

**Report of the Supervisory Board of Bank Polska Kasa Opieki Spółka Akcyjna on its activity in 2018 and on the results of assessment of the following: reports on the activity of Bank Polska Kasa Opieki Spółka Akcyjna and of the Bank Polska Kasa Opieki Spółka Akcyjna Capital Group for the year 2018, financial statements of Bank Polska Kasa Opieki Spółka Akcyjna and of the Bank Polska Kasa Opieki Spółka Akcyjna Capital Group for the period ended on 31 December 2018, motions of the Management Board of the Bank on covering the undistributed loss from previous years, created as a result of changes to accounting principles resulting from the application, for the very first time, of the International Financial Reporting Standard No. 9, on distributing the net profit of Bank Polska Kasa Opieki Spółka Akcyjna for the year 2018, and on the position of Bank Kasa Opieki Spółka Akcyjna, taking into account the assessment of the internal control, risk management and compliance systems, internal audit functions, as well as rationality of the Bank's policy concerning sponsorship and charitable activities.**

## **I. Composition and organization of work of the Supervisory Board in 2018.**

From 1 January 2018 and 31 December 2018, the following were the members of the Supervisory Board:

Paweł Surówka – Chairman of the Supervisory Board,  
Joanna Błaszczuk – Deputy Chairman of the Supervisory Board,  
Stanisław Ryszard Kaczoruk – Deputy Chairman of the Supervisory Board,  
Paweł Stopczyński – Secretary of the Supervisory Board,  
Sabina Bigos-Jaworowska – Member of the Supervisory Board,  
Justyna Głębiowska-Michalak – Member of the Supervisory Board,  
Grzegorz Janas – Member of the Supervisory Board,  
Michał Kaszyński – Member of the Supervisory Board,  
Marian Majcher – Member 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 criterion of independence.

The Supervisory Board was exercising continuous supervision over the activities of the Bank, in accordance with its rights and obligations set forth in the Code of Commercial Companies and in the Bank's Statute, and in accordance with the corporate governance rules and applicable good practices.

10 Supervisory Board meetings were held in 2018. The Supervisory Board examined 145 notifications, analyses and motions and passed 107 resolutions.

The following Supervisory Board committees operated in 2018: (i) Audit Committee, (ii) Nomination and Remuneration Committee (iii) and Risk Committee. Reports on the activity of those committees, approved by the Supervisory Board, are attached hereto.

## **II. Personnel-related issues**

From 1 January 2018 and 30 November 2018, the following were the members of the Management Board:

Michał Krupiński – President of the Bank's Management Board,  
Roksana Ciurysek-Gedir – Vice President of the Bank's Management Board,  
Andrzej Kopyrski – Vice President of the Bank's Management Board,

Tomasz Kubiak – Vice President of the Bank’s Management Board,  
Michał Lehmann – Vice President of the Bank’s Management Board,  
Marek Lusztyn – Vice President of the Bank’s Management Board,  
Tomasz Styczyński – Vice President of the Bank’s Management Board,  
Marek Tomczuk – Vice President of the Bank’s Management Board.

On 19 November 2018 Ms. Roksana Ciurysek-Gedir and Mr. Andrzej Kopyrski tendered their resignations from the position of Vice Presidents of the Bank’s Management Board, with the said resignations becoming effective on 30 November 2018.

On 19 November 2018, acting pursuant to Article 368 § 4, in conjunction with Article 369 § 1 of the Code of Commercial Companies, and with the compliance with suitability criteria taken into consideration, the Supervisory Board unanimously appointed the following persons as members of the Bank’s Management Board, for a three-year shared term in office commencing on the day following the date of the General Meeting of the Bank’s Shareholders approving the financial statements of the Bank for the financial year of 2018:

Michał Krupiński for the position of the President of the Bank’s Management Board,  
Marek Lusztyn for the position of the Vice President of the Bank’s Management Board in charge of managing the risk that is significant for the Bank’s activity,  
Tomasz Kubiak for the position of the Vice President of the Bank’s Management Board,  
Michał Lehmann for the position of the Vice President of the Bank’s Management Board,  
Tomasz Styczyński for the position of the Vice President of the Bank’s Management Board,  
Marek Tomczuk for the position of the Vice President of the Bank’s Management Board.

On 23 November 2018, with the suitability assessment taken into consideration, the Bank’s Management Board appointed Ms. Magdalena Zmitrowicz as a Member of the Bank’s Management Board, with the said appointment becoming effective on 1 December 2018, for the current, shared term in office, and entrusted her with the performance of duties of the Vice President of the Bank’s Management Board.

From 1 December 2018 to 31 December 2018, the following were the members of the Management Board:

Michał Krupiński – President of the Bank’s Management Board,  
Tomasz Kubiak – Vice President of the Bank’s Management Board,  
Michał Lehmann – Vice President of the Bank’s Management Board,  
Marek Lusztyn – Vice President of the Bank’s Management Board,  
Tomasz Styczyński – Vice President of the Bank’s Management Board,  
Marek Tomczuk – Vice President of the Bank’s Management Board,  
Magdalena Zmitrowicz – Vice President of the Bank’s Management Board.

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

Just like it was the case in previous years, the activity of the Supervisory Board in 2018 focused both on strategic issues and on those related to exercising supervision over the on-going operations of the Bank.

The strategic issues that the Supervisory Board was dealing with included, first and foremost, the following: approval of the internal procedure concerned with “Strategic Planning, Budgeting, Forecasting and Monitoring Financial Plans at Bank Pekao S.A.”, issuing a positive opinion on the distribution of the Bank’s profit for 2017 and positive assessment of the application of the Bank’s Management Board on determining the general directions for the distribution of the Bank’s profits for the years 2018-2020, approval of the “Multiannual Capital Management Strategy 2018 – 2020”,

“Credit Risk Policy and Strategy of Bank Pekao S.A. for 2018”, “Investment and Market Risk Policy for 2018”, “Information Policy of Bank Pekao S.A. Related to Capital Adequacy”, as well as “Bancassurance Policy of Bank Polska Kasa Opieki Spółka Akcyjna”. In addition, the Supervisory Board approved the “Financing Plan for 2018 – 2020”, the “Group Recovery Plan for the Bank Pekao S.A. Capital Group” and the updated “Individual Recovery Plan for Bank Pekao S.A.”.

In its discussions with the Management Board, the Supervisory Board focused on the macroeconomic outlook for Poland, the Bank’s investor relations, activity of the Bank’s subsidiaries and analyses concerned with development of the Bank’s business, with non-organic growth included as well.

The following were also analyzed by the Supervisory Board on a regular basis: (i) financial standing, (ii) sales results concerning key products, (iii) quality of assets and (iv) risk levels.

The Supervisory Board supervised the process of managing risk at the Bank. It conducted an in-depth analysis of quarterly reports concerned with the following: managing financial risk, controlling operational risk, credit portfolio and debt recovery operations.

The Supervisory Board issued its opinion on the financial statements of Bank Pekao S.A. and the Bank Pekao S.A. Capital Group, as well as on the reports on the activities of the Bank Pekao S.A. Capital Group, drawn up in accordance with the International Financial Reporting Standards approved by the European Union.

On 21 June 2018 the Supervisory Board submitted, to the Ordinary Meeting of Shareholders, a proposal to appoint KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa as the audit company authorized to conduct the statutory audit and review of the financial statements of Bank Pekao S.A. and the consolidated financial statements of the Bank Pekao S.A. Capital Group for the years 2018-2020. The Supervisory Board paid a lot of attention to internal operation functions. In particular, the Supervisory Board approved amendments to the 2018 Annual Audit Plan and acknowledged the report on the activity of the Internal Audit Department in 2017.

The Supervisory Board approved results of the review of the Bank’s internal control system performed in 2017.

