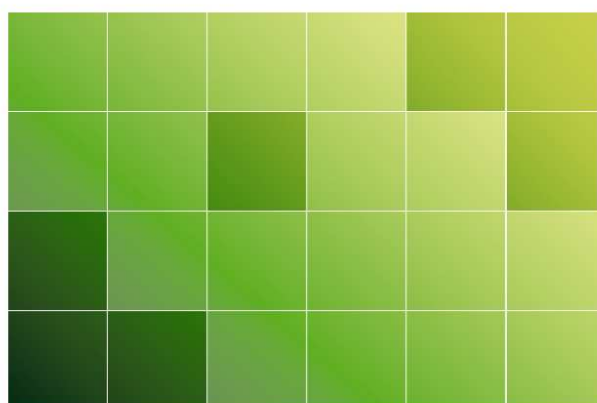


# Report of the Management Board on the BZWBK Group Performance in H1 2006



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# I. Introduction

***In the first half of 2006, Bank Zachodni WBK Group reported a record-high Profit-After-Tax of PLN 423.9m, which reflects:***

- *continued development of the Group's key business areas*
- *steady increase in income from the core banking activities*
- *excellent business and financial performance of mutual funds*

## 1. Financial Performance in Brief

- **In the first half of 2006, the Bank Zachodni WBK Group achieved record-breaking financial performance and growth rate y-o-y:**

- profit-before-tax was PLN 571.5m, an increase of 62.7% y-o-y;
- profit-after-tax was PLN 423.9m, an increase of 50.7% y-o-y.

- **With regard to financial performance, the most spectacular progress against the first half of 2005, was achieved in the following areas:**

- increase in total income by 27.6%, of which net commission income went up by 54.5%;
- reduction of the cost-to-income ratio from 61.1% to 51.5%;
- reduction of the NPL ratio from 7.8% to 6.3%.

## 2. Key Factors Affecting the Group's Profit and Activities

- **External environment, including:**

- economic growth and investment climate in Poland;
- labour market and salary levels;
- official interest rates levels;
- changes in the structure of household savings;
- trends in the credit market.

- **Steady business development:**

- growth of deposit base;
- rapid sales of BZ WBK Arka mutual funds (the funds' assets increased more than three-fold y-o-y);
- growth of strategic loan portfolios: cash and mortgage loans, leasing, business loans;
- continuous improvement of loan book quality;
- functional, procedural and pricing improvements in products and services;
- expansion of co-operation with external partners with regard to card service and distribution of selected bank products.



● **Effective cost management:**

- cost discipline maintained while business of the bank and subsidiaries quickly expanding.

● **Strong focus on service quality:**

- development of CRM technology, processes and competence of staff members;
- implementation of the "2006+ Standards" across the branch network;
- continued improvement and simplification of processes and procedures.

● **Development of alternative distribution channels:**

- increase in the sale of retail products through Direct Banking;
- expansion of functionality of the BZWBK24 and Minibank24 electronic banking solutions;
- establishment of a mobile sales network and launch of distribution through the sales network of an external partner.



## **II. Macroeconomic Situation**

### **1. Macroeconomic Environment in H1 2006**

#### **Economic Growth**

According to data from the Central Statistical Office, GDP growth in the first quarter of 2006 reached 5.2%, which was the best result since Poland's accession to the EU. A large role was played by domestic demand, which grew by 4.5%, while net export added 0.7 p.p. to the overall GDP growth. The breakdown of domestic demand was slightly different than expected due to slower investment increase (7.4% y-o-y after 10.1% y-o-y rise in the fourth quarter of 2005) and negative contribution of change in inventories. On the other hand, private consumption growth reached as much as 5.1% y-o-y (against 2.8% y-o-y in the fourth quarter of 2005 and 2.0% y-o-y on average in 2005). All in all, the data showed that Poland's economic situation was very good at the beginning of 2006.

Monthly data for the April-June period shows that fast economic expansion was continued in the second quarter of 2006. Growth rates of industrial output and retail sales reached the highest level since pre-accession boom in the first half of 2004. There were also positive tendencies in foreign trade maintained, i.e. rapid exports increase and only slightly lower rise in imports. On that basis, one may estimate that GDP growth pace in the second quarter of 2006 was again close to 5%.

Predictions for the remainder of 2006 are also optimistic. The economic growth should be mainly driven by domestic demand. Stabilisation of interest rates at record low level will be conducive to that. Consumption demand should receive significant support from the continued improvement of the labour market conditions.

#### **Labour Market Conditions**

Improvement on the labour market, observed for a few previous quarters, has become even stronger recently – employment increase in the enterprise sector accelerated to 3% in the second quarter of 2006, reaching the record high level of 3.1% y-o-y in June. The registered unemployment rate fell to 16% at the end of June, which means the fastest pace of unemployment reduction since mid-1998. Rapid increase in labour demand, stimulated by high economic activity, translates positively into wage growth. In the second quarter of 2006, average wage grew 4.6% y-o-y, the same as in the first three months of the year. Given moderate wage growth, strong employment increase and low inflation, the first half of 2006 saw the strongest growth in wage bill in the enterprise sector for many years. Positive tendencies in the labour market seem sustainable. This supports the expectation that private consumption growth will remain high in the coming quarters, but at the same it increases the Central Bank's caution as regards possible threat of excessive wage pressure in the economy.

#### **Economic Expansion in Monetary Statistics**

Along with acceleration in economic growth, the first half of 2006 brought further improvement in monetary statistics. Money supply grew 11.8% y-o-y in June 2006 against 10.4% y-o-y rise at the end of 2005. At the same time total deposits growth accelerated to 11.4% y-o-y from 9.4% y-o-y and like in the previous year this was mainly a consequence of an increase in corporate deposits (21.7% y-o-y growth in June 2006 versus 16.8% y-o-y rise in December 2005), although there was also some improvement in households' deposits, which increased by 5.6% y-o-y in June 2006 against a 3.6% y-o-y rise in December 2005.

As regards counterparts of money supply, a fast expansion of loans for households was continued. It increased by as much as 28.8% y-o-y in June 2006, which was related mainly to a rapid increase in mortgages. There was also continuation of gradual revival in corporate borrowing. In June 2006, it grew by 5.1% y-o-y against a mere 2.8% y-o-y rise in December 2005. As a result, total loans grew by 16% y-o-y in June 2006, which is the strongest growth since early 2001. One may expect that the remainder of 2006 will bring further recovery on the loans market.



## **Inflation**

A few quarters of fast economic growth did not bring signs of rising underlying inflation pressure. After CPI inflation fell to 0.7% y-o-y at the end of 2005 and to 0.4% y-o-y in March 2006, it increased only moderately to 0.8% y-o-y in June, but it was affected mostly by external factors such as higher food and fuel prices. The behaviour of other prices, which reflects fundamental inflation pressure in the economy and may be influenced by the monetary policy, was still very favourable. The so-called net inflation (CPI excluding food and fuel prices) remained below 1% y-o-y and should not exceed this level until year-end. Consequently, as for now there are no significant threats from the Central Bank's perspective.

## **Interest Rates**

Unexpectedly low inflation at the beginning of 2006 led the Monetary Policy Council to cut official interest rates again. As a result the reference rate fell to 4.0% from 4.5% in the first quarter of the year. In the following months, faster than predicted economic growth was the main factor being responsible for keeping rates on hold. Majority of members of the MPC expressed their opinion that existing interest rate level is appropriate given current and expected economic situation in Poland, and thus rates should be stable for some time. Taking into account quite favourable medium-term inflation prospects, one can expect that NBP rates will be unchanged at least until the end of 2006.

## **Fiscal Reforms Still to Come**

After the coalition government was formed, political situation in Poland has stabilised. Nevertheless, there are still many question marks as regards the shape of fiscal policy in the following years. Declarations of the government's officials to date have suggested that it will not be possible to meet Maastricht fiscal criteria (budget deficit below 3% of GDP) before 2009. The lack of credible programme of deficit reduction may increase volatility on financial markets and – to some degree – obstruct the functioning of enterprises. As for now, financial markets' participants gave a vote of confidence in the new cabinet, especially as macroeconomic situation is the best since many years. That is why, recent changes on the posts of Finance Minister and Prime Minister did not cause turmoil on the markets.

Polish currency as well as bonds and equities remained under influence of the situation on global financial markets, which was driven by higher risk aversion amid uncertainty connected with the monetary policy prospects in the U.S. Outflow from risky assets globally caused emerging markets sell-off, which was additionally boosted by macroeconomic instability in some countries in the region (Turkey, Hungary). As a result, the zloty exchange rate depreciated to above 4.0 against the Euro, although it was affected less than other currencies in the region thanks to strong economic fundamentals.



## 2. Main Macroeconomic Indicators

| Main macroeconomic indicators                 |          | 2003  | 2004  | 2005  | 2006F   |
|-----------------------------------------------|----------|-------|-------|-------|---------|
| GDP                                           | % y-o-y  | 3.8   | 5.3   | 3.4   | 5.1     |
| GDP                                           | PLN bn   | 842.1 | 923.2 | 980.9 | 1 037.2 |
| Total consumption                             | % y-o-y  | 2.5   | 3.9   | 2.6   | 4.2     |
| Private consumption                           | % y-o-y  | 1.9   | 4.0   | 2.0   | 4.6     |
| Fixed investment                              | % y-o-y  | -0.1  | 6.3   | 6.6   | 9.4     |
| Industrial production                         | % y-o-y  | 8.4   | 12.3  | 4.0   | 10.6    |
| Retail sales (real terms)                     | % y-o-y  | 3.6   | 7.1   | 1.5   | 11.1    |
| Unemployment rate *                           | %        | 20.0  | 19.1  | 17.6  | 15.9    |
| Gross wages in enterprise sector (real terms) | % y-o-y  | 2.8   | 4.1   | 3.2   | 5.1     |
| Budget deficit *                              | PLN bn   | -37.0 | -415  | -28.6 | -30.5   |
| Budget deficit *                              | % of GDP | -4.4  | -4.5  | -2.9  | -2.9    |
| CPI                                           | % y-o-y  | 0.8   | 3.5   | 2.1   | 0.8     |
| CPI *                                         | % y-o-y  | 1.7   | 4.4   | 0.7   | 1.5     |
| PPI                                           | % y-o-y  | 2.6   | 7.0   | 0.7   | 2.3     |
| Broad money (M3)*                             | % y-o-y  | 5.6   | 8.7   | 10.4  | 11.2    |
| Deposits *                                    | % y-o-y  | 3.7   | 8.1   | 9.4   | 9.5     |
| Loans *                                       | % y-o-y  | 8.1   | 2.9   | 11.8  | 15.0    |
| USD/PLN                                       | PLN      | 3.89  | 3.65  | 3.23  | 3.12    |
| EUR/PLN                                       | PLN      | 4.40  | 4.53  | 4.02  | 3.94    |
| PLN reference rate *                          | %        | 5.25  | 6.50  | 4.50  | 4.00    |
| WIBOR 3M                                      | %        | 5.69  | 6.21  | 5.29  | 4.21    |

Source: CSO, NBP, own estimates and forecasts

\* - end of period

F - forecast as at 18.07.2006



### III. Financial Performance

#### 1. Profit and Loss Account

The table below presents major developments in key categories of the profit and loss account of Bank Zachodni WBK Group in the first half of 2006 compared with the corresponding period last year.

