

**Bank Zachodni WBK**



Supervisory Board

## **REPORT ON THE SUPERVISORY BOARD ACTIVITY IN 2017**

**Warsaw, April 2018**

## TABLE OF CONTENTS

I.	ACTIVITIES OF THE SUPERVISORY BOARD OF BANK ZACHODNI WBK S.A. IN 2017.....	3
1.	BOARD COMPOSITION; DISCHARGE OF DUTIES AND RESPONSIBILITIES.....	3
2.	STATISTICAL DATA ON THE SUPERVISORY BOARD'S ACTIVITY IN 2017.....	4
3.	MAJOR AREAS OF THE SUPERVISORY BOARD'S ACTIVITY IN 2017.....	4
4.	ACTIVITIES OF THE SUPERVISORY BOARD AND ITS COMMITTEES.....	9
4.1.	NOMINATIONS AND REMUNERATION COMMITTEE.....	9
4.1.1.	NOMINATIONS COMMITTEE.....	12
4.1.2.	REMUNERATION COMMITTEE.....	13
4.2.	AUDIT & COMPLIANCE COMMITTEE.....	14
4.3.	RISK COMMITTEE.....	18
5.	ASSESSMENT OF THE SUPERVISORY BOARD ACTIVITY IN 2017.....	20
II.	REPORT OF THE SUPERVISORY BOARD ON THE EXAMINATION OF 2017 FINANCIAL STATEMENTS, THE MANAGEMENT BOARD REPORT ON PERFORMANCE IN 2017 AND THE BANK'S MANAGEMENT BOARD'S MOTION WITH REGARD TO NON-DISTRIBUTED PROFIT FOR 2016 21	
III.	ASSESSMENT OF BANK ZACHODNI WBK GROUP'S PERFORMANCE IN 2017.....	22
1.	BANK ZACHODNI WBK GROUP'S PERFORMANCE IN 2017.....	22
2.	ASSESSMENT OF INTERNAL CONTROL SYSTEM.....	27
3.	ASSESSMENT OF THE RISK MANAGEMENT SYSTEM.....	28
4.	ASSESSMENT OF COMPLIANCE RISK MANAGEMENT.....	30
5.	INTERNAL AUDIT FUNCTION ASSESSMENT.....	32
6.	ASSESSMENT OF THE SPONSORING AND CORPORATE GIVING POLICY OF BANK ZACHODNI WBK S.A.....	33
7.	ASSESSMENT OF THE MANNER OF FULFILLING BY BANK ZACHODNI WBK THE DISCLOSURE REQUIREMENTS WITH REGARD TO THE CORPORATE GOVERNANCE RULES SET OUT IN THE WSE RULES AND REGULATIONS PERTAINING TO CURRENT AND PERIODIC INFORMATION PUBLISHED BY ISSUERS OF SECURITIES.....	34
8.	SUMMARY.....	35
IV.	ASSESSMENT OF COMPLIANCE WITH THE CORPORATE GOVERNANCE RULES FOR SUPERVISED INSTITUTIONS.....	35
V.	ASSESSMENT OF THE REMUNERATION POLICY OF BANK ZACHODNI WBK.....	35

## I. ACTIVITIES OF THE SUPERVISORY BOARD OF BANK ZACHODNI WBK S.A. IN 2017

### 1. BOARD COMPOSITION; DISCHARGE OF DUTIES AND RESPONSIBILITIES

1.1. In the period from 1 January to 31 December 2017, the Supervisory Board worked in the following composition:

- Supervisory Board Chairman - Gerry Byrne
- Deputy Chairman of the Supervisory Board - José Luis De Mora,
- Members of the Supervisory Board: - José Garcia Cantera  
- Danuta Dąbrowska  
- David Hexter  
- Witold Jurcewicz  
- John Power  
- Jerzy Surma  
- Marynika Woroszyńska-Sapieha  
- José Manuel Varela

1.2. Changes in the Supervisory Board's composition:

Given the end of the term of office, the General Meeting of Shareholders of Bank Zachodni WBK S.A. appointed the following Members of the Supervisory Board on 17 April 2017:

- Gerry Byrne,
- José Manuel Campa
- José Garcia Cantera
- Danuta Dąbrowska
- José Luis de Mora
- David Hexter
- Witold Jurcewicz
- John Power
- Jerzy Surma
- Marynika Woroszyńska-Sapieha

The General Meeting of Shareholders appointed Gerry Byrne as the Supervisory Board's Chairman.

Acting in accordance with paragraph 26 of the Bank's Statutes, the Supervisory Board Members appointed José Luis de Mora as the Supervisory Board's Vice Chairman.

The Supervisory Board confirms compliance with rules of Policy on selection and suitability assessment of Supervisory Board Members in Bank Zachodni WBK adopted by the Annual General Meeting of Bank Zachodni WBK Shareholders on 20 April 2016.

The Nominations and Remuneration Committee conducted individual suitability assessments of candidates for the Supervisory Board as well as a collective assessment of the Supervisory Board as a collective body in accordance with the above Policy. Recommendation of the Nominations and Remuneration Committee of Bank Zachodni WBK Supervisory Board with regard to candidates for the new term of office of Bank Zachodni WBK Supervisory Board was published on the Bank's website prior to the AGM.

In the opinion of the Supervisory Board its diversified personal composition, with members having both general business experience as well as expert knowledge in different areas, supported by

many years of practical professional experience, ensures adequate and effective discharge of supervisory duties and warrants the due performance of the vested duties and responsibilities. The curricula vitae of the Supervisory Board Members are available at the Bank's website.

### 1.3. Independence of the Supervisory Board Members

In line with the criteria of independence for the Supervisory Board Members set out in paragraph 25 (2) of the Bank's Statutes and the Supervisory Board Regulations, the following individuals held the status of the independent Members:

- Danuta Dąbrowska
- Marynika Woroszyńska-Sapieha
- David Hexter
- Witold Jurcewicz
- Jerzy Surma

Each of the listed persons made a relevant written statement.

- 1.4. The Supervisory Board activities and manner of discharging its duties and responsibilities are governed by the Supervisory Board's Regulations available on the Bank's Internet site.

## 2. STATISTICAL DATA ON THE SUPERVISORY BOARD'S ACTIVITY IN 2017

From 1 January until 31 December 2017, the Supervisory Board held 9 meetings and passed 96 resolutions. Average attendance of the Supervisory Board Members was 94.4%.

## 3. MAJOR AREAS OF THE SUPERVISORY BOARD'S ACTIVITY IN 2017

The Supervisory Board carried out its activities based on the adopted schedule of meetings and the general work plan. The agenda of each meeting was extended (if required) by current business matters, issues submitted by the Bank's Management Board for consideration and any other issues the Board deemed necessary to be covered by the agenda. The Supervisory Board requested and received from the Bank's Management Board comprehensive materials and reports on issues covered by the agenda of meetings as well as those pertaining to other matters important to the Bank's operations.

In 2017, the Supervisory Board focused both on strategic matters as well as on the supervision of the Bank's day-to-day business. The key issues were:

- Discharging its obligations imposed by Paragraph 32 of the Bank's Statutes, the Supervisory Board made an on-going assessment of the performance of the Bank and BZ WBK Group as well as the current forecasts prepared based on such results, including the underlying business and operational trends, opportunities and threats, deviations from the Plan and management actions taken up by the Bank's Management Board. The assessment background were interim financial statements presented by the Bank's Management Board. As part of the reports presented by the Management Board President, at each meeting the Supervisory Board was updated on the key developments referring to the Bank and its environment, including up-to-date economic and market forecasts and their impact on the Polish economy as well as on the Bank and BZ WBK Group's financial and business performance. Moreover, the Supervisory Board was receiving information about projections and trends in the banking sector and performance of competitors as well as BZ WBK's performance benchmarked against the sector. The Supervisory Board was also updated by the Bank's Management Board about current priorities and the approach adopted to

management of funding, liquidity, capital, risk (including credit risk) and costs. Given the key importance of liquidity and funding, the related information covered the scenarios / strategies developed by the Management Board as well as actions taken to manage liquidity and diversify funding sources, including progress in works on verified business model and functioning model of future mortgage bank.

- Within its powers defined in the Bank's Statutes and pursuant to relevant legislation, the Supervisory Board took decisions with regard to approval of the following documents:
  - Updated 2017 Financial Plan – changes were triggered by re-segmentation of customers and their transfer between business segments. New regulatory guidelines issued by KNF and the Financial Stability Committee were taken into account.
  - Bank Zachodni WBK Strategy for 2018-2020 and Business Plan for 2018 – in line with the Policy on strategic, business and financial planning, the Supervisory Board conducted the annual analysis of the implementation of the to-date Strategy of Bank Zachodni WBK Group for the years 2017-2019, specifically taking into account: (i) the dynamics and complexity of changes in the macroeconomic environment in the context of current and future challenges; (ii) competitive environment, including the position of BZWBK in the sector; (iii) delivery of the Strategy in all areas of activity.  
Based on the outcome of the review, it was recommended that the Strategy revisited to work out the concept for the period of subsequent three years (2018-2020) taking into account new challenges in the external environment and arising from evolving structure of the Group and its development aspirations as regards strategic transformation of its business activity. The revised Strategy for 2018-2020 approved by the Supervisory Board in December 2017 represents the continuation of the to-date BZ WBK Group business directions, based on the adopted values and assumptions and addresses the identified challenges.  
The delivery of the above targets will be supported by the delivery of mid-term objectives and action plans developed within the 2018 Business Plan.
  - BZ WBK Group's financial Plan for 2018-2020 and BZ WBK Group's Financial Plan for 2018. The three-year Financial Plan for BZ WBK is based on the following assumptions: (i) net profit growth ; (ii) positive trends in interest and net fee income; (iii) tight cost management triggering reduction in the cost/income ratio; (iii) improvement in the quality of credit portfolio; (iv) slower growth in the average risk weighted assets than credit receivables.
  - The ALM strategy for 2018-2020 – the document is based on economic assumptions and business aspirations consistent with the 2018 BZ WBK Group's Financial Plan and 2018-2020 BZ WBK Group's Financial Plan. The document comprises the assumptions for financing and liquidity strategy, investment and interest rate strategy, balance sheet and ALM P&L, and hedging strategies subject to IFRS39.
  - The revised BZ WBK Recovery Plan approved by the Management Board and Supervisory Board in December 2016 had been updated given the comments passed by the Polish Financial Supervision Authority (KNF) and the schedule of updating Santander Group Recovery Plan part of which is BZ WBK Recovery Plan.
- As part of the general supervision over the internal capital adequacy assessment process, the Supervisory Board, based on reviews and recommendations of the Audit & Compliance Committee, approved:
  - Disclosures on BZ WBK capital adequacy – in accordance with the Bank's Disclosure Strategy, approved by the Management Board and the Supervisory Board, the Report presents information on the capital adequacy of BZ WBK Group on a consolidated basis, i.e. taking account of the subsidiaries, including Santander Consumer Bank, and was produced based on data as at 31 December 2016. The document was internally approved and reviewed by the Bank's external auditor, PricewaterhouseCoopers Sp z

ograniczoną odpowiedzialnością Sp. k., who performed an independent verification of the correctness of the capital requirement measurements presented in the document.