While exercising supervision over effective management of the risk of non-compliance, the Supervisory Board became acquainted with the annual report on the activities of the Compliance Department in 2017, approved the Plan of Activities of the Compliance Department for 2019 and analyzed periodic bancassurance risk analyses.

In 2018, the Supervisory Board became familiar with the report on the legal compliance supervision system in place at the Pekao Brokerage House in 2017 and with the report on the provision of brokerage services by the Bank in 2017, in relation to the “Guidelines on the provision of brokerage services on the OTC derivatives market” issued by the Polish Financial Supervision Authority.

The Supervisory Board issued a positive opinion on the application, by the Bank, in 2017, of the Corporate Governance Principles for Supervised Institutions, issued by the Polish Financial Supervision Authority, and on the manner in which the Bank fulfills its information obligations related to the application of the corporate governance principles set forth in the Stock Exchange Regulations.

The issues that were analyzed by the Supervisory Board included also remuneration policy and suitability assessment. The Supervisory Board approved the “Policy for the Assessment of Suitability of the Proposed and Appointed Management Board Members, Supervisory Board Members and Key Function Holders at Bank Polska Kasa Opieki Spółka Akcyjna”, issued a positive opinion on the application of the “Remuneration Policy of Bank Polska Kasa Opieki Spółka Akcyjna in 2017”, and approved the “Report on the application of the Remuneration Policy at Bank Polska Kasa Opieki Spółka Akcyjna in 2017”.

The Supervisory Board was also interested in the “Voluntary Resignation Program for Employees of Bank Pekao S.A.”

Within the scope of its statutory competence, the Supervisory Board assessed and approved motions and reports submitted by the Bank’s Management Board to the Ordinary Meeting of Shareholders and pertaining to the financial year 2017.

The Supervisory Board appointed a new member of the Nominations and Remuneration Committee.

**IV. Assessment of reports of the Bank’s Management Board on the activities of the Bank and of the Capital Group for the year 2018, as well as of the financial statements of the Bank and of the Capital Group for 2018, as well as of the motions of the Management Board of the Bank on covering the undistributed loss from previous years, created as a result of changes to accounting principles resulting from the application, for the very first time, of the International Financial Reporting Standard No. 9, and on distributing the net profit for the year 2018.**

Acting pursuant to Article 382 § 3 of the Code of Commercial Companies and fulfilling its statutory duties, the Supervisory Board of Bank Pekao S.A. assessed the Management Board’s reports on the activities of the Bank and of the Capital Group in 2018, as well as the financial statements of the Bank and of the Capital Group for 2018, in terms of their consistency with the books, documents and the factual state.

As a result of this assessment, and having become acquainted with the report of the independent certified auditor on the review of the financial statements of Bank Polska Kasa Opieki Spółka Akcyjna and of the consolidated statements of the Bank Polska Kasa Opieki Spółka Akcyjna Capital Group for the year 2018, the Supervisory Board issues its positive opinion on the achieved results, and recommends the General Meeting of Shareholders to pass resolutions approving these statements.

When formulating the aforementioned recommendation, the Supervisory Board took into consideration the following:

- 1) The Bank’s 2018 activities focused on continued, sustainable growth in all areas, on effective strengthening of its good position on the retail banking market, and of its leader position in the corporate banking domain.

In 2018, the Bank generated a net profit of PLN 2,310.6 million, which was by PLN 222.5 million, i.e. 10.7% higher than the net profit generated in 2017.

The net profit of the Bank Pekao S.A. Capital Group attributable to the Bank’s equity holders equaled PLN 2,287.2 in 2018 and was by PLN 187.9 million, i.e. 7.6% lower than the result reported for 2017.

The interest income was by 9.6% higher YoY in the Bank and by 7.8% higher YoY in the Capital Group, mainly thanks to the higher volumes of loans and deposits alike. Higher margin and higher dividend revenues.

The Group’s non-interest income achieved in 2018 was by 1.7% higher YoY, while for the Bank it was by 5.7% lower YoY. The result on fees on commissions (including commission resulting from margins on foreign exchange transactions with customer) was by 4.7% higher YoY in the Group and by 2.6% lower YoY in the Bank, compared to 2017.

Costs of the operating activity of the Bank and of the Group in 2018 were higher, by 3.1% YoY and 5.5% YoY, respectively, due to higher personnel costs (mainly to the amount of approximately PLN 50 million related to the Voluntary Resignation Program that could be taken advantage of by

employees eligible to retirement in 2018) and other administration costs (mainly those related to marketing).

- 2) Return on Equity amounted to 10.7% and 10.2% for the Bank and for the Group, respectively.
- 3) Thanks to the effective commercial activity of the Bank and the Group in 2018, a significant growth in loan volumes was reported both in the area of retail loans (by 10.6% YoY for the Bank and 10.5% YoY for the Group). Such a substantial increase in lending was largely financed by higher volumes of retail deposits growing by 11.9% YoY in the Bank and 11.8% YoY in the Group.
- 4) The solid liquidity structure of the Bank and of the Group is reflected by the net loans-to-deposits ratio which equaled, at the end of December 2018, 86.7% and 89.5%, respectively. This, in conjunction with the high value of capitals, allows continued and stable growth of the Bank's and the Group's operations. The total capital ratio (TCR) for the Bank amounted to 18.7% at the end of December 2018 and was higher (by 0.3 p.p.) than at the end of 2017. The total capital ratio (TCR) for the Group equaled 17.4% at the end of December 2018 and was higher (by 0.3 p.p.) than at the end of December 2017.
- 5) Bank Pekao S.A. was consistently implementing the strategy of strengthening its position on the market of financing housing and consumer goods. In 2018, the Bank sold nearly PLN 10 billion worth of mortgage loans, which is a record-high result and which has translated into a 12% (YoY) increase in the value of PLN-denominated mortgage loans. The market share in new sales equaled nearly 19%. This exceptional result was also boosted by the sale of loans granted under the government's "Apartment for the Young" (Mieszkanie dla Młodych - MdM) program supporting those under the age of 35 in the acquisition of their first, new apartment. The MdM Program was discontinued at the end of 2018. During the term in which it was available, Bank Pekao S.A. extended over 41,000 loans for the total value of nearly PLN 7.3 billion. In 2018 the value of cash loans for private customers increased by 16% YoY. Sale of cash loans was boosted by the competitive Express Loan (Pożyczka Ekspresowa) offering, individual loans based on CRM tools, and effective use of electronic sale channels: PeoPay mobile banking app and Pekao24 online banking system.
- 6) In line with the strategy it has adopted, Bank Pekao S.A. remains the Bank of first choice for corporate customers, rendering both a comprehensive range of services offered by a universal bank, and all other financial services available in Poland (including leasing, factoring and investment consulting, inter alia in relation to mergers and acquisitions). Every other big corporation in Poland is currently taking advantage of the Bank's services. The Corporate Banking, Markets and Investment Banking Division currently serves approximately 13,000 entities, including approximately 2,500 foreign customers and over 2,500 local government entities and municipal companies. The Bank maintains its position of the leading corporate bank a leader of innovative product solutions targeted for businesses and institutions. The broad product offering, innovative solutions and a customized approach allow it to provide a comprehensive range of services for businesses, institutions and public sector entities.
- 7) Bank Pekao S.A. is a universal bank offering all financial services that are available in Poland to private and institutional customers. The broad product offering, innovative solutions and a customized approach allow it to provide a comprehensive range of services for customers, and the customer service model relied upon guarantees the highest quality of that service and ensures that they are always suited to their changing needs. Since 2017 Bank Pekao S.A. has been a part of the PZU S.A. Capital Group – the largest financial institution in Central and Eastern Europe.
- 8) Pursuant to the "Strength of the Polish Bison" (Siła Polskiego Żubra) strategy adopted for 2018-2020, the Bank intends to continue activities aiming to attain the positions of a profitability leader by building lasting business relationships and improving its operational efficiency. The following

shall remain the Bank's strategic priorities for 2019: smart growth, building long-term customer relations based on an integrated service model, operational transformation designed to strengthen its position of the best recognized bank in Poland, thanks to a professional approach creating value for customers.

