

**Report of the Supervisory Board of Bank Polska Kasa Opieki Spółka Akcyjna on its activity in 2017 and the results of the performed assessment of the reports on the activity of Bank Polska Kasa Opieki Spółka Akcyjna and of Bank Polska Kasa Opieki Spółka Akcyjna Group for the year 2017, the financial statements of Bank Polska Kasa Opieki Spółka Akcyjna and of Bank Polska Kasa Opieki Spółka Akcyjna Group for the year ended on 31 December 2017, and of the motion of the Management Board of the Bank on the distribution of the net profit of Bank Polska Kasa Opieki Spółka Akcyjna for the year 2017 and the position of Bank Kasa Opieki Spółka Akcyjna, taking into account the assessment of the internal control and risk management systems, compliance and internal audit functions as well as rationality of the Bank's policy concerning sponsorship and charitable activities**

**I. The composition and organisation of work of the Supervisory Board in 2017.**

In the period from 1 January 2017 to 7 June 2017, the Supervisory Board was composed of the following members:

Jerzy Woźnicki – Chairman of the Supervisory Board,  
Gianni Papa – Deputy Chairman of the Supervisory Board,  
Leszek Pawłowicz – Deputy Chairman of the Supervisory Board,  
Massimiliano Fossati – Secretary of the Supervisory Board,  
Dariusz Filar – Member of the Supervisory Board,  
Katarzyna Majchrzak – Member of the Supervisory Board,  
Laura Penna – Member of the Supervisory Board,  
Doris Tomanek – Member of the Supervisory Board.

On 13 January 2017 the Bank informed that Mr. Gianni Papa, Mr. Massimiliano Fossati, Ms. Laura Stefania Penna and Ms. Doris Tomanek resigned from the positions of the Members of the Supervisory Board of the Bank on the condition and effective as of the date of: (i) indirect disposal by UniCredit S.p.A. of 52 494 007 shares of the Bank for the benefit of Powszechny Zakład Ubezpieczeń S.A. and (ii) direct disposal by UniCredit S.p.A. of 26 247 003 shares of the Bank for the benefit of Polski Fundusz Rozwoju S.A.

On 25 April 2017 the Bank informed that on 24 April 2017 the Bank received a statement from Mr. Gianni Papa, Mr. Massimiliano Fossati, Ms. Laura Stefania Penna and Ms. Doris Tomanek, reading that the resignations from the positions of the Members of the Supervisory Board of the Bank submitted by the persons, information about which the Bank included in the current report No. 2/2017 of 13 January 2017, shall be effective on the condition and effective as of the date of: direct disposal by UniCredit S.p.A. of the total number of 86 090 172 shares of the Bank for the benefit of Powszechny Zakład Ubezpieczeń S.A. and Polski Fundusz Rozwoju S.A. (Transaction). Pursuant to the statements, it is the consequence of change in the structure of the Transaction.

On 7 June 2017, in consequence of the disposal on 7 June 2017 by UniCredit S.p.A. of a total number of 86 090 172 (eighty six million ninety thousand one hundred and seventy two) shares of Bank Pekao S.A. for the benefit of Powszechny Zakład Ubezpieczeń S.A. and Polski Fundusz Rozwoju S.A., conditional resignations from the positions of Members of the Supervisory Board of the Bank submitted by Mr. Gianni Papa, Mr. Massimiliano Fossati, Ms. Laura Stefania Penna and Ms. Doris Tomanek became effective.

On 8 June 2017, the Extraordinary General Meeting of Bank Pekao S.A. dismissed the following Members of the Supervisory Board: Mr. Jerzy Woźnicki, Mr. Leszek Pawłowicz, Mr. Dariusz Filar, Ms. Katarzyna Majchrzak.

On 8 June 2017, the Extraordinary General Meeting of Bank Pekao S.A., taking into account the assessment of suitability, appointed Ms. Sabina Bigos-Jaworowska, Ms. Joanna Błaszczyk, Ms. Justyna Głębiowska-Michalak, Mr. Grzegorz Janas, Mr. Stanisław Ryszard Kaczoruk, Mr. Michał Kaszyński, Mr. Marian Majcher, Mr. Paweł Stopczyński, Mr. Paweł Surówka as Members of the Supervisory Board for a new three-year joint term of office, starting from 8 June 2017.

At the meeting held on 8 June 2017, the Supervisory Board of the Bank appointed Mr. Paweł Surówka as the Chairman of the Supervisory Board, Ms. Joanna Błaszczyk as the Deputy Chairman of the Supervisory Board, Mr. Stanisław Ryszard Kaczoruk as the Deputy Chairman of the Supervisory Board and Mr. Paweł Stopczyński as the Secretary of the Supervisory Board.

Five Members of the Supervisory Board, i.e. Stanisław Ryszard Kaczoruk, Sabina Bigos-Jaworowska, Justyna Głębiowska-Michalak, Michał Kaszyński and Marian Majcher, meet the independence criteria.

The Supervisory Board exercised permanent supervision over the Bank's activity in accordance with the rights and obligations defined in the Commercial Companies Code, the Bank's Articles of Association and resulting from the Corporate Governance Principles and the Code of Best Practice.

In 2017, the Supervisory Board held 12 meetings, considered 123 pieces of information, analyses and motions and adopted 118 resolutions.

The Supervisory Board performed its tasks both at the meetings and as part of the works of the Board committees.

The following committees of the Supervisory Board continued their activity in 2017: (i) Audit Committee, (ii) Nomination and Remuneration Committee, and (iii) Risk Committee. Reports on the activities of these committees, approved by the Supervisory Board, have been attached to this report.

## **II. Personnel issues.**

In the period from 1 January 2017 to 14 June 2017, the Management Board of the Bank was composed of the following members:

Luigi Lovaglio – President of the Management Board of the Bank,  
Diego Biondo – Vice President of the Management Board of the Bank,  
Andrzej Kopyrski – Vice President of the Management Board of the Bank,  
Adam Niewiński – Vice President of the Management Board of the Bank,  
Grzegorz Piwowar – Vice President of the Management Board of the Bank,  
Stefano Santini – Vice President of the Management Board of the Bank,  
Marian Ważyński – Vice President of the Management Board of the Bank.

At the meeting held on 14 June 2017, the Supervisory Board dismissed Mr. Luigi Lovaglio from the position of President of the Management Board of the Bank and from the composition of the Management Board of the Bank.

Mr. Stefano Santini and Mr. Diego Biondo submitted resignations from the positions of Vice President of the Management Board effective as of 14 June 2017; the said resignations were the consequence of the disposal by UniCredit S.p.A. on 7 June 2017 of 32.8% of shares of Bank Pekao S.A. for the benefit of Powszechny Zakład Ubezpieczeń S.A. and Polski Fundusz Rozwoju S.A.

At the meeting held on 14 June 2017, after taking into account the assessment of suitability, the Supervisory Board appointed Mr. Michał Krupiński as Member of the Management Board of the Bank effective as of 15 June 2017 and decided that until such time as the Polish Financial Supervision Authority grants its approval Mr. Michał Krupiński shall be appointed as Vice President of the Management Board in charge of chairing the Management Board, whereas after the aforesaid approval is obtained Mr. Michał Krupiński shall be appointed as the President of the Management Board of the Bank.

In the period from 15 June 2017 to 6 July 2017, the Management Board of the Bank was composed of the following members:

Michał Krupiński – Vice President of the Management Board of the Bank in charge of chairing the Management Board,  
Andrzej Kopyrski – Vice President of the Management Board of the Bank,  
Adam Niewiński – Vice President of the Management Board of the Bank,  
Grzegorz Piwowar – Vice President of the Management Board of the Bank,  
Marian Ważyński – Vice President of the Management Board of the Bank.

On 7 July 2017, the Bank informed that on 6 July 2017 Mr. Marian Ważyński and Mr. Grzegorz Paweł Piwowar submitted resignations from their positions as Vice Presidents of the Management Board and as Members of the Management Board of the Bank effective as of 6 July 2017.

At the meeting held on 6 July 2017, the Supervisory Board of the Bank, after taking into account the assessment of suitability, appointed Mr. Tomasz Kubiak, Mr. Michał Lehmann, Mr. Marek Lusztyn as Members of the Management Board of the Bank effective as of 7 July 2017 and entrusted them with the positions of Vice Presidents of the Management Board. The Supervisory Board decided to entrust Mr. Marek Lusztyn with the position of Vice President of the Management Board in charge of managing risk material to the operations of the Bank, effective as of the date of obtaining approval from the Polish Financial Supervision Authority.

At the meeting held on 7 July 2017, the Supervisory Board of the Bank, after taking into account the assessment of suitability, appointed Mr. Tomasz Styczyński effective as of 7 July 2017 and Mr. Marek Tomczuk effective as of 1 September 2017 as Members of the Management Board of the Bank and entrusted them with the positions of Vice Presidents of the Management Board of the Bank.