PLN m

| Key Profit & Loss Items | 1H 2006  | 1H 2005 | Change |
|-------------------------|----------|---------|--------|
| Total income            | 1 211.0* | 949.1   | +27.6% |
| Total costs             | (624.0)  | (579.8) | +7.6%  |
| Profit-before-tax       | 571.5*   | 351.3   | +62.7% |
| Income tax              | (107.9)  | (59.4)  | +81.6% |
| Profit-after-tax        | 423.9*   | 281.2   | +50.7% |

\* including equity disposals

In the first half of 2006, the Bank Zachodni WBK Group posted profit-before-tax of PLN 571.5m which exceeds the figure recorded in the corresponding period of 2005 by 62.7%. Excluding the one-off gains earned this year on equity disposals (PLN 30.5m), the underlying profit-before-tax increased by 54% y-o-y. This record half-yearly performance of the Group is attributable to the outstanding business results of the bank and subsidiaries, in particular: BZ WBK AIB Towarzystwo Funduszy Inwestycyjnych S.A., BZ WBK AIB Asset Management S.A. and BZ WBK Dom Maklerski S.A. The key factors driving the Group's financial profit were:

- steady development of key business volumes, including: investment fund assets (+230.2%), retail lending (+23.3%), lease rentals (+16.3%), business loans (+8.4%), deposits (+7.3%);
- robust growth of net fee and commission income (+54.5%), especially with regard to management and distribution of mutual funds, brokerage fees, insurance products, debit cards and payments;
- higher net interest income in the low interest rate environment;
- one-off gains earned in the equity market on the disposal of LZPS Protektor S.A. (PLN 7.8m) and TIM S.A. (PLN 22.6m) and 20.5% higher dividend income.

#### Income

In the first half of 2006, the BZ WBK Group posted a total income of PLN 1,211m, an increase of 27.6% on the corresponding period of the previous year. The main components of total income were as follows:

- **Net interest income**

Net interest income amounted to PLN 493m. Taking into account interest-related income from FX Swap and FX Basis Swap transactions (recognised in FX profit and gains from assets measured at fair value through profit and loss, respectively), which declined y-o-y from PLN 50.8m to PLN 14.3m, the underlying net interest income increased by 4.7%. This growth was achieved thanks to the improved business mix generating relatively stable credit margins and good Treasury performance in liquidity management. Interest margins, especially on customer deposits, were tighter due to increased competition and significantly lower interest rates.



- **Net commission income**

Net commission income amounted to PLN 489.3m and increased y-o-y by 54.5% driven by further expansion of the bank's and subsidiaries' business. Due to the fast flow of assets to the investment funds and private portfolios, the highest increase in net commission income was recorded in distribution fees charged to customers purchasing mutual fund units (+554%) and also in asset management fees (+284.6%) collected by BZ WBK AIB Towarzystwo Funduszy Inwestycyjnych S.A. and BZ WBK AIB Asset Management S.A. for investment services. The net brokerage fees of BZ WBK Dom Maklerski S.A. (Brokerage House) showed a strong growth as well (+100.7%) and this was in line with the rising business volumes amidst increasingly higher trading at the Warsaw Stock Exchange. There was also a noteworthy increase in net commission income generated by insurance products (+220%) and e-Business and Payments area (+12.6%), in particular debit cards, Western Union money transfers and third party card services.

- **Dividend income**

Dividend income of PLN 57.1m increased by 20.5% as a result of a higher dividend paid out by the Commercial Union Group members included in the bank's equity investment portfolio. In the first half of 2006, these entities disbursed PLN 53m as compared to PLN 44.1m in the same period last year.

- **FX profit**

FX profit was PLN 104.9m and 10.8% down y-o-y as a result of decline in FX SWAP income driven by the shrinking gap between the PLN and FX interest rates. Excluding FX SWAP impact, the line shows an increase of 14.5%, which reflects higher income from increased customer FX business.

- **Gains on assets measured at fair value through profit and loss**

Gains on financial transactions measured at fair value through profit and loss increased by 127.4% to 16.6m thanks to higher income on derivative transactions, including IRS and FRA transactions.

- **Gains on assets from the investment portfolio and disposal of subsidiaries and associates**

This increased due to the one-off gains in the equity market, i.e. profit earned on the sale of subsidiaries and associates (PLN 6.2m) and profit on disposal of TIM S.A. from the investment portfolio of Inwestycje Sp. z o.o. (PLN 22.6m).

## **Loan Impairment Charge**

In the first half of 2006, the impairment charge to the profit and loss account amounted to PLN 16.3m, which is by PLN 0.4m less than in the corresponding period of 2005. With the growing volume of the loan-book, the Group retained the impairment charge level y-o-y, thus confirming the steady improvement of its credit portfolio quality. At the end of June 2006, the impaired receivables accounted for 6.3% of the gross customer portfolio with a provision cover of 63.1%. A year before, the respective ratios were at 7.8% and 59.4%. This decline in the NPL ratio is a result of the consistent operation of the Group's credit risk management policy and a sharp focus on ensuring portfolio quality.

## **Costs**

The performance of Bank Zachodni WBK Group in the first half of 2006 caused reduction of its cost-to-income ratio to 51.5% from the level of 61.1% recorded in the corresponding period of the previous year.



Total operating costs of the Bank Zachodni WBK Group amounted to PLN 624m and were higher by 7.6% y-o-y. Their main components were as follows:

- **Staff and other administrative expenses**

The costs included under this heading increased by 10.3% y-o-y to PLN 521.1 m and were driven by dynamic business development of the bank and its subsidiaries. The biggest element of this figure, i.e. the Group's staff expenses, amounted to PLN 316.7 m and increased by 13.9% compared to the corresponding period of 2005 due to higher employment, growing competition among banks for highly skilled banking experts and performance-related bonuses. With a strong business growth, the Group's other administrative expenses increased merely by 5.1% y-o-y to PLN 204.4m. This movement results, among other things, from the Group's promotional activities in the area of investment funds. However, a number of other components of this cost heading remained flat or were even lower compared to the same period last year.

- **Depreciation**

Depreciation totalled PLN 86.4m and decreased by 8.4% compared to the first half of 2005 due to continued process of fixed assets optimisation.

- **Other operating costs**

Other operating costs of PLN 16.5m increased by 27.9% due to higher level of provisions.

## 2. Balance-Sheet Items

The table below presents major developments in key categories of the balance sheet of Bank Zachodni WBK Group as at the end of June 2006 versus the corresponding period of 2005.

PLNm

| Key balance-sheet items                        | 30-06-2006 | 30-06-2005 | Change |
|------------------------------------------------|------------|------------|--------|
| Balance sheet total                            | 31,001.0   | 29,306.6   | +5.8%  |
| <b>Key assets</b>                              |            |            |        |
| Loans and advances to customers                | 15,475.8   | 13,783.2   | +12.3% |
| Investment securities                          | 6,869.0    | 7,199.1    | -4.6%  |
| Loans and advances to banks                    | 3,499.1    | 2,041.1    | +71.4% |
| Securities at fair value through profit & loss | 1,828.8    | 2,882.4    | -36.6% |
| <b>Key liabilities</b>                         |            |            |        |
| Deposits from customers                        | 21,513.4   | 20,058.6   | +7.3%  |
| Deposits from banks                            | 1,815.8    | 1,726.9    | +5.1%  |
| Repo transactions                              | 1,661.6    | 1,027.3    | +61.7% |
| Debt securities in issue                       | 795.3      | 1,307.6    | -39.2% |

As at 30 June 2006, total assets of the Bank Zachodni WBK Group amounted to PLN 31 001m and were 5.8% up on the end of June 2005. The value and structure of the Group's balance sheet is determined by the bank's balance sheet which accounts for 95.2% of the consolidated total assets. Compared to 30 June 2005, the Group recorded a substantial increase in deposits from customers and also liabilities from repo transactions which resulted in higher bank-to-bank placements being recognised on the assets side. The growth of assets was mainly driven by loans and advances to



customers and banks, the latter reflecting stronger activity of the Group in the money and repo market.

## Deposit Base

Deposits from customers, which represent 69.4% of the Group's liabilities, are the main driver of the balance sheet growth and the primary source of funding its lending business. At the end of June 2006, customer deposits totalled PLN 21,513.4m and were higher by 7.3% y-o-y driven by balances in current and deposit business accounts (+19%). Excluding one-day deposits, total funds held in current customer accounts totalled PLN 7,159.4m and exceeded the figure as at 30 June 2005 by 24.7%. This growth is attributable to low interest rates which made customers more inclined to keep their financial resources in current accounts. Total term-deposit base (including one-day deposits) remained on the comparable level y-o-y (+0.5%) and amounted to PLN 13,869.4m. Deposits maintained by the Group were still dominated by amounts due to individuals (54.6%), though their share in the total customer deposit base decreased by 4 p.p. y-o-y as a result of the growing volumes of deposits from business and public sector customers.

As at the end of June 2006, the Group's liability arising from debt securities in issue totalled PLN 795.3m, a decrease of 39.2% y-o-y. The reduction of own bonds portfolio results from the redemption of PLN 448m worth of Bank Zachodni WBK bonds which were issued in 2003 under II Investment Bonds Issue Programme (PEOL). In the first half of 2006, there was one issue of own bonds and that was carried out by BZ WBK Finanse & Leasing S.A. under the public issue programme.

As at the end of June 2006, the Group's total savings and deposit base, including customer deposits and bonds in issue, amounted to PLN 22,308.7m.

## Credit Portfolio

At the end of June 2006, gross loans and advances to customers were PLN 16,207.7m and 11.6% up y-o-y due to increasing volumes of the Group's key loan-books: personal loans, business loans and lease rentals offered by the bank's subsidiaries, i.e. BZ WBK Finanse & Leasing S.A. and BZ WBK Leasing S.A. Retail portfolio increased over 12 months by 23.3% to PLN 3,677.5m, the main growth drivers being cash loans (+85.3%) and mortgages (+16.7%). As compared to the end of June 2005, the business credit portfolio grew by 8.4% to PLN 10,405.3m, reflecting the increased demand for business funding amidst economic expansion and better alignment of the Group's lending offer and service with the customers needs. The leasing portfolio increased by 16.3% on end-June 2005 and totalled PLN 1,743.1m.

The biggest item in the lending structure of the Bank Zachodni WBK Group were loans to business and public sector customers, accounting for 66% of the gross portfolio. Retail loans represented 23% of the overall portfolio, while leasing and other receivables made up 11%.

The Bank Zachodni WBK Group maintains an adequate diversification of the credit portfolio in accordance with its policy of exposure to industries and financial groups. As at the end of June 2006, the highest concentration level of 16.5% was recorded in the property sector services (property sector as a percentage of total portfolio before intercompany).

The quality of the Group's loan-book continued to improve during the year, which is reflected in the declining NPL ratio.

## Interest Rates on Loans and Deposits

In the first half of 2006, like in the previous periods, the interest rates offered to customers were tied to the rates shaped by the interbank market and the Monetary Policy Council (MPC).

