

**REPORT
ON THE SUPERVISORY BOARD ACTIVITY IN 2012**

March 2013 - Warsaw



WBK

Bank Zachodni WBK



Bank Zachodni WBK jest członkiem Santander Group.

I. BOARD COMPOSITION & MANNER OF DISCHARGE FROM DUTIES & RESPONSIBILITIES

1. As at 1 January 2012, the Supervisory Board (SB) had the following composition:

- Supervisory Board Chairman - Mr Gerry Byrne
- Deputy Chairman of the Supervisory Board - Mr Jose Manuel Varela
- Members of the Supervisory Board:
 - Mr Jose Antonio Alvarez,
 - Mr Witold Jurcewicz
 - Mr Jose Louis De Mora,
 - Mr Piotr Partyga,
 - Mr John Power

2. Changes in the Supervisory Board composition.

- Mr Piotr Partyga filed a resignation from the function of the Supervisory Board member effective as of 10 May 2012.
- On 10 May 2012, the General Meeting of Bank Zachodni WBK Shareholders appointed Mr Jerzy Surma as the Supervisory Board Member.

3. Independence of the Supervisory Board Members

All Members of the Supervisory Board submitted written statements on their independence as well as on their personal, factual and organizational connections with the Bank's shareholders.

In line with the submitted statements, as at 31 December 2012, the status of an independent Supervisory Board Member was held by the following individuals:

- Mr Witold Jurcewicz,
- Mr John Power (Chairman of the Audit Committee and Chairman of the Risk Oversight Committee),
- Mr Jerzy Surma.

4. The Supervisory Board activities and manner of discharging its duties and responsibilities are regulated by the Supervisory Board Terms of Reference available on the Bank's Internet site.

II. STATISTICAL DATA ON THE SUPERVISORY BOARD'S ACTIVITY IN 2012

From 1 January until 31 December 2012, the Supervisory Board held 6 meetings and passed 60 resolutions. The Board Members' average attendance rate was 98%.

III. MERGER WITH KREDYT BANK S.A.

- On 27 February 2012, the majority shareholders of Bank Zachodni WBK and Kredyt Bank, i.e. Banco Santander S.A. and KBC Bank NV entered into an investment agreement whereby they expressed the intent to merge the two banks. On the same day, the said banks entered into an agreement with regard to starting work aimed at merging Bank Zachodni WBK with Kredyt Bank.

- On 29 March 2012, an investment agreement between Bank Zachodni WBK, European Bank for Reconstruction and Development (EBRD) and Banco Santander was concluded, pursuant to which EBRD committed to become a minority shareholder of BZ WBK thanks to taking up additional shares worth PLN 332m in a private placement. The objective of that investment was to support the merger with Kredyt Bank which will benefit high level competition in the top tier banking segment
- The Supervisory Board stated that the scale of the merger process of Bank Zachodni WBK and Kredyt Bank, its material impact on both organisations, market, shareholders, including the minority ones, and employees of both banks triggers the need for an active oversight of the process. To that end, the Supervisory Board decides to second one of its members to individually oversee the merger process on the Board's behalf. The Board decided to vest this task with Mr John Power, an independent Member of the Supervisory Board, given his knowledge and experience in this respect as he previously kept oversight of the successfully completed process of merging Bank Zachodni and Wielkopolski Bank Kredytowy. At the same time, the Board agreed that while performing the task vested, Mr John Power would solely perform oversight functions of the merger process, liaising with the Merger Steering Committee and would present regular reports to the Supervisory Board in this respect.
While performing these duties at each Supervisory Board meeting, Mr Pan John Power informed the Board about current status of work related to the Merger Programme, including its individual milestones as well as about the status of work on the required application documentation, i.e. Information Memorandum and motion to Komisja Nadzoru Bankowego (Polish Financial Supervision Authority) seeking consent for the merger of Bank Zachodni WBK and Kredyt Bank. Mr John Power provided full explanation to the Board members as regards all matters related to the merger process.
- The Supervisory Board analysed and received full explanations on actions taken by the Bank's Management Board with a view to confirming that the share exchange ratio to be applied for the purposes of the Merger Plan was justified. The Supervisory Board also got acquainted with the outcome of the review carried out by the Bank's in-house analysts which confirmed that documents produced by finance advisors and concerning BZ WBK and Kredyt Bank valuations had been prepared with due care which gave confidence that they were law compliant and took account of all the required circumstances. In that basis the Supervisory Board approved the Bank's Management Board resolution re. the share exchange ratio and the Merger Plan.
- The Supervisory Board approved the budget of the Banks' Merger Programme for the years 2012-2015 presented by the Management Board, including the assumptions related to expected income and cost synergies that were set based on benchmarks of Santander Group and Boston Consulting Group, the Bank's advisor in the merger process.