**Assessment of the motions of the Management Board of the Bank on covering the undistributed loss from previous years, created as a result of changes to accounting principles resulting from the application, for the very first time, of the International Financial Reporting Standard No. 9, and on distributing the net profit for the year 2018**

The Supervisory Board of Bank Pekao S.A. assessed the motions of the Bank's Management Board on distributing the net profit generated by Bank Pekao S.A. in 2018 and on the proposed method of covering the undistributed loss from the previous years.

The Supervisory Board issued a positive opinion on the motion to distribute the net profit of Bank Pekao S.A. generated in 2018, taking into consideration the following factors:

- 1) strong capital standing of the Bank; the Common Equity Tier 1 capital ratio for the Bank Pekao S.A. Group equaled, in December 2018, without the 2018 net profit included, 15.8% (Tier 1 for the Bank equaled 17.0%). The Group's buffer by which the minimum Tier 1 requirements of the Polish Financial Supervision Authority are exceeded equals 4.4 pp. Furthermore, stress tests conducted by the European Banking Authority confirmed that the Bank is immune to the materialization of stress conditions. Such a strong capital standing ensures the safe position of the Bank even if the market becomes volatile, and allows it to pursue its growth plans,
- 2) fulfillment of the criteria and recommendations of the Office of the Financial Supervision Authority regarding profit distribution terms and restrictions,
- 3) low exposure to mortgage loans denominated in CHF,
- 4) compliance with the Financial Plan and the Capital Management Strategy for 2019.

Considering the above, the Supervisory Board decided to recommend the General Meeting to adopt a resolution on the distribution of net profit of Bank Polska Kasa Opieki Spółka Akcyjna for 2018 in the amount of PLN 2.310.599.572,17 in accordance with the motion of the Management Board, i.e.:

- 1) to allocate the amount of PLN 1,732,302,224.40 to dividend,
- 2) to allocated the amount of PLN 578,297,347.77 to reserve capital.

According to the above-mentioned recommendation, the payment of cash dividend shall amount to PLN 6.60 per share, which translates into a payout ratio of 75.0% of the Bank's net profit for 2018.

A the same time the Supervisory Board issued a positive opinion on the motion of the Bank's Management Board related to covering, fully by relaying on the Bank's reserve capital, the undistributed loss from previous years amounting to PLN 936,747,994.04, created as a result of changes to accounting principles resulting from the application, for the very first time, of the International Financial Reporting Standard No. 9 ("Financial Instruments"), and decided to recommend the General Meeting of Shareholders to adopt a resolution concerning this issue, in line with the motion of the Bank's Management Board.

**Assessment of internal control, risk management and compliance systems, as well as internal audit functions**

In accordance with the 2016 Code of Best Practices for WSE Listed Companies, the Supervisory Board drew up and presented to the Ordinary General Meeting of Shareholders an assessment of the

Bank's standing in 2017, with evaluation of internal control, risk management and compliance systems, as well as internal audit functions taken into consideration. The document containing the assessment has been attached hereto.

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

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

The primary objectives of the sponsoring activity of Bank Pekao S.A. include the following: building the image of the Bank as a leading financial institution in terms of CSR-related activities, i.e. an institution that is in close touch with its customers and with the communities in which it is active, distinguishing the Bank's brand against the brands of its market competitors, promoting awareness of the Bank and its products among the public, evoking positive associations between a given event and the Bank, forming and strengthening positive opinions about the Bank and its products, as well as providing the Bank's business Divisions with a reliable promotional platform enabling them to conduct promotional activities and to build strong and positive relations with the Bank's customers. The policy pursued by the Bank in this area is governed by internal regulations, i.e. an Ordinance of the President of the Bank's Management Board that defines the rules, procedures and competences related to granting donations and to sponsorship schemes in which Bank Polska Kasa Opieki Spółka Akcyjna participates.

In its sponsoring and charitable activity, the Bank supports selected organizations and institutions pursuing various types of projects in the following areas:

- 1) education and upbringing of children and youths,
- 2) scientific and research undertakings, as well as didactic undertakings of scientific institutions and schools,
- 3) popularizing knowledge about banking,
- 4) providing assistance to the ill and the disabled,
- 5) promoting physical education and sports,
- 6) protecting the environment,
- 7) pursuing projects and activities of charitable organizations,
- 8) promoting culture.

Due to the organizational changes commenced with the structures of the Foundation, no new initiatives were taken in 2018. Instead, previously assumed obligations were fulfilled, with funds earmarked, inter alia, for scholarships for talented students from poor families.

Before a donation is granted or a sponsoring agreement is concluded, the Bank assesses the risks involved (due diligence) in accordance with anti-corruption and conflict of interest prevention regulations in place at the Bank.

The Supervisory Board's opinion about the Bank's policy concerning sponsoring and charitable activities is positive.

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

Acting in accordance with its rights and obligations set forth in the Code of Commercial Companies, Banking Law, recommendations of the Polish Financial Supervision Authority, the Code of Best

Practices for WSE Listed Companies and the Bank's Statute, the Supervisory Board exercised, in 2018, permanent supervision over the activities of the Bank.

The good financial results of the Bank achieved in 2018, its position in the Polish banking sector, adequate capital management and effective risk management should be considered as stemming, inter alia, from proper and effective operation of the Supervisory Board and from proper fulfilment of the tasks and obligations it has been entrusted with.

With the information presented above taken into consideration, one may assess the activity of the Supervisory Board in 2018 as effective, professional and performed in accordance with the best practices.

## **Summary**

While assessing the activities of the Bank's Management Board, the Supervisory Board took into consideration, inter alia, the following:

(i) good financial results, (ii) effective cost management, (iii) efficient 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. enjoys a strong capital and liquidity structure, as well as exhibits the highest risk management standards and strives to continue improving its cost effectiveness. This allows the Bank to effectively pursue its strategic objectives set forth in the Bank's 2018-2020 "Strength of the Polish Bison" (Siła Polskiego Żubra) strategy, and to achieve the position of the profitability leader in the Polish banking sector by entering a path of smart growth, with its business model based on high effectiveness and quality of its processes.

With the above taken into consideration, the Supervisory Board recommends the General Meeting of Shareholders to approve, pursuant to Article 395 § 2(3) of the Code of Commercial Companies, the performance of duties, in 2018, of the following Members of the Bank's Management Board: Michał Krupiński, Tomasz Kubiak, Michał Lehmann, Marek Lusztyn, Tomasz Styczyński, Marek Tomczuk for the period between 1 January 2018 and 31 December 2018, Roksana Ciurysek-Gedir and Andrzej Kopyrski for the period between 1 January 2018 and 30 November 2018, and Magdalena Zmitrowicz for the period between 1 December 2018 and 31 December 2018.

With the 2018 activities described above taken into consideration, the Supervisory Board recommends the General Meeting of Shareholders to approve, pursuant to Article 395 § 2(3) of the Code of Commercial Companies, the performance of duties, in 2018, of the following Supervisory Board Members: Paweł Surówka, Joanna Błaszczuk, Stanisław Ryszard Kaczoruk, Paweł Stopczyński, Sabina Bigos-Jaworowska, Justyna Głębiowska-Michalak, Grzegorz Janas, Michał Kaszyński, Marian Majcher for the period between 1 January 2018 and 31 December 2018.

## **Report on the activity of the Audit Committee in 2018**

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



The Audit Committee is made up of 3 (three) to 5 (five) members selected from Supervisory Board members. At least one Audit committee Member shall have accounting or financial statement auditing-related knowledge and skills. The majority of Audit Committee Members, including its Chairperson, shall be independent from the Bank within the meaning of Article 129(3) of the Act on certified auditors, audit companies and public supervision. Audit Committee members shall have knowledge and skills related to the area in which the Bank operates. This condition shall be deemed fulfilled if at least one Audit Committee member possesses knowledge and skills related to that area, or if at least the individual members possess the knowledge and skills related that area in relation to their respective scopes of responsibility.

