fourth among the stable growth funds – the unit value rose by 10.48%.

In 2002 the number of investment funds managed by TFI BH increased from 5 to 8. In October 2002 a new fund targeted at retail customers was launched – CitiObligacji USD Fundusz Inwestycyjny Mieszany nominated in US dollars. CitiObligacji USD FIM is an offer addressed to customers looking for a product that would be potentially more attractive than a USD bank deposit. During the first subscription, which closed on December 6, 2002, customers signed up for the Investment Certificates totalling USD 9.467 million. Certificate subscription will be repeated periodically – next issue is scheduled for the 1Q 2003. In October a fund exclusively targeted at corporate entities – CitiPłynnościowy Specjalistyczny Fundusz Inwestycyjny Otwarty – was introduced to the TFI BH offering. This is a unique fund on the Polish market and an alternative solution to overnight and short-term deposits. Characterised by high liquidity, attractive profitability and low investment risk, CitiPłynnościowy SFIO is modelled on liquidity funds offered in many countries by Citigroup Asset Management. First assets in the amount of PLN 10 million flowed to the funds at the end of 2002.

Another significant event for TFI BH was the launch of Fundusz Własności Pracowniczej PKP SFIO (Employee Ownership Fund of the Polish State Railroads) in October last year. For the first time employees of a privatised institution may participate in the privatisation through an investment fund established especially for this purpose. 15% of all proceeds from the sale of assets belonging to the Polish State Railroads, including real estate and shares in subsidiary companies, will be placed in the fund, which at present has 380,000 participants. In the coming years FWP PKP SFIO may considerably influence the growth of assets managed by TFI BH - it is estimated that ultimately assets of the fund may reach PLN 1.3 billion. FWP PKP SFIO is a stable-growth fund – up to 60% of the assets will be invested in debt securities issued by the Treasury and other issuers of high credibility.

TFI BH also continues to be the clear leader on the Employee Pension Programme market. By the end of 2002, 24 Employee Pension Programmes were registered in the form of an agreement with the CitiSenior SFIO. As a result of the regular inflow of fees, assets of this fund rose in 2002 by over 138% and amounted to PLN 70.6 million as at the end of 2002.

In 2003 TFI BH is planning to expand the distribution network of *CitiFundusze*, by acquiring new external distributors. A considerable growth in the number of new customers, both individual and institutional, is anticipated. TFI BH expects a growth in the popularity of balanced and share funds.

Independent experts appreciated excellent performance of *CitiFundusze* in 2002. TFI BH won second place in the ranking of investment societies prepared by "Rzeczpospolita" daily. "Puls Biznesu" picked up CitiAkcji FIO as the best share fund in the country, based on the poll conducted among 150 financial analysts and professionals.

Special Purpose Investment Vehicles

In 2002 the Group conducted equity investment activities through four special purpose investment vehicles (SPVs), financed in a form of repayable contributions to capital and subordinated loans granted by the Bank. As a result of Management's intention to limit equity investment activities, it is expected that these companies will be gradually restructured or liquidated. According to information available at the date of preparation of the financial statements, basic financial data of the SPVs were as follows:

Name of undertaking	Location	Bank Handlowy's share in authorised capital	Total Assets	Capital	Net profit
		%		PLN '000	
Handlowy Inwestycje Sp. z o.o.	Warszawa	100.00	37,213	29,381	1,169
Handlowy Inwestycje II Sp. z o.o.	Warszawa	100.00	18,924	18,686	1,391
Handlowy Investments S.A.	Luksemburg	100.00	173,220	6,333	13,161
Handlowy Investments II S.a.r.l.	Luksemburg	100.00	43,548	16,730	1,883

* Bank Handlowy's share in capital includes indirect holdings; financial data prior to consolidation adjustments.

Handlowy Inwestycje Sp. z o.o.