IV. MAJOR AREAS OF THE SUPERVISORY BOARD'S ACTIVITY IN 2012

In 2012, the Supervisory Board focused both on strategic matters as well as on the supervision of the Bank's day-to-day business. Apart from the abovementioned independent oversight of the merger of Bank Zachodni WBK and Kredyt Bank, the key areas of the Supervisory Board's activity were as follows:

- 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 appropriate) by current business matters, issues submitted by the 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 the pursuit of its duties arising from §32 of the Bank's Statutes, the Supervisory Board conducted ongoing assessment of the financial performance of the Bank and BZ WBK Group as well as current projections prepared on that basis, taking account of the business and operating tendencies in place, opportunities and threats, variances against the Plan and management action taken by the Management Board. The assessment was based on financial reports presented by the Management Board.
- The Supervisory Board kept track of current macroeconomic and market forecasts and their impact on the Polish economy as well as operations, financial and business performance of the Bank and BZ WBK Group.
- The Supervisory Board was regularly advised on key trends emerging in the banking sector and performance of competitive banks as well as on BZ WBK's benchmarking and tendencies projected for the sector.
- The Supervisory Board was updated on an ongoing basis about progress in the process of integrating Bank Zachodni WBK and Banco Santander in terms of organisational structure, operating procedures and IT systems aimed to achieve maximum synergies by applying best practice and leveraging expertise and tested solutions of the strategic investor.
- The Supervisory Board requested information and was kept up-to-date by the Bank's Management Board about current priorities and approach to challenges relating to funding, liquidity, capital management, risk management, in particular credit risk management, and cost management. Given the significance of liquidity and funding for the strategic project, i.e. merger of Bank Zachodni WBK and Kredyt Bank, the Supervisory Board was advised by the Bank's Management Board of possible funding scenarios.
- As part of the overall supervision of the internal capital adequacy assessment processes (ICAAP), the Supervisory Board approved ICAAP policies and regular reports, based on Audit Committee reviews and recommendations.
- As part of the supervision exercised over the risk management process, the Supervisory Board undertook reviews of the main risk areas, focusing on the oversight of individual risks, compliance with applicable policies and internal procedures as well as KNF recommendations, relevant risk identification procedure and remedial action plans.
- Based on the reviews and recommendations of the Audit Committee, the Supervisory Board approved the acceptable risk level expressed as limits set out in the "Risk Appetite Statement". In line with the agreed process, the Supervisory Board supervised and monitored the level of internal limit utilization.
In the Supervisory Board's opinion, the risk appetite defined by the Bank is kept up-to-date and matches the current market environment. The risk analysis is supported by stress testing and scenario analysis which are to ensure that BZ WBK will continue as a stable and well-capitalized bank even amid adverse market conditions.

- As part of the supervision of the credit risk management process, the Supervisory Board was informed about the current lending strategy and performed current reviews of the loan portfolio to ensure compliance with the Regulatory Recommendations, changes in credit policies and key credit risk factors.