The interest rates on business loans are, for most facilities, directly linked to the market interest rates (WIBOR, LIBOR), and the bank's margin mainly depends on the credit risk attaching to individual transactions.

Interest rates on savings accounts, term deposits, credit cards and retail loans are set by Bank Zachodni WBK Assets and Liabilities Management Committee (ALCO). In the first half of 2006, interest rates were changed in response to the following factors: interest rates in the interbank market, need to retain competitiveness of the offered products and changes in law which became effective from



February 2006 and set a cap on the amount of interest charged on a loan. The maximum interest rate was set as four times the Lombard rate (5.50% since 1 March 2006).

In accordance with its strategy, the bank offers promotional rates of interest on PLN home mortgages, cash loans and credit cards.

### **3. Bank Zachodni WBK Rating**

In the first half of 2006, the ratings assigned to Bank Zachodni WBK by Fitch Ratings Ltd. remained unchanged and were as follows:

- individual rating: C
- long-term: A
- short-term: F1
- support: 1
- long-term rating outlook: positive

The last change of the Bank Zachodni WBK rating by Fitch Ratings Ltd was announced on 23 November 2005 when the bank's individual rating was increased to C from C/D. This reflects improved profitability of Bank Zachodni WBK following the successful completion of the restructuring programme, better asset quality and further enhancement of the bank's equity. The long-term, short-term and support ratings were confirmed based on potential support available from the majority shareholder Allied Irish Banks plc. The long-term rating is capped by Poland's long-term country ceiling which is "A".

### **4. Performance of Bank Zachodni WBK Shares**

In the first half of 2006, the shares of Bank Zachodni WBK S.A. increased by 26.5% against 16.8% increase in the sectoral WIG Banks index and 8.8% increase in the WIG 20 index.

In the reporting period, Bank Zachodni WBK shares made the best banking investment among the quoted banks in Central and Eastern Europe in terms of total rate of return (including dividend). Among the companies from the WIG 20 index, Bank Zachodni WBK S.A. is ranked fifth in terms of total return on investment and first among banks.



## IV. Business Development

### Bank Zachodni WBK S.A.

#### 1. Bank Zachodni WBK Brand Strategy

In 2006, Bank Zachodni WBK S.A. continued implementation of the "Po pierwsze klient" strategy, which is defined by the following mission statement:

***"To be regarded by our customers, wherever we operate, as outstanding for the quality of our customer proposition, and to turn this into superior profit growth."***

According to this statement, the bank's major objective is to be distinctive on the financial services market, to enhance its relations with customers and to proactively respond to their needs. In order to make this perception of the bank well-established in customer minds, the bank focuses on the brand quality, particularly on the following three brand values: Dependable, Engaging, Pioneering.

Implementing these values in its day-to-day activity and building its reputation on these foundations, Bank Zachodni WBK strives to be one of the top banking brands in Poland. The bank moves towards this objective by being distinctive as an "engaging bank". The idea of partnership is strongly promoted to ensure the bank is regarded as a customer-friendly institution which acts quickly, offers professional and attentive service and provides tailored solutions to meet the needs of different customer groups. This approach implies ongoing changes to internal processes and service standards to make them more customer-friendly. The results are already reflected in customer satisfaction surveys evidencing continuously growing satisfaction with the bank's commitment to the quality of customers' service.

In order to earn the reputation of being dependable, Bank Zachodni WBK S.A. strives to provide its customers with the service that meets top standards in security, reliability, availability, price transparency and clear and fair communication.

As a "pioneering bank", Bank Zachodni WBK S.A. constantly improves its product range and uses state-of-the-art bank technology in order to satisfy customers' requirements to the fullest possible extent.

#### 2. Key Business Developments in 2006

The actions undertaken by Bank Zachodni WBK S.A. in 2006 are a continuation and natural consequence of the development directions set out in the "Po pierwsze klient" strategy and pursued in prior periods.

Striving to build a sustainable competitive advantage and achieve a long-term profit growth, the bank develops its relations with customers in compliance with the concept of an "engaging bank". To this end, it maintains and improves the segmentation programme which allows to assign personal and business customers to individual advisors and undertakes effective CRM activities which, among others, involve encouraging customers to avail of new banking products.

The most important business areas of the bank's activity in the first half of 2006 included:

- simplification of credit products offering and reduction of the number of separate procedures and processes to achieve a uniform and shorter credit delivery process (these changes enabled, among others, the expansion of the credit offer with a universal product called Biznes Ekspres which is a "business cash loan");
- integrated approach to customers in the area of retail lending, which was reflected in the promotion of "credit of 15 salaries" (the customer is allowed to use a cash loan, overdraft limit and a credit card in a total amount of 15 times the customer's monthly income);
- dynamic growth of the savings base of the Bank Zachodni BZWBK Group due to active distribution of investment products of the bank's subsidiaries (mainly BZWBK Arka mutual funds) supported by promotional activities;



- pro-active acquisition activities targeting customers below 30 years of age carried out by means of promotional campaigns of personal account Konto<30;
- continued development of co-operation with external partners with regard to production and sale of co-branded debit and credit cards (e.g. the AlleKarta VISA card to the Konto24.pl account in liaison with Allegro.pl and a new co-branded credit card with the Money.pl web portal);
- the launch of a mobile sales network and distribution of the selected products through an independent financial intermediary.

During the last half-year, as part of a project to implement the quality management methodology, there were comprehensive reviews undertaken covering selected processes in the bank, including: mortgage lending, SME lending, credit card issuing, personal overdraft renewals and opening of personal accounts. Recommendations formulated on the basis of these reviews will allow certain processes to be modified to make them even more customer-friendly and effective for the organisation.

The second half-year will see delivery of further important initiatives, including implementation of a personal savings account, commencement of co-operation with new partners for the Konto24.pl account, significant improvement of the bank's foreign payments offering, preparation of a package for individuals travelling abroad, launch of pre-sanctioning for business customers, implementation of property leasing and export factoring.

### 3. Lending Policy

The bank pursues a policy oriented towards maintaining high quality of the loan portfolio by applying and monitoring policies that mitigate the credit risk.

The bank's lending policy consists of a number of rules and guidelines in the form of lending procedures and policies introduced by resolutions issued by the Management Board, Management Board Members and Chairman of the Credit Forum. They govern, among others, processes related to personal, commercial and corporate lending as well as securities.

Bank Zachodni WBK S.A. also operates a number of credit policies that address key lending issues and areas, including Credit Discretions Guidelines, FX Lending and Guarantees Policy, sector policies, policies addressing lending to individual client categories (corporate, SMEs, local authorities) and Credit Scoring Policy.

Individual credit products are regulated in detail in their respective procedures.

The credit discretions system is governed by relevant guidelines. Credit discretions are defined for specific positions in the Individual Discretionary Limits document. They vary depending on lending skills of the individuals engaged in the credit delivery process. Also, there are different discretionary limits for secured and unsecured exposures.

The bank's lending procedures and policies are subject to approval by the Credit Policy Forum which is chaired by the Chief Credit Officer or Deputy Chief Credit Officer, and consists of representatives of the Credit Division, Risk Management Division, Strategic Development Division, Customer Relationship & Sales Division and Finance Division.

The bank's subsidiaries which specialise in leasing and factoring are governed by their internal credit risk regulations.

### 4. Development of Customer Service

#### CRM

In accordance with the "engaging bank" idea, Bank Zachodni WBK S.A. undertakes a number of actions designed to build long-standing and stronger ties with its customer base. Proactive contacts with customers are regularly planned and strictly monitored for better efficiency. As part of the proactive contacts, the cross-selling potential is developed and better penetration of the customer base is ensured.

The bank develops specialist IT infrastructure to enhance proactive contacts, long-term relations with customers and to support delivery of sales campaigns. Processes are initiated to retain customers



and encourage loyalty by motivating them to keep their relationship with the bank and to avail of its products and services.

## **Service Quality Management**

In the first half of 2006, the bank service quality improvement efforts focused on reinforcing quality standards based on internal and external customer satisfaction surveys carried out in the fourth quarter of 2005. Priority was given to implementation of active service and sales standards known as "2006+ Standards" across the branch network.

- **2006+ Standards**

Following the annual external customer satisfaction survey, customer needs and expectations were defined along with those aspects of customer service which had to be enhanced enterprise-wide. This information was used to formulate "2006+ Standards" which were implemented in all branches in the first half of 2006. The new service standards are not meant to replace the existing ones but to enhance them and to structure the service process.

- **Branch service improvement programmes**

Results of the external customer satisfaction survey, carried out in the last quarter of 2005, confirm a steady growth of customer satisfaction. Following the analysis of the results, a number of actions were taken in the first half of 2006 with a view to enhancing customer service. Based on dedicated reports, each branch implemented individual service quality improvement programmes. As in the previous years, Service Quality Managers regularly visited the bank's branches to provide specialist support and staff training.

- **Customer Care Officer and complaints handling**

Bank Zachodni WBK S.A. is distinctive in the market in that it has a Customer Care Officer. Apart from being the contact person for customers, they are also involved in development of customer service standards through: developing complaints handling standards, supporting the bank's staff in handling the most difficult complaints, regular updates for the Management Board on the outcome of complaint analyses, initiatives aimed to eliminate sources of customer dissatisfaction and liaising with the Ombudsman at the Polish Banks Association.

- **Enhancement of internal customer service**

The drive to optimise relations between individual units within the bank results from the belief that high quality interactions in the organisation translate to better service for external customers. The measures taken in the first half of 2006 are based on the outcome of the internal customer satisfaction survey and are a part of the so-called Relationship Enhancement Programme.

## **5. Development of Products and Services (by Key Product Lines)**

### **Retail Loans**

Bank Zachodni WBK S.A. builds its competitive advantage in the retail loans market through high quality products, advanced technology and service processes, diversified distribution channels, effective promotions and highly competent staff. Activities undertaken in these areas during the first half of 2006 increased attractiveness of the bank's services and accelerated retail lending.

At the beginning of 2006, the bank continued to pursue its mortgage loans strategy whose objective is to develop the best PLN mortgage offer in the market, create multi-channel distribution system and achieve the highest level of customer service.

In the first half of 2006, the bank's mortgage lending offer underwent modifications which reduced the cost of credit for customers and made the bank's mortgage loans distinctive in the market. As part of a price promotion, from February 2006 customers seeking a housing loan in PLN



were offered new rates of interest, which were the lowest in the market. According to the new terms, promotional interest rate during the first two years of the credit life amounts to 6M WIBOR+0.5 p.p. and 6M WIBOR+1 p.p. in subsequent years.

In the area of cash loans the bank conducted intensive promotional actions, focussing on two key advantages of its offering, namely very quick turnaround time and a possibility to obtain the highest loan available in the market (15 times monthly income). In the first half of 2006, the bank also started the sale of cash loans in the new distribution channels, e.g. via the QS Financial House outlets and through mobile sales.