From 1 January 2018 to 31 December 2018 the Audit Committee was made up of the following members:

Justyna Głębiowska-Michalak – Chairwoman of the Committee,  
Joanna Błaszczak – 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 meet the criteria of independence.

The make-up of the Audit Committee fulfilled, in 2018, the requirements set forth in the Act on certified auditors, audit companies and public supervision dated 11 May 2017.

### **Duties of the Audit Committee**

No changes have been introduced to the scope of duties of the Audit Committee. The Audit Committee supports the Supervisory Board in the fulfillment of its obligations, inter alia those related to controlling and monitoring the following processes: financial reporting, effectiveness of internal control and risk management systems, as well as internal audit functions, performance of financial revision functions, independence of the certified auditor and of the audit company, efficiency of the legal and regulatory compliance monitoring system.

Meetings of the Audit Committee are held on the as-needed basis, but in no case less frequently than four times per year, on the dates that are crucial for key quarterly periods in the Bank's reporting cycle and in accordance with the annual audit plan submitted by the Internal Audit Department Director.

Meetings of the Audit Committee are attended, on a customary basis, by the President of the Bank's Management Board. All meetings of the Audit Committee are attended by directors of the following Departments: Internal Audit, Legal and Compliance, as well as by other Management members whose functions are related to the agenda of the meeting.

To ensure that the Committee operates in a transparent and unbiased manner, the Chairwoman of the Audit Committee, Ms. J. Głębiowska-Michalak held one-on-one meetings with the Internal Audit Department Director and the Compliance Department Director, without any other members of the Bank's management being in attendance. The Audit Committee has met the key certified auditor from KPMG Audyty Sp. z o.o. sp.k., without members of the Bank's Management Board being in attendance. Representatives of KPMG Audyty Sp. z o.o. sp.k. confirmed their independence from the Bank and from its subsidiaries, i.e. their fulfillment of the requirements set forth in Articles 69-73 of the Act on certified auditors, audit companies and public supervision of 11 May 2017.

Furthermore, the Chairwoman of the Audit Committee Ms. J.Głębikowska-Michalak held an individual meeting with PwC, devoted to an independent audit, to satisfy the requirement of performing an external assessment of compliance of internal audit functions with recommendation H of the Financial Supervision Authority and with the International Standards of Internal Audit Professional Practice.

On 21 June 2018 a resolution of the General Meeting of Shareholders on the principles applied while calculating the remuneration of the members of the Supervisory Board of Bank Polska Kasa Opieki Spółka Akcyjna entered into force, amending, inter alia, the remuneration of the chairpersons of the Committees operating within the structures of the Supervisory Board.

### **External Auditor**

On 9 May 2018 the Audit Committee approved the report on the tender procedure under which the services of a certified auditor and a review of the Bank's financial statements and the consolidated statements of the Bank's Capital Group were sought, and decided to recommend the Supervisory Board to select the audit company to conduct the statutory audit of the Bank's financial statements and the consolidated statements of the Bank's Capital Group for the years 2018 – 2020, from among the following audit companies: KPMG Audyt Sp. z o.o. sp.k. and Mazars Audyt Sp. z o.o.

The outcome preferred by the Audit Committee was to award the contract to KPMG Audyt Sp. z o.o. sp.k. ("KPMG"), i.e. a company that has submitted the best-priced bid for the audit and review of the financial statements of the Bank and the consolidated statements of the Bank's Capital Group for 2018-2020. The said bid has also received the highest merit-related score.

On 21 June 2018 the General Meeting of the Bank's Shareholders appointed KPMG as the audit company to audit and review the financial statements of Bank Polska Kasa Opieki Spółka Akcyjna and the consolidated statements of the Bank Polska Kasa Opieki Spółka Akcyjna Capital Group for 2018-2020.

### **Meetings of the Audit Committee**

In 2018, the Audit Committee met 8 times (21 February, 26 February, 9 May, 23 July, 2 August, 7 August, 6 November and 20 December).

The Audit Committee members who attended the individual meetings are listed below:

<u>Date</u>	<u>Members participating in the meeting</u>
21 February	J.Głębikowska-Michalak, S.Bigos-Jaworowska, J.Błaszczuk, M.Kaszyński
26 February	J.Głębikowska-Michalak, S.Bigos-Jaworowska, J.Błaszczuk, M.Kaszyński
9 May	J.Głębikowska-Michalak, S.Bigos-Jaworowska, J.Błaszczuk, G.Janas, M.Kaszyński
23 July	J.Głębikowska-Michalak, S.Bigos-Jaworowska, J.Błaszczuk, G.Janas, M.Kaszyński
2 August	J.Głębikowska-Michalak, J.Błaszczuk, G.Janas
7 August	J.Głębikowska-Michalak, J.Błaszczuk, M.Kaszyński
6 November	J.Głębikowska-Michalak, J.Błaszczuk, G.Janas
20 December	J.Głębikowska-Michalak, J.Błaszczuk, G.Janas

### **Key activities of the Audit Committee performed in 2018**

The Committee reviewed and discussed the following information with members of the Management Board of the Bank and with Directors of Internal Audit Department, Legal and Compliance Department and with the External Auditor, as required:

- audited financial statements of Bank Pekao S.A. and of the Pekao S.A. Capital Group for the year 2017; the Committee issued a positive opinion thereon;
- quarterly and semi-annual financial statements; the Committee issued a positive opinion thereon;
- plan of reviews of the financial statements of Bank Pekao S.A. and of the Bank Pekao S.A. Capital Group; the Committee acknowledged the information it has been provided with;
- summary of the results of the review of the financial statements of the Bank and of the Bank Pekao S.A. Capital Group for the period between 1 January 2018 and 30 June 2018; the Committee acknowledged the information it has been provided with;
- plan of and approach to review of the financial statements of Bank Pekao S.A. and of the Capital Group for the financial year ended on 31 December 2018; the Committee acknowledged the information it has been provided with;
- analysis of the amended Accounting Policy of the Bank, in connection with entry into force of IFRS 9 "Financial Instruments", and with the impact of IFRS 9; the Committee acknowledged the information it has been provided with;
- information on the status of the tender procedure concerned with the selection of the audit company to review the audit of the financial statement of the Bank for 2018 - 2020. The Committee acknowledged the information it has been provided with;
- information on the work of the Committee tasked with selection of an audit company to audit the Bank's financial statements for the years 2018 – 2020, along with approval of the report on the tender procedure conducted, and with issuing recommendations for the Supervisory Board; the Audit Committee approved the report on the tender procedure concerned with reviewing and auditing the financial statements of the Bank and the consolidated financial statements of the Bank's Capital Group, and has decided to recommend the Supervisory Board to select, for the purpose of conducting a statutory audit of the financial statements of the Bank and of the consolidated financial statements of the Bank's Capital Group for 2018 – 2020, one of the following audit companies: KPMG Audyt Sp. z o.o. sp.k. and Mazars Audyt Sp. z o.o.

The outcome preferred by the Audit Committee was to award the contract to KPMG Audyt Sp. z o.o. sp.k. ("KPMG"), i.e. a company that has submitted the best-priced bid for the audit and review of the financial statements of the Bank and the consolidated statements of the Bank's Capital Group for 2018-2020. The said bid has also received the highest merit-related score.