- Periodical reports on the internal capital adequacy assessment process (ICAAP) – data included in the ICAAP Report as at 31 December 2016 confirmed that BZ WBK Group had own funds adequate to the scale and type of risk. Moreover, the Supervisory Board was given assurance that: (i) capital ratios as at 31 December 2016 adequately reflected the risk; (ii) in subsequent years, adequately to known regulatory requirements and capital ratios, incl. those related to the capital surplus and TCR, capital ratios should stay at the level ensuring the safety of the business operations, both from the shareholders' and customers' perspective; (iii) the Bank takes actions aimed at optimising the capital consumption through RWA levels as well as by increasing the capital base through Tier 2 issuances.
- As part of supervision exercised over the risk management system, during each regular meeting the Supervisory Board carried out a review of the main risk areas based on the Risk Dashboard Report and paid special attention to, amongst others, trends, supervision over individual risk types, compliance with applicable internal policies and procedures and the KNF recommendations, the EU and the EBA regulations, as well as, to relevant identification of threats and determination of management actions adjusted to the needs and to the scale of the Bank's business thus ensuring their effectiveness.
- As part of the supervision over credit risk, the Supervisory Board was updated on the current lending strategy and key credit risk factors. The Supervisory Board conducted regular reviews of the loan portfolio, also in terms of compliance with the Recommendations of the Polish Financial Supervision Authority. Moreover, the Supervisory Board was informed about individual loan portfolios with a breakdown by products/customer segments, focusing on issues related to their quality and profitability.  
The Supervisory Board was also regularly updated on the CHF loan portfolio issues, including the information on the risk run in the case of that portfolio as well as assessment of different legislation proposals for restructuring fx mortgage loans along with their potential impact on the Bank and the banking sector.  
The Supervisory Board was advised about the Financial Stability Committee's (KSF) position based on the resolution passed on 13 January 2017 on recommendations with regard to restructuring of fx mortgage loan book and the KSSF's expected implementation schedule and assessment of KSF's recommendations whose impact was assessed.
- In line with the Compliance Risk Management Policy applicable in Bank Zachodni WBK, the Supervisory Board assessed the effectiveness of compliance risk management in BZ WBK. Its results are presented in the further part of this Report (it. III. 4).  
Notwithstanding the above, the Supervisory Board assesses the compliance risk management upon each presentation of the report on the performance of the Compliance Area to the Audit & Compliance Committee.
- The Supervisory Board was informed about the activity of the Internal Audit Area on an ongoing basis in current reports presented by the Chairman of the Audit and Compliance Committee.  
The outcome of the overall assessment of the Internal Audit function taking into account the review performed by the Supervisory Board at the meeting in December 2017 was presented in the further part of the Report (point III.5).
- Based on the conducted review, the Supervisory Board approved the acceptable risk level for 2017, expressed as limits set out in the Risk Appetite Statement (RAS) for local metrics. BZWBK sets its risk appetite using the system of limits defined for key risks triggered by its business operations. The scope of changes implemented as a result of annual review covered, among others: (i) incorporation of capital requirements set by KNF as a pre-

condition for the payment of dividend in the adopted metrics; (ii) taking into account additional stress factors; (iii) adjustment of credit risk ratios, including the ratio of portfolio concentration. For all metrics in the case of which limits had been exceeded in 2017, risk mitigation plans were set for identified risks and were monitored on an on-going basis. The Supervisory Board was given assurance that the adopted metrics correspond to business and financial targets set out in 2017 Plans.

The Supervisory Board also approved the updated Risk Appetite Statement for 2017; the update was driven among others by the need to: (i) include additional metrics for operational systems safety (ii) adjustment of operational risk metrics, (iii) increase of the limit for PLN mortgage backed loans.

In the Supervisory Board's opinion, the risk appetite defined by the Bank matches the current market environment. The risk analysis is supported by stress testing and scenario analyses which are to ensure that BZ WBK will continue as a stable and adequately capitalized bank even amid adverse market conditions.

- In line with Recommendation U and the Bancassurance Policy applicable in the Bank, the Supervisory Board was provided with reports on that business, reviewed them on a quarterly basis and, separately, reviewed issues related to management of bancassurance risk. The scope of information included in these reports allows the Supervisory Board to exercise effective oversight of this business area.
- The Supervisory Board got acquainted with the evaluation assigned to the Bank by the Polish Financial Supervision Authority (KNF) in the BION (Supervisory Review and Evaluation) process as at 31 December 2016 as well as with the quarterly updates of this evaluation, and analysed in detail the information on the areas that drove the evaluation. The Supervisory Board was also informed about the BION process conducted in the Bank as at 31 December 2016 and received confirmation that in line with the requirements of the process the Internal Audit Area and the Compliance Area conducted an independent review of the conformity of drafted documentation with the actual status and that its final version was approved by the Bank's Management Board.
- The Supervisory Board was notified of the implementation status of KNF's recommendations issued after inspections in the Bank in 2016. Based on information verified by the IAA in cooperation with the Compliance Area, the Supervisory Board was provided with assurance that there were no delays in the scheduled management actions and that their status was reported to KNF as required.
- The Supervisory Board was informed about actions taken to ensure relevant level of IT security in Bank Zachodni WBK, including implementation of the Cyber Security Strategy for 2017-2019 and its adjustment to the current level of threats, infrastructure and Bank's resources.
- The Supervisory Board reviewed the strategy and activity of business segments other areas of the Bank and its subsidiaries and was informed about progress in implementing regulatory projects significant for the Bank: GDPR, MSSF9, MIFID II, PSD II and strategic projects and programmes as part of the Strategic Transformation: (i) Business transformation; (ii) Business model transformation; (iii) Digital transformation covering: process digitalisation, development of internet, mobile and phone banking, CRM development programme, development of iBiznes24 platform, development of insurance (Programme 4Sure); (iv) communication and marketing; (v) cultural transformation; (vi) Agile transformation.
- Purchase a de-merged business of Deutsche Bank Polska S.A - on 14 December 2017 a transaction agreement with Deutsche Bank AG (DB AG) was signed including retail banking, private banking, business banking (SME) and DB Securities S.A. along with a pre-merger

agreement setting the principles of cooperation between BZ WBK and DBP to close the said transaction.

- The Supervisory Board analysed and obtained full explanations on actions taken by the Bank's Management Board and was assured that due diligence was exercised in examining all transaction circumstances, including: (i) detailed, precise and diligent analysis of all the aspects of DBP purchase transaction and impact of the transaction on the Bank's standing and related development opportunities for BZ WBK Group; (ii) analysis of the due diligence reports, including reports of an independent legal advisor – Allen & Overy, A.Pędzich sp. k. law firm - and an independent financial advisor – KPMG Audyt sp. z o.o. sp.k., (iii) analysis of the outcome of the negotiations of the transaction's terms and conditions.  
Given the above, the Supervisory Board approved the Management Board's resolution on acquisition of the carved out business of Deutsche Bank Polska and approval for signing the transaction agreement with Deutsche Bank AG as well as *pre-demerger agreement* with Deutsche Bank Polska S.A.
- In view of the scale of the process of integrating the demerged part of Deutsche Bank Polska S.A. with Bank Zachodni WBK as well as its impact on both organisations, market, employees and shareholders, including minority shareholders, triggering the need for an active oversight of the process by the Supervisory Board, the Supervisory Board decided to delegate John Power, the Supervisory Board Member to exercise ongoing, individual oversight of that process. John Power, in liaison with the Integration Process Strategic Committee will individually exercise oversight of the process and provide the Supervisory Board with regular reports on performed activities.
- As recommended by relevant Committees, the Supervisory Board approved changes in the following internal documents required due to the changes in corresponding regulation or as a result of reviews made based on applicable regulatory rules:
  - Bank Zachodni WBK Information Strategy with regard to capital adequacy;
  - Bank Zachodni WBK Group capital policy;
  - Bank Zachodni WBK Contingency Plan;
  - Bank Zachodni WBK Liquidity Contingency Plan and liquidity stress test results;
  - "Respect and Dignity" Policy,
  - BZWBK Group's Remuneration Policy;
  - Remuneration policy for Members of Bank Zachodni WBK Management Board;
  - Bank Zachodni WBK Risk Management Policy;
  - BZ WBK Credit Risk Management Policy;
  - Operational Risk – Governance & Control Framework;
  - Bank Zachodni WBK Group operational risk management policy;
  - Bank Zachodni WBK Internal Control System Policy;
  - Control Function Matrix Methodology;
  - Bank Zachodni WBK Compliance Policy;
  - Special Situations Management Policy;
  - Report on Internal Liquidity Adequacy Assessment Process (ILAAP) in Bank Zachodni WBK S.A.;
  - Asset and Liability Management Process Models;
  - Policy for appointing the External Auditor
  - The Policy for Non-Audit Services Rendered by the Auditor;
  - Financial Planning Policy of Bank Zachodni WBK S.A. Group;
  - the Compliance Unit Regulations
  - Policy on managing conflicts of interests in Bank Zachodni WBK S.A.;
  - Reputational Risk Management Model;
  - Internal Audit Charter of Bank Zachodni WBK S.A.;
  - Policy on cooperation between BZ WBK Internal Audit Area and the External Auditor;
  - Bank Zachodni WBK Concentration Risk Management Policy;
  - Liquidity Risk Management Policy;



- Terms of reference of the Supervisory Board's Committees.

#### 4. ACTIVITIES OF THE SUPERVISORY BOARD AND ITS COMMITTEES

Independently of the Supervisory Board's meetings, the Supervisory Board Members worked in the following Board's committees:

- Nominations and Remuneration Committee - since 17 May 2017, the committee operated as two separate committees: Nominations Committee and Remuneration Committee,
- Audit & Compliance Committee,
- Risk Committee.

The Committees' respective procedures are set out in their Terms of Reference, introduced by relevant resolutions of the Supervisory Board. The Terms of Reference are available in the Supervisory Board Secretariat.

The Members of individual Committees have knowledge and experience suitable for their roles and adequate discharge of their responsibilities.

The Committees contribute a lot to improving the effectiveness of the Board's work by supporting it in the discharge of its statutory duties as well as by preparing recommendations and proposed decisions relating to the Board's own motions as well as those submitted by the Bank's Management Board.

In order to enable the Supervisory Board Members to appraise in full the Committees' work and give them insight into the Committees' current operations, the Chairpersons present relevant reports at the meetings of the Supervisory Board and the Supervisory Board members are provided with copies of the minutes of each meeting of the Committees.

Individual Committees received sufficient, reliable and timely information and reports from the Management Board allowing them to discharge their responsibilities in 2017.

##### 4.1. NOMINATIONS AND REMUNERATION COMMITTEE

The Nominations and Remuneration Committee operated until 17 May 2017. After that date, the Nominations Committee and Remuneration Committee have operated as two separate committees.

##### **Role, tasks and composition of the Committee**

The Nominations and Remuneration Committee operated in the following composition:

- Gerry Byrne – Chairman
- Danuta Dąbrowska
- José Luis de Mora
- Witold Jurcewicz
- Jerzy Surma

In the period from 1 January until 17 May 2017, the Committee held 3 meetings and its activity focused on the following issues:

- Assessment of the suitability of the Bank's Management Board Members - in execution of the Policy on Selection and Suitability Assessment of Management Board Members and Key Function Holders in Bank Zachodni WBK S.A.; at its meeting held on 15 February 2017, the Committee conducted:

- individual suitability assessment of those Members of the Bank's Management Board who were not assessed in 2016; the assessment was based on the criteria included in the competence profiles approved earlier by the Supervisory Board that refer accordingly to tasks and responsibilities of individual job role holders;
- a collective suitability assessment of the Management Board competencies – the Committee deemed it purposeful to assess the skills matrix in place given: (i) changes in the Bank's Management Board composition that took place in recent months and (ii) the expiry of the current Management Board's term of office on the day of the Bank's Annual General Meeting of Shareholders which would approve the Bank's Financial Statements, Balance Sheet and P&L Account for the accounting year 2017.

The Committee recommended to the Supervisory Board the approval of individual suitability assessment of the Management Board Members and the assessment of the Management Board's skills matrix.

- Changes in the Bank's Management Board composition:
  - Given the resignation from the function of the Management Board Member in charge of the Financial Management Division filed on 16 February 2017 by Eamonn Crowley, the Committee decided to recommend to the Supervisory Board the appointment of Maciej Reluga, Chief Economist of the Bank, to that function.
  - With a view to ensuring best support for achieving BZ WBK's strategic objective, i.e. the position of the best bank on the Polish market, the Committee decided to recommend to the Supervisory Board the following changes aimed at extending the competence profile of the Management Board and strengthening the Bank's leadership:
    - ✓ Extension of the Management Board composition by the function of the Management Board in charge of the Retail Distribution Area and Branch Network and appointment of Arkadiusz Przybył, the to-date President of the Bank's subsidiary, Santander Consumer Bank, to this role.
    - ✓ Appointment as the Vice Presidents of the Bank's Management Board the following persons who had performed for many years the function of the Management Board Members, managing the key areas of the Bank's business: Andrzej Burliga, Juana de Porras Aguirre, Michael McCarthy, Mirosława Skiba and Feliks Szyszkowiak.

For persons recommended to take up functions on the Bank's Management Board for the first time, the Committee presented relevant motions for the Supervisory Board's approval with regard to the assessment of the suitability criteria as per Article 22aa of the Banking Law Act for each individual. These assessments were conducted in line with the Policy on Selection and Suitability Assessment of Management Board Members and Key Function Holders in Bank Zachodni WBK S.A., based on the Individual Competence Profiles approved by the Supervisory Board. The assessments took into account their suitability from the perspective of ensuring adequate skills of the Management Board as a whole.