Bank Zachodni WBK S.A. offers a wide range of credit cards in Visa and MasterCard payment systems with options tailored to the needs and potential of particular market segments. Further development of this business is facilitated by acquiring new external partners for the issue of co-branded cards. Since the end of April 2006, the bank has been selling a new co-branded card issued in co-operation with the Money.pl web portal. In the Expander ranking of May 8, 2006, the card was assessed as the best product of the kind in the market and its popularity among customers keeps growing. In June 2006, a new co-branded card was launched in cooperation with a Multikino multiplex cinema network and this will be actively sold in the second half-year. As part of the ongoing upgrading of the credit card service, in the first half of 2006 the bank gave its customers an option to select the frequency of charging the credit card fees (annually or monthly) and modified the process of filing credit card applications and signing credit card agreements. Also, discounts were offered to the frequent users of credit cards.

## **SME Lending**

The business offer of Bank Zachodni WBK S.A. distinguishes itself by a wide range of credit facilities that meet varying financial requirements of the SME sector. In the first half of 2006, the bank introduced a new competitive product called Biznes Ekspres loan. This facility caters both for working capital and investment requirements of companies. Its main advantages are minimum documentary requirements, no obligation to document the purpose of the loan and fast decision-making process. Bank Zachodni WBK S.A. was one of the first banks to introduce such a product in the market, responding to the demands of customers.

Bank Zachodni WBK S.A. is also among the top banks operating in the EU funds market and continues to strengthen its position in this area as envisaged by the strategy "Together in the EU". This is confirmed, among others, by the bank's first position in the ranking of banks (published by the Polish Agency for Entrepreneurship Development) which fund projects qualified for delivery under the fourth run of the "Growth in Business Competitiveness, Action 2.3". During the last half-year the bank's offer with regard to funding projects covered by EU programmes was expanded to include a new proposal for institutional clients as part of another programme of support from the funds of EFTA countries (EEA Financial Mechanism and the Norwegian Financial Mechanism).

To respond to the needs of farmers, an AGRO Package was developed, with comprehensive solutions for: account maintenance, working capital and investment funding, deposits, electronic banking and payment instruments. As part of the AGRO Package, farmers can avail of a wide range of credit facilities, including - in addition to standard loans - preferential loans, loans refinanced from the EU funds and lease of machinery, equipment and vehicles. With such a proposition, the bank can satisfy diverse requirements of the target market segment. At its web site ([www.bzwbk.pl](http://www.bzwbk.pl)) the bank launched a new information service called AGRO BIZNES which presents the full range of products available to farmers.

## **Personal Accounts and Business Accounts**

In order to simplify and increase transparency of the personal account offer, in January 2006 the bank removed the Konto24 Plus package from its product range and initiated a campaign to support migration of the Konto24 Prestiz account to its subscription-based version (with fixed monthly fee covering account maintenance, basic banking operations and issue/use of the Visa Electron Prestiz card). In the first half of 2006, sales campaigns focused on Konto<30 which is recognised as the leading one on the bank's offer on account of the prospective business from the segment of customers below 30 years of age. Under the most recent summer promotional campaign for Konto<30, launched in May 2006, no fees are charged for withdrawing cash from ATMs abroad using Visa Electron<30 card.



In 2005, the bank started to provide comprehensive services for SMEs as part of the BIZNES Package, while in the last half-year an AGRO Package was developed and implemented for individual farmers. The package is built around the current account with special pricing conditions ("Schedule of fees and charges for Agrobiznes").

## **Deposit and Investment Products**

Bank Zachodni WBK S.A. provides its customers with a comprehensive offer of savings and investment products, giving them an option to diversify their portfolios according to their individual preferences and investment objectives.

In the first half of 2006, retail customers most frequently used short-term deposits of 7 and 14 days and the 1-month Lokata24 deposit. There was also a good demand for IMPET deposits with very attractive interest rates. Business customers usually preferred short periods for their placements, with terms and conditions negotiated individually.

In addition to the wide range of term deposits, the bank's branch network distributes investment products of the bank's subsidiaries, mainly the BZWBK Arka mutual funds managed by BZ WBK AIB Towarzystwo Funduszy Inwestycyjnych S.A. In the first half of 2006, the bank offered the five main categories of Arka funds: balanced fund, stable growth fund, equity fund, money market fund and bonds fund. These products achieved a remarkable success thanks to the favourable stock market, excellent investment results and intensive marketing campaigns. In June the bank began to sell a new fund, Arka BZ WBK Foreign Shares Fund FIO, which invests at least a half of its assets in foreign shares funds. This product gives customers access to the global shares markets and allows them to diversify risk geographically.

## **Insurance Products**

In accordance with the bank's strategy, bancassurance services are becoming an increasingly important element of the bank's business. In the first half of 2006, Bank Zachodni WBK S.A. supplemented its offering with a cash loan insurance package designed to protect borrowers against consequences of unemployment, temporary or permanent inability to work or death. Also, an insurance option targeted at mortgage borrowers is being developed (life assurance, home insurance) along with debit and credit card insurance propositions. The bank offers its insurance products in liaison with three insurance groups: AIG, Commercial Union and TU Europa.

## **FX Transactions**

The bank offers a full range of foreign trade finance and international settlement services. In the first half of 2006, a noticeable year-on-year growth was observed in this area of banking, especially in import documentary business (the number and value of import letters of credit and collections increased by 21% and 45%, respectively). Export finance instruments, i.e. forfeiting, discount of export receivables and pre-financing of exports proved to have considerable business potential as well.

Cross-border payments are an increasing source of banking fees. The number of direct payments processed by the bank (without intermediary of a third bank) in the first half of 2006 went up by 22% on the corresponding period of 2005. Payment order messages generated by the bank have been for many years characterised by high quality which brings measurable benefits to customers, i.e. low costs and short processing time. Bank Zachodni WBK S.A. is frequently awarded by its foreign counterparties in recognition of the error-free message formatting. In the first half of 2006, the bank was awarded by: Bank of New York – for customer payments and JP Morgan Chase Bank – for interbank payments. The efficient organisation of the payment handling process and the high quality of customer service is best proven by the bank being placed among the institutions that comply with the ISO 9001-2000 standard for cross-border payment orders. The relevant certificate will be officially granted at the beginning of August. The bank's payment processing services will be even more competitive as a result of downward revision of the pricing offer for cross-border payment orders to be launched at the beginning of the second half of 2006.



Bank Zachodni WBK S.A. also acts as an intermediary for the growing number of Western Union money transfers (+30% y-o-y). The bank continues to expand the network of agents processing Western Union transfers through its intermediary.

The first half of 2006 witnessed a considerable growth in the number of cheque processing (+13% y-o-y), driven mainly by cheques cleared with recourse which is a service available in Poland exclusively from Bank Zachodni WBK S.A.

## Debit Cards

### • BZWBK Debit Cards

Bank Zachodni WBK S.A. offers a wide range of debit cards which address the needs of all the customer segments and are available in two main payment systems: VISA and MasterCard. Similarly to credit cards, all the newly issued debit cards are equipped with a chip to ensure top security of card transactions. As many as 70% of all the valid debit cards have been migrated to the chip technology and the migration process is well on schedule.

Equipped with the comprehensive and innovative debit card offering, in the first half of 2006 the bank introduced only a few changes to improve product functionality and complement the offer. Two new types of re-loadable pre-paid cards were added: allowance card facilitating payments for people who receive financial assistance from social service agencies and "Pajacyk" affinity card issued in liaison with Polska Akcja Humanitarna (Polish Humanitarian Organization). The Pajacyk card offers standard payment functionality for card holders while contributing part of proceeds to the charitable undertakings of PAH. All holders of re-loadable cards have been offered a new service, i.e. using SMS for checking card balance and history of the most recent transactions.

The bank launches communication actions as well as promotional campaigns which contribute to the higher volume of non-cash transactions and ATM withdrawals. The number of active debit cards is growing (+11% y-o-y) which is attributable mainly to two attractive package propositions: Allekarta and Visa Electron<30.

In the first half of 2006, Bank Zachodni WBK S.A. was the first bank in Poland to issue V Pay card as part of a pilot programme and the first bank in the world to test such cards with non-standard account number length and thus verify the flexibility of the supporting platform. The tested card is a new European product of Visa International. It is based on the microchip EVM (Europay, Visa, MasterCard) standard where each transaction has to be confirmed with a PIN. The pilot was successful and is expected to pave the way to a wider use of V Pay cards in Poland and in Europe.

## Processing of Other Banks' Cards

Bank Zachodni WBK S.A. issues and processes payment cards for other institutions, being a leading provider of such services in the market. The offer includes chip cards and the latest product – bar-code cards. The bank offers its customers a modern IT infrastructure and a real-time access to transaction data. In the first half of 2006, three other banks decided to use the bank's services. One of them was offered access to Bank Zachodni WBK ATM network and the other two avail of the full scope of our services (card issuance and processing). As at the end of June 2006, the bank processed more than 1m cards for other institutions.

## Investment Banking

In the first half of 2006, Bank Zachodni WBK S.A. participated in delivery of the public offer of bonds of BZ WBK Finance & Leasing S.A. as a continuation of issue programme for a total of up to PLN 2bn. The nominal value of the bonds placed amounted to PLN 35m. The bank also arranged bond issues for two external clients, totalling PLN 21.6m. These issues were allocated to the entities indicated by the issuers.

In the first half of 2006, Bank Zachodni WBK S.A. acted as an advisor in the sales of PBG S.A. shares (public offer and sale on the secondary market) as well as in the public sale of two series of Hydrobudowa S.A. shares. The bank provided also advisory services to EMAX S.A. and their majority shareholder during consultations on the agreement providing for the planned merger with Computerland S.A.



During the first months of 2006, Bank Zachodni WBK S.A. disposed of 586,416 shares of LZPS Protektor S.A. at the Warsaw Stock Exchange, representing 37.56% of the company's share capital and voting power at AGM, for PLN 13.2m. The bank also sold 3,422,405 shares of Stalexport S.A. on the OTC market, which brought revenues of PLN 5.9m. In May 2006, the bank's entire stake (13,331 interests) in AIB WBK Fund Management Sp. z o.o., representing 54% of the company's capital, was sold under MBO transaction for PLN 270k.

## **Treasury Services**

During the first half of 2006, Treasury Services operations have continued to develop in close cooperation with Corporate and Commercial Banking activities, while maintaining focus on the retail branch client network.

In the first half of the year, wholesale activity reported strong gains, primarily through strategic interest rate positions taken in expectation of declining PLN interest rates. These gains have been realized within the framework of a conservative appetite to risk taking, consistent with previous years.

The transfer of the wholesale operations from Poznań to Warsaw was successfully completed in January 2006.

## **6. Distribution Channels**

### **Branch Network**

At the end of June 2006, Bank Zachodni WBK S.A. operated through 384 branches. During the first half of the year the bank was making preparations to launch a number of new branches in attractive locations.

The bank's branch network covers all provinces country-wide with the biggest concentration in the south-west of Poland. The bank's retail network is also present in other major economic and administration centres of Poland such as: Warsaw, Kraków, Łódź, Trójmiasto (Tri-city), and Szczecin.

The bank's branch network is divided in fourteen regions supervised by three macroregions in Poznań, Warsaw and Wrocław. The regional and macroregional offices provide direct business and operational support to the local branches. Branches receive support from the owners of business lines who ensure best management within individual strategic products. The biggest cities also have auxiliary structures whose objective is to develop business in branches, including Mobile Sales Teams, Housing Market Specialists and Investment & Savings Products Managers.