In addition, the Supervisory Board was provided with information about individual credit portfolios broken down by products/ customer segments with a special focus on their quality and profitability.

Following the sudden deterioration of the construction sector's conditions in mid-2012, the Supervisory Board was informed on findings from the review of the loan portfolio performed by the Management Board in respect of customers from the above-mentioned sector, on the implementation of respective changes to the policy in order to reduce the portfolio's risk profile and the bank's position, as well as on the plan for management initiatives which included a close monitoring of these customers.

- The Supervisory Board approved the BZWBK Risk Management Policy which defines the framework principles for risk management in BZ WBK, and assignment of responsibilities, as well as addresses the requirements arising from KNF Resolution no 258/2011 on the detailed principles of the risk management system. The Policy also introduces the guidelines for the delivery of the due diligence process in line with KNF recommendations and stipulates that the Bank 's risk profile will be defined in such a way that allows for dividend payouts, in accordance with KNF letter dated. December 2012.
- The Supervisory Board undertook a review of the financial, business and strategic planning process as well as of the solutions implemented in the Bank,, in the context of KNF requirements. The Supervisory Board has established that the strategic planning, monitoring, review and update process is formalized, the Management Board reviews the strategy on a regular basis and submits amendments thereto to the Supervisory Board for approval. The competencies of the Management Board and Supervisory Board in respect of the planning process are clearly defined.
- The Supervisory Board undertook a review of the strategy and different areas of the Bank and its subsidiaries paying particular attention to areas requiring improvement, high and steady income streams, their diversification and market share growth.
- The Supervisory Board approved a change to the Bank's Organisational Regulations whereby:
 - The Credit Division was merged with the Risk Management Division, so that the tasks of both units rest with the Risk Management Division. This solution follows the organizational model for credit risk management that is prevalent in the Polish banking sector as well as matches the corporate model adopted in the Santander Group where a single organizational unit is responsible for defining the credit risk management strategy, quality of generated portfolio and debt collection and recovery tasks.
 - New Financial Accounting and Control Division and Financial Management Division were established in place of the Finance Division. This change was aimed to optimize the finance management model, align BZ WBK organizational structure in this area with respective solutions in the Santander Group, ensure the optimum focus on the Bank's financial requirements as well as provide effective support for further business growth and integration with Kredyt Bank.

V. OPERATIONS OF THE SUPERVISORY BOARD COMMITTEES

Independently of the Supervisory Board meetings, Supervisory Board Members sat on the following Board's committees:

- Nominations & Remuneration Committee,
- Audit & Compliance Committee,
- Risk Oversight Committee.

The scope and mode of the Committees' operations is set out in their Terms of Reference, introduced by relevant resolutions of the Supervisory Board. The Terms of Reference are available at the Supervisory Board Secretariat.

The Members of individual Committees have knowledge and experience appropriate for their roles and adequate fulfilment 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 motions as well as those submitted by the Bank's Management Board.

In order to enable the Supervisory Board to appraise in full the Committees' work, their Chairmen present relevant reports at the meetings of the Supervisory Board and the Board Members are submitted together with copies of the minutes of each meeting of the Committees.

Individual Committees received on time relevant and reliable information from the Management Board allowing them to fulfil their responsibilities in 2012.

▪ NOMINATIONS & REMUNERATION COMMITTEE

One of the key duties of the Supervisory Board is the introduction of remuneration policies and practice which are both fair and competitive that is highly important given their impact on the effectiveness of the organisation and its capability to recruit, retain and motivate the Management Board Members and senior management. The task of the Nominations and Remuneration Committee is to support the Supervisory Board in attaining these objectives as well as ensuring the consistency of the remuneration policy with the Bank's corporate culture, objectives, strategy, competitive behaviours as well as recommendation of regulators with regard to remuneration in the banking sector. Dealing with such matters, the Committee members have no personal financial interest other than that of the Bank's shareholders and are driven by the best interest of the Bank and its shareholders.