- Given the expiry of Supervisory Board's term of office and the election of the new Board for the new term scheduled for the Annual General Meeting on 17 May 2017, the Committee conducted individual suitability assessments of candidates for the Supervisory Board as well as a collective assessment of the Supervisory Board as a collective body in accordance with BZ WBK Policy on Selection and Suitability Assessment of Supervisory Board Members adopted by force of the AGM's resolution no. 34 on 20 April 2016. Taking into consideration the individual and collective suitability assessment of Supervisory Board Members, the Committee decided to recommend to the AGM that the indicated candidates be appointed to the Supervisory Board for its new term of office. The Committee also confirmed that the recommended composition of the Supervisory Board for the new term of office was in compliance with the provisions of paragraph 25 of the Bank's Statutes with regard to the number of independent members and members knowing the Polish market, including the number of independent members permanently residing in Poland and who speak Polish. The Committee's recommendation along with the list of candidates to the Supervisory Board and their professional CVs was published on the Bank's website prior to the AGM.

- Preparation of recommendations for the Supervisory Board with regard to the assessment of the Management Board Members performance in 2016 based on the Performance Evaluation Sheets for the Management Board Members in line with the procedure of setting objectives for the Management Board Members. In line with the Polish Financial Supervision Authority's recommendation, the said evaluation took into account the three-year horizon of the Bank's performance, cost of risk, capital and liquidity risk as well as quantitative and qualitative metrics;
- Recommendations for the Supervisory Board on bonuses for 2016 for the Bank's Management Board Members, based on the Bonus Regulations and in compliance with the Bank's applicable regulations in this respect.
- Annual review of the bonus scheme applicable to the Bank's Management Board Members and providing the Supervisory Board with recommendations on adopting the 2017 Bonus Regulations specifying the terms and conditions of awarding bonuses and setting bonus pools, with a focus on adequate support in achieving the goals assumed in the Business Plan and in the Financial Plan for 2017 as well as compliance with applicable regulations with respect to variable components of remuneration of key function holders. The Committee also got acquainted with the assumptions underpinning the incentive schemes and bonus policies for other staff groups which are designed to support the Bank's business targets and values in the best way.
- In relation to the review that aimed at developing a document that would comprehensively regulate the staff remuneration issues in Bank Zachodni WBK Group, the Committee recommended to the Supervisory Board the approval of:
  - the Remuneration Policy of Bank Zachodni WBK Group that covers all employees of BZ WBK Group - the document fulfills the Group's obligation to apply remuneration practice consistent with currently applicable EU and local regulations, taking into account the Remuneration Policy adopted by the Santander Group;
  - the updated Remuneration Policy for Members of Bank Zachodni WBK Management Board, which represents a separate part of BZ WBK Group's Remuneration Policy.
- In line with Bank Zachodni WBK Nomination and Succession Planning Policy for Management Board Members and Key Function Holders (Succession Policy), based on the results of the regular review, the Committee recommended to the Supervisory Board the approval of the updated list of successors for the Bank's Management Board roles. The updated list of successors reflects the availability of relevant skills and the level of readiness to take up the job role as at the given moment; in line with the Policy the list would be subject to further regular reviews.
- Review of the progress against the conditions of Incentive Scheme V, defined in resolution no. 4 of the Extraordinary Meeting of the Bank's Shareholders of 30 June 2014 that introduced Incentive Scheme V – given that the scheme came to an end, the Committee recommended to the Supervisory Board: (i) confirmation of the Scheme's triggers and vesting the award entitlement for 2016; (ii) establishment of the Total Award entitlement for the Programme's Participants taking into account the progress against objectives in individual years of the scheme.
- Recommendation to the Supervisory Board a new three-year Incentive Scheme VI to be executed in the years 2017-2019. The scheme is a continuation of the earlier programmes applicable in the Bank and leverages the experience gathered under these schemes. The scheme is geared at incentivising key employees of the Bank and subsidiaries (250 individuals in total) over a longer time horizon in connection with the long-term financial effectiveness of the Bank and BZ WBK Group and shareholder's expectations, remaining at

the same time compliant with the relevant Polish legislation, EU Commission and Parliament regulations and European Banking Authority's guidelines.

The Annual General Meeting of Bank Zachodni WBK S.A. held on 17 May 2017 adopted resolutions that enabled it to launch Inventive Scheme VI.

#### 4.1.1. NOMINATIONS COMMITTEE

##### **Role, tasks and composition of the Committee**

The tasks of the Nomination Committee appointed by the Supervisory Board on 17 May 2017 include in particular: (i) preparation and issuing recommendations to the Supervisory Board in terms of appointing and removing Members of the Supervisory Board, the Management Board and other key function holders by the Bank's relevant body; (ii) active performance of the Bank's responsibilities arising from the adopted Suitability Policy for Members of the Supervisory Board, Management Board and key function holders; (iii) analysing and recommending succession plans for the Bank's Management Board Members to the Supervisory Board.

The Committee operates under the Terms of Reference, which were approved by force of the Supervisory Board's resolution No. 39/2017 of 17 May 2017.

On 17 May 2017, in view of commencing the new term of office, the Supervisory Board appointed the following composition of the Committee:

- Witold Jurcewicz – Chairman of the Committee
- Gerry Byrne
- Danuta Dąbrowska
- José Luis de Mora
- Marynika Woroszylska-Sapieha
- Jerzy Surma

The majority of the Committee members, including the Chairperson, are independent in line with the definition of the Supervisory Board's Member independence specified in the Bank's Statutes.

From 17 May to 31 December 2017 the Committee held 2 meetings with the agenda covering:

- Changing the distribution of responsibilities in the Bank's Management Board – the change recommended to the Supervisory Board aimed at ensuring increasingly better delivery of the Bank's strategic ambitions and achieving end-to-end consistency and synchronisation of all customer touchpoints and sales through:
  - Vesting Mirosław Skiba, Vice President of the Management Board, with oversight over the Wealth Management Programme, which is intended to build competitive advantage in the segment of high net worth customers; in addition to oversight over the Programme's project structure, this will include oversight over the Private Banking Department and consolidated oversight over Asset Management in Bank Zachodni WBK Group;
  - Extending the responsibilities of Arkadiusz Przybył, Member of the Management Board, who, in addition to managing the Bank's Retail Distribution Network, will also be in charge of the Retail Banking Division units.

Taking into account the above, the Committee decided to recommend to the Supervisory Board:

- ✓ Adoption of proposals of individual Competence Profiles for the Vice President of the Management Board in charge of the Wealth Management Programme and for the Management Board Member in charge of the Retail Banking Division and Retail Distribution Network.

- ✓ Accepting the performance rating of Arkadiusz Przybył made due to extension of his responsibilities in line with the Policy on Selection and Suitability Assessment of Management Board Members and Key Function Holders in Bank Zachodni WBK S.A.
  - ✓ Waiver of the suitability assessment indicated in Art. 22aa of the Banking Law for Mirosław Skiba given that the scope of responsibilities covers the Bank's business areas that he had already supervised.
  - ✓ Approval of the assessment of the collective competence of the Bank's Management Board in connection with the recommended changes in the assignment of responsibilities.
- Given the changes in the Bank's organisational structure as well as personal changes resulting from the staff turnover, in order to ensure effective management and continuity of business processes, in line with Bank Zachodni WBK Nomination and Succession Planning Policy for Management Board Members and Key Function Holders (Succession Policy), the Committee made a regular review and updated the list of the Bank's Management Board Members' successors.

#### 4.1.2. REMUNERATION COMMITTEE

##### **Role, tasks and composition of the Committee**

The tasks of the Remuneration Committee appointed by the Supervisory Board on 17 May 2017 include:

- Monitoring the Bank's remuneration policy and supporting the General Meeting, the Supervisory Board and the Management Board in developing and implementing that policy. In particular, the Committee specifies the remuneration policy for the Management Board Members and provides the Supervisory Board with recommendations on remuneration for individual Members of the Bank's Management Board in compliance with the rules for remuneration adopted in the Bank and performance evaluation.
- Issuing opinions to the remuneration policy referred to in the Banking Law and regular reviews of the policy and its performance, including preparation of the report on the policy performance for the Annual General Meeting.
- Oversight of the bonus scheme for Management Board Members, and analyses of incentive solutions and other bonus schemes proposed for implementation at the Bank and its subsidiaries and presenting relevant recommendation in this scope to the Supervisory Board.

The Committee operates under the Terms of Reference, which were approved by force of the Supervisory Board's resolution No. 40/2017 of 17 May 2017.

On 17 May 2017, in view of commencing the new term of office, the Supervisory Board appointed the following composition of the Committee:

- Danuta Dąbrowska - Chairperson of the Committee
- Gerry Byrne
- Witold Jurcewicz
- José Luis de Mora
- Marynika Woroszyńska-Sapieha

The majority of the Committee members, including the Chairperson, are independent in line with the definition of the Supervisory Board's Member independence specified in the Bank's Statutes.

From 17 May to 31 December 2017, the Committee held 2 meetings with the agenda covering:

- Preparation and recommendation of the templates of Participation Agreements and the list of persons recommended to be included in the 6th Incentive Scheme to the Supervisory Board

for approval. The list covers all Members of the Bank's Management Board and key employees of Bank Zachodni WBK S.A. Group indicated by the Management Board. The participants include a specific group of material risk takers (identified participants) to whom separate vesting criteria apply.

- Recommendation to the Supervisory Board for approval the 2017 List of individuals identified by the Bank on the basis of the criteria set out in the Delegated Regulation, whose professional activities have a material impact on the Bank's risk profile. The identification process was conducted in line with the applicable external and internal regulations based on the criteria set out in the Delegated Regulation, whose professional activities have a material impact on the Bank's risk profile (Material Risk Takers, MRT). As part of the process, the impact of individual persons on the risk profile was analysed, verifying at the same time whether they meet the qualitative and quantitative criteria specified in the Commission Delegated Regulation (EU) no. 604/2014.
- The review and recommendation for the Supervisory Board with regard to approval of the updated Procedure for setting objectives and performance evaluation for Members of Bank Zachodni WBK Management Board. The changes stem from the need to adjust the Procedure to the Bank's approach to managing and monitoring performance.
- Update of the 2017 list of individuals whose professional activity has a significant impact on the Bank's risk profile due to organisational and personal changes and recommendation of the list to the Supervisory Board for approval.

## **4.2. AUDIT & COMPLIANCE COMMITTEE**

### **Role, tasks and composition of the Audit & Compliance Committee**

The Audit & Compliance Committee's role is to assist the Supervisory Board in discharging its oversight responsibilities to shareholders and other stakeholders in relation to: (i) the quality and integrity of the accounting policies, financial statements and disclosure practices; (ii) compliance of the Bank's business with laws and internal regulations; (iii) independence and performance of internal and external Auditors; and (iv) the assessment of the effectiveness of the system of internal control and management of financial and non-financial risks.

The Committee operates under the Terms of Reference, which were updated and approved by force of the Supervisory Board's resolution No. 44/2017 of 17 May 2017. The amended Committee's Terms of Reference reflect legislative changes stemming from the new Polish Auditors Act of 11 May 2017 taking effect in June 2017. The act transposed to the Polish legislation the stipulations of Regulation (EU) No 537/2014 of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities and the EU Directive on statutory audits of annual accounts. These changes introduced to the Terms of Reference trigger primarily an increased number of tasks and duties related to the Committee's co-operation with the External Auditor as well as introduce the extended independence criteria for the Committee's Members.

From 1 January to 17 May 2017, the Audit and Compliance Committee was composed of:

- Danuta Dąbrowska – Chairperson
- David Hexter
- John Power
- Jerzy Surma

On 17 May 2017, in view of commencing the new term of office, the Supervisory Board appointed the Audit and Compliance Committee in the following composition:

- David Hexter – Chairman
- Danuta Dąbrowska
- Witold Jurcewicz
- Marynika Woroszyńska-Sapieha
- Jerzy Surma

All individuals appointed by the Supervisory Board to the Committee for the new term of the Supervisory Board office meet the independence criteria both as per the Polish Auditors Act of 11 May 2017 and the Bank's Statutes and confirmed that in the submitted written statements.