### **Corporate Business Centres**

Bank Zachodni WBK S.A. provides services to corporate customers through five Corporate Business Centres based in Warsaw, Wrocław, Poznań, Kraków and Gdańsk. The operational model adopted by the Centres is based on the CRM principles and assigns the key role in the customer relationship management to Relationship Managers within the Corporate Business Centres. It also requires a close co-operation with the bank's branches which provide corporate customers with operational services.

The Corporate Business Centres strategy is to optimise the income potential from corporate customers by satisfying their needs in a comprehensive manner and based on the specific knowledge of the local market. This means that customers seeking facilities receive full and individually tailored offer after a thorough review of their requirements. Apart from the lending proposals, it also covers Treasury products, foreign trade finance, investment banking services, etc.

### **Cash Management Unit**

At the beginning of 2006, the Cash Management Unit was created which operates from Poznań, Wrocław and Warsaw. Cash Management Unit is responsible for the sales of comprehensive products and services for financial institutions, corporate clients and intermediaries with regard to liquidity management, mass payments, all types of domestic and international payments, card transactions, etc. The unit provides top quality standard and tailored products and services.



## Electronic Distribution Channels

- **BZWBK24**

BZWBK24 is a modern package of banking services, designed to provide retail and business customers with a convenient and secure access to their accounts via phone, mobile or the Internet, with a wide range of finance management options. As part of the BZWBK24 electronic business service, business customers may choose a standard package or "Moja Firma Plus" which offers extra opportunities, such as: ongoing multi-user access to business accounts, possibility to make transfers which require signatures of two persons, higher daily limit for transactions and convenient and effective finance management. The bank ensures the highest security level for electronic services thanks to its transaction authorization method via smsKod and alternative logging into BZWBK24 Internet via smsKod or token authorization.

In the first half of 2006, Bank Zachodni WBK S.A. continued to expand functionality and improve safety of its electronic banking service for business and retail customers. Users of "Moja Firma Plus" package have been offered order batching and new transaction management options while retail users of BZWBK Internet have been given the possibility to use eWyciąg (an electronic equivalent of a paper account statement) and make transfers from credit card account.

Compared with the corresponding period last year, the base of BZWBK24 users increased by 165,3k to 787.5k at the end of June 2006.

- **Minibank24**

Electronic banking for corporate customers - available within the MiniBank24 system addressed to corporate customers – is a simple and safe way to handle a wide range of banking transactions. In the half-year ending 30 June 2006, the application was upgraded to include additional functionalities. Also, new transaction authorization cards were introduced to ensure the highest security level. At the end of June 2006, 4.4k Minibank24 installations were operative.

- **ATMs**

At the end of June 2006, the ATM network of Bank Zachodni WBK S.A. was composed of 595 machines. To enhance effectiveness of ATMs, the network location optimization process was continued, driven by customer needs and business potential of the locality. Also, seasonal installations were put in place with application of mobile solutions in many prime tourist locations. In order to provide customers with top class technical infrastructure, the bank continued to upgrade its ATM network and replaced older ATMs with the latest generation machines. The functionality of BZWBK ATMs is very extensive and constantly developed. Most machines meet the requirements of EVM chip card standards.

## Direct Banking

Direct Banking in Bank Zachodni WBK S.A. operates on the basis of the restructured multi-channel Communication Centre in Środa Wielkopolska. Direct Banking enjoys specialist and continuously improving telecom and IT infrastructure to facilitate efficient customer service and relationship management ("contact center").

In the first half of 2006, the bank continued development of Direct Banking by delivering projects aimed to enhance and intensify phone and Internet-based sales. In both channels a new and customer-friendly credit card sales model was introduced, which makes it possible to make a credit decision within 24 hours from filing the application. As part of the projects aimed to promote Internet-based sales, relations with external financial portals were continued (Money.pl, Bankier.pl, Onet.pl, Interia.pl, Wp.pl).

The actions taken in the first half-year helped the bank to generate considerable sales growth via phone and the Internet. Compared with the corresponding period of 2005, the sale of credit cards increased by 90% y-o-y (in terms of number) and of unsecured cash loans by 88% (in terms of value).



## External Distribution Channels

In the first half of 2006, two new distribution channels were launched, i.e. mobile sales network and a financial intermediaries network.

In the first half of 2006, the building of mobile sales network based on self-employed Financial Advisors and Team Co-ordinators was continued. The advisors operate in 6 regions covering the area of northern, central and south-western Poland.

In 2005, the bank commenced works necessary to liaise with external partners. A separate sales process was developed for credit facilities, based on an automated decision-making system. Also, a technology base and IT platform were put in place. In the first half of the year, following the test of the IT solutions, an agency agreement was signed with QS Financial House and the sales of cash loans via QS offices was launched.



## **Subsidiaries Consolidated with Bank Zachodni WBK S.A.**

### **1. Composition of Bank Zachodni WBK Group and the Scope of its Activity**

Bank Zachodni WBK S.A. forms a group with the following ten subsidiaries consolidated on a line-by-line basis. These are:

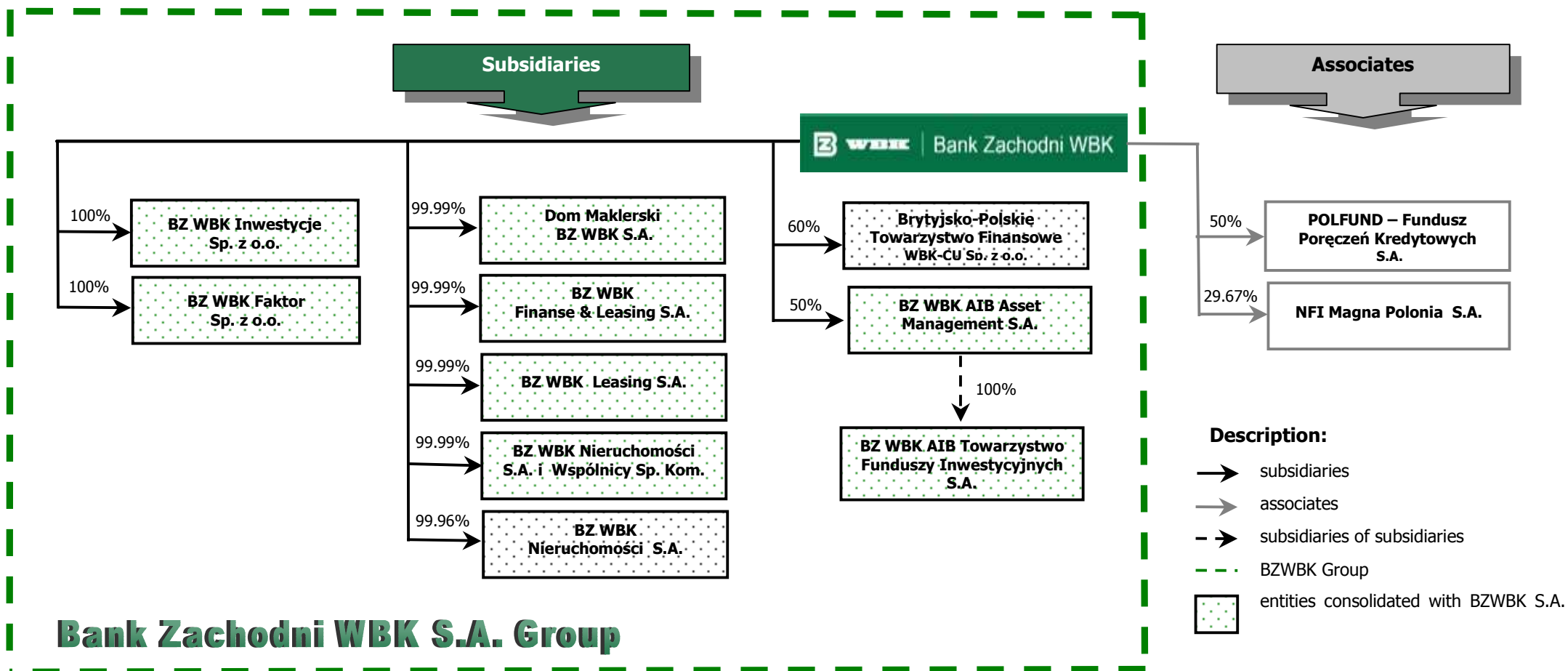
- 1) Brytyjsko-Polskie Towarzystwo Finansowe WBK-CU Sp. z o.o.
- 2) BZ WBK AIB Asset Management S.A.
- 3) BZ WBK Inwestycje Sp. z o.o.
- 4) BZ WBK Faktor Sp. z o.o.
- 5) BZ WBK Finanse & Leasing S.A.
- 6) BZ WBK Leasing S.A.
- 7) Dom Maklerski BZ WBK S.A.
- 8) BZ WBK Nieruchomości S.A.
- 9) BZ WBK Nieruchomości S.A. i Wspólnicy Spółka Komandytowa
- 10) BZ WBK AIB Towarzystwo Funduszy Inwestycyjnych S.A. - subsidiary of BZ WBK AIB Asset Management S.A.

The entities connected with the bank are chiefly financial institutions which conduct specialised activities in securities trading, leasing, asset/fund management, factoring, distribution of insurance/banking products and trading in equity securities. The composition of the Group, the multi-dimensional relationships between its companies and the good coordination of their actions ensure substantial enterprise-wide synergies which improve effectiveness of individual units. In addition to multiple forms of co-operation, the bank gives the subsidiaries access to its extensive branch network, which substantially increases their selling potential. On the other hand, the products and services of subsidiaries supplement the bank's offer and improve its competitive edge in the financial services market. Some of their products, namely investment funds, factoring and lease rentals have been incorporated in the bank's corporate strategy executed in close liaison with respective subsidiaries.

As compared with the end of June 2005, the composition of the Group has changed as the bank disposed of its entire shareholding in AIB WBK Fund Management Sp. z o.o.



# Entities connected with Bank Zachodni WBK S.A.



## 2. Business Development of Major Subsidiaries

### Dom Maklerski BZ WBK S.A.

In the first half of 2006, the dynamic market continued at the Warsaw Stock Exchange with a record-high volume of stock trading quoted in the equity market. In this environment, Dom Maklerski BZ WBK S.A. broke another record in its stock trading. During the last six months the trading volume was PLN 18.4bn, which is 109% higher than in 2005, despite lower activity of foreign corporate investors. This performance gave the company a market share of 11.4%, which is similar to the last year's figure (11.9%).

In the futures market, which is the second most important WSE market, the brokerage house acted as an agent for concluding 828.6k transactions, which is 43% higher y-o-y and accounts for a market share of 12.1% (vs. 13.1% in the first half of 2005).

The first half of 2006 also saw a noteworthy increase in the company's share in the options market from 5.6% in the first half of 2005 to 12.3% in the last six months as a result of outperforming competitors with the turnover growth rate.

With this performance, Dom Maklerski BZ WBK S.A. was ranked third in Poland in each of the above-mentioned markets (i.e. the equity market, futures market and options market) and generated record-high financial profits.

In the first half of 2006, the brokerage house sold the shares of PBG S.A. in the secondary market and acted as an agent for another issue of PBG S.A. shares in the primary market.