- review of the Financial Division's HR resources; the Committee acknowledged the information it has been provided with;
- information on civil litigation with the participation of the Bank, in Q3 2017, in 2017, in Q1 2018, in the 1<sup>st</sup> half of 2018 and in Q3 2018; the Committee acknowledged the information it has been provided with;
- request to the Audit Committee to authorize the expansion of the scope of services rendered by KPMG for the benefit of the Bank and of its subsidiaries, and for the performance of non-prohibited services; the Committee approved the extension of the scope of services rendered by KPMG for the benefit of the Bank and of its subsidiaries, and for the performance of non-prohibited services;
- review of the Internal Control System of Bank Pekao S.A. for the year 2017; the Committee acknowledged the aforementioned document, issued a positive opinion thereon and decided to recommend the Supervisory Board to adopt it;
- report on the activities of the Compliance Department in 2017 and on the operation of the system supervising the compliance of the operation of the Pekao Brokerage House with legal regulations in 2017; the Committee acknowledged the report it has been submitted with and decided to recommend the Supervisory Board to adopt it;

- report on the activities of the Compliance Department in Q1, Q2 and Q3 2018, and the plan of activities of the Compliance Department for 2019; the Committee acknowledged the reports it has been submitted with and decided to recommend the Supervisory Board to approve the plan of activities of the Compliance Department;
- information on the status of implementation of post-inspection recommendations issued by the Financial Supervision Authority after a problem inspection conducted at the Bank in 2017, and information on their verification performed by the Internal Audit Department; the Committee acknowledged the information it has been provided with and recommended that it be submitted to the Supervisory Board for information as well;
- information on the status of M&A projects in progress at the subsidiaries; the Committee acknowledged the information it has been provided with
- information on IT-related spending in Q1 and Q2 2018; the Committee acknowledged the information it has been provided with;
- information on marketing cost of Bank Pekao S.A. in Q1 and Q2 2018; the Committee acknowledged the information it has been provided with;
- request for the approval of amendments to the 2018 annual Audit Plan, along with information on the intention to conduct an independent assessment of the activities of the Internal Audit Department, pursuant to recommendation H of the Financial Supervision Authority; the Committee issued a positive opinion on the amendments to the annual Audit Plan and decided to recommend the Supervisory Board to approve them. Furthermore, the Committee acknowledged information on the intention to conduct an independent assessment of the activities of the Internal Audit Department, pursuant to recommendation H of the Financial Supervision Authority;
- request of the Management Board of a subsidiary company - Pekao Financial Services – to approve the performance, by KPMG Advisory Spółka z ograniczoną odpowiedzialnością spółka komandytowa (“KPMG Advisory”), of an Authentication Service by reviewing a transfer agent’s description of the services rendered by Pekao Financial Services; the Committee approved the performance, by KPMG Advisory, of the Authentication Service consisting in a review of a transfer agent’s description of the services rendered by Pekao Financial Services;
- information on the review of the Bank’s shares held in affiliated companies with Italian shareholding, as at 30 June 2018; the Committee acknowledged the information it has been provided with;
- information on the legal suit filed by Euronet Polska Sp. z o.o.; the Committee acknowledged the information it has been provided with;
- Internal Audit Strategy for 2018 - 2020; the Committee issued a positive opinion on the Internal Audit Strategy for 2018 - 2020 and decided to recommend the Supervisory Board to approve it;
- Audit Plan of Bank Pekao S.A. for 2019, including, inter alia, the 2019 annual audit plan, the 2019-2023 long term audit plan, as well as the annual and the long-term Pekao Brokerage House audit plan; the Committee issued a positive opinion on the Audit Plan of Bank Pekao S.A. for 2019, including, inter alia, the 2019 annual audit plan, the 2019-2023 long term audit plan, as well as the annual and the long-term Pekao Brokerage House audit plan and decided to recommend the Supervisory Board to approve it.

As far as the Internal Audit function is concerned, the Committee was reviewing reports on the activities of the Internal Audit function on a regular basis.

The Committee has also appointed the Audit Committee Secretary. Additionally, the Audit Committee has approved the candidate for the position of the Head of Internal Audit, and the terms of their remuneration.

The Audit Committee was performing its tasks in accordance with the scope of its rights and obligations.

## **Report on the activity of the Nominations and Remuneration Committee in 2018**

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

The Nominations and Remuneration Committee is made up of three to five members selected from Supervisory Board members.

From 1 January 2018 to 31 December 2018 the Nominations and Remuneration Committee was made up of the following members:

Paweł Stopczyński – Chairman of the Committee,  
Sabina Bigos-Jaworowska – Member of the Committee,  
Paweł Surówka - Member of the Committee,  
Joanna Błaszczuk - Member of the Committee (from 23 July 2018).

### **Duties of the Nominations and Remuneration Committee**

The Committee operates pursuant to the Bank Supervisory Board Regulations and pursuant to the Nominations and Remuneration Committee Regulations that were amended on 11 October 2016.

It is the aim of the Committee to support the Bank's Supervisory Board in the performance of its duties, inter alia by the following:

- submitting proposals concerning employment contract terms and conditions, or terms and conditions establishing a different form of a legal relationship between the Bank and the Management Board members, including terms and conditions of remuneration of the Bank's Management Board members, approving the policy concerned with variable components of remuneration of persons holding managerial positions at the Bank, pursuant to separate regulations, as well as submitting, to the General Meeting of Shareholders, proposals concerning remuneration of the Supervisory Board,
- coming up with recommendations concerning the fulfilment of suitability requirements for the purpose of appointing members of the Bank's management Board and Supervisory Board,
- drawing up, for the General Meeting of Shareholders, a report on the functioning of the Bank's remuneration policy.

In its activities, the Committee relies on prudent and stable risk, capital and liquidity management policies, as well as on care for long-term well-being of the Bank, interests of the Bank's shareholders and investors.

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

In 2018 the Nominations and Remuneration Committee met on 8 occasions, on 26 February, 13 March, 29 March, 9 May, 12 July, 20 August (and on 23, 27 August and 19 October), 30 October, 13 November.

The Committee members who attended the individual meetings are listed below:

The Nominations and Remuneration Committee members who attended the individual meetings are listed below:

<u>Date</u>	<u>Members participating in the meeting</u>
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26 February	P.Stopczyński, S.Bigos-Jaworowska
13 March	P.Stopczyński, S.Bigos-Jaworowska, P.Surówka
29 March	P.Stopczyński, S.Bigos-Jaworowska, P.Surówka
9 May	P.Stopczyński, S.Bigos-Jaworowska, P.Surówka
12 May	P.Stopczyński, S.Bigos-Jaworowska, P.Surówka
20, 23, 27 August	
And 19 October	P.Stopczyński, S.Bigos-Jaworowska, P.Surówka, J.Błaszczuk
30 October	P.Stopczyński, S.Bigos-Jaworowska, P.Surówka
13 November	P.Stopczyński, S.Bigos-Jaworowska, P.Surówka, J.Błaszczuk

**In 2018, the Nominations and Remuneration Committee issued and opinions and recommendations on, or acknowledged information about the following:**

- Issuing an opinion on the Variable Remuneration System for Managerial Staff and assumptions for the Variable Remuneration System for Managerial Staff in 2018;
- Issuing an opinion on the establishment of individual objectives for Management Board members for 2018;
- Issuing an opinion on updating the Suitability Assessment Policy;
- Acknowledging information on the Program of Voluntary Resignations for the Bank's employees;
- Acknowledging information about the Report on Variable Remuneration Components Policy;
- Acknowledging information on the methods used to identify the holders of key positions (Risk Takers);
- Issuing an opinion on the Report on the assessment of the application of the Remuneration Policy of Bank Polska Kasa Opieki Spółka Akcyjna in 2017;
- Acknowledging information and issuing an opinion on the distribution of the bonus quota in 2017, and on the achievement of the individual objectives of the Bank's Management Board members holding their positions in 2017, along with the variable remuneration element-related settlements;
- Holding a discussion on the performance of Supervisory Board's duties related to the implementation of the resolutions of the General Meeting of Shareholders dated 21 June 2018 on the remuneration of Supervisory Board and Management Board members, with issuing an opinion on documents for the Management Board members and on the Management Board members' remuneration terms and conditions;
- Issuing an opinion the remuneration terms and conditions for Management Board member candidates, and for persons appointed to hold key positions at the Bank;
- Issuing an opinion on the processing of reports made by Supervisory Board members and concerned with their holding of additional positions in the statutory bodies of entities, which may impact the assessment of individual and collective suitability of Supervisory Board members;
- Acknowledging information on amendments to the Banking Law.