The Committee assists the Supervisory Board in:

1. succession planning at the Bank's Management Board level;
2. issuing recommendations for the SB with regard to the composition of the Management Board;
3. overall monitoring of the market remuneration practices and levels;
4. preparing recommendations for the Supervisory Board decisions as to fair and competitive Remuneration policies and practices, ensuring adequate motivation for the Management Board Members and senior management to constantly improve the Bank's performance.

The Nominations and Remuneration Committee 's composition in 2012 was:

- Mr Gerry Byrne (Chairman),
- Mr José Antonio Alvarez – the Committee Member,
- Mr José Luis de Mora – the Committee Member.

The Committee usually invites the President of the Management Board, the Head of the HR Management Division and other executives, as deemed relevant to considered matters, to its meetings.

In 2012, the Committee focused on the following issues:

- Preparation of a recommendation concerning 2011 bonus payment to Management Board members based on adopted bonus regulations.
- Appointment of the Management Board for the new term of office – the Committee recommended to the Supervisory Board to appoint a Management Board comprising of 9 members. The composition of the Management Board for the new term of office takes account of the resignation from seeking reappointment for the next terms of office filed by Mr Justyn Konieczny and Mr Janusz Krawczyk. Mr Piotr Partyga is a new member of the Management Board, recommended by the Committee to head the HR Management Division. Management Board Members appointed to the new term of office held consents of the Financial Supervision Commission:
 - Mr Mateusz Morawiecki - to perform the function of the Management Board President,
 - Mr Andrzej Burliga - to perform the function of Member of the Bank's Management Board in charge of risk management.
- Preparation of a template of an employment contract with the Management Board Member - the contract template for the new term of office recommended to the Supervisory Board was based on the existing template and adjusted to the currently applicable legislation and the standing of the Bank. An agreement on the competition ban was entered into with each Member of the Management Board.
- Presentation of recommended terms and conditions of remuneration for the Management Board Members based on the conducted remuneration review.
- Presentation to the Supervisory Board of a recommendation with regard to filling in the position of the management Board Member in charge of the Financial Accounting and Control Division given the set of a new division in the Bank's organisational structure.
- Presentation to the Supervisory Board of a recommendation as regards approval of the updated Policy on variable components of remuneration paid to individuals holding managerial positions in Bank Zachodni WBK Group adjusted to the guidelines passed by KNF and practice established on the Polish market.
- Succession planning for the Management Board functions and senior management positions - as in the previous years, this issue was one of the Committee's and Supervisory Board's priorities in 2012; actions in this area involved the provision of adequate development programs for individuals covered by succession planning, both at the Bank and its subsidiaries.

Preparing recommendations for the Supervisory Board, the Committee used current results of the banking sector's remuneration survey carried out by an independent agency.

▪ **AUDIT & COMPLIANCE COMMITTEE**

The Audit & Compliance Committee's role is to assist the Board in discharging its oversight responsibilities to shareholders and other stakeholders in relation to:

1. the quality and integrity of the accounting policies, financial statements and disclosure practices;

2. the monitoring of compliance with relevant laws and regulations, taxation obligations and relevant Codes of Conduct and good business ethics;
3. the monitoring of independence and performance of the internal and external Auditors; and
4. the assessment of the effectiveness of the system of internal controls and management of financial and non-financial risks.

The Audit Committee is composed of the following members:

- Mr John Power (Chairman)
- Mr Piotr Partyga (resigned 10th May 2012)
- Mr Witold Jurcewicz
- Mr Jose Manuel Varela
- Mr Jerzy Surma (joined 10th May 2012)

Attendance

Number of meetings held:	9
- Mr John Power (Chairman)	9
- Mr Piotr Partyga	3/4
- Mr Witold Jurcewicz	8
- Mr Jose Manuel Varela	9
- Mr Jerzy Surma	5/5

Both the Audit Committee's scope of duties and composition are in accordance with the Polish Chartered Auditors Act of 7 May 2009.