In the period from 7 July 2017 to 20 August 2017, the Management Board of the Bank was composed of the following members:

Michał Krupiński – Vice President of the Management Board of the Bank in charge of chairing the Management Board,  
Andrzej Kopyrski – Vice President of the Management Board of the Bank,  
Tomasz Kubiak – Vice President of the Management Board of the Bank,  
Michał Lehmann – Vice President of the Management Board of the Bank,  
Marek Lusztyn – Vice President of the Management Board of the Bank,  
Adam Niewiński – Vice President of the Management Board of the Bank,  
Tomasz Styczyński – Vice President of the Management Board of the Bank.

At the meeting held on 1 August 2017, the Supervisory Board of the Bank decided that the appointment of Mr. Marek Tomczuk as Vice President of the Management Board of the Bank shall be effective as of 21 August 2017.

In the period from 21 August 2017 to 21 September 2017, the Management Board of the Bank was composed of the following members:

Michał Krupiński – Vice President of the Management Board of the Bank in charge of chairing the Management Board,  
Andrzej Kopyrski – Vice President of the Management Board of the Bank,  
Tomasz Kubiak – Vice President of the Management Board of the Bank,  
Michał Lehmann – Vice President of the Management Board of the Bank,  
Marek Lusztyn – Vice President of the Management Board of the Bank,  
Adam Niewiński – Vice President of the Management Board of the Bank,  
Tomasz Styczyński – Vice President of the Management Board of the Bank,  
Marek Tomczuk – Vice President of the Management Board of the Bank.

On 21 September 2017, the Bank informed that on 21 September 2017 Mr. Adam Niewiński submitted a resignation from the position of Vice President of the Management Board and as Member of the Management Board of the Bank effective as of 21 September 2017.

At the meeting held on 21 September 2017, the Supervisory Board of the Bank, after taking into account the assessment of suitability, appointed Ms. Roksana Ciurysek-Gedir as Vice President of the Management Board effective as of 1 January 2018.

In the period from 22 September 2017 to 6 November 2017, the Management Board of the Bank was composed of the following members:

Michał Krupiński – Vice President of the Management Board of the Bank in charge of chairing the Management Board,  
Andrzej Kopyrski – Vice President of the Management Board of the Bank,  
Tomasz Kubiak – Vice President of the Management Board of the Bank,  
Michał Lehmann – Vice President of the Management Board of the Bank,  
Marek Lusztyn – Vice President of the Management Board of the Bank,

Tomasz Styczyński – Vice President of the Management Board of the Bank,  
Marek Tomczuk – Vice President of the Management Board of the Bank.

On 17 October 2017, the Bank informed that the Polish Financial Supervision Authority, at the meeting held on 17 October 2017, unanimously approved the appointment of Mr. Marek Lusztyn as Member of the Management Board of Bank Pekao S.A. in charge of managing risk material to the operations of the Bank.

On 7 November 2017, the Bank informed that on 7 November 2017 the Polish Financial Supervision Authority unanimously approved the appointment of Mr. Michał Krupiński as President of the Management Board of Bank Polska Kasa Opieki Spółka Akcyjna.

In the period from 7 November 2017 to 31 December 2017, the Management Board of the Bank was composed of the following members:

Michał Krupiński – President of the Management Board of the Bank,  
Andrzej Kopyrski – Vice President of the Management Board of the Bank,  
Tomasz Kubiak – Vice President of the Management Board of the Bank,  
Michał Lehmann – Vice President of the Management Board of the Bank,  
Marek Lusztyn – Vice President of the Management Board of the Bank,  
Tomasz Styczyński – Vice President of the Management Board of the Bank,  
Marek Tomczuk – Vice President of the Management Board of the Bank.

### **III. Main activities of the Supervisory Board.**

The activity of the Supervisory Board in 2017, like in previous years, was focused both on the strategic issues and the issues related to supervision over the current activity of the Bank.

The strategic issues included primarily the approval of updated Strategic Areas of the Bank for the years 2018-2020 by the Management Board of the Bank, the issuance of a positive opinion on the Financial Plan of the Bank Pekao S.A. Group for 2017 and for 2018, and the approval of the internal procedure concerning “Strategic Planning, Budgeting, Forecasting and Financial Plans Monitoring in Bank Pekao S.A.”. As part of the strategic issues, the Supervisory Board approved the Capital Management Strategy – 2017 and 2018, the Credit Risk Policy and Strategies for 2017, the Investment and Market Risk Policy for 2017, the Funding Plan for 2017 and 2018, the “Capital Management Policy at Bank Pekao S.A.”, “Capital Planning at Bank Pekao S.A. – Handbook”, “Contingency Capital Plan Policy of Bank Pekao S.A.” and “Information Policy of the Bank on Capital Adequacy”. The Supervisory Board also approved the “Group Recovery Plan for Bank Pekao S.A. Capital Group”. In addition, in relation to the execution of the Letter of Intent with Alior Bank S.A. aimed to enable the performance of a feasibility study and analyses of various forms of potential cooperation, the Supervisory Board approved the performance of the due diligence process at the Bank.

The Supervisory Board discussed with the Management Board the information on the macroeconomic outlook in Poland, including, *inter alia*, GDP growth perspectives, inflation and interest rates, deposits and loans.

The Supervisory Board analysed capital management reports and the liquidity situation of the Bank on a quarterly basis.

On a regular basis, the Supervisory Board analysed the following: (i) the financial situation, (ii) the results of sale of the key products, i.e. PLN mortgage loans, consumer loans, mutual funds, (iii) asset quality, and (iv) risk level.

The Supervisory Board supervised the process of risk management at the Bank. The Supervisory Board approved the warning level for operating losses and warning sub-levels for event classes for the year 2017 as well as the "Strategy of Operational Risk Management" and the "Policy of Operational Risk Management". The Supervisory Board approved the results of the annual ICAAP review, the updated "ICAAP Policy" and the updated "Model Risk Management Principles" Policy. The quarterly reports on financial risk management, operational risk control and on credit portfolio and workout activity were analysed by the Supervisory Board with due attention.

In addition, the Supervisory Board established the composition of the Risk Committee.

The activity of the Bank's subsidiary companies was also within the area of interest of the Supervisory Board. The Supervisory Board acknowledged the information on the activity of the subsidiaries of the Bank Pekao S.A. Group.

The Supervisory Board got acquainted with the information on the Letter of the Bank's Auditor concerning the financial statements for the year 2016, divided into particular areas of activity of the Bank, together with the list of recommendations and business units of the Bank's Head Office responsible for their implementation, the status of implementation of the recommendations and deadlines for their implementation, and the summary of recommendations by thematic area.

The Supervisory Board issued opinions on the separate and consolidated annual and interim financial statements of Bank Pekao S.A. and Bank Pekao S.A. Capital Group, as well as annual and interim reports on the activities of the Bank Pekao S.A. Capital Group, which were prepared in accordance with the International Financial Reporting Standards approved by the European Union.

The Supervisory Board adopted the "Policy regarding the selection of an audit firm to perform the statutory examination of the financial statements of Bank Pekao S.A.", "Procedure for the selection of an audit firm to perform the statutory examination of the financial statements of Bank Pekao S.A.", and "Policy regarding the supply of permitted services other than the examination by the audit firm performing the examination, entities affiliated to that audit firm and by a member of that audit firm's network".

The Supervisory Board paid a lot of attention to the issues related to functioning of the internal audit. The 2018 Annual Audit Plan and the Internal Audit Strategy for the years 2018-2020 were approved. The Supervisory Board acknowledged: (i) the report on the activity of the Internal Audit Department in 2016, (ii) the assessment of the internal audit activity results, (iii) the internal audit report on the review of the policy of variable remuneration components implementation, in accordance with the Resolution No. 258/2011 of the Polish Financial Supervision Authority.

The Supervisory Board supervised the implementation of post-audit recommendations from the Polish Financial Supervision Authority and got acquainted with the results of verification of these recommendations by the Internal Audit Department.

The Supervisory Board approved the Audit Charter of Bank Pekao S.A. and the Policy of cooperation of the Internal Audit Department of Bank Pekao S.A. with the Audit Office of PZU S.A., internal audit units of the Bank's subsidiaries and the statutory auditor.

Furthermore, the Supervisory Board adopted amendments to the Regulations of the Audit Committee and established the composition of that Committee.

The Supervisory Board approved the amended regulations concerning the Bank's internal audit function. Furthermore, the Supervisory Board reviewed the internal control system and acknowledged the "Statement on executive assessment of the Internal Control System – 2016".

The Supervisory Board acknowledged the report on the activity of the Compliance Department in 2016, including, among others, the Department's organisational model, activity in 2016, compliance risk assessment, second level controls and 2017 priorities plan. The Supervisory Board also acknowledged quarterly reports on the activities of the Compliance Department. In accordance with the approved strategy of the Bank in the area of bancassurance, the Supervisory Board acknowledged regular bancassurance activity risk reports.

The Supervisory Board approved the "Compliance Policy of Bank Pekao S.A.", "Regulations on the functioning of the Compliance Department of Bank Pekao S.A.", the internal division of competencies in the whistleblowing process and the "Whistleblowing Policy of Bank Pekao S.A.", and the "Policy of cooperation of the Compliance Department of Bank Pekao S.A. with the Compliance Office of PZU S.A. and compliance units of the Bank's subsidiaries".

The Supervisory Board issued a positive opinion on the application by the Bank in 2016 of the Corporate Governance Principles for Supervised Institutions, issued by the Polish Financial Supervision Authority, and acknowledged the Report on application by the Bank of the Corporate Governance Principles for Supervised Institutions in 2016.