In 2017, the Committee met 5 times and the turnout was as follows:

- Danuta Dąbrowska	5/5
- David Hexter	5/5
- Witold Jurcewicz	3/3
- John Power	2/2
- Marynika Woroszyńska-Sapieha	3/3
- Jerzy Surma	5/5

### **The Committee's activity in 2017**

The regular attendants of the Committee meetings are: the Bank's auditor, PricewaterhouseCoopers Sp. z o.o. (PWC), the Head of Risk Management Division, the Head of Accounting and Financial Control Division, the Head of Financial Management Division, the Head of Legal & Compliance Division, and the Chief Audit Executive. Other Members of the Management Board and the Bank's executives are also invited to attend as appropriate in order to present reports on the areas under their management.

In line with its Terms of Reference, the Committee held separate meetings with the Management Board Members in charge of the Risk Management Division and the Legal & Compliance Division, and with the Chief Audit Executive with a view to discussing material issues.

Moreover, the Committee members met privately either before or after the meetings to assess particular issues that may require further review.

The Committee reviewed key areas of material controls, including those underpinning financial, operational, and regulatory compliance controls. On an on-going basis, the Committee received reports on internal audit, legal and regulatory issues, corporate governance matters, anti-money laundering, and ICM/SOX certification in order to assess the effectiveness of internal control environment.

In 2017, these reports covered:

- Significant/major issues reported under the Respect and Dignity Policy, Code of Conduct in Securities Markets;
- Updates on significant projects in the Bank;
- Information on liquidity and funding;
- Detailed analyses of capital ratios;
- Internal Capital Adequacy Assessment Process (ICAAP);
- Results of the regular status reports on the implementation of the Polish Financial Supervision Authority's and Internal Audit's recommendations;
- Complaint handling process;

- Review of the Bancassurance business;
- Updates on: Anti Money Laundering and Code of Conduct in the Securities Markets.

The Committee focused on: (i) preparations to ensure compliance with the General Data Protection Regulation (GDPR), IFRS 9 and MIFID II, i.e. projects that will impact major areas of the Bank's business; (ii) alignment actions aimed at ensuring compliance with the KNF's Recommendation H regarding internal control system in banks and the Polish Auditors Act.

The standing item on the Audit and Compliance Committee's agenda in 2017 was a status report on the target operational model for Compliance and Internal Audit functions, meeting Recommendation H requirements. The implemented solutions pertained to:

- organisation of the internal control system at BZ WBK;
- compliance risk control and management;
- internal audit control and management.

Other areas reviewed in more detail by the Audit & Compliance Committee in 2017 included:

- Financial reporting.

The Committee reviewed and discussed the Bank's and BZ WBK Group's audited financial statements for 2017 with the Management Board bearing the primary responsibility for preparing the financial statements. The Committee placed particular emphasis on fair presentation of data therein and the reasonableness of the judgmental factors, in particular:

- the level of IBNR provisions for each credit portfolio, the level of legal risk provisions;
- the appropriateness of significant accounting policies used in the preparation of statements and the basis for the valuation of Level III shareholdings (unquoted assets measured through expert valuation models);
- the impact of one-off items that were of a significant nature in the preparation of the year-end financial statements.

The Committee also reviewed and discussed with PwC their independent review of the financial statements and issues raised with Management. Specifically, the Committee held a dedicated meeting to review and assess the scope of Auditor's additional report explaining the results of the conducted review of the financial statements, required first time for 2017 reporting purposes.

The Committee continued its detailed review of the Group's capital, liquidity and risk frameworks as well as the new regulatory requirements. The Committee analysed the proposed assumptions, methodology and process followed in determining the amount of capital and liquidity required to support the Group's business plans and the adequacy of its capital resources.

Based on the Bank Auditor's additional report for the Committee, taking account of conducted reviews, challenges and debates, the Committee decided to recommend that the Supervisory Board approve the audited financial statements for inclusion in the Company's annual report for the year ended 31 December 2017, and the Supervisory Board endorsed the Committee's recommendations.

- Internal Audit Area

The Committee, through the Chief Audit Executive, receives objective independent reports on the operation of internal controls in the Group. The Committee approved the 2017 the Audit Plan and on that basis it reviewed the progress in work and status of key recommendations, focusing on the timeliness of their delivery as well as on the level of training and skills of the resources in the internal audit function (IAA) and changes to the internal audit methodology. The Committee also approved the IAA budget and conducted the annual review of the IAA employees' remuneration. Moreover, in order to comply with Recommendation H, the Committee analysed the proposed changes to internal regulations



on IAA operations and recommended their approval to the Supervisory Board. In 2017, the Internal Audit Area continued its Internal Audit Quality Assurance reporting in accordance with the International Auditing Standard.

- External Audit

There is a process in place whereby the Audit & Compliance Committee reviews and, if considered appropriate, approves, within parameters approved by the Supervisory Board, any non-audit services undertaken by the Auditor, and the related fees. The process ensures that the objectivity and independence of the Auditor is safeguarded.

Based on the Audit & Compliance Committee, the Supervisory Board appointed PricewaterhouseCoopers Sp. z o.o. (PwC) to perform: (i) semi-annual audit of the Bank's financial statements and semi-annual audit of consolidated financial statements of BZ WBK Group for H1 2017 and 2018; (ii) annual audit of the Bank's financial statements and annual audit of consolidated financial statements of BZ WBK Group for 2017 and 2018.

In 2017, BZ WBK Group paid PLN 5.05m to PwC for audit and review services, relating to the statutory audit of the Group and Bank financial statements and the audit of Group subsidiaries (including Santander Consumer Bank) and associates pursuant to legislation.

The fees for other services which included advice on accounting, regulatory matters and the fees directly relating to work mentioned above were PLN 0.73m giving a total fee to PwC of PLN 5.8m .

The Committee is satisfied that the Group's external Auditors provided effective, independent assessment and challenge to the Supervisory Board and the comprehensive Management Letter provides valuable recommendations for improvement of internal controls. Moreover, the Committee received the written annual confirmation that PricewaterhouseCoopers Sp z o.o. and statutory auditors reviewing the Bank's and BZ WBK Group's financial statements for 2017 for the period from 1 January 2017 to 31 December 2017 were independent and that this independence was adequately safeguarded.

To comply with the Polish Auditors Act of 11 May 2017, the applicable policy on selecting the audit firm was adequately extended and amended and additionally supplemented by an appendix including the audit firm selection procedure. Moreover, the Policy for Non-Audit Services Rendered by the Auditor was introduced; it determines the scope of audit-related and non-audit services (i.e. services other than review of financial statements) rendered by the auditor for the Bank and its subsidiaries. The policy also lays down the process of accepting the services provided, and a list of authorised services which the auditor of the Bank's/Group's financial statements may provide at the time of the audit, and a list of prohibited services. Formally, the ownership of the above documents rests with the Audit & Compliance Committee.

- Other matters

The Committee conducts a continuous review of its process and performance. The form of the review involved a discussion on the format of the meetings and the effectiveness of the reporting processes.

- Focus for 2018

For 2018 the Committee's areas of focus will be:

- Supervision over control mechanisms aimed at finalising the acquisition of a de-merged business of Deutsche Bank Polska
- Implementation of IFRS9 and its impact on the provisioning process, models and the related reporting;
- Recommendations on the independent assessment of Internal Audit function (5-year-cycle);

- Activity of Dom Maklerski BZWBK;
- Management of the HR function, including control mechanisms for the staff turnover.

### 4.3. RISK COMMITTEE

#### Role, tasks and composition of the Committee

The Risk Committee's role is to assist the Supervisory Board in discharging its responsibilities to the shareholders and other stakeholders in relation to: (i) appropriate risk management philosophy, as articulated in relevant legal regulations and regulatory recommendations and market standards; (ii) risk appetite, as reflected in policies and risk limits; (iii) a sharpened and focused oversight on the significant business risks undertaken by the Bank Zachodni WBK; and; (iv) the appropriateness of the overall risk governance framework.

The Committee acts in accordance with the Terms of Reference approved by the Supervisory Board. The Terms of Reference applicable earlier were changed by force of the Supervisory Board resolution no 14/2017 of 16 February 2017. The basis for updating the Terms of Reference were: (i) European Banking Authority guidelines on corporate governance and Remuneration Policies; (ii) Basel Committee guidelines on banking supervision; (iii) European Commission Recommendation on the role of non-executive or supervisory directors; (iv) Best Practice for WSE-listed Companies; (v) in-house regulations with regard to the Internal Governance Model. The key change was the introduction of the statement on the independence of the Committee Chairman in line with the independence criteria defined for the Supervisory Board Member in the Bank's Statutes - this change applies from 17 May 2017.

Until 17 May 2017, the Risk Committee worked in the following composition:

- John Power – Chairman
- David Hexter
- Witold Jurcewicz
- Marynika Woroszyńska-Sapieha
- Jose Manuel Varela

On 17 May 2017 in view of commencing the new term of office, the Supervisory Board appointed the Risk Committee in the following composition:

- Jerzy Surma – Chairman
- José Manuel Campa
- David Hexter
- John Power

In 2017, the Committee met 5 times and the turnout was as follows:

- |                                |     |
|--------------------------------|-----|
| - John Power                   | 5/5 |
| - Jose Manuel Campa            | 3/3 |
| - David Hexter                 | 5/5 |
| - Witold Jurcewicz             | 2/2 |
| - Marynika Woroszyńska-Sapieha | 2/2 |
| - Jerzy Surma                  | 3/3 |
| - Jose Manuel Varela           | 2/2 |

Discharging their responsibilities, the Committee Members are aware that the Bank is in the risk-taking business, whilst the risk level has to be adequate to the scale and type of business undertaken as well as governed by the industry standards, regulatory guidance and

recommendations, referring to operational risk, credit risk, market risk and liquidity risk. Given the above, in its operations the Committee focuses in particular on:

- issuing opinions on the current and future readiness of the Bank to take up risk,
- issuing opinions on the risk management strategy developed by the Bank's Management Board and the information tabled by the Management Board on its execution;
- supporting the Supervisory Board in overseeing the implementation of the risk management strategy in the Bank's operations by the senior management,
- verifying if the prices of assets and liabilities offered to customers fully reflect the Bank's business model and risk strategy; otherwise, the Committee presents to the Management Board proposals to ensure that the price of assets and liabilities is adequate to relevant risk types.

The Committee's tasks are reflected in the adopted annual work plan, in line with which the Committee discharges its responsibilities.

The regular attendants of the Committee meetings are: the Bank's Auditor PricewaterhouseCoopers Sp. z o.o, the Head of Risk Management Division, the Head of Accounting and Financial Control Division, the Head of Financial Management and the Head of BZ WBK Internal Audit (Chief Audit Executive). Other Members of the Management Board and the Bank's executives are also invited to attend as appropriate in order to present reports on the areas under their management.

### **The Committee's activity in 2017**

The key areas of the Committee's work were:

- Review and evaluation the Group's Risk Appetite Statement and recommendations for the Supervisory Board with regard to approving the risk appetite.
- Verification of the current risk profile of BZ WBK Group based on Risk Dashboards and monitoring the consumption of internal limits from, bearing in mind the current business strategy and the macroeconomic environment.
- Comprehensive assessment of the credit portfolio and credit policies.
- Review and recommendations for the Supervisory Board with regard to approving the Internal Capital Adequacy Assessment Report (ICAAP Report) for BZ BK Group as well as on-going monitoring of actions taken to optimise the capital consumption through RWA levels and growing the capital base by Tier II issuances.
- Review of the operational risk management, including the management of business continuity, information security, outsourcing and insourcing risk and fraud prevention in all areas of the Bank's business - the Committee conducted a detailed overview of e.g. BCM plans for major outsourcing contracts made by the Bank to verify the risk of unavailability of providers or services.
- Review of the risk management and internal control in subsidiaries (BZ WBK-AVIVA, Santander Consumer Bank, BZ WBK Leasing and BZ WBK Faktor) and the Bank's different areas of operations (Multichannel Communication Centre, Treasury, SME Banking Division, Branch Banking - branch network and partner outlets).
- Management of the Treasury risk - compliance with Recommendation P issued by the KNF, including management and control of the structural liquidity risk, in particular intraday liquidity limits.
- Review of Internal Liquidity Adequacy Assessment Report (ILAAP) in BZ WBK as well as models and processes for assets and liabilities management.
- Monitoring the progress in implementing the Bank's key projects and programmes with regard to risk management (A-IRB, RDA, ALM Risk, IFRS9).
- Implementation of the Directive (EU) 2015/2366 of the European Parliament and of the Council on payment services in the internal market (PSD2), taking into account the impact

on the Bank with the simulations leveraging of the arising opportunities given the business strategies and needs of individual Segments.