In 2002 Handlowy Inwestycje Sp. z o.o. managed a portfolio that included shares in Handlowy Heller S.A. (25.00% shareholding), Handlowy Leasing S.A. (99.99% shareholding) and Lubelska Fabryka Maszyn Rolniczych S.A. (12.31% shareholding), totalling PLN 4,941.5 thousand. In addition, the company held a portfolio of debt securities including commercial paper issued by the Bank's associated undertaking Hortex Holding S.A. and the remaining bonds of Zakłady Odzieżowe Bytom S.A., totalling PLN 25,000 thousand. Majority of bonds issued by Z.O. Bytom S.A. and held by Handlowy Inwestycje Sp. z o.o., as well as the commercial paper of Hortex Holding S.A., were sold during 2002. Profit booked on those transactions totalled PLN 8,052.9 thousand (including impact of the reserve reversals). The gross value of the remaining portion of bonds issued by Z.O. Bytom S.A. and held by Handlowy Inwestycje Sp. z o.o., amounting to PLN 3,793 thousand, was fully covered with reserves. According to the rehabilitation agreement signed with Z.O. Bytom S.A., those bonds will be redeemed by no later than June 2003 under pain of suspending the agreement.

Handlowy Inwestycje II Sp. z o.o.

In 2002, Handlowy Inwestycje II Sp. z o.o. managed a portfolio consisting of shareholdings in TIM S.A., Inter Groclin Auto S.A., Z.O. Bytom S.A. and Rafamet S.A. According to information available at the date of preparation of the financial statements, the total value of the portfolio amounted to PLN 1,205 thousand as compared with PLN 7,128 thousand at the end of 2001. The decrease in value of the portfolio was related to sales of shares of the following listed companies: Fasing S.A., Karen S.A., EMA S.A., Browary Strzelec S.A. and Inter Groclin Auto S.A. Gains recognized on these transactions were PLN 2,545 thousand (including reserve reversals). Likewise Handlowy Inwestycje Sp. z o.o., the company held a portfolio of receivables related to the rehabilitation agreement with Z.O. Bytom S.A. A portion of these receivables was sold during 2002, while the remaining amount of PLN 3,939 thousand was fully provisioned.

Handlowy Investments S.A.

In 2002, Luxembourg-based company of Handlowy Investments S.A. managed a portfolio comprised of investments in the following entities: Eastbridge N.V., NIF Fund Holdings PCC Ltd., Polimex-Cekop S.A., Handlowy Investments II S.a.r.l., Pol-Mot Holding S.A. and Hortex Holding S.A. In 2002 Handlowy Investments S.A. refrained from major sale/purchase of equity investments or revaluation of already held securities, except for the sale of 4 shares of Hortex Holding S.A. Due to a negligible size of this transaction, the euro-denominated value of the company's assets remained roughly unchanged at EUR 37,549 thousand.

Handlowy Investments II S.a.r.l.

In 2002, Handlowy Investments II S.a.r.l., the other SPV domiciled in Luxembourg, managed the portfolio comprised of shareholding in Techmex S.A (19,34% share in capital) and 1 share in Handlowy Investments S.A.(0,0003% share in capital). During 2002 the company refrained from equity transactions and revaluation of its financial assets, which has been valued at EUR 5,497.

KP Konsorcjum Sp. z o.o.

KP Konsorcjum Sp. z o.o. provides management services for two National Investments Funds ("NIFs"): VIII NFI Octava S.A. (since 1995) and XII NFI Piast S.A. (since 1999). These activities, conducted within the framework of the previously adopted strategy, include making and implementing investment decisions, restructuring the NIFs' portfolio companies and reinvesting or distributing cash obtained from sales of portfolio stockholdings.

Basic financial data of KP Konsorcjum Sp. z o.o. as at 30/06/2002

Name of undertaking (legal form)	Location	Bank Handlowy's share in authorised capital	Total Assets	Capital	Net profit
		%			
				PLN '000	
KP Konsorcjum Sp. z o.o.	Warszawa	49.99	13,007	9,767	5,324

* Financial data prior to consolidation adjustments.

As at the end 2002 Bank Handlowy w Warszawie SA owned 49.99% of authorised capital and 49.99% of voting rights at a General Meeting Stockholders of KP Konsorcjum Sp. z o.o. The total value of assets of both NIFs managed by the company amounted to PLN 311.0 million, of which PLN 207.2 million was related to their investment portfolios (i.e. stockholdings in the companies participating in the NIF programme).

Polimex-Cekop S.A.

Investment in Polimex-Cekop S.A. was made by Handlowy Investments S.A. in September 1997. In 2001 Handlowy Investments increased its shareholding in Polimex-Cekop S.A. from 27.63% to 36.64% due to participation in the company's new share issue.