Furthermore, in 2017 the Supervisory Board got acquainted with the report on the functioning of the compliance system at the Pekao Brokerage House in 2016, the method of implementation of “Guidelines concerning the supply of brokerage services on the OTC derivatives market” issued by the Polish Financial Supervision Authority, and the Report on the implementation of “Guidelines concerning the management of information technology areas and IT environment security at investment companies” (IT Guidelines) as well as with information contained in the “Form for the self-assessment of the compliance of business activity with the IT Guidelines in investment firms”, and positively assessed the degree of implementation of standards specified in the IT Guidelines in the Pekao Brokerage House.

In accordance with the “Information Policy of Bank Pekao S.A. on Capital Adequacy”, the Supervisory Board got familiar with the documents “Information on Capital Adequacy of the Bank Pekao S.A. Capital Group”.

The Supervisory Board got acquainted with periodical reports on the Bank’s IT security in 2016 as well as business continuity and crisis management.

The Supervisory Board also acknowledged the annual summary concerning data quality management at Bank Pekao S.A. for 2016.

Performing its statutory duties, the Supervisory Board considered and issued positive opinions on the motions and reports addressed by the Management Board of the Bank to the Ordinary General Meeting for the fiscal year 2016.

The Supervisory Board considered and issued positive opinions on draft resolutions of the Extraordinary General Meeting of the Bank submitted by the Shareholder of the Bank and convened the Extraordinary General Meeting of Bank Pekao S.A. at the request of the Shareholder of the Bank with a specific agenda and resolutions.

Other issues analysed by the Supervisory Board were issues related to the remuneration policy and suitability assessment. The Supervisory Board reviewed the functioning of the “Remuneration Policy of Bank Polska Kasa Opieki Spółka Akcyjna in 2016”, approved the Report on the review of the functioning of the “Remuneration Policy of Bank Polska Kasa Opieki Spółka Akcyjna” for 2016, approved the “Remuneration Policy of Bank Polska Kasa Opieki Spółka Akcyjna” and adopted the amendments to the Nomination and Remuneration Committee Regulations. The Supervisory Board approved the Rules of the Variable Remuneration System for the Executive Staff for 2017 for the Members of the Management Board of the Bank and the identified positions as well as amendments to the previous years’ systems, together with the assumptions of that System.

The Supervisory Board assessed the individual performance for 2016 and approved the pay-out of remuneration to Members of the Management Board of the Bank, in accordance with the Rules of the Variable Remuneration System for the Executive Staff. Next, the Supervisory Board set individual goals for 2017 and approved the amount of target bonus for the year 2017 for Members of the Management Board of the Bank. The Supervisory Board also approved the motions on conditions of remuneration and extra benefits for Members of the Management Board of the Bank.



In addition, the Supervisory Board got acquainted with information on the review of remunerations of Internal Audit Department and Compliance Department employees.

Acting pursuant to § 18 p. 12 of the Bank's Articles of Association, the Supervisory Board also issued opinions with regard to motions of the Management Board of the Bank concerning the establishment and accession of the Bank as a shareholder (stockholder) to companies and the disposal of shares (stocks) in cases in which these investments are of a long-term and strategic nature.

Within the scope of its competencies set out in § 18 p. 16 of the Bank's Articles of Association, the Supervisory Board also considered motions regarding the sale of real estate.

Within the scope of its competencies set out in § 18 p. 17 of the Bank's Articles of Association, the Supervisory Board also considered motions to undertake liabilities or dispose of assets, the value of which, with respect to a single entity, exceeds 5% of the Bank's equity.

Furthermore, within the scope of its competencies set out in § 18 p. 18 of the Bank's Articles of Association, the Supervisory Board considered motions of the Management Board of the Bank regarding outsourcing in strategic areas of business activity pursued by the Bank.

The Supervisory Board got acquainted with information regarding pending civil court proceedings involving the Bank's participation in 2016.

The Supervisory Board got acquainted with information regarding the sale of the portfolio of non-performing debt of customers from the natural persons segment and micro-enterprise segment.

Furthermore, the Supervisory Board got acquainted with information regarding the commencement of work on the issue of non-public subordinated bonds of the Bank in 2017.

#### **IV. Assessment of the reports of the Management Board on activities of the Bank and the Capital Group for the year 2017, the financial statements of the Bank and the Capital Group for the year 2017, and the motion of the Management Board of the Bank concerning the distribution of net profit for the year 2017.**

The Supervisory Board of Bank Pekao S.A., acting in accordance with Article 382 § 3 of the Commercial Companies Code and performing its statutory duties, assessed the Management Board's reports on activities of the Bank and the Capital Group in 2017 as well as the financial statements of the Bank and the Capital Group for the year 2017 in terms of their consistency with the books, documents and the factual state.

As a result of this assessment and having acknowledged the report of the statutory auditor from the examination of the financial statements of Bank Polska Kasa Opieki Spółka Akcyjna and the consolidated statements of Bank Polska Kasa Opieki Spółka Akcyjna Capital Group for the year 2017, the Supervisory Board issues its positive opinion on the achieved results and recommends to the General Meeting to adopt resolutions approving these statements.

Putting forward this recommendation the Supervisory Board took the following into consideration:

- 1) The Bank's activity in 2017 was focused on maintaining further sustainable growth in all areas, effective strengthening of its position on the retail banking market and its leader position in corporate banking.

The net profit of Bank Pekao S.A. for 2017 amounted to PLN 2,088.1 million and was PLN 190.3 million (i.e. 8.4%) lower YOY in nominal terms, whereas excluding the settlement of the transaction consisting in the acquisition of Visa Europe Limited by Visa Inc in 2016 – net profit was 1.1% higher YOY. Strong contribution to the achieved results was brought by a substantial growth in the volume of loans and deposits.

The net profit of the Bank Pekao S.A. Capital Group attributable to shareholders of the Bank in 2017 amounted to PLN 2,475.1 and was PLN 195.8 million (i.e. 8.6%) higher YOY. A factor that had a strong contribution to the results achieved by the Bank Pekao S.A. Capital Group in 2017 was profit achieved on the remeasurement of previously held shares at fair value, related to the acquisition of remaining shares in Pioneer Pekao Investment Management S.A. and Dom Inwestycyjny Xelion Spółka z o.o. amounting to PLN 414 million.

Net interest income achieved by the Bank was 6.3% higher YOY and net interest income achieved by the Group was 4.9% higher YOY, mainly due to higher loan and deposit volumes.

Net non-interest income achieved by the Bank and the Group in 2017 was 1.6% and 1.9% higher YOY, respectively, excluding the settlement of the transaction consisting in the acquisition of Visa Europe Limited by Visa Inc in 2016 (8.6% lower YOY for the Bank and 7.3% lower YOY for the Group in nominal terms). Net fee and commission income achieved by the Bank and the Group (including commissions in respect of margin on foreign exchange transactions with customers) was 2.6% and 1.5% lower YOY, respectively, mainly due to lower commissions on loan, card and other activity.

Operating expenses of the Bank and the Group in 2017 were 1.1% and 1.6% higher YOY, respectively, mainly due to higher personnel costs.

- 2) The return on average equity (ROE) of the Bank and the Group amounted to 9.6% and 11.0%, respectively.
- 3) Thanks to the effective commercial activity of the Bank and the Group in 2017, a significant growth in loan volumes was reported in the area of retail loans (an increase of 10.7% YOY for the Bank and 10.4% YOY for the Group) and in the area of corporate loans (an increase of 6.0% YOY for the Bank and 5.5% YOY for the Group). The growth in lending activity was financed by higher volumes of retail deposits (which went up by 7.7% YOY for the Bank and 7.5% YOY for the Group) and corporate deposits (which went up by 6.3% YOY for the Bank and 5.8% YOY for the Group) as well as higher Deposit Certificates volumes.

- 4) The solid liquidity structure of the Bank and the Group is reflected by net loans to deposits ratio at 86.6% and 88.5%, respectively, as at the end of December 2017. This, together with high equity level, enables further sound and stable development of activities pursued by the Bank and the Group. The total capital ratio (TCR) of the Bank amounted to 18.4% and was 0.2 pp higher than as at the end of 2016. The total capital ratio (TCR) of the Group amounted to 17.1% and was slightly (0.5 pp) lower than as at the end of 2016.
- 5) Bank Pekao S.A. consequently realised the strategy of strengthening its position on the housing and consumer goods financing market. In 2017, the Bank further strengthened its strong position in the area of mortgage loans, granting loans for the highest amount in history – PLN 9.1 billion (up by 33% YOY). The Bank is also the leader in granting housing loans under the government programme “*Mieszkanie dla Młodych*” (“Apartment for the Young”) which provides support to persons aged up to 35 in the acquisition of the first new apartment, with a market share of over 41% in 2017. The value of cash loans granted by the Bank also reached a record level of PLN 8.8 billion (up by 14% YOY).
- 6) Bank Pekao S.A. remains the bank of first choice for corporate customers, providing a wide range of universal bank services as well as any other financial services available in Poland (including leasing, factoring and investment advice). The Bank maintains its position as the leading corporate bank and the leader of innovative product solutions for enterprises and institutions. A wide range of products, innovative solutions and an individual approach allow to provide comprehensive financial services to enterprises, institutions and budgetary units. The Bank is available to clients at every stage of the business activity. It supports financial management processes related to production and sales processes, the automation of service processes, finances the development of the product and service range, as well as provides advisory services and funds for investments and international expansion.
- 7) Bank Pekao S.A. is a universal bank which as of 2017 forms part of the PZU S.A. capital group, the largest financial institution in Central and Eastern Europe. The strategic objectives of the Bank, announced as part of the new strategy of the Bank for the years 2018-2020 “Strength of the Polish Bison”, are to become the leader in terms of profitability in the Polish banking sector by taking the path of smart growth in the business model based on high efficiency and quality of processes. Business growth is based on strong capital and liquidity position while maintaining the highest standards in risk management and further improving cost-efficiency.