- Assessment of prices for assets and liabilities offered to customers.
- Recommendations for the Supervisory Board with regard to approval of the strategy and policies referring to risks embedded in the Bank's business. In particular, the recommendations concerned the introduction of changes as a result of annual review of the applicable strategy and risk management policies, the implementation of detailed requirements arising from the Polish Financial Supervision Authority Recommendations (e.g. Recommendation C on the management of concentration risk).

The issues subject to the in-depth review by the Committee in 2017 included: (i) the management of security of ICT environment, including compliance with KNF Recommendation D, at the same time taking into account the growing cyber-risks; (ii) management actions taken to raise employee operational risk awareness and build the appropriate risk culture.

Reviews of the key risks embedded in the Bank's business covered also the mode of identifying threats and the process of defining and monitoring remedial actions, including those taken up as the follow up of KNF inspections and Internal Audit reviews as well as the timeliness of their delivery.

A key element of the Risk Committee's work is the oversight of the stress testing undertaken by the Bank in accordance with its own assumptions and benchmarked against the requirements set by the KNF. These tests are one of the elements of the credit risk management process and are used to evaluate (i) potential impact of specific events on the markets, movements in financial and macroeconomic ratios as well as changes in the risk profile on the condition of the Bank and BZ WBK Group; (ii) changes of quality of credit portfolios should adverse events materialise. The results of the stress testing are linked closely with the review of the Group's Risk Appetite Statement and provide management information on the adequacy of the set limits and allocated internal capital.

On a regular basis the Committee receives reports on BZ WBK Group's risk profile. In particular, the reports refer to (i) performance against the defined risk appetite level and exceptions in this respect, (ii) risk trends, (iii) risk concentrations; (iv) key performance indicators.

### **Focus for 2018**

In 2018, the Committee will review amendments to the Group's Risk Appetite Statement and continue its comprehensive review of the emerging risks in both the core business of the Group and the overall banking industry as well as it will supervise the way of mitigating risks triggered by acquiring the de-merged business of Deutsche Bank Polska. The Committee will continue to pay special attention to management of risk related to IT processes, including the cybersecurity issues.

## **5. ASSESSMENT OF THE SUPERVISORY BOARD ACTIVITY IN 2017**

The Supervisory Board assessed its performance for 2017 in accordance with point 1, sub-point 2, section 3 of the "Best practice for the GPW listed companies".

On that basis, the Supervisory Board stated that it had duly discharged its responsibilities laid down in the Commercial Companies Code, the Banking Law, the Bank's Statutes and the KNF recommendations as it held its meetings at a frequency that ensured that all matters within the Supervisory Board's remit were duly addressed. In their actions, the Supervisory Board Members were guided solely by the interest of the Bank and the independence of judgements and opinions. Both the composition of the Supervisory Board and knowledge and experience of its individual Members, their active participation in the meetings of the Supervisory Board and its

committees ensured sound and effective performance of the Supervisory Board as well as proper and effective supervision over the Bank's operations in 2017.

## **II. REPORT OF THE SUPERVISORY BOARD ON THE EXAMINATION OF 2017 FINANCIAL STATEMENTS, THE MANAGEMENT BOARD REPORT ON PERFORMANCE IN 2017 AND THE BANK'S MANAGEMENT BOARD'S MOTION WITH REGARD TO NON-DISTRIBUTED PROFIT FOR 2016**

### **1. EXAMINATION OF 2017 FINANCIAL STATEMENTS, REPORT ON THE MANAGEMENT BOARD PERFORMANCE IN 2017**

Pursuant to Art. 382 (3) of the Commercial Companies Code and paragraph 32 (1) (6) of the Bank's Statutes, the Supervisory Board examined the Bank's Financial Statements and BZ WBK Group Consolidated Statements for 2017 as well as the Report on BZ WBK Group's Performance in 2017, incorporating the Bank's Management Board report on the Bank Zachodni WBK Performance in 2017 as regards their consistency with the books, documents and the actual status. These documents will be submitted by the Bank's Management Board to the Annual General Meeting of Bank Zachodni WBK Shareholders convened for 16 May 2018.

By force of Resolution no. 31/2017 of 19 April 2017, the Supervisory Board vested PricewaterhouseCoopers Sp. z o. o. (PwC) with the examination of the foregoing Statements.

Pursuant to the opinions of PwC included in the external auditor's reports from the audit for the AGM and the Supervisory Board of Bank Zachodni WBK S.A.:

- Report from the audit of the annual report Report from the audit of standalone Financial Statements of Bank Zachodni WBK S.A. for the financial year starting on 1 January and ending on 31 December 2017;
- Report from the audit of consolidated annual Financial Statements of Bank Zachodni WBK S.A. Group for the financial year starting on 1 January and ending on 31 December 2017,

The Supervisory Board stated that Financial Statements for 2017, presented by the Management Board, had been prepared correctly, in all material respects, and provided a true and fair view of the financial position of the Bank and the Group as at 31 December 2017 and of their financial performance and their cash flows for the year ended 31 December 2017, in accordance with International Financial Reporting Standards adopted by the European Union, and were in compliance with the respective regulations that apply to the Bank's standalone financial statements and the consolidated financial statements.

PwC opinions referred to above are consistent with the external auditor's additional report for the Audit and Compliance Committee.

Given the above, by force of Resolution no. 9/2018 of 13 February 2018, the Supervisory Board decided to submit the following documents for the Annual General Meeting's approval:

- Financial Statements of Bank Zachodni WBK for 2017,
- Consolidated Financial Statements of Bank Zachodni WBK Group for 2017,
- Management Board Report on Bank Zachodni WBK Group Performance in 2017 (including Management Board Report on Bank Zachodni WBK Performance in 2017).

## **2. REVIEW OF THE BANK'S MANAGEMENT BOARD MOTION RELATED TO THE NON-DISTRIBUTED PROFIT FOR 2016**

In its assessment of the Management Board's recommendation on the distribution of profit for the period from 1 January to 31 December as well as allocating part of the retained profit from 2016 to the payment of the dividend, the Supervisory Board considered individual recommendations issued to the Bank by the Polish Financial Supervision Authority.

In view of the foregoing, the Supervisory Board approved the position of the Management Board on retaining the entire profit earned from 1 January to 31 December 2017 and earmarking 50% of that amount to reserve capital while keeping the remaining 50% undistributed. At the same time, in view of a strong capital position of the Bank and the Group, the Supervisory Board issued a positive opinion on the Management Board's proposal on allocating PLN 307,627,055.40 out the undistributed profit from 2016 towards the dividend payment. This means that the proposed dividend per share will be PLN 3.10.

In its recommendation, the Supervisory Board took into account the capital ratios which as at 31 December 2017, both on the standalone and consolidated basis, were above the minimum required under the KNF's capital decision and recommendation. In addition, the Supervisory Board took into account that: (i) the level of the retained profit is sufficient to deliver the strategy adopted by the Bank/Group and ensures adequate balance between the capital consumption and growth; (ii) the existing capital base reflects the prudent approach and acceptable level of risk associated with the Bank's current and future operations and ensures safety of customer deposits.

### **III. ASSESSMENT OF BANK ZACHODNI WBK GROUP'S PERFORMANCE IN 2017**

Acting in compliance with the Best Practice for the WSE Listed Companies, the Supervisory Board assessed the Bank's and BZ WBK Group's standing in 2017, covering the internal control system, risk management, compliance risk management, internal control function, including financial reporting and operational business as well as the assessment of the reasonableness of the Bank's sponsoring and corporate giving policy as well as the assessment of the manner of discharging disclosure requirements by the Bank with regard to the application of the corporate governance rules.

#### **1. BANK ZACHODNI WBK GROUP'S PERFORMANCE IN 2017**

##### **Economic growth**

In 2017, the economic growth accelerated much stronger than expected. The GDP dynamics was 4.6% throughout the year. The growth driver was strong consumer demand supported by 500+ programme, high remuneration dynamics, lower savings rate and record high optimism of households. The GDP growth acceleration was also fuelled by exceptionally favourable external environment, such as sound revival in the EUR zone that stimulated Polish export. The long-awaited rebound in investments started to materialise in the H2 2017 to gain momentum at the end of the year. The Polish industry and construction sectors recorded much higher growth in output than in 2016. Most of the year the surplus on the current account balance continued despite strong domestic demand which reached a record high level in November, i.e. 0.3% of the GDP.

##### **Inflation**

In January the inflation rate exceeded 1.5% YoY and ranged between that level and the target inflation of 2.5% that was reached in November for the first time in nearly five years. The average inflation rate in 2017 was 2% YoY.

The fluctuations were caused by prices of food and fuels. Base inflation, excluding prices of food and fuels, accelerated from 0% to 0.8% in the first months of the year, and only slightly deviated from the level for the rest of the year.

### **Monetary Policy**

The Monetary Policy Council did not change the reference rates in 2017. The majority of the Council members continue to believe that the existing rates, incl. the reference rate of 1.50%, are adequate and support both the delivery of the inflation target and investments as well as sustainable growth of the Polish economy.

### **Deposit and credit market**

In 2017, the pace of growth in total deposits slowed down from 8.3% in January to 4.1% in December. The slowdown was recorded both in the business and household sectors. The overall credit growth pace was stable - 4.5% YoY. Personal loans slowed down at the end of the year, mainly due to PLN strengthening. Taking into account positive fx rate fluctuations, loans recorded a positive growth of ca. 4% YoY. Mortgage loans (on a constant currency basis) recorded a slight acceleration from 3% YoY at the beginning of the year to ca. 3.5% at year end, including growth in PLN mortgage loans by 10.6% YoY. Consumption loans stabilised in 2017 at 7.0%-7.5%. In the business sector, investment loans recorded a minor slow down from 16% YoY in mid-year to ca. 12.5% YoY and O/Ds accelerated from ca. 4.5% YoY in June to 8.5% YoY in December.

### **Financial market**

Optimism prevailed on the financial market in 2017. The investor sentiment was impacted mostly by the following factors: improving economic prospects worldwide and stronger revival of the domestic economy; actions taken by central banks, including those taken by the Federal Reserve (that hiked the interest rates three times to reflect its belief in the strength of economic revival and economic outlook) and by the ECB (whose Council decided to lower the scale of monthly bonds purchase); geopolitical factors, including the failure of populist parties in the elections in the Netherlands and France which boosted market optimism.

Internal factors also significantly contributed to the quotations of PLN and Polish bonds. Economic growth was much quicker than projected which strengthened PLN while the accompanying improvement in fiscal situation positively impacted Polish bonds. The dovish rhetoric of the Monetary Policy Council translated into lower profitability of the domestic debt market.

In 2017, the most important agencies ceased suggesting a potential lowering of the outlook or credit rating for Poland. They revised upward their macroeconomic and fiscal projections for Poland and in May Moody's upgraded A2 rating outlook from negative to stable.

In 2017, PLN was the second strongest currency in the emerging markets in the EUR zone against the US dollar, CHF and GBP. Over the year, EUR/PLN fell by 5.7% (to 4.17 from 4.42), USD/PLN declined by 17% (to 3.48 from 4.18, mainly due to EUR/USD growth), CHF/PLN lowered by 13% (to 3.57 from 4.12, the trends were favoured by EUR/CHF growth) and GBP/PLN by ca. 10% (to 4.70 from 5.14 thanks to global CHF depreciation following the uncertainty as to the Brexit conditions).

### **Stock Market**

All stock market indices gained throughout 2017. The benchmark WIG and WIG20 indices grew by 23% and 26% respectively, which was only enough to make up for losses suffered in 2016 and stabilise at the levels reported two years ago.

Positive investment sentiment observed across global stock markets nearly throughout 2017 positively contributed to the demand on the WSE. A key argument supporting the demand of equity holders was the lasting business growth in the Polish and global economies.

### **Profit and loss account**

In 2017, Bank Zachodni WBK Group posted a profit before tax of PLN 3,335.2m, up 6.8% YoY.

Excluding one-off gains on equity instruments from the corresponding period (i.e. PLN 316.1m from the settlement of the acquisition of Visa Europe Ltd by Visa Inc in 2016), the profit before tax increased by 18.9% YoY.

The profit attributable to the shareholders of Bank Zachodni WBK was PLN 2 213.1m and went up by 2.1% YoY. Taking into account the base period adjustments by the above one-off gain on the equity shares, the underlying attributable profit went up by 15.8% YoY.