Polimex-Cekop S.A. specializes in the execution of investment projects for the chemical, petrochemical, petroleum, and gas industries, environmental protection, industrial and housing construction, projects for the power industry and seaport building for domestic and foreign clients. Product and service exports to the European, African and Asian markets are an important part of the Company's sales. In Asia the company's operations have been traditionally concentrated in the Middle East countries. In 1999, the Polish government recommended Polimex-Cekop for participation in

tenders and projects organized by NATO. Polimex-Cekop S.A. is also the parent entity of the capital group comprised of several companies operating in the construction, manufacturing and engineering industry. Approximately 7,5 thousand people are employed by the whole Group, of which major members are Naftobudowa S.A. (61,82% share in authorised capital), Mostostal Siedlce S.A. (55,05% share in authorised capital, including indirect holdings) and ZREW S.A. (28,26% share in authorised capital). In 2002 Polimex-Cekop S.A. undertook activities aimed at consolidating the Group's companies into one multi-facility entity, based on the planned friendly mergers of the Group's members.

For the year 2002, the Capital Group of Polimex-Cekop S.A. reported sales of PLN 968.9 million and a net loss of PLN 10.3 million

4. Banking institutions

In 2002 the Group continued to implement the strategy of decreasing its equity investments in other banks, which was earlier pursued due to diminishing usefulness of those affiliations after the accession to the global banking network of Citigroup. In 2002, the following transactions contributed to the realisation of this strategy:

- disposal on March 26, 2002 of all shares in the subordinated company Cuprum Bank S.A. to Dominet S.A., a subsidiary of Merrill Lynch Global Emerging Markets LP. Prior to the transaction the Bank had a 55.26% interest in the capital of Cuprum Bank S.A., which gave it the right to 50.20% votes at the General Meeting of Shareholders,
- disposal on April 26, 2002 of 87,741 shares in the subordinated company Bank Handlowy International S.A. in Luxemburg („BHI”). The transfer of rights to the shares took place on May 6, 2002. The shares subject to the transaction represented 73.12% of share capital and gave the holder the right to exercise 73.12% votes at the General Meeting of Shareholders of BHI,
- disposal on September 30, 2002 of all shares (i.e. 19.99%) in Mitteleuropäische Handelsbank AG to Nordeutsche Landesbank Girozentrale with the registered seat in Hanover,

The purchase of additional shares in Bank Rozwoju Cukrownictwa S.A. („BRC”), as a result of which the Bank's share in BRC increased from 95.77% to 100.00% of the capital and from 86.49% to 100.00% of the votes in the General Meeting of Shareholders, was connected with the planned sale (liquidation) of the company,

VI. Major risk factors relating to the Group's environment and operations

1.1 Competition within the banking sector

Mounting competition is observable on the Polish banking market between banks active in particular segments of that market. Many international financial institutions have been investing in the Polish banking industry. In addition, corporates are making use of financing alternatives to bank loans, such as commercial paper, bonds, equity issues or lease finance. There is a strong likelihood that the increase in foreign investment in the banking sector, coupled with the consolidations taking place in that sector, will result in fiercer competition on the banking market. The progressive integration of Poland with the European Union will strongly expose the Polish banking industry to competition from foreign institutions. particularly in such segments of the market as asset management and corporate

finance. The growing level of competition within the banking sector could have an adverse effect on the Group's operations.

1.2 *Equity investment risk*

Due to a number of macroeconomic effects, the situation on equity market and other factors having an impact on activities of the companies, in which the Bank is a shareholder, the selling price of owned shares may turn out lower than expected, or even lower than their value in the Bank's books, which may have a negative impact on the market valuation of the Bank's shares. The risk associated with equity investments is estimated moderate.

VII. **Prospects for the Group's development**

1. **General objectives of the Group's development**

Equity investments of Bank Handlowy w Warszawie SA are divided into three categories:

- strategic investment portfolio
- available-for-sale investment portfolio
- active investment portfolio

In the near future the Group will continue its policy of restructuring equity investment portfolio aligned with macroeconomic and structural changes in the economy. The guiding principle of this policy is to seek to achieve the target profile of the Group while optimising the earnings stream from capital transactions and minimising the risk, including reputation risk carried by those transactions.