## **Assessment of the motion of the Management Board of the Bank concerning the distribution of net profit for the year 2017**

The Supervisory Board of Bank Pekao S.A. assessed the motion of the Management Board of the Bank concerning the distribution of net profit of Bank Pekao S.A. for the year 2017.

The Supervisory Board gave its positive opinion on this motion having considered:

- 1) that the Bank has a strong capital position; the Common Equity Tier 1 capital ratio (CET1) of the Bank Pekao S.A. Group in December 2017, without incorporating net profit for 2017, reached the level of 16.1% (and for the Bank the CET1 amounted to 17.3%). The capital buffer of the Group above the minimum regulatory requirements of the Polish Financial Supervision Authority for Tier 1 capital amounts to 5.3 pp. The level of Tier 1 capital is above the average for the European banking sector, which amounts to 15.3%. Such a strong capital base ensures the safe position of the Bank, even in the event of volatility on the market, and it allows to pursue development plans,
- 2) that the Bank meets the criteria laid down by the Office of the Polish Financial Supervision Authority regarding the conditions and restrictions in profit distribution,
- 3) that the Bank has a low exposure to mortgage loans denominated in CHF,
- 4) compliance with the Financial Plan and Capital Management Strategy for the year 2018.

Considering the above, the Supervisory Board decided to recommend to the General Meeting to adopt the resolution on the distribution of net profit of Bank Polska Kasa Opieki Spółka Akcyjna for 2017 in the amount of PLN 2,088,128,692.79 in accordance with the motion of the Management Board of the Bank, i.e.:

- 1) the amount of PLN 2,073,513,268.60 to be allocated to the dividend,
- 2) the amount of PLN 14,615,424.19 to be allocated to reserve capitals.

According to the above-mentioned recommendation, the payment of dividend shall amount to PLN 7.90 per share, which translates into a payout ratio of 99.30% of the Bank's net profit for 2017.

## **Assessment of the internal control systems, risk management, compliance and internal audit functions**

In accordance with the Code of Best Practice for WSE Listed Companies 2016, the Supervisory Board has prepared and presents to the Ordinary General Meeting the assessment of the Bank's position in 2016, including the assessment of the internal control and risk management systems, compliance and internal audit function; the document containing the assessment has been attached to this report.

## **Assessment of the Bank's policy concerning the sponsorship and charitable activities**

The Supervisory Board has prepared and presents to the Ordinary General Meeting the assessment of rationality of the Bank's policy concerning sponsorship and charitable activities.

The major objectives of sponsorship activity of Bank Pekao S.A. include: building the image of the Bank as the leading financial institution in the area of CSR activities, as institution close to customers and communities in which the Bank operates, distinguishing the Bank's brand among the brands of its market competitors, popularisation of the Bank and its products in the public opinion, inducing positive connotations between the given event and the Bank, forming and strengthening the positive opinion about the Bank and its products, and ensuring a permanent communication platform for promotional activities for business divisions of the Bank as well as strong and positive relations with customers of the Bank. The Policy of the Bank in this respect is regulated by internal regulations, i.e. the Ordinance of the President of the Management Board of the Bank. The aforesaid Ordinance defines rules, procedure and competencies related to granting donations and sponsorships by Bank Polska Kasa Opieki Spółka Akcyjna.

In its charitable and sponsorship activity, the Bank supports the selected organisations and institutions which carry out different projects in the following areas:

- 1) high culture;
- 2) sport;
- 3) aid provided to the children in need;
- 4) environmental protection, taking into special account the protection of wisents;
- 5) responsible economic development;
- 6) support provided to young consumer groups;
- 7) useful innovations;
- 8) development of entrepreneurship;
- 9) propagation of ethics in business activity;
- 10) local and regional initiatives, important from the standpoint of developing and supporting local communities.

Before a donation is made or sponsorship agreement is concluded, the Bank performs a risk assessment (due diligence), in accordance with regulations on counteracting corruption and conflict of interest in force at the Bank.

The Supervisory Board positively assesses the sponsorship and charitable activity policy pursued by the Bank.

### **Self-assessment of work of the Supervisory Board**

In accordance with the rights and obligations defined in the Commercial Companies Code, Banking Law, recommendations of the Polish Financial Supervision Authority, the Code of Best Practice for WSE Listed Companies and the Bank's Articles of Association, in 2017 the Supervisory Board exercised permanent supervision over activity of the Bank.

The good financial performance of the Bank in 2017, its position in the Polish banking sector, adequate capital management and effective risk management should be considered as the result, *inter alia*, of proper and effective operation of the Supervisory Board and proper fulfilment of the tasks and obligations imposed on it.

Taking into consideration the presented information, the activity of the Supervisory Board in 2017 can be assessed as effective, professional and performed in accordance with the best practices.

## **Conclusion**

Assessing the Management Board of the Bank, the Supervisory Board considered, *inter alia*, the following:

(i) good financial results, (ii) effective cost management, (iii) effective and consistent risk management, (iv) strong capital and liquidity base, (v) high level of the Bank's security, (vi) efficient internal control system, and (vii) operational effectiveness.

In the opinion of the Supervisory Board, Bank Pekao S.A. has a strong capital and liquidity structure while also maintaining the highest risk management standards and continuing to improve cost efficiency. This allows to effectively achieve strategic objectives of the Bank, announced as part of the new strategy of the Bank for the years 2018-2020 "Strength of the Polish Bison", and become the leader in terms of profitability in the Polish banking sector by taking the path of smart growth in the business model based on high efficiency and quality of processes.

Considering the above, in accordance with Article 395 § 2 p. 3 of the Commercial Companies Code, the Supervisory Board recommends to the General Meeting the acknowledgement of the fulfilment of duties in 2017 by Members of the Management Board of the Bank: Messrs. Luigi Lovaglio for the period from 1 January 2017 to 14 June 2017, Diego Biondo for the period from 1 January 2017 to 14 June 2017, Stefano Santini for the period from 1 January 2017 to 14 June 2017, Grzegorz Piwowar for the period from 1 January 2017 to 6 July 2017, Marian Ważyński for the period from 1 January 2017 to 6 July 2017, Adam Niewiński for the period from 1 January 2017 to 21 September 2017, Michał Krupiński for the period from 15 June 2017 to 31 December 2017, as well as Tomasz Kubiak, Michał Lehmann, Marek Lusztyn, Tomasz Styczyński for the period from 7 July 2017 to 31 December 2017, Marek Tomczuk for the period from 21 August 2017 to 31 December 2017, and Andrzej Kopyrski for the period from 1 January 2017 to 31 December 2017.

Taking into account the activity in the year 2017 presented above, in accordance with Article 395 § 2 p. 3 of the Commercial Companies Code, the Supervisory Board recommends to the General Meeting the acknowledgement of the fulfilment of duties in 2017 by Members of the Supervisory Board: Messrs. Gianni Papa, Massimiliano Fossati, Mss. Laura Penna, Doris Tomanek for the period from 1 January 2017 to 7 June 2017, Messrs. Jerzy Woźnicki, Leszek Pawłowicz, Dariusz Filar and Ms. Katarzyna Majchrzak for the period from 1 January 2017 to 8 June 2017, Mr. Paweł Surówka, Ms. Joanna Błaszczyk, Mr. Stanisław Ryszard Kaczoruk, Mr. Paweł Stopczyński, Ms. Sabina Bigos-Jaworowska, Ms. Justyna Głębiowska-Michalak, Mr. Grzegorz Janas, Mr. Michał Kaszyński, Mr. Marian Majcher for the period from 8 June 2017 to 31 December 2017.

## **Report on the activity of the Audit Committee in 2017**

### **Members of the Audit Committee**

The Audit Committee is comprised of 3 (three) to 5 (five) Members selected from among the Members of the Supervisory Board. At least one Audit Committee Member has knowledge and skills in the area of accounting or examining the financial statements. The majority of Audit Committee Members, including its Chairperson, is independent from the Bank in accordance with Article 129 paragraph 3 of the Act on Statutory Auditors, Audit Firms and Public Supervision. Audit Committee Members have knowledge and skills in the Bank's trade area. This condition is deemed to be met, if at least one Audit Committee Member has knowledge and skills in that trade area or at least specific members have knowledge and skills to the specific extent within that trade area.