### **Income**

The total income of Bank Zachodni WBK Group for 2017 was PLN 7 763.3m and exceeded the level recorded last year by 2.1%. Excluding the gain of PLN 316.1m arising on the acquisition of Visa Europe Ltd by Visa Inc, the underlying total income increased by 6.5% YoY.

In 2017, net interest income amounted to PLN 5,276.9m and increased by 10.6% YoY.

The cumulated net interest margin of Bank Zachodni WBK Group (annualised) went up from 3.68% in 2016 to 3.84% in 2017. The margin growth was supported by a slight increase in mid-term market interest rates in 2017. At the same time, the Group's funding costs decreased driven by the optimisation of funding sources and adaptation processes within the Group's product portfolio.

In 2017, net fee and commission income amounted to PLN 2,013.1m and increased by 5.1% YoY.

The highest YoY growth in the net fee and commission income was reported in relation to brokerage services (+25.8% YoY), which reflected higher volumes of trading in the secondary market and the management of initial public offerings.

The higher net fee and commission income from fund distribution and asset management (+23.3% YoY) reflects an increase in the average net value of assets under management in BZ WBK TFI, mainly equity, corporate bond and stable growth funds, driven by stronger management results and an improvement in investor sentiment. In 2017, the structure of investment funds sale changed towards a bigger share of equity funds.

An improvement in the FX fee income (+8.2% YoY) is attributed to higher turnover driven by the Group's comprehensive measures taken to support foreign trade and develop e-FX services in iBiznes24.

The net fee and commission income from issuance and management of credit cards went up by 12.2% YoY on account of a 4.1% YoY increase in the size of the combined credit card portfolio of Bank Zachodni WBK and SCB, a higher volume of credit card transactions and the revision of selected credit card fees and charges of both banks.

The decline of 19.9% YoY in the net fee and commission income from the insurance business was connected with the legal and regulatory regime of the bancassurance market, in particular the statutory ban imposed by the Act effective as of 1 April 2016 on collection of insurance fees by banks acting as insuring parties in relation to group insurance plans.

The net trading income of Bank Zachodni WBK S.A. capital group in 2017 was PLN 195.0m and declined by 30.6% YoY. On the financial derivatives and fx interbank operations markets the Group generated a profit of PLN 153.0m vs. PLN 254.4m in 2016. Other fx trading income amounted to PLN 43.7m and increased by PLN 23.5m YoY.

The gains on other financial instruments decreased by 88.2% YoY to PLN 47.5m. In 2017, gains on equity instruments available for sale were PLN 26.4m, including PLN 13.5m arising from the sale of all shares in PBG, PLN 10.8m representing the sale of all shares in Polimex Mostostal and PLN 2.1m is connected with the sale of the entire stake of the WSE- traded shares from the bank's available-for-sale portfolio of equity investments. The corresponding gains in 2016 reached PLN 317.8m, including PLN 316.1m on account of the total remuneration for BZ WBK and SCB as a result of settlement of the acquisition of Visa Europe Ltd. by Visa Inc.



Gains on the sale of debt instruments (mainly treasury bonds and BGK bonds) were PLN 20.8m, down PLN 72.4m YoY.

In 2017, the Group disclosed dividend income of PLN 76.8m, i.e. down PLN 19.8m YoY on account of lower dividends from Aviva Group companies from the bank's portfolio of equity investments.

### **Costs**

In 2017, the total costs of BZ WBK Group amounted to PLN 3,372.4m, and were stable compared with the previous year (+0.1% YoY), despite high costs of transformation projects resulting from business and legal/regulatory requirements.

In 2017, staff expenses increased by 3.5% YoY and depreciation and amortisation went up by 15% YoY due to the extension of IT infrastructure. BZ WBK Group recorded a decline in operating costs by 3.4% YoY and other operating costs by 26.5% YoY.

Excluding gains on a one-off equity transaction from the total income for 2016, the Group's cost to income ratio improved from 46.2% to 43.4% in 2017.

### **Assets**

As at 31 December 2017, the total assets of Bank Zachodni WBK Group were PLN 152,674.4m, which is an increase of 1.7% YoY. The value and structure of the Group's financial position is determined by the parent entity, which accounts for 87.0% of consolidated total assets vs. 87.6% as at the end of December 2016.

### **Credit portfolio**

As at 31 December 2017, consolidated gross loans and advances to customers were PLN 112,686.0m and higher by 4.4% YoY. On a constant currency basis, the figure increased by 4.6% YoY.

As at 31 December 2017, loans and advances to individuals increased by 2.7% YoY to reach PLN 57 822.4m.

Housing loans, which represent the major portion of loans and advances to individuals, increased by 0.8% to PLN 37 293.3m. The cash loan portfolio went up by 9.4% YoY to PLN 13,051.3m. Loans and advances to enterprises and public sector entities were PLN 48,005.2m, 5.8% higher driven mainly by lending to SME and large corporate customers.

Finance leases, which include the portfolios of BZ WBK Leasing, Santander Consumer Multirent and PSA Finance Polska, increased by 12.3% YoY to PLN 6,849.0m.

In 2017, the loan impairment charge to the income statement of Bank Zachodni WBK Group was PLN 690.5m, down 12.0% YoY. The impairment charge posted by SCB Group was PLN 110.8m vs. PLN 181.8m a year before.

As at 31 December 2017, non-performing (impaired) loans to customers accounted for 5.8% of the gross portfolio of Bank Zachodni WBK Group vs. 6.6% twelve months before. The provision coverage ratio for impaired loans was 63.1% compared with 59.0% as at 31 December 2016.

### **Equity and liabilities**

Significant changes were also observed in the subordinated liabilities and debt securities in issue disclosed in the consolidated statement of financial position of Bank Zachodni WBK Group. This line item increased by 23.7% compared with 31 December 2016 on account of securities issued in 2017.

In the reporting period, Bank Zachodni WBK issued three series of certificates of deposit with a total nominal value of PLN 1,420.0m and issued subordinated debt in the form of green bonds with a nominal value of EUR 137.1m. BZ WBK Faktor issued bonds with a nominal value of PLN 700m, and SCB issued bonds of PLN 873.5m as part of a debt securities issuance programme guaranteed by Santander Consumer Finance.

In 2017, Bank Zachodni WBK and SCB redeemed matured bonds and certificates of deposit for a total amount of PLN 1,430m and PLN 665m, respectively. Based on the analysed aggregate - pursuant to the KNF decision - two issues of bonds of EUR 120.0m with a 10-year maturity issued by Bank Zachodni WBK on 2 December 2016 and green bonds of EUR 137.1m issued on 22 May 2017 were reposted from debt securities in issue to subordinated liabilities.

### **Deposits**

Consolidated deposits from customers were generally stable YoY (-0.9%) and amounted to PLN 111,481.1m as at the end of December 2017.

In 2017, the management of deposit products focused on increasing the strength of relationship with deposit customers and offer optimisation. During the year, balances of low-interest bearing current and savings accounts gradually increased, while balances of term deposits reduced. Given the record low level of interest rates and improved business climate on the stock market, the customers availed more of solutions available under the investment fund offering. In effect, the flow of deposits to BZ WBK Towarzystwo Funduszy Inwestycyjnych S.A (BZ WBK TFI) increased significantly.

The net value of assets in mutual funds and private portfolios increased by 20% YoY to PLN 16.4bn.

### **Share price of Bank Zachodni WBK S.A.**

The share price of Bank Zachodni WBK rose by more than 25.4% in 2017. On 2 January the share price reached its minimum of PLN 319.90 and maximum of PLN 400 on 27 December 2017.

The highest pace of growth was observed during the first and the last months of the year. The bank's market capitalisation increased from PLN 31,358.1m as at 31 December 2016 to PLN 39,360.9m as at 31 December 2017 thanks to buoyant stock market conditions, in particular improved sentiments in the banking sector.

Adjusting for a dividend of PLN 5.40 per share paid out in the first half of the year (from non-distributed earnings for 2014 and 2015) and dividends paid in the previous years, the share price of Bank Zachodni WBK hit an all-time high at the close of 2017. Aside from solid growth in domestic consumption, the increase in the bank's stock price was stimulated by stronger Polish zloty, which improved the structure of BZ WBK credit portfolio.

### **Rating**

Ratings of Bank Zachodni WBK as at 31 December 2017 were assigned by Fitch Ratings on 20 October 2017.

Ratings of Bank Zachodni WBK as at 31 December 2017 were affirmed by Moody's Investors Service in the credit opinion dated 9 August 2017.

On 29 January 2018, Moody's Investors Service changed the outlook for Bank Zachodni WBK long-term deposit ratings from stable to positive and affirmed the existing ratings. The above change reflects improving asset quality, sound capitalisation and strong profitability of the bank. It also factors in positive implications of BZ WBK's acquisition of the de-merged business of Deutsche Bank Polska and estimated costs associated with the legislation regarding the foreign currency mortgage portfolio.

### **Acquisition of a de-merged business of Deutsche Bank Polska oraz DB Securities S.A.**

On 14 December 2017, Bank Zachodni WBK and Banco Santander signed a transaction agreement with Deutsche Bank AG (DB AG) to purchase a de-merged business of Deutsche Bank Polska S.A. (DBPL), including retail banking, private banking, business banking (SME) and DB Securities S.A.

## 2. ASSESSMENT OF INTERNAL CONTROL SYSTEM

As required by the Statutes, the Bank operates an internal control system which supports the decision-making processes and contributes to the Bank's efficient operations, compliance with risk management rules, reliability of financial reporting as well as compliance with the law, international standards, internal regulations and best practice.

The Supervisory Board positively assesses the Bank's internal control system which is adequately adjusted to the Bank's organisational structure and risk management system as well as to the size and complexity of the Bank's business. It covers all units across the Bank as well as its subsidiaries. The internal control system covers all significant controls, including those related to reporting and the Bank's operational activity.

The Management Board is responsible for developing and implementing the internal control system, and ensuring that an adequate and effective internal control system is in place for each organisational unit and employee, updating documented procedures of the internal control system as well as establishing the adequacy and effectiveness criteria for assessing the internal control system. The internal control system includes: risk controls, monitoring and testing of the Bank's compliance with external and internal regulations, and internal audit.

Internal control and risk management systems are structured into three lines of defence. Control measures under the first line of defence check compliance with procedures and they are an ad hoc response to any identified deficiencies or shortcomings.

The second line of defence is formed by specialized units performing control functions which support the Bank's management in risk identification and management and provide assessment of the first line controls.

The third line of defence is the Internal Audit Area, whose activity is supervised by the Audit and Compliance Committee of the Supervisory Board. The IAA provides independent and objective examination as well as assurance on the first and second tier controls as well as on the Bank's management system, including the effectiveness of managing the risk related to the Bank's business. For that matter, the Internal Audit Area verifies the adequate coverage of the Group's risks, in compliance with the applicable management policies, procedures and internal and external regulations. Using its own risk matrix and knowledge, the IAA performs a regular assessment of the present and future risk across the Bank and Bank Zachodni WBK Group, developing annual audit plans to cover it. Also, priorities highlighted by the Bank's management, the Audit and Compliance Committee, the external auditor, and banking supervision institutions are taken into account.

The Supervisory Board is responsible for the supervision over the implementation and maintenance of the internal control system, for assessing its adequacy and effectiveness and for approving the adequacy and effectiveness criteria of the internal control system. The Supervisory Board receives current and accurate information on identified irregularities and on the management actions undertaken to remove these issues, completeness and correctness of accounting procedures as well as the adequacy, functionality and security of the IT systems.

The Risk Committee and the Audit & Compliance Committee are updated on a regular basis on the operation of the internal control system from the units of the second and third lines of defence which facilitates the on-going monitoring of the system's effectiveness.

The control findings are taken into account and used to improve the existing processes and safety by making relevant changes to internal processes and regulations. These are regularly verified by the Internal Audit Area.

The Audit & Compliance Committee is informed about the results of assessing the risk of failure to comply with the overall internal control targets. The analysis of the design and effectiveness of controls made in 2017 indicates the low impact of the identified deficiencies relative to the delivery of the internal control targets.

In 2017, the deficiencies identified in the process of the internal control model certification were estimated at the lowest materiality level (Control Deficiency) which combined with the lower number of indented deficiencies compared with 2016 confirms the maturity of the Bank's internal control system and the effectiveness of the applied controls.

The internal control system addresses, among others, compliance with the requirements of the Sarbanes-Oxley Act, Volcker Rule (section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act) as well as requirements of RDA/RRF (Basel Committee on Banking Supervision 239: Principles for effective risk data aggregation and risk reporting).