Dom Maklerski BZ WBK S.A. maintained its leading position among brokerage companies in Poland in terms of Internet accounts it operates. The number increased by 38% y-o-y to 26.2k at the end of June 2006. The company also improved its rate of migration of retail transactions to the remote distribution channels.

### BZ WBK AIB Towarzystwo Funduszy Inwestycyjnych S.A.

During most of the first half-year, customer savings would flow rapidly to mutual funds in expectation of above-average returns due to the favourable stock exchange climate. However, the sale of participation units decelerated in May following a decline in stock prices, which impeded the previously rapid growth of mutual funds assets and inclined customers to invest in bonds funds.

Following the market scenario, the first quarter of 2006 saw a dynamic development of the mutual funds managed by BZ WBK AIB Towarzystwo Funduszy Inwestycyjnych S.A. This trend was additionally driven by the effective promotional campaign emphasising the excellent performance of BZWBK Arka funds ("Arka has earned you more. For years"). Despite the slower growth rate in the second quarter, the company was very distinctive in the market by increasing the value of its assets by 230% y-o-y to PLN 12,664.8m (while the market grew by 71% y-o-y). The highest increase – in percentage terms and by value – was recorded by Arka BZ WBK Akcji FIO, Arka BZ WBK Zrównoważony FIO and Arka BZ WBK Stabilnego Wzrostu FIO. At the end of June 2006, Arka BZ WBK Zrównoważony FIO accumulated assets of PLN 3,546.1m, which made it the biggest fund managed by BZ WBK AIB Towarzystwo Funduszy Inwestycyjnych S.A. As a result of the significant business growth, the company's share in the mutual funds market increased from 8.5% to 16.4% y-o-y, moving it from the third to the second position in Poland.

In May 2006, another mutual fund was established: Arka BZ WBK Funduszy Akcji Zagranicznych FIO. The fund invests in selected mutual funds operating in the world's equity markets, which ensures potential significant returns, and due to the geographical and sectoral diversification of investments, mitigates the risk of dependence on the ups and downs of a single market. The fund's units were first quoted on 30 May 2006.

In the first half of 2006, the sales network of Arka mutual funds has been expanded to include outlets of two other distributors: BRE BANK S.A. Private Banking and Bankowy Dom Maklerski PKO BP S.A.

In the annual ranking published by "Rzeczpospolita" BZ WBK AIB Towarzystwo Funduszy Inwestycyjnych S.A. for the third consecutive year was ranked best financial institution in the category of mutual funds (*"BZWBK AIB: on top for the third time running" of 14.06.2006*). The assessment panel members, who are financial and capital market practitioners and theoreticians, thoroughly



screened the mutual funds operating in Poland, looking at such aspects as: asset growth, financial position, investment results as well as quality and distinctiveness of the offer.

### **BZ WBK AIB Asset Management S.A.**

The strong interest in stock investments had a positive impact on the sale of individual portfolios of BZ WBK AIB Asset Management S.A., leading to their increase by 143% in terms of number and 242% in terms of asset value y-o-y. The most rapid growth was recorded in the balanced portfolios (+380%) and the shares portfolios (+350%).

At the end of June 2006, the value of assets managed by BZ WBK AIB Asset Management S.A., including investment funds of BZ WBK AIB Towarzystwo Funduszy Inwestycyjnych S.A., increased by 231% y-o-y to PLN 14,085.3m.

### **BZ WBK Finanse & Leasing S.A. and BZ WBK Leasing S.A.**

Bank Zachodni WBK Group operates on the leasing market through two leasing companies which specialize in funding two different asset categories. BZ WBK Finanse & Leasing S.A. focuses on the lease of machines and equipment as well as computers and office equipment for businesses. There is also a customised offer for selected customer groups. BZ WBK Leasing S.A. specialises in financing vehicles for businesses and personal customers.

Both companies strive to gain competitive edge through enhancements and modifications of their product range, optimisation of sales processes and development of delivery channels.

In the first half of 2006, BZ WBK Leasing S.A. ran a pilot of a new product - car loan for retail customers, and then implemented it in the branch network of Bank Zachodni WBK S.A. country-wide. The new product is a competitive alternative for car loans offered by banks. BZ WBK Finanse i Leasing S.A. implemented - in co-operation with suppliers - an attractive offer of financing selected machines. According to the strategic priorities for 2006, both companies reduced the credit decision turnaround time by 50% and implemented a rating of SME customers based on scoring methods.

In the first half of 2006, the two companies leased net assets totalling PLN 541.6m, i.e. 27% up y-o-y. The share of machines and equipment in the total sales continued to grow, which is partly attributable to the attractive leasing offers for investors who avail of structural subsidies from EU.

In the last half-year, BZ WBK Finanse & Leasing S.A. marketed bonds with a nominal value of PLN 35m as a continuation of public issuance programme of up to PLN 2bn worth of bonds. The last issue included bearer coupon bonds of PLN 100 each, with a maturity of 3 years. In February 2006, the Bank Zachodni WBK Group was awarded by the President of the Board of MTS-CeTO "for being the most innovative in the CeTO market in 2005" in recognition, among other things, of the issue of bonds of the Group's leasing subsidiaries.

Priorities of the leasing companies for the second half of 2006 include initiatives designed to introduce new products, such as property leasing and supplementary products, and to increase efficiency of leasing distribution channels.

### **BZ WBK Faktor Sp. z o.o.**

BZ WBK Faktor Sp. z o.o. provides recourse and non-recourse factoring services, including: purchase of trade receivables from customers, debtors management, working capital funding, monitoring of repayments and debt collection, takeover of debtors' insolvency/default risk. In the first half of 2006, work was undertaken to expand the company's product range with international factoring.

In the first half of 2006, the value of receivables purchased was PLN 346.6m and was 29% higher than in the corresponding period of the previous year. In terms of factoring turnover, the company was ranked sixth in Poland, with a market share of 4.7%. The increase in turnover and exposure was achieved thanks to the acquisition of new customers and a stronger activity of the existing ones.



## **BZ WBK Inwestycje Sp. z o.o.**

In the first half of 2006, BZ WBK Inwestycje Sp. z o.o. continued its search for investors with a view to selling its shareholdings. In April 2006, the company disposed of the hold TIM S.A. shares through the Warsaw Stock Exchange. The transaction, which involved the sale of 2m of shares for PLN 12.3 each, yielded the income of PLN 24.6m.



## V. Risk Management

### 1. Capital Management

The policy of Bank Zachodni WBK S.A. is to maintain a strong capital base and to use it effectively in order to add value for shareholders.

At the end of June 2006, the bank's capital resources amounted to PLN 3,031.1m (BZWBK Group – PLN 3,348m), with the solvency ratio of 14.14% (BZWBK Group – 15.53%).

### 2. Financial Risk Management

The main objective of financial risk management is to ensure effective operations to support development within the approved risk limits. Risk management practice in the bank is in keeping with the AIB Group policy and covers the three main financial risk areas: credit risk, market risk and liquidity risk.

The bank's Management Board, which is responsible for risk management, delegated its powers in this regard to the following Committees: Asset and Liabilities Management Committee (ALCO), Credit Committee, Credit Forum and Provisions Committee. These Committees are responsible for managing individual risk areas, monitoring the bank's general risk on a on-going basis and for shaping the current policy within the framework set by the Management Board.

#### Credit Risk Management

Bank Zachodni WBK's credit delivery activities focus on growing a high quality loan-book with a good yield and customer satisfaction.

Credit risk arises mainly from lending activities on the retail, corporate and inter-bank markets. This risk is managed as part of the policy approved by the Management Board on the basis of the adopted credit delivery procedures as well as on the basis of discretionary limits allocated to individual credit officers based on their knowledge and experience. The bank's internal system of credit grading and monitoring allows for an early identification of likely defaults that might impair the loan book.

- **Credit Forum**

To manage the credit risk effectively, Bank Zachodni WBK S.A. established the Credit Forum whose key role is to develop and approve credit and sectoral policies, industrial analyses, credit grading systems and credit risk assessment addressed for the branch network and Business Support Centre units directly responsible for business growth and support. The Credit Forum is composed of senior representatives of individual Bank Zachodni WBK divisions.

- **Credit policies**

Credit policies contain guidelines for the identification and assessment of areas where specific types of risks manifest themselves and also provide the methods of limiting those risks to a level acceptable to the bank (e.g. FX risk in the case of foreign currency loans). Credit policies comply with the AIB Group standards and are adapted to the local credit market conditions where Bank Zachodni WBK S.A. operates.

At the same time, credit policies are subject to periodical reviews aimed to bring these guidelines up to date with the bank's current needs.

- **Credit grading**

Intensive work has been undertaken to further develop credit risk assessment tools which conform to the Basel requirements and IAS. These efforts are accomplished based on AIB Group expertise and best practices, as well as in close liaison with external, internationally recognized advisors.



Currently the bank uses new credit risk grading models for its key credit portfolios, including corporate customers, SMEs and housing loans. Work is under way to develop tools compliant with Basel requirements for other portfolios, i.e. cash loans, credit cards, retail overdrafts and real estate loans.

- **Provisioning**

In Bank Zachodni WBK S.A. and its subsidiaries provisions are raised in accordance with the International Accounting Standards/International Financial Reporting Standards (IAS/IFRS). The provisions reflect credit impairment which is recognised if the bank presents an objective evidence that such amounts cannot be recovered in line with the signed loan agreement. The impairment is calculated on the basis of the estimated recoverable amount. Impairments are analysed using both the individual and collective approach.

Ensuring adequate level of provisions is the responsibility of the Provisions Committee.

- **Return on risk**

Bank Zachodni WBK S.A. continues to develop and implement risk based methods of grading loans, allocating capital and measuring returns. Currently for all significant portfolios risk valuation models based on EVA (Economic Value Added) are being implemented.

- **Credit decision making process**

The credit decision-making process as part of the risk management policy is based upon discretionary limits vested in credit officers, commensurate with their knowledge and experience relating to particular activities (retail banking, corporate banking and SMEs). Credit exposures in excess of PLN 15m are referred to the Credit Committee composed of senior management and top executives of Bank Zachodni WBK S.A.

Bank Zachodni WBK S.A. continually strives to ensure best quality credit service to meet the borrowers' expectations and relevant risk policy standards. To this end, the credit risk approval function has been separated from the sales function. The responsibility for credit decisions and loan portfolio quality assurance lies with the Chief Credit Officer and managers reporting to him.

In order to ensure better risk management, the bank implemented scoring techniques for retail customers, SMEs and home mortgages. The scoring systems are continuously upgraded which has improved the quality of risk management, accelerated the decision-making process and ensured compliance with the Basel Committee requirements and International Accounting Standards.

- **Credit reviews**

Demonstrating the utmost care about the loan-book quality, Bank Zachodni WBK S.A. performs regular reviews to ensure conformity with the best credit practices, to determine the actual quality of the credit portfolio, to confirm that adequate credit grading and provisioning processes are in place and to objectively assess professionalism in credit management. The reviews are performed by the Credit Review Department and Quality Assurance Department which are a function independent of risk-taking units.