As at 1 January 2017, the Audit Committee comprised the following members:

Dariusz Filar – Chairman of the Committee,  
Massimiliano Fossati – Member of the Committee,  
Leszek Pawłowicz – Member of the Committee,  
Laura Stefania Penna – Member of the Committee,  
Jerzy Woźnicki – Member of the Committee.

Messrs. D. Filar, L. Pawłowicz and J. Woźnicki were considered to be independent.

In connection with the appointment of a new composition of the Supervisory Board of the Bank, the composition of the Audit Committee has changed.

As of 9 June 2017, the Audit Committee comprised the following members:

Justyna Głębiowska-Michalak - Chairwoman of the Committee,  
Joanna Błaszczyk – Member of the Committee,  
Grzegorz Janas – Member of the Committee.

By means of Resolutions No. 93/17 and 94/17, respectively, on 21 September 2017 the Supervisory Board additionally appointed Sabina Bigos-Jaworowska and Michał Kaszyński to the Audit Committee as its Members.

As at 31 December 2017, the Audit Committee comprised the following members:

Justyna Głębiowska-Michalak - Chairwoman of the Committee,  
Joanna Błaszczyk – Member of the Committee,  
Grzegorz Janas – Member of the Committee,  
Sabina Bigos-Jaworowska – Member of the Committee,  
Michał Kaszyński – Member of the Committee.

Ms. J.Głębiowska-Michalak, Ms. S.Bigos-Jaworowska and Mr. M.Kaszyński were considered to be independent.

The composition of the Audit Committee in 2017 met the requirements laid down in the Act on Statutory Auditors, Audit Firms and Public Supervision of 11 May 2017.

### **Responsibilities of the Audit Committee**

The Audit Committee supports the Supervisory Board in performing its responsibilities related, *inter alia*, to controlling and monitoring: the financial reporting process, the internal control and risk management systems and internal audit function effectiveness, the performance of financial review activities, the independence of the statutory auditor and the audit firm, the effectiveness of the system for monitoring compliance with applicable law and regulations.

The meetings of the Audit Committee are held as needed, but not less frequently than four times a year, on dates consistent with key quarterly dates in the reporting cycle of the Bank and the analysis of the annual audit plan presented by the Head of the Internal Audit Department.

The Audit Committee Regulations were amended in 2017 in connection with the provisions of the Act of 11 May 2017 on Statutory Auditors, Audit Firms and Public Supervision. "Regulations of the Audit Committee of the Supervisory Board of Bank Pekao S.A." were adopted by way of Resolution No. 81/17 of 1 August 2017. Resolution No. 41/14 of the Supervisory Board of 12 December 2014, previously in force, has been repealed.

Audit Committee meetings are usually attended by the President of the Management Board of the Bank and each Committee meeting is attended by Heads of the following Departments: Internal Audit, Legal and Compliance, as well as other Members of the Management Team whose functions are relevant to the meeting agenda.

To ensure transparency and objectivism, the Chairwoman of the Audit Committee, J.Głębikowska-Michalak, held individual meetings with the Head of the Internal Audit Department and the Head of the Compliance Department, without the participation of other members of the management team of the Bank. The Audit Committee met with the key statutory auditor from Deloitte Polska, without the participation of Members of the Management Board of the Bank.

### **External Auditors**

The entity authorised to examine and review the financial statements of the Bank and Bank Pekao S.A. Capital Group for the years 2013-2017 was the audit firm Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k. under the agreement of 17 June 2013.

### **Audit Committee Meetings**

The Audit Committee met 10 times in 2017 (on February 6<sup>th</sup>, March 23<sup>rd</sup>, May 5<sup>th</sup>, June 13<sup>th</sup>, July 6<sup>th</sup>, July 13<sup>th</sup>, August 1<sup>st</sup>, November 7<sup>th</sup>, November 16<sup>th</sup> and December 7<sup>th</sup>).



The attendance of Audit Committee Members at specific meetings was as follows:

| <u>Date</u>               | <u>Participating Members</u>   |
|---------------------------|--|
| February 6 <sup>th</sup>  | D.Filar, M.Fossati, L.Pawłowicz, L.Penna, J.Woźnicki                             |
| March 23 <sup>rd</sup>    | D.Filar, L.Pawłowicz, L.Penna, J.Woźnicki  |
| May 5 <sup>th</sup>       | D.Filar, L.Pawłowicz, L.Penna, J.Woźnicki  |
| June 13 <sup>th</sup>     | J.Głębikowska-Michalak, J.Błaszczuk, G.Janas                                     |
| July 6 <sup>th</sup>      | J.Głębikowska-Michalak, J.Błaszczuk, G.Janas                                     |
| July 13 <sup>th</sup>     | J.Głębikowska-Michalak, J.Błaszczuk, G.Janas                                     |
| August 1 <sup>st</sup>    | J.Głębikowska-Michalak, J.Błaszczuk, G.Janas                                     |
| November 7 <sup>th</sup>  | J.Głębikowska-Michalak, S.Bigos-Jaworowska,<br>J.Błaszczuk, G.Janas, M.Kaszyński |
| November 16 <sup>th</sup> | J.Głębikowska-Michalak, S.Bigos-Jaworowska,<br>J.Błaszczuk, G.Janas, M.Kaszyński |
| December 7 <sup>th</sup>  | J.Głębikowska-Michalak, S.Bigos-Jaworowska,<br>J.Błaszczuk, G.Janas, M.Kaszyński |

### **Key functions performed by the Audit Committee in 2017**

The Committee reviewed and discussed the following information with Members of the Management Board of the Bank, Heads of the following Departments: Internal Audit, Legal and Compliance, and the external auditor:

- the financial statements for the year 2016 examined by the external auditor; the Committee gave its positive opinion on these statements;
- the quarterly and semi-annual financial statements; the Committee gave its positive opinion on these statements;
- the plan for the review of the financial statements of Bank Pekao S.A. and Bank Pekao S.A. Capital Group for a period of 6 months ended 30 June 2017; the Committee acknowledged the presented information;
- the plan of activities connected with the audit of the financial statements for the year 2017; the Committee acknowledged the presented information;
- the review of human resources in the Financial Division; the Committee acknowledged the presented information;
- information on disputable matters conducted by Bank Pekao S.A. in 2016 and in the first half of 2017; the Committee acknowledged the presented information;
- motions for opinion on non-audit services to be provided to the Bank by entities authorised to examine the financial statements; the Audit Committee expressed consent to the performance of the aforementioned services;

- the review of the Internal Control System (ICS) of Bank Pekao S.A. in 2016 and the Statement regarding the ICS; the Committee acknowledged the aforementioned information;
- the amended Internal Control System of Bank Pekao S.A.; the Committee acknowledged information regarding the amended ZPZ regulation “Internal Control System of Bank Polska Kasa Opieki Spółka Akcyjna”;
- the quarterly report on the activity of the Compliance Department; the Committee acknowledged the presented report;
- the audit report concerning the implementation of the Policy of Variable Remuneration Components; the Committee acknowledged the presented report;
- “Policy regarding the selection of an audit firm to perform the statutory examination of the financial statements of Bank Pekao S.A.”, “Procedure for the selection of an audit firm to perform the statutory examination of the financial statements of Bank Pekao S.A.”, and “Policy regarding the supply of permitted services other than the examination by the audit firm performing the examination, entities affiliated to that audit firm and by a member of that audit firm’s network”; the Committee developed and adopted the aforementioned documents and decided to present them for adoption by the Supervisory Board;
- information regarding the status of implementation of post-audit recommendations issued by the Polish Financial Supervision Authority, including the results of verification carried out by the Internal Audit Department; the Committee acknowledged the presented information;
- information regarding Pekao Pioneer PTE; the Committee acknowledged the presented report;
- information regarding the Bank’s credit exposure towards entities and banks whose registered office is located abroad, as at 30 September 2017; the Committee acknowledged the presented information;
- information regarding the centralisation of activities performed by the transfer agent as part of the insurance and banking group; the Committee acknowledged the presented information;
- the Internal Audit Plan for the year 2018; the Committee gave its positive opinion on this document;
- the Internal Audit Strategy for the years 2018-2020; the Committee gave its positive opinion on the aforementioned Strategy;
- the Audit Charter of Bank Pekao S.A. and the Policy of cooperation of the Internal Audit Department of Bank Pekao S.A. with the Audit Office of PZU S.A., internal audit units of the Bank’s subsidiaries and the statutory auditor; the Committee gave its positive opinion on the aforementioned documents;

- motion to issue the consent of the Audit Committee to introduce amendments to the Agreement of 17 June 2013 on the Review and Examination of the Financial Statements and the Review and Examination of the Consolidation Package and the Supply of Non-Prohibited Services; the Committee gave its consent to the introduction of amendments to the aforementioned Agreement.

In relation to the Internal Audit function, the Committee regularly reviewed Internal Audit activity reports.

The Audit Committee approved the candidate for the position of Internal Audit Executive.

The Audit Committee performed its duties in accordance with its rights and obligations.

## **Report on the Activity of the Nomination and Remuneration Committee in 2017**

### **Members of the Nomination and Remuneration Committee**

The Nomination and Remuneration Committee is comprised of three to five members selected from among the Members of the Supervisory Board.