The Nominations and Remuneration Committee was performing its task in accordance with the scope of its duties and obligations and was taking advantage of services rendered by an external consultant who supported the on-going activities of the Nominations and Remuneration Committee and of the Supervisory Board in remuneration-related issues.

**Report on the activity of the Risk Committee in 2018**

## **Members of the Risk Committee**

The Risk Committee is made up of three members selected from Supervisory Board members, with at least one of them being an independent Supervisory Board member.

From 1 January 2018 to 31 December 2018 the Risk Committee was made up of the following members:

Stanisław Ryszard Kaczoruk – Chairman of the Committee,  
Michał Kaszyński - Member of the Committee,  
Marian Majcher - Member of the Committee.

## **Duties of the Risk Committee**

The Risk Committee operates pursuant to the “Risk Committee Regulations” adopted by the Supervisory Board, by means of its resolution No. 55/15 of 18 December 2015. It is the mission of the Committee to support the Supervisory Board in the fulfillment of its duties in the following areas: exercising supervision over the risk management system and over the assessment of adequacy and effectiveness of that system. In its activities, the Committee pursues a prudent and stable approach to risk, capital and liquidity management, attaching particular attention to long-term well-being of the Banka and to the interests of its shareholders.

It is the task of the Committee to express its opinion about the following:

- the overall readiness of the Bank to accept risk, both currently and in the future, expressed in the form of its risk appetite,
- the strategy for managing risk in the operation of the Bank, as drawn up by the Management Board, including credit, financial and operational risk policies,
- reports concerned with risk profile and with implementation of risk management strategies, as submitted by the Bank’s Management Board.

It is also the task of the Risk Committee to support the Supervisory Board in exercising supervision over the implementation, by the top management, of the strategy concerned with managing risk in the operation of the Bank, as well as in verifying whether the general prices of assets and liabilities offered to customers fully account for the business and risk strategies of the Bank. Where the level of such prices fails to appropriately reflect those types of risk in the manner provided for in the said strategies, the Committee is tasked with submitting, to the Bank’s Management Board, proposals aiming to ensure the adequacy between the prices of assets and liabilities on the one hand, and the relevant risk types on the other.

While analyzing risk-related issues, the Risk Committee decided to become acquainted with IT and GDPR-related topics affecting the Bank’s operation, considering that such problems may be of key significance, especially in terms of cybersecurity, effectiveness of business support or personal data management.

The Risk Committee performs also other tasks stemming from the applicable legal regulations or from recommendations issued by supervision authorities.

## **Meetings of the Risk Committee**

In 2018 the Risk Committee met on 3 occasions (26 February, 9 May, 23 July).

The Risk Committee members who attended the individual meetings are listed below:

<u>Date</u>	<u>Members participating in the meeting</u>
26 February	S.R.Kaczoruk, M.Kaszyński, M.Majcher
9 May	S.R.Kaczoruk, M.Kaszyński, M.Majcher
23 July	S.R.Kaczoruk, M.Kaszyński, M.Majcher

### **Main issues reviewed by the Risk Committee in 2018**

The Committee reviewed and discussed the following materials:

- Review of the ICAAP process along with the 2018 ICAAP policy; the Risk Committee issued a positive opinion on the results of the review and on the said Policy;
- Operating loss limits and alert values for 2018; the Risk Committee issued a positive opinion on the aforementioned document;
- 2018 Investment and Market Risk Policy; the Risk Committee issued a positive opinion on the aforementioned Policy;
- 2018 Credit Risk Policy and Strategies of Bank Pekao S.A.; the Risk Committee issued a positive opinion on the aforementioned Policy;
- 2018-2020 IT Strategy of Bank Pekao S.A. and ICT Security Strategy for 2018-2020, along with information on implementation of the ITC Strategy in 2017; the Risk Committee issued a positive opinion on these documents;
- Annual risk Models Report for 2017 and updated "Risk Models Management Principles" Policy; the Risk Committee issued a positive opinion on these documents;
- Quarterly credit portfolio and debt-recovery reports; the Risk Committee issued a positive opinion on the aforementioned documents;
- Quarterly financial risk reviews; the Risk Committee issued a positive opinion on the aforementioned documents;
- Quarterly operating risk controlling reports; the Risk Committee issued a positive opinion on the aforementioned documents;
- Periodic report on the business continuity and crisis management system in place at Bank Pekao S.A. in 2017; the Risk Committee issued a positive opinion on the report;
- Periodic report on the business continuity and crisis management system in place at Bank Pekao S.A. in 2017; the Risk Committee issued a positive opinion on the report;
- Information on the highest exposures of the Bank classified as at-risk exposures on 31 December 2017; the Risk Committee issued a positive opinion on the aforementioned document;
- Information on cash turnover at Bank Pekao S.A.; the Risk Committee acknowledged that information;
- Information on IT-related issues, with a particular emphasis placed on the development of the Bank's IT systems in the nearest future; the Risk Committee acknowledged that information;
- GDPR implementation status at the Bank; the Risk Committee discussed and acknowledged that information.

The Committee's meetings were attended by Vice Presidents of the Board in charge of the Risk Management Division and the Operations and Service Area, as well as by other management representatives responsible for performing tasks within the aforementioned areas.

### **Evaluation of the Bank's standing in 2018, broken down into assessment of internal control, risk management and compliance systems, as well as the internal audit function**



Pursuant to the Code of Best Practices for WSE Listed Companies, the Supervisory Board of Bank Polska Kasa Opieki Spółka Akcyjna has assessed the standing of the bank in 2018, evaluating also the internal control system and the risk management system in place at the Bank.

### **General assessment of the Bank's standing**

In the opinion of the Supervisory Board, the general economic and financial standing of Bank Pekao S.A. is stable. Bank Pekao S.A. meets all safe operations and capital adequacy requirements and ensure the security of funds deposited by its customers, displaying exceptional capital strength and resilience. The Supervisory Board Bank Pekao S.A. has a positive opinion about the results achieved by the Bank and the Bank Pekao S.A. Capital Group in 2018.

The Bank's 2018 activities focused on continued, sustainable growth in all areas, on effective strengthening of its good position on the retail banking market, and of its leader position in the corporate banking domain.

In 2018, the Bank generated a net profit of PLN 2,310.6 million, which was by PLN 222.5 million, i.e. 10.7% higher than the net profit generated in 2017.

The net profit of the Bank Pekao S.A. Capital Group attributable to the Bank's equity holders equaled PLN 2,287.2 in 2018 and was by PLN 187.9 million, i.e. 7.6% lower than the result reported for 2017.

The interest income was by 9.6% higher YoY in the Bank and by 7.8% higher YoY in the Capital Group, mainly thanks to the higher volumes of loans and deposits alike. Higher margin and higher dividend revenues.

The Group's non-interest income achieved in 2018 was by 1.7% higher YoY, while for the Bank it was by 5.7% lower YoY. The result on fees on commissions (including commission resulting from margins on foreign exchange transactions with customer) was by 4.7% higher YoY in the Group and by 2.6% lower YoY in the Bank, compared to 2017.

Costs of the operating activity of the Bank and of the Group in 2018 were higher, by 3.1% YoY and 5.5% YoY, respectively, due to higher personnel costs (mainly to the amount of approximately PLN 50 million related to the Voluntary Resignation Program that could be taken advantage of by employees eligible to retirement in 2018) and other administration costs (mainly those related to marketing)

Return on Equity (ROE) amounted to 10.7% and 10.2% for the Bank and for the Group, respectively.