In order to manage risk associated with the preparation of financial statements, the Bank tracks legal and regulatory changes related to reporting obligations for banks and updates its accounting rules and disclosures accordingly. The Bank, through its representatives sitting on supervisory boards of individual subsidiaries, exercises oversight of its consolidated subsidiaries.

Financial statements are approved by the Disclosure Committee, which is responsible for ensuring that the financial disclosures of BZ WBK Group comply with all legal and regulatory requirements before they are released. Annual reports on operations of the Disclosure Committee are subject to a review by the Audit & Compliance Committee which subsequently recommends them to the Supervisory Board.

The Audit & Compliance Committee reviews Financial Statements, Management Board Report on the Group's Performance and additional reports (such as Information on Capital Adequacy of the Group) prepared as part of financial reporting on a half-yearly and yearly basis, and submits them to the Supervisory Board for acceptance/ approval. As part of its reviews, the Audit & Compliance Committee gets acquainted with the outcome of external auditor's work (review or audit, respectively), in particular with key risks within the scope the auditor's analysis and conclusions arising from auditing activities.

In the Supervisory Board's opinion, the controls implemented in the Bank effectively address the risk of a material misstatement in the financial statements. Moreover, the effectiveness of controls in financial reporting is additionally assessed by an independent external auditor as part of the annual certification process for compliance with the Sarbanes-Oxley Act.

### **3. ASSESSMENT OF THE RISK MANAGEMENT SYSTEM**

Bank Zachodni WBK has an integrated risk management framework ensuring that all risks having material impact on the Bank's operations are identified, measured, monitored and controlled. In the opinion of the Supervisory Board, the risk management structure is adequate versus the size of the Bank and the risk it is exposed to. It is also being optimised on an ongoing basis, and adjusted to the changing external environment, as well as the risk profile deriving from the adopted strategy.

The responsibility for the management of individual risks was split between the Bank's organizational units that are supported by relevant Committees. The risk management strategy is set by the Management Board of the Bank and supporting Risk Management Committee (RMC) and the Risk Control Committee (RCC) overseeing the activity of other Committees having risk management authority. Additionally, the Risk Management Sub-Committee was established within the Risk Management Committee to ratify the key decisions of lower-level committees (mostly with regard to key credit transactions). The fact that Members of the Management Board and senior management sit on key Committees ensures senior management engagement in the risk management of the Bank as representatives of both first and second line of risk management.

One of the basic elements of the risk management framework of Bank Zachodni WBK is setting the levels of risk that the Bank is ready to accept in its day-to-day business (the so-called risk

appetite). The acceptable risk level is expressed in the form of quantifiable limits set out in the BZ WBK Group Risk Appetite Statement approved by the Management Board and the Supervisory Board. The Bank conducts a detailed review of the limits with regard to the existing and potential risks, market conditions as well as the financial and capital plan at least once a year. Stress-testing and scenario analyses represent the key tool used to analyse the limits and ensure that the Bank retains an adequate capital position even in extreme and severe circumstances.

The Bank has methodologies and processes in place to identify and assess risks to determine their potential impact on the Bank's operations now and in the foreseeable future. With a view to identifying and assessing risks for the entire organisation, the review of material risks is carried out as part of the Internal Capital Adequacy Assessment Process (ICAAP). The identified risks are managed using policies and best practice to keep them at an acceptable level. The Bank uses various risk assessment and measurement techniques depending on risk type and materiality, including:

- Customer and/or transaction grading models - for credit risk assessment purposes;
- VAR methodology for market risk; and
- Operational risk self-assessment methodologies.

The comprehensive risk management framework is supported by a consistent and transparent system aimed at monitoring and reporting risk levels and excesses against defined limits. The reporting system covers key management levels. The Supervisory Board receives regular reports assessing the level of identified risks and reports assessing the effectiveness of actions taken by the Bank's Management Board.

The Bank aims to keep the right risk/reward balance. Support for the Bank's development strategy, while retaining best in class risk management standards and compliance with the regulatory environment, is amongst the key assumptions underlying the risk management process.

In 2017, credit portfolio growth of all major segments (personal, SME, and corporate customers) was observed, maintaining an acceptable risk level at the same time. The Bank thoroughly analysed the macroeconomic market fluctuations and closely monitored the risk exposure, thus adjusting, on an ongoing basis, the risk management policy parameters to the changing market climate in order to keep the risk profile safe.

The Bank continued its ongoing work aimed at strengthening the risk assessment processes and tools. A number of projects and programmes were run to that end, including (i) the Digital Transformation Programme aimed at overall improvement of IT tools used in credit processes, (ii) the Risk Data Aggregation project aimed at harmonising the data system and reporting tools across the Bank; (iii) the Advanced Operational Risk Management programme striving for excellence in operational risk management; (iv) the ALM project aimed at developing liquidity risk reporting methods, (v) the IFRS9 project consisting in the implementation for that standard for provisioning purposes (system changes were successfully implemented - reporting for January 2018 was made using the new approach), (vi) AIRM project (Advanced Internal Rating Based capital calculation) to streamline capital management; (vii) the ALPHA project consisting in strengthening management reporting, monitoring and management of effectiveness of debt recovery activities. The RDA and AORM projects were completed in 2017. Other initiatives will be continued in 2018.

In 2017, other works were underway to ensure compliance with regulatory requirements, including Recommendation H (internal control system).

The Supervisory Board and the Risk Committee were informed on the progress in implementing the most important risk programmes and projects on an ongoing basis in the form of Risk Dashboard (Unit Report).

#### 4. ASSESSMENT OF COMPLIANCE RISK MANAGEMENT

The compliance risk management system in place covers the units listed below together with their scope of responsibilities:

- Legal and Compliance Division - compliance with legal and regulatory requirements in particular areas of the business activity, in particular with regard to: protection of consumer rights, implementation and sale of new products, prevention of money laundering, ethical issues, protection of sensitive information, protection of personal data and conflict of interests management.
- Specialist units dedicated to identifying and interpreting remaining legal and regulatory requirements the Bank being a legal entity is obliged to fulfill (labour regulations, tax and reporting, prudential standards).
- Specialist committees that are supervised by the Risk Management Committee.

The Bank Zachodni WBK Compliance Policy adopted by the Management Board and approved by the Supervisory Board provided the Compliance Area and Anti-Money Laundering Department (AMLDD) with mandate to effectively support management in the process of managing compliance risk, including 4 categories: regulatory risk, conduct risk, money laundering and terrorism financing risk and reputational risk. The Compliance Area and AMLDD report to the Risk Management Committee and to the Audit and Compliance Committee of the Supervisory Board which supervise the discharge of regulatory obligations and approve internal control principles and compliance policy framework. As part of the process of compliance risk management, the Audit and Compliance Committee regularly reviews key compliance issues identified by the Compliance Area and AMLDD.

Mitigation of compliance risk, maintenance of proper relations with market regulators and provision of support to the authorities of the Bank and Bank Zachodni WBK Group in the process of taking strategic decisions with respect to ensuring compliance as well as implementation of uniform standards of compliance risk management in the Group's subsidiaries are ensured by taking the following measures:

- independent identification, monitoring and assessment of compliance risk;
- providing advice and reporting to the Risk Management Committee, the Bank's Management Board and the Audit and Compliance Committee on the effectiveness of processes established to ensure compliance with legal and regulatory requirements;
- communication of policies and procedures, providing the management and staff with guidance on compliance risk management;
- coordination of contact with market regulators (Financial Supervision Authority (KNF), Office of Competition and Customer Protection (UOKiK), General Inspector of Financial Information (GIIF), Inspector General for the Protection of Personal Data (GIODO));
- coordination of the approval of new products;
- embedding the principles of ethical business conduct and building the corporate governance culture across the organisation.

Key units managing reputational risk at Bank Zachodni WBK S.A.: are the Compliance Area and the Communications, Marketing and Quality Management Area. The units are responsible for protecting the Bank's image as well as reducing and eliminating the impact of adverse events on the Bank's image and financial performance. To this end, they use a series of mitigants, in particular, the Bank's policies applicable to a given area and other tools/internal processes, such as, for example: (i) media monitoring, including monitoring of some foreign media and social media, (ii) customer satisfaction survey and compliant handling process, (iii) issuing opinions on new products or changes and related internal regulations, communication, advertising materials and initiatives addressed to customers, such as special offers and competitions, training materials

for sales force on ethical business, (iv) supervision over the post-sale control process and mystery shopping exercises for specific product groups.

In 2017, the Compliance Area and AMLD were highly engaged in the works aimed at ensuring the Bank's compliance with the regulatory requirements, particularly in respect of: MiFID2/MiFIR, PRIIPS, EMIR, CRS, GDPR, PSD2, PAD and STIR.

The Supervisory Board in particular noted the actions performed in 2017 that were aimed at further development of the compliance function and its alignment to the internal and external environment, including:

- active participation in works aimed at adjusting the Bank's activity to Recommendation H as part of which the Compliance Policy was implemented (consistent with the Internal Control Policy) and the Control Function Matrix and related Methodology were developed in cooperation with the Bank's relevant units;
- strengthening the compliance risk assessment process – regulatory risk and conduct risk self-assessment campaign for BZWBK Group and implementation of the principles of overall compliance risk assessment;
- further development of reputational risk management model - implementation of Reputational Risk Management Policy and implementation of subsequent environmental policies for individual sectors;
- implementation of consumer protection model, including Consumer Protection Policy and development of complaint management and lessons learnt processes;
- limitation of money laundering risk – works on implementation of the requirements of 4th AML Directive and participation in projects implementing tax frauds regulations.

In line with the Policy on compliance risk management in Bank Zachodni WBK, each year the Supervisory Board assesses the effectiveness of compliance risk management in BZ WBK. The last such assessment was performed by the Supervisory Board in October 2017. Following the assessment, the Supervisory Board established that it was given assurance about the following:

- ✓ Independence of the Compliance Area resulting from: (i) BZ WBK Compliance Policy approved by the Supervisory Board; (ii) the place of the Compliance function in the Bank's organisational structure and its direct reporting line to the member of the management board who (as a result of internal allocation of powers within the management board) is in charge of supervision over the compliance risk and is not in charge of duties referred to in Article 22a(4) and (6)(2) of the Banking Law Act.
- ✓ the Compliance Area operated properly and was effective in exercising its role, also as the second line of defence and that it has adequate resources given its tasks. The Area representatives are represented in those other committees of the Bank where their presence is required. The Compliance Area reviews all projects that require their opinion. The Compliance Area is actively engaged in building awareness in respect of ethical business operations, anti-money laundering issues as well as preparing and coordinating the certification process for savings and investment products.
- ✓ The compliance risk management was effective and adequate to the Bank's business scale and needs and did not expose the Bank to the risk of regulatory sanctions, financial losses or loss of reputation caused by non-compliance with the law, regulatory guidelines, standards and codes of conduct applicable to its operations.

This assessment took also into account that as part of the process of compliance risk management, at each of its regular meetings the Audit and Compliance Committee reviews key compliance issues identified by the Compliance Area and as well as those arising from the unit's operations. Information in this respect is presented to the Supervisory Board as part of the Committee's report.

## 5. INTERNAL AUDIT FUNCTION ASSESSMENT

The Supervisory Board assesses the adequacy and effectiveness of internal audit function upon each presentation of the report on the performance of the Internal Audit Area to the Audit & Compliance Committee.

In December 2017, the Supervisory Board conducted the overall review and assessment of the Internal Audit Function.