As at 1 January 2017, the Nomination and Remuneration Committee functioning within the Bank was comprised of the following members:

Dariusz Filar,  
Katarzyna Majchrzak – as of 6 February 2017,  
Gianni Papa,  
Doris Tomanek,  
Jerzy Woźnicki.

In connection with the appointment of a new composition of the Supervisory Board of the Bank, the composition of the Nomination and Remuneration Committee has changed.

By means of Resolutions No. 51/17, 52/17 and 50/17 respectively, on 9 June 2017 the Supervisory Board appointed Paweł Stopczyński, Sabina Bigos-Jaworowska and Paweł Surówka as Members of the Nomination and Remuneration Committee.

As at 31 December 2017, the Nomination and Remuneration Committee comprised the following members:

|                         |                           |
|-------------------------|---------------------------|
| Paweł Stopczyński       | Chairman of the Committee |
| Sabina Bigos-Jaworowska | Member of the Committee   |
| Paweł Surówka           | Member of the Committee   |

## **Responsibilities of the Nomination and Remuneration Committee**

The Nomination and Remuneration Committee operates based on the Rules of Procedure of the Supervisory Board and Rules of Procedure of the Nomination and Remuneration Committee adopted on 27 April 2015 and then amended by Resolution No. 75/16 of 11 October 2016 and Resolution No. 46/17 of 9 June 2017.

The objective of the Committee is to support the Supervisory Board in the performance of its duties, including by:

- submitting recommendations regarding the determination of the terms and conditions regulating the employment relationship or other legal relationship between members of the Management Board and the Bank, including remunerations for Members of the Management Board of the Bank, and regarding the approval of the policy on variable components of remuneration for persons holding managerial positions in the Bank in accordance with separate regulations and in order to submit recommendations to the General Meeting regarding the remuneration for Members of the Supervisory Board,
- preparing recommendations regarding the fulfilment of suitability requirements for the purpose of appointment of members of the Management Board of the Bank and members of the Supervisory Board,
- preparing a report for the General Meeting regarding the assessment of functioning of the remuneration policy in the Bank.

## **Meetings of the Nomination and Remuneration Committee**

In 2017, the Nomination and Remuneration Committee met 9 times (February 6<sup>th</sup>, March 23<sup>rd</sup>, May 29<sup>th</sup>, June 2<sup>nd</sup>, June 9<sup>th</sup>, July 6<sup>th</sup>, July 20<sup>th</sup>, September 21<sup>st</sup>, December 7<sup>th</sup>).

The attendance of Committee Members at specific meetings was as follows:

| <b><u>Date</u></b>         | <b><u>Participating Members</u></b>          |
|----------------------------|--|
| February 6 <sup>th</sup>   | D.Filar, K.Majchrzak, J.Woźnicki             |
| March 23 <sup>rd</sup>     | D.Filar, K.Majchrzak, D.Tomanek, J.Woźnicki  |
| May 29 <sup>th</sup>       | D.Filar, K.Majchrzak, J.Woźnicki             |
| June 2 <sup>nd</sup>       | D.Filar, K.Majchrzak, J.Woźnicki             |
| June 9 <sup>th</sup>       | P.Stopczyński, S.Bigos-Jaworowska, P.Surówka |
| July 6 <sup>th</sup>       | P.Stopczyński, S.Bigos-Jaworowska, P.Surówka |
| July 20 <sup>th</sup>      | P.Stopczyński, S.Bigos-Jaworowska, P.Surówka |
| September 21 <sup>st</sup> | P.Stopczyński, S.Bigos-Jaworowska, P.Surówka |
| December 7 <sup>th</sup>   | P.Stopczyński, S.Bigos-Jaworowska, P.Surówka |

## **Key topics covered by the Nomination and Remuneration Committee in 2017**

In 2017, the Nomination and Remuneration Committee issued opinions and recommendations on the following topics:

- the evaluation of results at the Bank level and decision about launching a bonus pool for 2016;
- the evaluation of individual performance for 2016 and settlement of variable components of remuneration for Members of the Management Board of the Bank;
- the monitoring of variable remuneration for persons holding managerial positions;
- the Report on the functioning of the Remuneration Policy of the Bank in 2016;
- amendments to the Remuneration Policy of Bank Polska Kasa Opieki Spółka Akcyjna;
- opinion on: (i) the review of remuneration paid to Internal Audit Department employees, (ii) the review of variable remuneration of the Managing Director of the Compliance Department and selected positions in the Risk Management Division, (iii) the review of remuneration for Compliance Department employees;
- the review of terms and conditions of remuneration for control function chief candidates;
- the terms and conditions of employment and remuneration for Members of the Management Board of the Bank;
- the acceptance of assumptions to the Rules of the Variable Remuneration System for the Executive Staff for the year 2017;
- the establishment of individual targets for the year 2017 for Members of the Management Board of the Bank;
- decision on the performance of the assessment of suitability of candidates for Members of the Supervisory Board and recommendations on meeting the requirements of individual and collective suitability to hold the function of Member of the Supervisory Board of the Bank;
- discussions regarding changes to the Management Board of the Bank;
- the assessment of individual suitability of candidates for Members of the Management Board of the Bank and collective suitability of the Management Board of the Bank;
- information on the review of current remuneration systems.

## **Report on the Activity of the Risk Committee in 2017**

### **Members of the Risk Committee**

The Risk Committee is comprised of three members selected from among the Members of the Supervisory Board, of whom at least one is an independent Member of the Supervisory Board.

As at 1 January 2017, the Risk Committee comprised the following members:

Massimiliano Fossati – Chairman of the Committee  
Katarzyna Majchrzak – Member of the Committee  
Leszek Pawłowicz – Member of the Committee

In connection with the appointment of a new composition of the Supervisory Board of the Bank, the composition of the Risk Committee has changed.

By means of Resolutions No. 53/17, 55/17 and 54/17, respectively, on 9 June 2017 the Supervisory Board appointed Stanisław Ryszard Kaczoruk, Michał Kaszyński and Marian Majcher as Members of the Risk Committee.

As at 31 December 2017, the Risk Committee comprised the following members:

Stanisław Ryszard Kaczoruk – Chairman of the Risk Committee  
Michał Kaszyński – Member of the Committee  
Marian Majcher – Member of the Committee

### **Responsibilities of the Risk Committee**

The Risk Committee operates on the basis of the “Rules of Procedure of the Risk Committee”, which was adopted by the Supervisory Board by way of Resolution No. 55/15 of 18 December 2015. The mission of the Committee is to support the Supervisory Board in the performance of its duties relating to: supervision over the risk management system and assessment of the adequacy and effectiveness of that system. The Committee, in its activity, shall aim at prudent and stable management of risk, capital and liquidity as well as at special care for the long-term interests of the Bank and of its shareholders.

The tasks of the Committee include giving opinions on:

- the overall current and future readiness of the Bank to take risks, expressed as risk appetite,
- strategy for managing risk in the Bank’s activity, developed by the Management Board of the Bank, including policies on credit, financial and operational risks,
- reports concerning risk profile and realisation of the risk management strategy, submitted by the Management Board of the Bank.

The Committee is also supporting the Supervisory Board in supervising the implementation of the risk management strategy in the Bank by senior management and reviews whether prices of liabilities and assets offered to customers take fully into account the bank's business and risk strategies and in case prices do not properly reflect risks in accordance with these strategies, presenting the Management Board of the Bank with proposals aiming to ensure the adequacy of the prices of assets and liabilities to these risks.

The Risk Committee also performs other tasks arising from applicable laws or recommendations issued by supervisory authorities.

### **Risk Committee Meetings**

In 2017, the Risk Committee met six times (on February 6<sup>th</sup>, March 23<sup>rd</sup>, June 13<sup>th</sup>, July 6<sup>th</sup>, September 21<sup>st</sup>, December 7<sup>th</sup>).

The attendance of Committee Members at specific meetings was as follows:

| <u>Date</u>                | <u>Participating Members</u>         |
|----------------------------|--------------------------------------|
| February 6 <sup>th</sup>   | M.Fossati, K.Majchrzak, L.Pawłowicz  |
| March 23 <sup>rd</sup>     | K.Majchrzak, L.Pawłowicz             |
| June 13 <sup>th</sup>      | S.R.Kaczoruk, M.Kaszyński, M.Majcher |
| July 6 <sup>th</sup>       | S.R.Kaczoruk, M.Kaszyński, M.Majcher |
| September 21 <sup>st</sup> | S.R.Kaczoruk, M.Kaszyński, M.Majcher |
| December 7 <sup>th</sup>   | S.R.Kaczoruk, M.Kaszyński, M.Majcher |

### **Key topics covered by the Risk Committee in 2017**

The Committee reviewed and discussed the following:

- The ICAAP review, including the update of the ICAAP Policy and Policy concerning model risk management principles; the Risk Committee gave its positive opinion on the review results.
- Risk appetite in 2017 and 2018; the Risk Committee gave its positive opinion regarding the risk appetite proposed for both 2017 and 2018.
- Warning levels and sub-levels of operating losses for 2017, Operational Risk Management Policy and Strategy; the Risk Committee gave its positive opinion regarding these documents.
- Investment and Market Risk Policy for 2017; the Risk Committee gave its positive opinion regarding the aforementioned Policy.
- Credit Risk Policy and Strategies for 2017; the Risk Committee gave its positive opinion regarding the aforementioned Policy.
- Capital Management Policy for 2017; the Risk Committee gave its positive opinion regarding the prepared document.
- Quarterly reports on the credit portfolio and work-out activities; the Risk Committee assessed them positively.
- Quarterly reports on financial risk; the Risk Committee assessed them positively.