Thanks to the effective commercial activity of the Bank and the Group in 2018, a significant growth in loan volumes was reported both in the area of retail loans (by 10.6% YoY for the Bank and 10.5% YoY for the Group). Such a substantial increase in lending was largely financed by higher volumes of retail deposits growing by 11.9% YoY in the Bank and 11.8% YoY in the Group.

The solid liquidity structure of the Bank and of the Group is reflected by the net loans-to-deposits ratio which equaled, at the end of December 2018, 86.7% and 89.5%, respectively. This, in conjunction with the high value of capitals, allows continued and stable growth of the Bank's and the Group's operations. The total capital ratio (TCR) for the Bank amounted to 18.7% at the end of December 2018 and was higher (by 0.3 p.p.) than at the end of 2017. The total capital ratio (TCR) for the Group equaled 17.4% at the end of December 2018 and was higher (by 0.3 p.p.) than at the end of December 2017.

Bank Pekao S.A. was consistently implementing the strategy of strengthening its position on the market of financing housing and consumer goods. In 2018, the Bank sold nearly PLN 10 billion worth of mortgage loans, which is a record-high result and which has translated into a 12% (YoY) increase in the value of PLN-denominated mortgage loans. The market share in new sales equaled nearly 19%.

This exceptional result was also boosted by the sale of loans granted under the government's "Apartment for the Young" (Mieszkanie dla Młodych - MdM) program supporting those under the age of 35 in the acquisition of their first, new apartment. The MdM Program was discontinued at the end of 2018. During the term in which it was available, Bank Pekao S.A. extended over 41,000 loans for the total value of nearly PLN 7.3 billion. In 2018 the value of cash loans for private customers increased by 16% YoY. Sale of cash loans was boosted by the competitive Express Loan (Pożyczka Ekspresowa) offering, individual loans based on CRM tools, and effective use of electronic sale channels: PeoPay mobile banking app and Pekao24 online banking system.

In line with the strategy it has adopted, Bank Pekao S.A. remains the Bank of first choice for corporate customers, rendering both a comprehensive range of services offered by a universal bank, and all other financial services available in Poland (including leasing, factoring and investment consulting, inter alia in relation to mergers and acquisitions). Every other big corporation in Poland is currently taking advantage of the Bank's services. The Corporate Banking, Markets and Investment Banking Division currently serves approximately 13,000 entities, including approximately 2,500 foreign customers and over 2,500 local government entities and municipal companies. The Bank maintains its position of the leading corporate bank a leader of innovative product solutions targeted for businesses and institutions. The broad product offering, innovative solutions and a customized approach allow it to provide a comprehensive range of services for businesses, institutions and public sector entities

Bank Pekao S.A. is a universal bank offering all financial services that are available in Poland to private and institutional customers. The broad product offering, innovative solutions and a customized approach allow it to provide a comprehensive range of services for customers, and the customer service model relied upon guarantees the highest quality of that service and ensures that they are always suited to their changing needs. Since 2017 Bank Pekao S.A. has been a part of the PZU S.A. Capital Group – the largest financial institution in Central and Eastern Europe.

Pursuant to the "Strength of the Polish Bison" (Siła Polskiego Żubra) strategy adopted for 2018-2020, the Bank intends to continue activities aiming to attain the positions of a profitability leader by building lasting business relationships and improving its operational efficiency. The following shall remain the Bank's strategic priorities for 2019: smart growth, building long-term customer relations based on an integrated service model, operational transformation designed to strengthen its position of the best recognized bank in Poland, thanks to a professional approach creating value for customers.

The Bank invests in training, professional growth of its employees (in line with their abilities and potential), in creating a friendly working atmosphere and surveys employee involvement and satisfaction levels.

The Bank relies on certified training-related programs and processes and was the only financial institution in Poland that received, in 2018, the Pearson Assured status awarded under a rigorous audit conducted by Pearson.

Bank Pekao S.A. was once again distinguished with the Top Employers Polska certificate awarded by the Top Employers Institute – an achievement that confirms the Bank's employee-focused approach.

As it was the case in previous years, the Bank was rewarded and distinguished, in 2018, for its achievements and for the innovation-oriented nature of the solutions it offers, in various prestigious contests organized by foreign and domestic magazines. Congratulating the Bank on the prizes it has won, the Supervisory Board agrees with the Management Board that awards received for innovative products and services are of particular significance for the institution.

Bank Pekao S.A. received, for the second year in a row, from the Global Banking and Finance Magazine, the title of Poland's Best Corporate Bank (Best Corporate Bank in Poland 2018).

In February 2018 Bank Pekao S.A. received a distinction for the most active participants of the National Securities Deposit and the Central Counterparty, during a Gala summing up the Stock Exchange Year of 2017, held at Warsaw's Stock Exchange Center. Those institutions were awarded during the ceremony that received the best results in 2017 and considerably contributed to the development of the Polish capital market.

Bank Pekao S.A. was the winner of the 2018 Business Inspiring Companies competition, winning in the INNOVATIONS category with its Pekao Connect service. The contest is organized by the Newseria News Agency under the patronage of the National Center for Research and Development (NCBR) and the Scientific and Academic Computer Network (NASK).

Bank Pekao S.A. received, for the second year in a row, the title of "The Best Investment Bank in Poland for 2018" awarded by the Global Finance Magazine.

Bank Pekao S.A. received the Europe Banking Award 2017 from the prestigious EMEA Finance magazine – a distinction that acknowledges the Bank's position of one of the best financial institutions in Europe.

Bank Pekao S.A. received, for the sixth time in a row, the Best Sub-Custodian award from the Global Finance magazine.

Bank Pekao S.A. received also, for the third time in a row, the highest 5-star note in the prestigious private banking ranking by "Forbes". This particular distinction confirms the high quality of private banking services and the availability of solutions that are tailored to the needs of a particularly demanding group of customers.

The Private Banking offering of Pekao S.A. has been ranked, for the fourth time in a row, as the best solution of this type in Poland by Global Finance. Global Finance's Private Bank Awards 2019 is one of the most comprehensive rankings classifying the banks' offering for the most affluent customers.

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

Bank Pekao S.A. has in place an internal control system that complies with the guidelines set forth in Recommendation "H" of the Polish Financial Supervision Authority. The said system comprises the following:

- 1) a control function (control mechanisms, independent monitoring of compliance with control mechanisms, control function-related reporting),
- 2) an independent compliance unit (Compliance Department),
- 3) an independent internal audit unit (Internal Audit Department)

and covers all organizational units of the Bank and its subsidiaries.

The Supervisory Board positively assesses the functioning of the internal control system at Bank Pekao S.A., as it ensures effectiveness and efficiency of the Bank's operations, reliability of financial reports, compliance with risk management principles in place at the Bank, compliance of the Bank's operations with applicable laws, internal regulations and market standards. The rules pursuant to which internal control is exercised, including the control mechanisms approved by the Management Board and the Supervisory Board of Bank Pekao S.A., are adapted to the organizational structure of the Bank, to the magnitude and profile of risks identified in the ICAAP Procedure, and to the scale of the Bank's activity. These rules are reviewed and assessed within the framework of internal audit procedures.

The Internal Control System in place at the Bank comprises all organizational levels and is enforced by the Bank's statutory organs, by its individual organizational units, by persons in charge of exercising supervision at all management levels, and by all employees. The primary objectives of the Internal Control System include the following:

- 1) ensuring effectiveness and efficiency of the Bank's operations,
- 2) ensuring reliability of financial reports,
- 3) ensuring that risk management principles in place at the bank are complied with,
- 4) compliance of the Bank's operations with applicable laws, internal regulations and market standards.