Given the above, the Supervisory Board stated that:

- The Internal Audit Area is a function independent of any other functions and units whose activity is to provide assurance to the Management Board, Supervisory Board and other members of senior management with regard to the quality and effectiveness of internal control, management of risks (current or new), processes and systems helping thus to protect the company's goodwill, solvency and reputation.
- The independence of the IAA is confirmed to the Audit and Compliance Committee on an annual basis and is ensured in particular by the following:
  - In line with the Bank's Statutes, the IAA reports directly to the President of the Management Board. Audit and Compliance Committee supervises the activity of the internal audit function.
  - The Head of the Internal Audit Area has a direct and unlimited access to the Chairman of the Audit and Compliance Committee and participates in all meetings on this Committee as well as the Risk Committee. At least once a year, a meeting with the Audit and Compliance Committee is held in absence of the Management Board Members.
  - The IAA Head participates in meetings of the Management Board and is a member of the Risk Control Committee and Risk Management Committee (without the voting rights in both committees) which provides him with a full insight into the operations of those governing bodies and opportunity to express his opinion.
  - A detailed procedure of appointing and removing the IAA Head has been developed.
  - The IAA has unlimited access to all information, documents, systems, applications and physical locations necessary to complete assigned tasks.
- The internal audit system is adequate and effective - the Internal Audit Area has resources sufficient to carry out responsibilities set out in the Audit Plans both in terms of the number of auditors and the adequacy of skills. The auditors' qualifications are continuously enhanced with professional certifications. The remuneration level in the Internal Audit Area as well as the training plans are regularly reported to and reviewed by the Audit and Compliance Committee.
- The existing IAA regulations are adequate, take into account the commonly applicable law, Bank's internal regulations, supervisory recommendations and market standards adopted in the Bank. The IAA functions in line with the "International Standards for the Professional Practice of Internal Auditing" issued by the Institute of Internal Auditors which was confirmed by an independent external assessment.

In H2 2017, the IAA regulations were updated, including the Internal Audit Charter to adapt them to requirements arising from the KNF's Recommendation H.

The internal audit methodology reflects the current professional standards and enables the identification of significant risks in BZ WBK Group:

- The annual audit planning is based on a comprehensive risk assessment process and clearly identifies audit objectives and scope of work. In line with the adopted internal audit methodology both the requirements of the Bank's senior governing bodies (Supervisory Board, Management Board) and of the Regulator were covered in the Audit Plan. Moreover, as part of the annual risk assessment process, a strategic and operational audit plan was developed.
- In the opinion of the Bank's Management Board and the Audit & Compliance Committee, the Audit Plan for 2017 covered all significant issues and ensured an independent and objective manner of reviewing and assessing controls applied as part of the first and second line of defence and the Bank's management system, including the effectiveness of



managing risk related to the Bank's operations. Moreover, audit findings are used to improve the existing processes and operational security.

- Audit findings indicating irregularities in internal control and risk management system identified in conducted audits are presented in audit reports and represent the basis for issuing a recommendation for the audited unit aimed at eliminating the identified irregularities.
- Actions taken by audited units in response to audit findings and delivery of issued recommendations are each time verified by the IAA. The status of recommendations' implementation is monitored and reported to the Bank's Management Board and the Audit and Compliance Committee on a regular basis.
- The audit findings are presented to the Audit and Compliance Committee, Management Board and Supervisory Board on a periodical basis.
- There are adequate policies and practices to monitor the quality of internal audit work that are compatible with professional standards and the approved methodology. The quality assurance report is presented to the Bank's Management Board and the Audit & Compliance Committee on an annual basis.

## **6. ASSESSMENT OF THE SPONSORING AND CORPORATE GIVING POLICY OF BANK ZACHODNI WBK S.A.**

The sponsoring and corporate giving policy of Bank Zachodni WBK S.A. is laid down in the document "Strategy behind sponsoring actions and sponsoring action plan of Bank Zachodni WBK S.A.". The delivery of tasks pursuant to the Policy is the responsibility of the Sponsorship and Relationship Projects Office and the Foundation of Bank Zachodni WBK.

In the opinion of the Supervisory Board, the Sponsoring and Corporate Giving Policy (the Policy) of the Bank is pursued in a thought-out, rational and responsible manner, building the Bank's image as a responsible corporate citizen.

The projects are primarily designed to strengthen the Bank's image as the third largest financial institution in the banking sector in Poland, the best commercial bank in Poland, a trustworthy, reliable, resilient institution with a nation-wide footprint. The subjects and scope of the projects focus on the following areas:

- sharing the Polish culture values with a wide audience (Bank for the aspiring, affluent segment);
- supporting development of the Polish science and financial education (investments in the future, employer branding actions building the image of the Bank as a good employer);
- promoting sport as the local community integration vehicle along with the active life-style and fair play rules (the Bank as a partner for customers);
- projects significant for local communities (shaping the image, establishing partnership relations, supporting engaged attitude of employees – employee volunteering).

Marketing and image-building actions delivered in 2017, including sponsoring and community-oriented projects, brought the expected results and effectively engaged the target groups - BZWBK strengthened its position as banking brands leader and is the third most recognisable brand in Poland.

The key sponsoring projects of the Bank in 2017 include: Santander Orchestra (3rd edition), BZ WBK Press Photo (13 edition), "How's Your Driving" CSR project, cooperation with the National Museum in Wrocław – "Fashion for Cranach" exhibition. Moreover, actions aimed at counteracting social exclusion and supporting the "Barrier-Free Banking Service" programme were continued.

The Foundation of Bank Zachodni WBK delivers an average of 300 contracts with social partners each year, the most important of which are regular subsidy programmes. In 2017, subsidies were

granted under the following programmes: “Bank of the Ambitious Youth”, “Here I live, here I make changes” (3rd edition) and “Bank of Young Sports Champions” (1st edition). Overall, 201 grants were distributed worth PLN 1 100 000 in total.

The staff volunteering programme covered over 80 local community projects, coordinated and financially supported by the Foundation, which were initiated and delivered by the bank’s employees. The activities of this kind engage more than 500 volunteers from the bank each year.

The Bank’s sponsorship and corporate giving activities also support the key directions of the Corporate Social Responsibility and Sustainable Development Policy of Bank Zachodni WBK, which are based on five pillars: support for third-level education; scientific research and entrepreneurship; activities for local communities; environmental protection and active dialogue with stakeholders.

In 2017, Bank Zachodni WBK issued the fourth Corporate Social Responsibility Report for 2016 that comprehensively outlined the Bank’s actions for responsible and sustainable business, covered key business data, and presented figures and information on key sponsoring projects and social investments.

## **7. ASSESSMENT OF THE MANNER OF FULFILLING BY BANK ZACHODNI WBK THE DISCLOSURE REQUIREMENTS WITH REGARD TO THE CORPORATE GOVERNANCE RULES SET OUT IN THE WSE RULES AND REGULATIONS PERTAINING TO CURRENT AND PERIODIC INFORMATION PUBLISHED BY ISSUERS OF SECURITIES**

The obligation to assess the Bank’s fulfilment of disclosure requirements with respect to its compliance with the corporate governance rules arises directly from rule II Z. of 2016 Best Practice for WSE Listed Companies approved by the Annual General Meeting of Shareholders held on 20 April 2016 and previously by the resolution of the Management Board and Supervisory Board.

To ensure compliance with the aforementioned practice, the Bank’s Supervisory Board fulfils its obligations related to the Annual General Meeting of Shareholders scheduled for 16 May 2018. The foregoing annual assessment does not require any separate resolution of shareholders and can be approved as part of the approval of the Supervisory Board’s performance report.

To discharge its corporate governance information obligations, in 2017 the Corporate Legal Governance Office (in the Legal and Compliance Division) re-assigned individual principles to specific business units (the so-called business owners) and received confirmation that Best Practice was applied. As a result, the Bank did not need to report any cases of non-compliance with any of the rules. In line with the obligation set forth in Par. 29 (3) of the WSE Rules under the “comply or explain” solution, the non-adherence or incidental non-adherence to a given rule triggers an obligation for a company to immediately report such a situation. The required statement on compliance with the corporate governance rules arising from the Best Practice document is reported through the “Corporate Governance Statement for 2017” included in the annual report. This is treated as a fulfilment of the obligation to provide the WSE with a report on compliance with the corporate governance rules. The statement was included in one of the sections of the 2017 Management Board Report on Bank Zachodni WBK Group performance published on 13 February 2018.

Given the above, the Bank’s fulfilment of disclosure requirements in relation to the adherence to the Corporate Governance Rules in 2017 is positively assessed by the Supervisory Board, whilst the Bank’s disclosures are a reliable source of information on its compliance with the corporate governance rules.

## 8. SUMMARY

Based on the assessment whose results are presented above, the Supervisory Board, states that the situation of the Bank Zachodni WBK and Bank Zachodni WBK Group is good and stable. The assessment is justified by:

- Good financial results in a challenging economic environment;
- Effective risk management;
- Strong capital and liquidity position;
- Excellent cost management; and
- Efficient internal control system.

## IV. ASSESSMENT OF COMPLIANCE WITH THE CORPORATE GOVERNANCE RULES FOR SUPERVISED INSTITUTIONS

As of 1 January 2015, Bank Zachodni WBK S.A. has followed and adhered to the Corporate Governance Rules for Supervised Institutions (“Corporate Governance Rules”) implemented under Resolution No. 218/2014 issued by the Polish Financial Supervision Authority (KNF) on 22 July 2014. This is an important document for the Bank’s corporate policy as a public trust institution. The Corporate Governance Rules were approved by way of Resolution no. 29 passed by the Annual General Meeting of Shareholders held on 23 April 2015 based on the relevant resolution of the Bank’s Management Board and Supervisory Board.

The Rules cover a wide range of issues, including among others internal and external relations of the Bank, also with the shareholders and customers, organisation and functioning of internal supervision and key internal systems and functions, statutory bodies and principles of cooperation, which requires the Bank to comply with top standards and to ensure that the obligations arising from the regulations are adequately fulfilled. Therefore the Bank precisely defined business units (the so called business owners) responsible for the adherence to and implementation of assigned rules in line with their area of responsibility. Throughout 2017 all business owners took appropriate measures to ensure their units’ compliance with the Corporate Governance Rules.

At the end of 2017, all business owners were asked to report on their business unit’s compliance with the Corporate Governance Rules. All business owners fulfilled their obligations on time by providing assurance on the application of the Corporate Governance Rules and indicating taken actions. They acted professionally, reliably and with a due care.

Given the above, the Supervisory Board stated that the process of implementing the Corporate Governance Rules in the Bank was carried out adequately. The process was subject to current, in-depth supervision by the business owners. The coordination of the process and collaboration between business owners in joint implementation of certain rules were also effective. Therefore, the assessment of the Bank’s application of the Corporate Governance Rules is positive.

## V. ASSESSMENT OF THE REMUNERATION POLICY OF BANK ZACHODNI WBK

In addition, pursuant to the Corporate Governance Rules approved by Resolution no. 29 issued during the Bank’s Annual General Meeting on 23 April 2015, the supervising body should present the legislative body with a report on the Remuneration Policy of the supervised institution on an annual basis.

Following implementation of the Resolution of the Minister of Development and Finance of 6 March 2017 on the risk management system and the internal control system, remuneration policy and detailed method of internal capital estimation in banks, all internal legal documents related to remuneration policy were reviewed. The review also covered best practice defined in the Remuneration Policy applicable in Santander Group. As part of the process, the existing internal acts were incorporated into the Remuneration Policy of Bank Zachodni WBK. At present, the Remuneration Policy of Bank Zachodni WBK S.A. comprises:

1. *BZ WBK Group Remuneration Policy*
2. *Remuneration Policy for Members of Bank Zachodni WBK Management Board*

Those remuneration policies are consistent with relevant statutory acts and implementing acts and were approved by the Management Board and the Supervisory Board.

The principles of fixed and variable remuneration paid to the Management Board Members and key function holders are based on those policies. The remuneration policy in Bank Zachodni WBK is linked to the strategic objectives of the organisation, its short and long-term goals, long-term interests and performance; the policy also takes into account qualitative and quantitative criteria and solutions aimed at avoiding discrimination for any reason.

The Bank has a centre of excellence with sufficient knowledge and skills enabling independent update and verification of the list of employees holding the status of Material Risk Takers. Similarly to 2016, the Bank identified employees whose professional activity has a significant impact on risk profile of the institution based on standards defined in the Commission delegated regulation. In 2017 the said policy covered 73 individuals in Bank Zachodni Group. In 2017 the identification was benchmarked to banking sector practices in Poland and was made in cooperation with an external consulting company. Once the work has been completed and the list of MRTs approved by resolution of the Supervisory Board, a formal communication process addressed to all MRTs takes place. In Q4 2017, the list of identified employees was verified. Following the review, the list was extended with two additional job roles.

The Supervisory Board performed oversight of the implemented Remuneration Policy, also by verifying whether the criteria and conditions for variable remuneration had been fulfilled prior to the payment of the variable remuneration, either in part or in full.

According to the Supervisory Board, the Policy supports the Bank's growth and security, and in particular sound and effective risk management and is compatible with its business strategy, objectives, values and long-term interests.

The abovementioned assessment reflects the results of the review of the Policy on variable remuneration components of key function holders in the Bank carried out in H1 2017 by the Internal Audit Area.