- Quarterly reports on operational risk control; the Risk Committee assessed them positively.
- Operational Risk Management Strategy and Operational Risk Management Policy; the Risk Committee gave its positive opinion amendments to the Strategy and Policy.
- Issues related to IT risk; the Risk Committee discussed them, paying attention to issues related to ensuring the continuity of operation of IT infrastructure and the costs of adopted solutions.
- Capital Management Strategy for 2018; the Risk Committee gave its positive opinion regarding this document.

Committee meetings were attended by the President of the Management Board of the Bank, Vice Presidents of the Management Board of the Bank in charge of the Risk Management Division, Financial Division and the Operations and Services Area, and other management staff relevant to the topic discussed.



## **Assessment of the situation of the Bank in 2017, including the assessment of the internal control systems, risk management, compliance and internal audit functions**

In accordance with the Code of Best Practice for WSE Listed Companies, the Supervisory Board of Bank Polska Kasa Opieki Spółka Akcyjna assessed the situation of the Bank in 2017, taking into consideration the assessment of the internal control and risk management systems functioning in the Bank.

### **General assessment of the situation of the Bank**

In the assessment of the Supervisory Board, the general economic and financial situation of Bank Pekao S.A. is stable. Bank Pekao S.A. meets all requirements of safe operations and of capital adequacy, and it ensures safety of funds entrusted by customers, presenting exceptional capital strength and resilience. The Supervisory Board of Bank Pekao S.A. positively assesses the results achieved in 2017 by the Bank and the Capital Group of Bank Pekao S.A.

The Bank's activity in 2017 was focused on maintaining further sustainable growth in all areas, effective strengthening of its position on the retail banking market and its leader position in corporate banking.

The net profit of Bank Pekao S.A. for 2017 amounted to PLN 2,088.1 million and was PLN 190.3 million (i.e. 8.4%) lower YOY in nominal terms, whereas excluding the settlement of the transaction consisting in the acquisition of Visa Europe Limited by Visa Inc in 2016 – net profit was 1.1% higher YOY. Strong contribution to the achieved results was brought by a substantial growth in the volume of loans and deposits.

The net profit of the Bank Pekao S.A. Capital Group attributable to shareholders of the Bank in 2017 amounted to PLN 2,475.1 and was PLN 195.8 million (i.e. 8.6%) higher YOY. A factor that had a strong contribution to the results achieved by the Bank Pekao S.A. Capital Group in 2017 was profit achieved on the remeasurement of previously held shares at fair value, related to the acquisition of remaining shares in Pioneer Pekao Investment Management S.A. and Dom Inwestycyjny Xelion Spółka z o.o. amounting to PLN 414 million.

Net interest income achieved by the Bank was 6.3% higher YOY and net interest income achieved by the Group was 4.9% higher YOY, mainly due to higher loan and deposit volumes.

Net non-interest income achieved by the Bank and the Group in 2017 was 1.6% and 1.9% higher YOY, respectively, excluding the settlement of the transaction consisting in the acquisition of Visa Europe Limited by Visa Inc in 2016 (8.6% lower YOY for the Bank and 7.3% lower YOY for the Group in nominal terms). Net fee and commission income achieved by the Bank and the Group (including commissions in respect of margin on foreign exchange transactions with customers) was 2.6% and 1.5% lower YOY, respectively, mainly due to lower commissions on loan, card and other activity.

Operating expenses of the Bank and the Group in 2017 were 1.1% and 1.6% higher YOY, respectively, mainly due to higher personnel costs.

The return on average equity (ROE) of the Bank and the Group amounted to 9.6% and 11.0%, respectively.

Thanks to the effective commercial activity of the Bank and the Group in 2017, a significant growth in loan volumes was reported in the area of retail loans (an increase of 10.7% YOY for the Bank and 10.4% YOY for the Group) and in the area of corporate loans (an increase of 6.0% YOY for the Bank and 5.5% YOY for the Group). The growth in lending activity was financed by higher volumes of retail deposits (which went up by 7.7% YOY for the Bank and 7.5% YOY for the Group) and corporate deposits (which went up by 6.3% YOY for the Bank and 5.8% YOY for the Group) as well as higher Deposit Certificates volumes.

The solid liquidity structure of the Bank and the Group is reflected by net loans to deposits ratio at 86.6% and 88.5%, respectively, as at the end of December 2017. This, together with high equity level, enables further sound and stable development of activities pursued by the Bank and the Group. The total capital ratio (TCR) of the Bank amounted to 18.4% and was 0.2 pp higher than as at the end of 2016. The total capital ratio (TCR) of the Group amounted to 17.1% and was slightly (0.5 pp) lower than as at the end of 2016.

Bank Pekao S.A. consequently realised the strategy of strengthening its position on the housing and consumer goods financing market. In 2017, the Bank further strengthened its strong position in the area of mortgage loans, granting loans for the highest amount in history – PLN 9.1 billion (up by 33% YOY). The Bank is also the leader in granting housing loans under the government programme “*Mieszkanie dla Młodych*” (“Apartment for the Young”) which provides support to persons aged up to 35 in the acquisition of the first new apartment, with a market share of over 41% in 2017. The value of cash loans granted by the Bank also reached a record level of PLN 8.8 billion (up by 14% YOY). Bank Pekao S.A. is one of the leaders in electronic banking in Poland. As part of its electronic banking service, the Bank offers to its customers a wide range of solutions, such as: online and mobile service, mobile application for phones and tablets.

Bank Pekao S.A. remains the bank of first choice for corporate customers, providing a wide range of universal bank services as well as any other financial services available in Poland (including leasing, factoring and investment advice). The Bank maintains its position as the leading corporate bank and the leader of innovative product solutions for enterprises and institutions. A wide range of products, innovative solutions and an individual approach allow to provide comprehensive financial services to enterprises, institutions and budgetary units. The Bank is available to clients at every stage of the business activity. It supports financial management processes related to production and sales processes, the automation of service processes, finances the development of the product and service range, as well as provides advisory services and funds for investments and international expansion.

Bank Pekao S.A. is a universal bank which as of 2017 forms part of the PZU S.A. capital group, the largest financial institution in Central and Eastern Europe. The strategic objectives of the Bank, announced as part of the new strategy of the Bank for the years 2018-2020 “Strength of the Polish Bison”, are to become the leader in terms of profitability in the Polish banking sector by taking the path of smart growth in the business model based on high efficiency and quality of processes. Business growth is based on strong capital and liquidity position while maintaining the highest standards in risk management and further improving cost-efficiency.

The Bank invests in training, professional development of employees (in line with their skills and capabilities), creation of a friendly work environment and conducts questionnaire surveys on employees’ opinions and satisfaction.

Similarly to previous years, activity of the Bank in 2017 was rewarded and distinguished for achievements and innovation of offered solutions in the competitions organised by the prestigious foreign and domestic magazines. Congratulating the achieved prizes, the Supervisory Board agrees with the Management Board that awards for innovative products and services are of particular importance.

The Global Finance magazine selected the winners of the competition for the best investment bank in the world for the 18<sup>th</sup> time. Bank Pekao S.A. received the title “The Best Investment Bank in Poland for 2017”.

Bank Pekao S.A. was recognised as “The Best Trade Finance Provider” in Poland, according to a study by the prestigious magazine Euromoney, for the third time in a row (this time for 2017).

The Private Banking service offered by Bank Pekao S.A. was recognised for the third time as the best in Poland by the prestigious magazine Global Finance in the third edition of the World’s Best Private Banks Awards competition.

Bank Pekao S.A. once again received a certificate in the Top Employers Poland 2017 and Top Employers Europe 2017 competitions by the Top Employers Institute, which confirms the pro-employee activities implemented at the Bank.

### **Assessment of the internal control system**

Bank Pekao S.A. has the internal control system consistent with the guidelines laid down in Recommendation “H” of the Polish Financial Supervision Authority, which includes the following:

- 1) control function (control mechanisms, independent monitoring of compliance with control mechanisms, reporting within the control function),
- 2) independent compliance unit (Compliance Department),
- 3) independent internal audit unit (Internal Audit Department) and applies to all organisational units of the Bank and its subsidiaries.

The Supervisory Board positively assesses the functioning of the internal audit function at Bank Pekao S.A., which ensures: effective and efficient operation of the Bank, reliable financial reporting, compliance with risk management rules in force at the Bank, compliance of the Bank's operations with applicable laws, internal regulations and market standards. The rules for exercising internal control include the procedures and internal control mechanisms approved by the Management Board and the Supervisory Board of Bank Pekao S.A. that are adjusted to the organisational structure of the Bank, the size and profile of risks identified in the ICAAP Procedure, and to the scale of activity of the Bank. These rules are reviewed and assessed as part of the internal audit.