1.1 *Strategic Investment Portfolio*

The Group seeks to expand its product range and presence and also strengthen its competitive position on financial services market. The strategy is implemented through specialised strategic subsidiary undertakings of the Bank. Examples of these investments include the Dom Maklerski Banku Handlowego S.A. the Towarzystwo Funduszy Inwestycyjnych Banku Handlowego S.A. Handlowy Zarządzanie Aktywami S.A., Handlowy Leasing S.A., Citileasing Sp. z o.o. and Handlowy Heller S.A.

1.1.1 *Brokerage activity*

Brokerage activity of the Group is performed by Dom Maklerski Banku Handlowego SA (DMBH). Major client of DMBH in terms of revenue generation are institutional investors. DMBH increases its efforts to seek new institutional customers, especially among foreign institutions. In addition, DMBH will focus on increasing its share in servicing of domestic retail customers. Cost efficiency in this case will be achieved by close cooperation of DMBH with the Consumer Banking Sector and also providing internet access to the account.

1.1.2 *Asset management*

Asset management services (AM) are conducted by two entities from the Group fully owned by the Bank: Handlowy Zarządzanie Aktywami (HanZA) and Towarzystwo Funduszy Inwestycyjnych Banku Handlowego (TFI BH). AM products have been introduced to the Citibank branch network. TFI BH launched CitiPłynnościowy SFIO, an investment fund exclusively targeted at corporate entities, which was introduced to the offer of the Bank's Cash Management Division. Actions have

been undertaken to widen cooperation with insurance companies offering insurance with investment fund and to expand distribution network for TFI BH funds by offering them through other financial institutions outside the Capital Group

1.1.3 Leasing activity

The Group's leasing operations are currently performed via two entities fully owned by the Bank: Handlowy Leasing S.A. and Citileasing Sp. z o.o. It is planned to merge the entities in 2003 in order to increase market share.

1.1.4 Factoring activity

Factoring services are provided both directly by Bank Handlowy w Warszawie SA and by the specialised company of Handlowy-Heller S.A. The strategy for development of factoring activity within the Capital Group of Bank Handlowy w Warszawie SA will be formulated in 2003.

1.2 Available-for-sale investment portfolio

The available-for-sale portfolio comprises of equity investments without a predetermined rate of return (including restructuring related investments) and former strategic investments that were reclassified.

1.3 Active investment portfolio

The active investment portfolio comprises equity holdings offering a potentially high return on investment. Investments within active investment portfolio are undertaken directly by Bank Handlowy or indirectly by its specialised investment subsidiaries (where the Bank holds 100% stake), i.e. Handlowy Inwestycje Sp. z o.o. Handlowy Inwestycje II Sp. z o.o., Handlowy Investments S.A., Handlowy Investments S.a.r.l. In line with sales of investments currently held in the active portfolio, a liquidation of the special purpose investment vehicles will be considered. There are no plans to acquire any new investments into the active portfolio in 2003.

2. Co-operation with other Citigroup members operating in Poland

Corporate finance products of Bank Handlowy w Warszawie SA will be offered in a close co-operation with Schroder Salomon Smith Barney in order to merge the execution of large, multinational transactions with local operations conducted with smaller entities.

The customers of the Consumer Banking Sector of Bank Handlowy w Warszawie SA and CitiFinancial are offered the insurance products developed in co-operation with CitiInsurance Polska Towarzystwo Ubezpieczeń na Życie S.A. Activities will be undertaken to widen this co-operation by development of the insurance offer dedicated for corporate customers of the Bank.

Signatures of all Management Board Members

19.05.2003	Cezary Stypulkowski	President	
.....
Date	Name	Position	Signature
19.05.2003	Shirish Apte	Vice President	
.....
Date	Name	Position	Signature
19.05.2003	Wiesław Kalinowski	Vice President	
.....
Date	Name	Position	Signature
19.05.2003	Philip King	Vice President	
.....
Date	Name	Position	Signature
19.05.2003	David J. Smith	Vice President	
.....
Date	Name	Position	Signature
19.05.2003	Witold Walkowiak	Vice President	
.....
Date	Name	Position	Signature