The Committee operates under a written Terms of Reference, which were updated and approved by the Supervisory Board on the 20th April 2011. The Committee undertakes its duties in line with an agreed annual work programme that allows the committee to monitor (and seek assurance on) the management of the financial risks identified in the company's business plan.

The Audit Committee continued their work programme against the background of the merger of the Bank with Kredyt Bank and the slowing economic environment in Poland. The changing regulatory environment also shaped our discussions around internal controls, regulatory compliance and Santander Group control requirements. There are some areas of potential overlap in the approach to reviewing risk with the Risk Oversight Committee but given the commonality of membership both Committees ensured that such overlaps were managed appropriately. The Committee members meet privately either before or after the meetings to assess particular issues that individual members may want to further review.

The Committee met 9 times during the course of the 2012 and the members' attendance record is set out above. The Committee reviewed key areas of material controls, including financial, operational, regulatory compliance and risk management systems. On a regular basis it receives reports on risk management, fraud, anti money laundering, legal, regulatory and corporate governance matters in order to assess the effectiveness of the risk management and control frameworks. Again in 2012, these reports included material/significant notifications arising under the Group policy on "whistle blowing", updates on significant projects in the Bank, detailed analysis of capital ratios, adequacy of provisioning including IBNR provisions, the implementation of EU Directives, Sarbanes Oxley compliance, Basel II compliance and IT system implementations. In addition we received updates on the progression of the implementation of the Santander Internal Control Model which the Committee believes will enhance the overall control environment of the Bank.

Key Issues addressed in 2012:

Implementation of the Code of Conduct for Securities markets.

CIO Report on IT Services including monitoring controls and governance around technology.

Specific control environment reviews from some of the following businesses:

- Partner Outlets
- Joint Venture with Aviva
- Asset Management
- Business Support Division

The independent Auditors, Deloitte Audyt, the Bank's Internal Auditor, the Chief Risk Officer, the Head of Compliance and the President were invited to attend all meetings. Other members of the Supervisory Board and Management Board are also invited to attend as appropriate in order to present reports. In addition, the Committee held separate meetings with members of senior management and the external auditors to discuss issues relevant to the committee.

The Committee, through the Group Internal Auditor, receives objective independent reports on the operation of internal controls in the Group. The Committee reviewed the plans and work undertaken during the year, the level of training and skills of the resources of the internal audit function and changes to the internal audit methodology. During 2012 the Group continued its Internal Audit Quality Assurance reporting in accordance with the International auditing standards and the committee is satisfied that where improvements were identified that they were incorporated into future reports and audit processes.

The Committee has reviewed and discussed the Company's audited financial statements with Management, which has primary responsibility for preparing the financial statements. It placed particular emphasis on their fair presentation and the reasonableness of the judgmental factors in particular the level of IBNR provisions for each loan portfolio, the approach to business segmentation and the appropriateness of significant accounting policies used in their preparation. In particular we considered 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 Deloitte Audyt their independent review of the financial statements and issues raised with management.

In addition, the Committee continued its detailed review of the Group's capital, liquidity and risk frameworks against the requirements of the KNF stress test scenarios, Basel II and the volatility in the global financial markets. The Committee considered 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.

In reliance of these reviews and discussions, the Committee recommended that the Supervisory Board approve the audited financial statements for inclusion in the Company's annual report for the year ended 31st December 2012, and the Board accepted the Committee's recommendations. The Committee recommended to the Supervisory Board, following the consultations with the majority shareholder, that Deloitte Audyt SP. z o.o. be appointed the Company's independent auditor to examine the Bank's and BZWBK Group's Financial Statements for 2012.