More detailed, specific objectives of the Internal Control System are identified as well for each of the general goals listed above.

The Internal Control System in place at the Bank comprises three lines of defense:

- 1) first line of defense – managing the risk inherent in the Bank's operational activity,
- 2) second line of defense – risk management control exercised by employees holding specific positions, or by organizational units – independently of risk management performed as part of the first line of defense,
- 3) third line of defense – independent Internal Audit Department.

The Bank ensures independent monitoring of compliance with control mechanisms in relation to all of its processes, by:

- 1) horizontal monitoring performed within the framework of the first line of defense and vertical monitoring of the first line of defense performed by the second line of defense,
- 2) horizontal monitoring within the framework of the second line of defense,
- 3) horizontal monitoring within the framework of the third line of defense.

Compliance with control mechanisms is monitored, independently, via: on-going verification and testing.

The dedicated structures fully cover the crucial risk areas that the three lines of defense referred to above are concerned with.

Control functions are performed, in relation to subsidiaries, by the Bank's representatives being members of their supervisory boards.

The Management Board of the Bank is responsible for designing, implementing and ensuring that an independent, adequate and effective Internal Control System is available at all organizational units and at all organizational positions of the Bank.

The Supervisory Board oversees the introduction and operation of the adequate and effective Internal Control System.

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

The Supervisory Board has a positive view on the risk management system in place at the Bank and in the Pekao Group.

The risk management system is of a comprehensive and consolidated character and covers 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 in accordance with the regulatory requirements was approved by the Supervisory Board. The ICAAP Policy is subject to regular reviews and the required updates in order to adjust it to the best market practices, legal norms and changes taking place in the Bank and in its operating environment, and also 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 the law and with supervisory regulations, the Management Board of the Bank is responsible for achieving the strategic risk management goals. The Supervisory Board, supported by the Supervisory Board's Risk Committee, oversees the compliance of the Bank's policy related to exposure to various risks with the Bank's overall strategy and financial plan, in particular by defining the Bank's risk appetite and by approving the following documents adopted by the Management Board: risk management strategy (ICAAP Policy), capital management strategy, credit policy, investment and market risk policy, operational risk strategy and model policy, as well as by reviewing periodic reports of the Management Board concerned with the management of individual risk types.

The risk management system in place at the Bank constitutes an integral element of the Bank's management system. The system has been adapted to the Bank's organizational structure and it is adequate to the activities conducted by the Bank, as well as to the magnitude and profile of Pillar I risks and Pillar II risks defined under ICAAP.

The Bank applies, as part of the risk management system, formal procedures aiming to identify, measure and monitor risks, as well as risk-mitigating limits. The managerial information system in place at the Bank enables effective monitoring of risk levels. The risks are monitored with regard to profitability and the capital required to take them.

Credit risk, liquidity risk, market risk and operational risk are managed by the Risk Management Division which is supervised by the relevant Vice President of the Management Board. Other risks are managed jointly between the Risk Management Division and other divisions involved in controlling such risks.

The following play an important role in risk management: credit risk - Credit Committee, market and liquidity risk - Asset, Liability and Risk Committee, operational risk - Operational Risk Committee and Bank Security Committee, model risk – Model Risk Committee. Effective risk management is one of the strong points of the Bank.

### **Assessment of the non-compliance risk management system**

The Supervisory Board has a positive view on the system used to manage the risk of non-compliance that aims to ensure the activities of the Bank and of its employees comply with the applicable laws, internal regulations and market standards relied upon in the Bank's processes.

There is a separate compliance unit operating with the Bank's structure, namely the Compliance Department that is fully independent (both organizationally and operationally) and that reports directly to the President of the Bank's Management Board. The Compliance Department constitutes a key element in the process of ensuring compliance within the Bank.

The Bank ensures compliance by applying purpose-designed control mechanisms and tools relied upon to manage the risk of non-compliance. While performing its control functions, the Compliance Department designs and supervises the implementation of control mechanisms aiming to ensure compliance with applicable laws, internal regulations and market standards, or applies these on its

own, and monitors, in an independent manner, their application by other organizational units of the Bank. The Compliance Department is responsible for implementation, at the Bank, of the process of managing the risk of non-compliance that consists in identifying, assessing, controlling and monitoring the risk of non-compliance of the Bank's activity and in submitting relevant reports. Reports on the implementation of the tasks of the Compliance Department, along with estimates of the risk of non-compliance, are submitted to the Management Board and to the Supervisory Board. The Bank oversees also the risk of non-compliance related with the activity of its subsidiaries.

Assumptions of the process relied upon to manage the risk of non-compliance have been defined in specific regulations drawn up by the Management Board and approved by the Supervisory Board. These include the following: Compliance Policy of Bank Pekao S.A. and Regulations of the Bank Pekao S.A. Compliance Department. The key elements supporting the aforementioned process include:

- a) supervision exercised by the Supervisory Board over, and liability of the Management Board for effective management of the risk of non-compliance,
- b) properly defined organizational structure and relevant HR policy,
- c) internal regulations concerned with ensuring compliance,
- d) process of identifying, assessing, controlling, monitoring and reporting the risk of non-compliance,
- e) training,
- f) on-going cooperation of the Compliance Department with the Internal Audit Department and with other organizational units responsible for performing control functions and for managing the risk of non-compliance.

In order to ensure compliance with applicable laws, internal regulations and market standards, all of the Bank's employees apply relevant control mechanisms or monitor, in an independent manner, the compliance with control mechanisms, in accordance with their scopes of duties and obligations.

The Supervisory Board oversees the process of managing the risk of non-compliance with the support of the Audit Committee. The Supervisory Board assesses effectiveness of the process of managing the risk of non-compliance based on periodic and annual reports of the Compliance Department, information from the Management Board and opinions of the Audit Committee. The Supervisory Board reviews and approves the Bank's annual report on the management of the risk of non-compliance. The Supervisory Board is also responsible for approving the Compliance Plan for the following year.

In the opinion of the Supervisory Board, cooperation with the Compliance Department is good.

### **Assessment of the internal audit function**

The Supervisory Board has a positive view on the activity of the internal audit function of Bank Pekao S.A. Appropriate independence of the Internal Audit Department was ensured, and it was also provided with the human resources and funds required for its effective operation. From the organizational point of view, the Internal Audit Department reports directly to the President of the Management Board, while from the functional point of view – to the Audit Committee and the Supervisory Board.

The Supervisory Board approved the appointment of the new Internal Audit Department Director and approved the report on the activity of the Internal Audit Department in 2017.

Changes to the 2018 Annual Audit Plan were approved in 2018.

The positive opinion on the internal audit function is also based on the assessment of key performance indicators presented, on an annual basis, to the supervisory organs by the Director of

the Internal Audit Department and proving that the objectives that have been set forth are actually met.

The Director of the Internal Audit Department submitted, to the Audit Committee, quarterly reports on the operation of the Internal Audit Department. The annual report on the activity of the Internal Audit Department was submitted to the Supervisory Board. Information on the assessment of adequacy and efficiency of internal control and risk management systems was submitted by the Internal Audit Department as well.

## **Summary**

The Supervisory Board considers the situation of the Bank to be satisfying and stable. Such an opinion is justified by the following: (i) good financial results, (ii) effective cost management processes, (iii) effective and consistent risk management processes, (iv) strong capital and liquidity base, (v) high level of security offered by the Bank, (vi) efficient operation of the internal control system, and (vii) operational efficiency.

In the opinion of the Supervisory Board, Bank Pekao S.A. enjoys a strong capital and liquidity position and while maintaining the highest risk management standards and continuing to improve its cost effectiveness. This enables the Bank to effectively implement its strategic objectives set forth in the Bank's 2018-2020 "Strength of the Polish Bison" strategy and to achieve the position of a profitability leader in the Polish banking sector by entering the path of smart growth thanks to a business model that is based on high efficiency and quality of its processes.