The Internal Control System in force at the Bank is carried out at all organisational levels and by statutory bodies of the Bank, by particular organisational units, supervisors at all managerial levels and by all employees. The general objectives of the Internal Control System are to:

- 1) ensure the effective and efficient operation of the Bank,
- 2) ensure reliable financial reporting,
- 3) ensure compliance with risk management principles in force at the Bank,
- 4) ensure compliance of the Bank's operations with applicable laws, internal regulations and market standards.

As part of the general objectives of the Internal Control System, the Bank identifies specific objectives of the Internal Control System.

The Internal Control System functioning at the Bank includes three lines of defence:

- 1) the first line of defence – managing risk in the Bank's operating activity,
- 2) the second line of defence – risk management performed by employees in specially established positions or organisational units, irrespective of the risk management constituting the first line of defence,
- 3) the third line of defence – includes an independent Internal Audit unit.

The Bank ensures independent monitoring of compliance with control mechanisms in all processes functioning at the Bank through:

- 1) horizontal monitoring as part of the first line of defence and vertical monitoring of the first line of defence by the second line of defence,
- 2) horizontal monitoring as part of the second line of defence,
- 3) horizontal monitoring as part of the third line of defence.

The independent monitoring of compliance with control mechanisms takes place through: continuous verification and testing.

Dedicated structures fully cover the key risk areas on the so-called three lines of defence.

Control functions in regard to subsidiaries are exercised via the Bank's representatives in supervisory boards of these subsidiaries.

The Management Board of the Bank is responsible for designing implementing and operating an independent, adequate and effectively functioning Internal Control System in all organisational units, business units and at all organisational positions of the Bank.

The Supervisory Board exercises supervision over the implementation of the Internal Control System and assurance of its adequate and effective functioning.

### **Assessment of the risk management system**

The Supervisory Board positively assesses the risk management system functioning in the Bank and in the Pekao Group.

Risk management follows a comprehensive and consolidated approach and it extends to all units of the Bank and its subsidiaries.

The risk management strategy in the form of the ICAAP Policy adopted by the Management Board of the Bank was approved by the Supervisory Board in accordance with the regulatory requirements. The ICAAP Policy is subject to regular reviews and required updates in order to adjust it to the best market practices, legal norms and changes in the Bank and in its operating environment, and in order to maintain its validity and adequacy to the scale and complexity of the activities performed by the Bank and by the Group.

In accordance with applicable law and supervisory regulations, the Management Board of the Bank is responsible for achieving the strategic risk management goals. The Supervisory Board, supported by the Risk Committee of the Supervisory Board, oversees whether the Bank's policy of taking exposure to various risks is compliant with the Bank's overall strategy and financial plan, in particular by defining the Bank's risk appetite and approving the following documents adopted by the Management Board: the risk management strategy (ICAAP Policy), capital management strategy, credit policy, investment and market risk policy, operational risk strategy and policy, as well as model policy, and by considering periodic reports of the Management Board on management of particular risks.

The system of risk management in the Bank is an integral element of the Bank's management system. The system is in line with the Bank's organisational structure and it is adequate to the activities conducted by the Bank, the size and profile of the Pillar I risks and Pillar II risks defined within the ICAAP.

As part of the risk management system, the Bank uses formal procedures to identify, measure and monitor risks, as well as limits restricting risks. The system of managerial information in the Bank enables the effective monitoring of risk levels. Risks are monitored with regard to profitability and the capital required to take them.

The management of credit risk, liquidity risk, market risk and operational risk is carried out by the Risk Management Division, which is supervised by the relevant Vice President of the Management Board. The management of other risks is shared between the Risk Management Division and the other divisions involved in their control.

An important role in credit risk management is played by the Credit Committee, in market and liquidity risk management by Asset, Liability and Risk Committee, in operational risk management by the Operational Risk Committee and the Bank Security Committee, and in model risk management by the Model Risk Committee. Effective risk management is one of the strong points of the Bank.

### **Assessment of compliance risk management system**

The Supervisory Board has positively assessed the compliance risk management system, whose purpose is to ensure the compliance of activities performed by the Bank and its employees with the provisions of law, internal regulations and market standards in the processes functioning within the Bank.

There is a separate unit for compliance matters functioning within the Bank, i.e. the Compliance Department, organisationally and operationally independent and subordinated directly to the President of the Management Board of the Bank. The Compliance Department is the key element of ensuring compliance within the Bank.

The Bank ensures compliance through application of control mechanisms and compliance risk management process carried out by Compliance Department and encompassing identification, assessment, control and monitoring of compliance risk connected with the Bank's activity and presentation of reports in this scope. As part of its control function, the Compliance Department designs and supervises the implementation of compliance risk management control mechanisms or applies them independently as well as independently monitors compliance with those mechanisms by other organisational units of the Bank. The reports on the performance of tasks by the Compliance Department, together with the level of assessed compliance risk, are presented to the Management Board and the Supervisory Board. The oversight of compliance risk related to the activities of subsidiaries is performed within the Bank.

The assumptions of the compliance risk management process were defined in regulations developed by the Management Board and approved by the Supervisory Board, i.e. the Compliance Policy of Bank Pekao S.A. and Regulations on the Functioning of the Compliance Department of Bank Pekao S.A. There are following key elements supporting the compliance risk management process:

- a) supervision of the Supervisory Board and responsibility of the Management Board for the effective management of compliance risk,
- b) properly defined organisational structure and HR policy,
- c) internal regulations on compliance matters,

- d) compliance risk identification, assessment, control, monitoring and reporting processes,
- e) training activities,
- f) regular cooperation of the Compliance Department with the Internal Audit Department and other organisational units performing duties as part of the compliance risk control and management functions.

As part of compliance with applicable laws, internal regulations and market standards each employee of the Bank applies appropriate control mechanisms and performs independent monitoring of adherence to control mechanisms, within the scope of duties assigned to him/her.

The Supervisory Board supervises the compliance risk management process with the support of the Audit Committee. The Supervisory Board assesses the effectiveness of compliance risk management based on periodic and annual Compliance Department reports, information from the Management Board and opinions of the Audit Committee. The Supervisory Board also examines and approves the annual report on compliance risk management within the Bank. The Supervisory Board also approves the Compliance Risk for the current year.

The Supervisory Board positively assesses cooperation with the Compliance Department.

### **Evaluation of the Internal Audit Function**

The Supervisory Board positively assesses the functioning of internal audit in Bank Pekao S.A. The Internal Audit Department was given independence, appropriate personnel and financial resources necessary to ensure its efficient operation. The Internal Audit Department reports directly to the President of the Management Board of the Bank and is functionally subordinate to the Audit Committee and the Supervisory Board.

The Supervisory Board approved the nomination of a new Internal Audit Department Director and accepted the report on the activities of the Internal Audit Department in 2017. The Internal Audit Department Director confirmed the organisational independence of Internal Audit operations in 2017.

A new strategy of operation of the Internal Audit Department for the years 2018-2020 was developed in 2017, the main objective of which is to support the implementation of the Bank's strategy. The Internal Audit Department develops IT tools to support audit process implementation and enable the implementation of advanced data analysis methods, cooperates with other control functions within the Bank and coordinates the activities of internal auditors in Pekao Group subsidiaries.

In 2017, the Supervisory Board approved the new Audit Charter which sets out the mission, scope and operating principles of the Internal Audit Department. The document was developed and implemented in order to adapt the Bank to the requirements laid down in Recommendation "H" concerning the internal control system in banks.

The Supervisory Board also approved the rules of cooperation of the Bank's internal audit unit with corresponding units of PZU S.A. and subsidiaries as well as the statutory auditor.

The 2018 Audit Plan, approved by the Supervisory Board, was based on the scope of audit, updated in relation to the Bank's exit from the UniCredit Group, organisational changes in the Bank and risk assessment. The remarks of the management staff of the Bank and regulatory authorities were included in the Plan. The Internal Audit Department also analysed audit plans for 2018 prepared by independent internal auditors in subsidiaries, in order to ensure a cohesive approach and compliance with audit regulations.

The positive assessment of the internal audit function also takes into account the evaluation of key performance indicators, presented annually to supervisory authorities by the Internal Audit Department Director, to ensure that the set objectives are being achieved.

The Internal Audit Department Director presented quarterly reports on the activity of the Internal Audit Department to the Audit Committee and annual reports on the activity to the Supervisory Board. The Internal Audit also provided an adequate information on the evaluation of the adequacy and effectiveness of internal control systems and risk management.

## **Summary**

The Supervisory Board assesses the situation of the Bank as satisfying and stable. The assessment is justified by: (i) good financial results, (ii) effective cost management, (iii) effective and consistent risk management, (iv) strong capital and liquidity base, (v) high level of the Bank's security, (vi) efficient internal control system, and (vii) operational effectiveness.

In the opinion of the Supervisory Board, Bank Pekao S.A. has a strong capital and liquidity structure while also maintaining the highest risk management standards and continuing to improve cost efficiency. This allows to effectively achieve strategic objectives of the Bank, announced as part of the new strategy of the Bank for the years 2018-2020 "Strength of the Polish Bison", and become the leader in terms of profitability in the Polish banking sector by taking the path of smart growth in the business model based on high efficiency and quality of processes.