There is a process in place by which the Audit & Compliance Committee reviews and, if considered appropriate, approves, within parameters approved by the Supervisory Board, any non-

audit services undertaken by the Auditors, and the related fees. This ensures that the objectivity and independence of the Auditors is safeguarded. This was particularly relevant in 2012 given the additional work that Deloitte Audyt Sp. z o.o. had to complete for the merger with Kredyt Bank. In addition, the Group paid PLN 1 867k to Deloitte Audyt Sp. z o.o. for audit services in 2012, relating to the statutory audit of the Group and Company financial statements and the audit of Group subsidiaries and associates pursuant to legislation. The fees for other services which included advice on accounting, regulatory matters and the fees directly relating to work on the merger were PLN 1 030k giving a total fee to Deloitte Audyt Sp. z o.o. of PLN 2 897k. We are satisfied that the Group's external auditor provides effective, independent challenge to management and that their management letter provides valuable recommendations for improvement of internal controls.

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. Areas where we could enhance our performance include the form and content of information presented which we are pleased to confirm that positive enhancements have been made in this respect during the year.

For 2013 the Committee's areas of focus will be influenced by the integration of Kredyt Bank, the impact of the slowing economic environment in Poland and the changing regulatory environment. Of particular focus will be the governance and control environment for operational risk.

▪ **RISK OVERSIGHT COMMITTEE**

The Risk Oversight Committee is appointed by the Supervisory Board of Bank Zachodni WBK to assist the Board in discharging its oversight responsibilities to shareholders and other stakeholders and to protect the Group from future events that impede the sustainable achievement of its performance objectives in relation to:

1. Appropriate Risk philosophy, as articulated in Risk Principles;
2. Risk appetite, as reflected in policies and risk limits;
3. A sharpened focused oversight on the more significant business risks undertaken by the bank and;
4. The appropriateness of the overall risk governance framework

The Risk Oversight Committee is composed of the following members:

- Mr John Power (Chairman)
- Mr Piotr Partyga (resigned 10th May 2012)
- Mr Witold Jurcewicz
- Mr Jose Manuel Varela
- Mr Jerzy Surma (joined 10th May 2012)

The Committee is conscious, when undertaking its duties that the Bank is in the business of taking risk but at a level that is appropriate relative to the Group's scale and type of business undertaken. The Committee focused on the oversight of forward looking risk issues and the key risk management indicators prepared in accordance to the business strategy.

The Committee operates under a written Terms of Reference updated and approved by the Supervisory Board on 20th April 2011. The Committee undertakes its duties in line with an agreed annual work programme that allows the committee to review the effectiveness of the risk philosophy and the appropriateness of the overall risk governance framework.

The Committee met 4 times during the course of the 2012 and reviewed key areas of the business including Global Banking Markets, Asset & Liability Management, Corporate Banking and Retail Banking. On a regular basis it receives reports on the Group's risk profile and key performance indicators, particular in relation to (a) the Top 5 risks, (b) performance vs. risk appetite and tolerance, (c) risk trends, (d) risk concentrations. The Risk Oversight Committee took a forward looking risk assessment approach in each of these business lines and seeks to identify the risks associated with their respective five year strategies.

A key element of the Risk Oversight 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. The results of the stress testing are linked closely with the Committee's review of the Group's Risk Appetite Statement and policies appropriate to the overall strategy adopted by the Supervisory Board.

In addition we reviewed and recommended approval to the Supervisory Board, the Group's economic capital framework, the governance over the Internal Capital Adequacy Assessment Process (ICAAP) and the effective implementation of this process by Management.

The independent Auditors, Deloitte Audyt, the Bank's Internal Auditor, the Chief Risk Officer, the Head of Compliance and the President were invited to attend all meetings. Other members of the Supervisory Board and Management Board are also invited to attend as appropriate in order to present reports.

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.

Looking forward to 2013 the merger of Kredyt Bank will increase the risk profile of the Group. Management are currently aligning the risk profile to the merged bank's consolidated position and the Committee will both assess the consolidation risk profile and monitor progress against the new performance indicators.