## **Market Risk and Liquidity Risk Management**

The Bank Zachodni WBK ALCO is responsible for strategic balance sheet management in keeping with the individual risk management policies approved by the Management Board. The focus of ALCO's attention is the management of capital, sources of funding and liquidity as well as identification and management of market risk. ALCO consists of representatives of the bank's senior management.

Market risk and liquidity are managed within the framework developed by the AIB Group and approved by the Bank Zachodni WBK Management Board. The ALCO's policy defines the underlying principles of management of liquidity, interest rate and FX risks arising from the bank's and the Group's balance sheet structure.



- **Market risk management**

The key objective of the market risk policy operated by the bank is to reduce the impact of interest and FX rates changes on the bank's profitability and market value as well as to increase income within the strictly defined risk limits and to ensure the bank's liquidity.

The bank's practice in market risk management complies with the following rules:

- Upon the recommendation from ALCO, the Management Board approves the Strategies and Policies for market risk management along with the limits that define the maximum acceptable exposure to individual types of this risk.
- Market risk is managed by qualified personnel using the appropriate systems and controls. Management of interest rate, FX and liquidity risks is centralised in the Bank Zachodni WBK Treasury Division.
- Market risk is measured and its compliance with the stated risk limits is monitored by qualified personnel segregated from the unit which manages and generates the risk. Exposure to market risk is regularly reviewed by ALCO.
- Risk limits are periodically reviewed to align them with the bank's strategy and the current objectives of the bank.
- A special portfolio of highly rated debt securities generates a stable income flow, mitigating the structural balance sheet risk connected with liabilities that are not sensitive to interest rate changes. According to the Policy approved by the Management Board, any decisions relating to the value or structure of this portfolio are taken by ALCO.

ALCO identifies, on an on-going basis, the market risk connected with retail and commercial activities and transfers the risk to the Treasury Division. Treasury Division then executes relevant transactions (e.g. in the inter-bank market, in securities, derivatives, etc.) in order to maintain the risk at an acceptable level.

Interest rate and FX risks are monitored using the Value at Risk (VaR) methodology which is a standard industry tool for measurement of interest rate and FX risk. VaR methodology uses a statistical process to determine the Probable Maximum Loss (PML) in economic value as a result of an adverse change in market parameters with a specified probability level. The bank applies the VaR methodology both to the trading and banking portfolio. According to the bank's policy, the interest rate risk measured as PML may not exceed 8.25% of the bank's own funds, while PML connected with FX risk may not exceed 0.5% of own funds

- **Liquidity risk management**

Bank Zachodni WBK S.A. manages liquidity risk in accordance with its liquidity policy.

The policy is to counter-balance the contracted or contingent outflows with expected/contracted inflows or realisation of liquid assets (mainly debt securities) to resist any extraordinary or crisis situations triggered both by internal factors (e.g. sudden increase in the value of facilities drawn under the sanctioned credit lines) or external ones (e.g. material drop in liquidity on the FX swaps market). The policy covers all assets and liabilities as well as off-balance sheet items impacting the liquidity level. Contractual and behavioural maturity is also taken into account, based on the statistical analysis of stability of the deposit base and the credit portfolio. Liquidity risk is measured daily using a liquidity gap report.

The bank is obliged to maintain necessary funds to allow for all withdrawals of term deposits, demand deposits, loan payments, guarantee payments and settlements. The bank does not maintain those funds in full amount because as experience and analyses show, a certain percentage of funds with short-term maturity will be reinvested. The bank's policy states that the bank should maintain funds to cover 100% of the payments expected to be made within 1 month horizon and not less than 10% in a period longer than a month. Long-term liquidity position is also monitored.



The Bank Zachodni WBK Group has a scenario-based contingency plan approved by the Management Board to cater for unexpected liquidity problems, whether caused by external or internal factors.

## Operational Risk Management

Operational risk is exposure to losses related to the failure of internal processes, human and system errors and external factors. Bank Zachodni WBK S.A. has been working on full implementation of operational risk management standards which conform with the Basel Committee requirements, across the Group.

Operational risk management in the Bank Zachodni WBK Group is operated at the following three levels of responsibility:

- Organizational units responsible for management of the operational risk that may manifest itself in the area of their operations (identification, assessment and monitoring of the risk based on the self-assessment methodology, implementation and monitoring of risk controls, learning lessons from financial and non-financial operational losses).
- The Operational Risk Management Department is responsible for coordination of the whole process (implementation of an effective risk management structure, development of methodology, providing support to other units, maintenance and analysis of a database with information on financial and non-financial losses, reporting, management of financial lines insurance).
- The Internal Audit function is responsible for overseeing and assessing the quality of operational risk management.
- All operational risk management processes are monitored by the dedicated Operational Risk Management Committee (ORMCO).

Bank Zachodni WBK S.A. has developed and implemented operational risk management policies, standards and procedures, concerning in particular the risk management structure and model, fraud prevention, information security, reporting, learning lessons from operational losses, personal data protection, money laundering and approval of products and projects.

Furthermore, Bank Zachodni WBK S.A. monitors the ongoing implementation of a business continuity management policy (across the Group), analyses the needs and develops and tests disaster recovery plans on a regular basis.

The bank co-operates closely with AIB Group in the area of development and implementation of strategies and policies of operational risk management, selection and launch of supporting instruments, and in ensuring compliance with the requirements of the New Capital Accord.



# VI. Human Resources and Corporate Values

## 1. Human Resources

As at 30 June 2006, the number of FTEs in Bank Zachodni WBK Group was 7,798, which was higher by 277 than twelve months earlier. The increase in the bank's headcount (by 224 FTEs) is due to the organisational development of the Business Support Centre in the area of banking products as well as changes in the branch network. The employment in the consolidated subsidiaries went up (by 53 FTEs) with dynamic business growth and consequent increase in workload.

The bank continues the Performance Management process which adds value to the corporate culture, is positively viewed by employees and brings expected results. Through the individual objectives planning process, monitoring and assessment of progress, the bank's employees gain knowledge about their role in delivery of the "Po pierwsze Klient" strategy and obtain the necessary support and feedback about their performance.

The bank pays a lot of attention to the improvement of staff knowledge and skills. Training courses are organised in response to the business needs and in keeping with the bank's strategic priorities. Compliance with the operational and strategic requirements of the organisation is ensured through the training planning and co-ordination process applicable bank-wide, with support from representatives of key business areas and branch banking. The integrated training plan facilitates the logistics and monitoring of training quality and costs. In the first half of 2006, the majority of training projects were addressed to the branch banking staff of whom 74% were trained through e-learning. Training for branches covered mainly the following areas: strategic products, sales techniques facilitating team work and customer service quality, SME lending and security of banking operations. In response to the feedback from the last staff attitude survey, 2006 saw continuation of initiatives addressed to different employee groups, including Leaders of the Future, Directors' Programme, a programme for new managers and an induction programme. In the first half of 2006, the total number of trainees and participants of the development programmes in Bank Zachodni WBK S.A. reached 27.7k.

## 2. Corporate Values

### Code of Business Ethics

The bank implemented the Code of Business Ethics which applies across the AIB Group. The Code sets out the general standards of behaviour which underpin the Group's corporate culture.

According to the Code, in all the aspects of its activities the bank complies with the business ethics requirements, conforms with the law and acts in accordance with the best corporate governance and risk management models. The bank seeks to create a climate of trust in its dealings with customers, employees, shareholders and other stakeholders, promoting such values as integrity, professionalism, prudence and competence. The opinion of being a dependable organisation is perceived as a pre-requisite for further development and success, but the bank also has the ambition to be recognised for being engaging and pioneering. As a socially responsible organisation, the bank supports corporate-giving and sponsorship programmes.

Following implementation of the Code of Business Ethics, the bank launched special communication channels for staff to consult on ethical matters and report any issues.

### Corporate Culture

- **Corporate behaviours**

The key element of the Bank Zachodni WBK brand strategy is a constant reinforcement of the desired corporate behaviours in the organisation. There are various initiatives undertaken to support development of the bank's internal culture in line with its key values: Dependable, Engaging, Pioneering. In the first half of 2006, all the bank employees were briefed on the assumptions of the "Po pierwsze Klient" corporate strategy for 2006, with cascading communication on the bank's goals and challenges directed to individual teams and staff. The first half of the year also saw completion of the first programme for teams of the Bank Zachodni WBK Group called "Warto być razem". The



purpose of the programme was to recognise the teams for their outstanding achievements in delivery of the "Po pierwsze klient" strategy and to promote desired values and behaviours.

- **Compliance culture**

The bank attaches a great importance to compliance with legal and regulatory requirements in all aspects of its activities. Creation of a business culture of strict adherence to law and best practices and promotion of such an approach is one of the key objectives of the bank's Compliance Area. The activities undertaken by this function are meant to raise the awareness among employees that their individual actions can have a bearing on the bank's reputation. A well-developed compliance culture improves the bank's image among regulators, shareholders, investors and customers.

## **Corporate Governance**

Bank Zachodni WBK S.A. complies with all the corporate governance rules contained in the document "Best Practice in Public Companies in 2005", introduced by Resolution no. 44/1062/2004 of the Warsaw Stock Exchange Board. Compliance with good practices is also supported by the bank's internal procedures, including provisions of the Statutes, Supervisory and Management Board regulations. To facilitate access to information about Bank Zachodni WBK S.A., the bank's web site has a special section for investors with all current and periodic reports, corporate documents and other material information.

### **3. Bank in the Society**

#### **Corporate Citizenship**

According to the declaration contained in the Code of Business Ethics, the bank is actively involved in local community matters, supporting different charity initiatives.

The bank's corporate giving is carried out under "The Bank of Children Smiles" Programme and focuses on children from poverty stricken families. The programme is delivered both through the bank's own initiatives and through provision of financial support to the organisations which help children.

Among the bank's own initiatives, noteworthy are creative workshops "My World on Both Sides of the Camera from BZ WBK" for children of the so-called difficult background and "Academy of the Bank of Children Smiles", a programme of funding English lessons for children from poor families. From January to April the bank ran a campaign called "Smile for 1%" designed to raise funds as part of personal income tax settlements and spend them on organisation of summer holidays for poor children and other charitable purposes. In the first half of 2006, the bank launched the second edition of the Scholarship Programme of "the Bank of Children Smiles" which supports development of children gifted in science, sports, music and arts.



## VII. Major Internal Developments and Events

### 1. Ownership Structure of Bank Zachodni WBK S.A.

According to the information held by the bank's Management Board, as at 30 June 2006 the shareholder having a minimum 5% of the total number of votes at the Bank Zachodni WBK Annual General Meeting of Shareholders was AIB European Investments Ltd. based in Dublin.

| Shareholder                   | Number of shares held | Share in the share capital | Number of votes at AGM | Voting power at AGM |
|-------------------------------|-----------------------|----------------------------|------------------------|---------------------|
| AIB European Investments Ltd. | 51,413,790            | 70.50%                     | 51,413,790             | 70.50%              |

### 2. Governing Bodies

#### Annual General Meeting of Shareholders

The General Annual Meeting of Bank Zachodni WBK Shareholders (AGM), which was convened on 4 April 2006, approved the Bank's and the Group's Financial Statements and the Management Board Report on the Bank's and the Group's Performance in 2005. The AGM approved the Report on Activities of the Supervisory Board and its Committees as well as the Supervisory Board's Report on Examination of the Bank's and the Group's Annual Report along with its assessment of both subjects' operations in 2005. Also, the profit distribution and dividend pay-outs were approved and the Management and Supervisory Board Members were given a word of approval for performance of their duties in 2005. The AGM implemented a three-year Incentive Scheme for senior management members of the bank and its subsidiaries who significantly contribute to the growing value of Bank Zachodni WBK S.A. The Incentive Scheme entitles its participants to acquire bonds with a pre-emptive right and to acquire, at a preference rate, shares issued by the bank as part of conditional increase of share capital. In order to enable delivery of the Incentive Scheme, the AGM passed a resolution to issue bonds with pre-emptive rights and to conditionally increase the share capital by a maximum amount of PLN 2m by issuing new ordinary bearer shares. The AGM approved changes to the bank's Statutes and adopted its consolidated version. The introduced changes resulted, inter alia, from the need to comply with new banking law provisions and were related to the bank's internal control system and division of discretions among the Management Board Members.

#### Supervisory Board

As at 30 June 2006, the composition of the Bank Zachodni WBK Supervisory Board was as follows.

| Function                                 | Name                |
|------------------------------------------|---------------------|
| Chairman of the Supervisory Board        | Aleksander Szwarc   |
| Deputy Chairman of the Supervisory Board | Gerry Byrne         |
| Members of the Supervisory Board:        | Kieran Crowley      |
|                                          | Waldemar Frąckowiak |
|                                          | Aleksander Galos    |
|                                          | Declan Mc Sweeney   |
|                                          | John Power          |
|                                          | Jacek Ślotała       |

The persons listed above were appointed by the AGM of 14 April 2005 for a new 3-year term of office. Throughout the first half of 2006, there were no membership changes in the Supervisory Board.



As at 30 June 2006, the following members of the Supervisory Board held an independent status: Mr Aleksander Szwarc, Mr Waldemar Frąckowiak, Mr Aleksander Galos, Mr John Power and Mr Jacek Ślotała. In addition to the Supervisory Board meetings, its members worked in internal committees, i.e. Nominations and Remuneration Committee, Audit Committee and Social Responsibility Committee. The Audit Committee was composed exclusively of independent members of the Supervisory Board. The Report on Activities of the Supervisory Board and its Committees as well as the Supervisory Board's report on Examination of the Bank's and the Group's Annual Report along with its assessment of both subjects' operations in 2005 were published in the current report no. 27/2006 which conveyed the resolutions passed by the AGM on 4 April 2006.

## Management Board

As at 30 June 2006, the composition of the Bank Zachodni WBK Management Board was as follows.

| Function                           | Name               |
|------------------------------------|--------------------|
| President of the Management Board: | Jacek Kseń         |
| Members of the Management Board:   | Declan Flynn       |
|                                    | Michał Gajewski    |
|                                    | Justyn Konieczny   |
|                                    | Janusz Krawczyk    |
|                                    | Jacek Marcinowski  |
|                                    | Mateusz Morawiecki |
|                                    | James Murphy       |
|                                    | Marcin Prell       |
|                                    | Feliks Szyszkowski |

The Management Board members listed above were appointed by the Supervisory Board to a new three-year term of office on 4 April 2006. Compared to 30 June 2005, the composition of the Management Board changed as follows: Mr Aleksander Kompf stepped down from his role on the Management Board after expiry of his term of office. Mr Marcin Prell was appointed Management Board Member responsible for the Legal and Compliance Division.

In the current report no. 9/2006 dated 25 January 2006, Bank Zachodni WBK S.A. announced the decision of Mr Jacek Kseń to hold his position as President of the Management Board till the end of April 2007. That decision had been approved by the bank's Supervisory Board.

## Appointment and Removal of Executives

The members of the Bank Zachodni WBK Management Board are appointed and removed in accordance with the Commercial Companies Code, the Banking Law and the bank's Statutes. The bank's Management Board consists of at least three persons (including the Management Board President) appointed by the Supervisory Board for a joint three-year term of office. At least a half of the Management Board members should be Polish citizens. Two Management Board members, including the Management Board President, are appointed with the approval of the Banking Supervisory Commission. Management Board members may be removed by the Supervisory Board or the General Meeting at any time.

## Powers of Executives

The Bank Zachodni WBK Management Board manages and represents the bank. The Management Board has all powers that are not restricted by law or Statutes to the remit of other governing bodies of the bank.

The Management Board takes decisions to incur obligations or transfer assets whose total value for one entity exceeds 5% of the bank's own funds. The Management Board can also, by way of resolution, delegate its powers to take such decisions to other committees or persons in the bank. The



Management Board members run the bank's affairs jointly, and in particular: define the bank's mission, set long-term action plans and strategic objectives, prepare assumptions for the bank's business and financial plans, approve the plans and monitor their performance, regularly report to the Supervisory Board on the bank's position in the scope and at the dates agreed with the Supervisory Board, appoint permanent and ad hoc committees and designate individuals responsible for managing the work of such committees. The committees are composed of both Management Board members and persons from outside the Management Board. Permanent committees operative in the bank include: ALCO, Credit Committee, Provisions Committee, Credit Forum, Operational Risk Management Committee, Capital Expenditure Committee, Strategy Committee for Savings and Investment Products.

Management Board members acting severally do not have any specific powers. They cannot take decisions on issuing or redeeming shares.

### Shares in Possession of the Supervisory and Management Board

The tables below provide information on the number and nominal value of Bank Zachodni WBK shares in possession of the Supervisory and Management Board Members as at 30 June 2006:

| Shareholder              | Number of shares | Nominal value of shares in PLN |
|--------------------------|------------------|--------------------------------|
| <b>Supervisory Board</b> |                  |                                |
| Waldemar Frąckowiak      | 278              | 2780                           |
| <b>Management Board</b>  |                  |                                |
| Jacek Kseń               | 500              | 5000                           |
| Marcin Prell             | 1                | 10                             |

### Incentive Scheme

Pursuant to the resolution of the Annual General Meeting of Shareholders of 4 April 2006, Bank Zachodni WBK S.A. introduced a three year Incentive Scheme for the years 2006-2009. The Scheme is addressed to the Management Board members and senior management of Bank Zachodni WBK S.A and its subsidiaries recommended by the Management Board and approved by the Supervisory Board with the maximum number of 100 participants in the programme.

The Incentive Scheme entitles the participants to buy bonds with pre-emptive rights and in the next stage to take up – at a preferential price – the bank's shares issued as part of the conditional increase of the share capital. The right of participants will be exercised contingent upon the growth in consolidated earnings per share (EPS) within 3 years of the Incentive Scheme's duration. It is the Supervisory Board that will decide about the satisfaction of the defined criteria based on the financial performance of the Group as approved by the Annual General Meeting of Shareholders. The respective resolution will be adopted by 30 August 2009.

The adopted Incentive Scheme is to reinforce the bond between the bank and its senior management as well as to ensure the long-term competitiveness and effectiveness of the Bank Zachodni WBK Group, which will contribute to the growth in the bank's value and bring sustainable returns to shareholders.

## 3. Changes to the Management Organisation

The organisation of the Business Support Centre in Bank Zachodni WBK S.A. is modified to follow dynamic market environment, modification of banking processes and continued efforts for more efficient operations.

In April 2006, two previously independent functions of the Business Support Centre - Legal Area and Compliance Area – were merged into one Legal and Compliance Division. The change contributed to a more effective use of skills and resources to ensure full compliance of the Bank Zachodni WBK Group with the legal and regulatory requirements.



## **4. Capital Expenditure**

The capital expenditure incurred by Bank Zachodni WBK S.A. in the first half of 2006 amounted to PLN 15.2m. From the total expenditure, an amount of PLN 12.2m was spent on IT projects while the remainder was connected with properties and other fixed assets.

IT initiatives included work on preparation of the banks systems to support external distribution channels, i.e. mobile sales network and agencies of a financial intermediary. Another noteworthy accomplishment was the completion of rollout of the system for measuring profitability of products. In order to ensure the best level of card services, the bank purchased a modern production line for personalisation and distribution of cards. The high quality of the bank's card personalisation services was confirmed by the recommendation of the bank's auditor for award of the ISO 9001:2000 certificate. The certificate will be officially granted at the beginning of August. In addition to the described initiatives, the bank also continued the decongestion process, extension and upgrade of the ATM network and completed subsequent stages of implementation of the new IT platform for managing HR processes.

Outlays on properties and fixed assets were earmarked mainly for the two projects, i.e. further upgrade of technical security measures and launch of a new branch.

## **5. The Auditor of Financial Statements of Bank Zachodni WBK S.A.**

In accordance with § 32 point 10 of the Statutes of Bank Zachodni WBK S.A., on 21 June 2006 the bank's Supervisory Board passed a resolution appointing KPMG Audyt Sp. z o.o. as an auditor of the stand-alone and consolidated financial statements of the bank for the year 2006. KPMG Audyt Sp. z o.o. audited the bank's stand-alone and consolidated financial statements for the prior four financial years and provided consulting services permitted by law and the bank's internal regulations, which ensured adequate impartiality and independence of an auditor.

Auditor is selected by the Supervisory Board in accordance with the Bank Zachodni WBK Group policy which stipulates that all Group companies use the services of the same auditing firm.



## VIII. Representations of the Management Board

### Corporate Governance

According to its statement issued in the current report no. 54/2006 of 28 June 2006, Bank Zachodni WBK S.A. complies with all the corporate governance principles defined in Best Practices in Public Companies in 2005 and introduced by Resolution No. 44/1062/2004 of the Warsaw Stock Exchange Board.

### True and Fair Presentation of the Financial Statements

According to the Management Board's best knowledge and belief, the financial figures and the comparable data presented in the Consolidated Financial Statements of Bank Zachodni WBK Group for the First Half of 2006 were prepared in keeping with the applicable accounting policies and give a true and fair view of the assets and profit of Bank Zachodni WBK Group. The Management Board's Report contained in this document shows a true picture of the Group's development, achievements and position (including the underlying risks) in the first half of 2006.

### Selection of Auditor

The auditing firm responsible for reviewing the consolidated financial statements of the Bank Zachodni WBK Group for the first half of 2006 was selected in compliance with the applicable legislation. The auditing firm and its auditors satisfied the necessary conditions to ensure they provide an unbiased and independent report compliant with Polish law.

| Date:      | Name               | Position            | Signature |
|------------|--------------------|---------------------|-----------|
| 26-07-2006 | Jacek Kseń         | President           |           |
| 26-07-2006 | Declan Flynn       | Member of the Board |           |
| 26-07-2006 | Michał Gajewski    | Member of the Board |           |
| 26-07-2006 | Justyn Konieczny   | Member of the Board |           |
| 26-07-2006 | Janusz Krawczyk    | Member of the Board |           |
| 26-07-2006 | Jacek Marcinowski  | Member of the Board |           |
| 26-07-2006 | Mateusz Morawiecki | Member of the Board |           |
| 26-07-2006 | James Murphy       | Member of the Board |           |
| 26-07-2006 | Marcin Prell       | Member of the Board |           |
| 26-07-2006 | Feliks Szyszkowiak | Member of the Board |           |

